

# Inclusive Framework BEPS Agreement

Update on Pillar One and Pillar Two of BEPS 2.0 – July 2023

Policy Perspectives Update – the Hong Kong SAR



## Latest releases on Pillar One and Pillar Two of BEPS 2.0

Further to our [Hong Kong BEPS Publication](#) on the OECD's [news release](#) and [Outcome Statement](#) on the progress of work on Pillar One and Pillar Two under BEPS 2.0, the OECD published a number of documents relating to Pillar One and Pillar Two on 17 July 2023.

We provide a brief overview of the latest documents released by the OECD in this publication. Another publication with a more detailed discussion of these documents and our comments will be issued in due course.

### The latest documents issued by the OECD

The OECD released the following four documents on 17 July 2023:

1. [Public consultation document on Amount B \(Pillar One\)](#)
2. [The Subject to Tax Rule \(Pillar Two\)](#)
3. [Template and guidance on the GloBE Information Return \(Pillar Two\)](#)
4. [The second tranche of Administrative Guidance on the GloBE Rules \(Pillar Two\)](#)

A brief overview of the four documents is set out below:

#### 1. Pillar One - Public consultation document on Amount B

Amount B of Pillar One provides for a simplified and streamlined approach to the application of the arm's length principle to in-country baseline marketing and distribution activities, with a particular focus on the needs of low-capacity countries.

The public consultation document outlines the design elements of Amount B and was released in order to obtain inputs from stakeholders on the **scoping** and **pricing framework** of Amount B. Comments are sought by 1 September 2023. The OECD has also prepared a document entitled [Pillar One Amount B in a Nutshell](#) to provide an overview on the main design features of Amount B.

As highlighted in the BEPS 2.0 Outcome Statement released on 12 July 2023, further work will be undertaken on the following aspects where inputs from stakeholders are sought:

- Ensuring an appropriate balance between a quantitative and qualitative approach in identifying baseline distribution activities.
- The appropriateness of:
  - the pricing framework, including in light of the final agreement on scope;
  - the application of the framework to the wholesale distribution of digital goods;
  - country uplifts within geographic markets; and
  - the criteria to apply Amount B utilising a local database in certain jurisdictions.

## 2. Pillar Two - The Subject to Tax Rule (STTR)

The STTR is a treaty-based rule that enables developing countries to update bilateral tax treaties to “tax back” certain intra-group income (i.e. covered income) in the source state where such income is subject to no or low / nominal taxation in the residence state of the payee.

The document on the STTR contains the model Article on Subject to Tax Rule to be included in a tax treaty and the Commentary. Some of the key features of the STTR include:

- The STTR applies before the GloBE Rules.
- The STTR applies to the following payments between “**connected persons**” (as defined based on the de facto control test):
  - i. interest;
  - ii. royalties;
  - iii. payments for the use of, or the right to use, distribution rights in respect of a product or service;
  - iv. insurance and reinsurance premiums;
  - v. financial guarantee / other financing fees;
  - vi. certain equipment rentals; and
  - vii. fees for provision of services.
- The STTR **minimum rate** is set at **9%** and is subject to:
  - certain **exclusions** - e.g. does not apply to covered income derived by a regulated investment fund, an insurance company and a widely held real estate investment vehicle, subject to certain conditions;
  - a **materiality threshold** - does not apply where the gross amount of covered income is **less than EUR 1 million or EUR 250,000**, depending on the size of the smallest economy of the two Contracting States; and
  - a **mark-up threshold** for covered income falling within **items (iii) to (vii) above** - does not apply where there is a limited return i.e. the gross amount of covered income **does not exceed the costs incurred** by the person deriving the income that are directly or indirectly attributable to earning such income **plus a mark-up of 8.5%**.
- The tax that may be imposed by the source state under the STTR is limited to: Gross amount of the covered income x specified rate (i.e. 9% - the tax rate applied to the covered income in the residence state of the payee after taking into account any “preferential adjustment” to the covered income – the tax rate applicable to the covered income in the source state under the applicable tax treaty).
- The STTR will be administered through an **ex-post annualised charge** so the tax would not be collected at the time a payment of covered income is made.
- There are **specific anti-avoidance rules** that deal with two types of abuse, namely (1) the interposition of an unconnected person between two connected persons and (2) the routing of a payment of covered income through a high-tax connected person onto a low-tax connected person. Annex A of the document contains five examples to illustrate the operation of these anti-avoidance rules.

The document also contains new clauses to be added to the Article on Elimination of Double Taxation in a tax treaty. The effect of these clauses is to (i) disapply the exemption method in cases it would not have applied in the absence of the STTR (under the exemption method of relief) and (ii) disallow a foreign tax credit for the tax paid under the STTR (under the credit method of relief). These outcomes permit the source state to apply the tax at the specified rate under the STTR without resulting in a reallocation of tax rights away from the residence state that would arise solely as a result of the operation of the STTR.

## 3. Pillar Two – The GloBE Information Return

- The GloBE Information Return (GIR) document contains the data points that would be used for completing the GIR (in Annex A1) and the explanatory guidance (in Annex A2).
- The revised version of the GIR consists of (i) a general section that applies to the MNE group as a whole and (ii) multiple jurisdictional sections with a template that applies for every jurisdiction where the MNE group is operating.
- Under the general section, an MNE Group provides the general information about the MNE Group as a whole, identifies the Filing Constituent Entity and outlines its corporate structure. The MNE Group also needs to report in a summary table a high-level overview of the application of the GloBE Rules in respect of every jurisdiction where it is operating.

- The jurisdictional section includes a short section that requires limited information in respect of jurisdictions where relevant safe harbours and exclusions apply. For jurisdictions where safe harbours and exclusions do not apply, the MNE Group needs to report the ETR computations, followed by Top-up Tax computations where necessary, and finally the allocation of Top-up Tax (if any) for the jurisdictions.
- The transitional simplified jurisdictional reporting framework – which is available for jurisdictions in respect of which (i) no top-up tax liability arises or (ii) top-up tax liability arises but it does not need to be allocated on a CE-by-CE basis (i.e. allocated to each of the Constituent Entities (CEs) located in the jurisdiction). The simplification would apply to all Fiscal Years beginning on or before **31 December 2028** but not including a Fiscal Year that ends after **30 June 2030** (the transitional period).

For those jurisdictions where the MNE Group has elected the simplified jurisdictional reporting framework, the MNE Group is not required to report all adjustments to the Financial Accounting Net Income or Loss, current tax expense or deferred tax expense on a CE-by-CE basis (other than in respect of a few enumerated items) and all adjustments can be reported on a net basis.

#### 4. Pillar Two – Second tranche of Administrative Guidance on the GloBE Rules

The second set of administrative guidance includes:

- A **QDMTT Safe Harbour**, under which the top-up tax payable in a jurisdiction that has introduced a qualified domestic minimum top-up tax (QDMTT) **would be deemed as zero**. A QDMTT must meet the following three additional standards to qualify for the safe harbour:
  - the **QDMTT Accounting Standard** – QDMTT to be computed based on the UPE's Financial Accounting Standard or Local Financial Accounting Standard, subject to certain conditions;
  - the **Consistency Standard** – QDMTT computations to be the same as the computations required under the GloBE Rules other than in enumerated cases where mandatory / optional variations are required / allowed; and
  - the **Administration Standard** – QDMTT jurisdictions to meet the requirements of an ongoing monitoring process similar to the one applicable to jurisdictions implementing the GloBE Rules.

A domestic minimum tax of a given jurisdiction will first need to qualify as a QDMTT and then such QDMTT will qualify for the QDMTT Safe Harbour if the above three additional standards are met.

The compliance burden of in-scope MNE groups can be reduced under the QDMTT Safe Harbour as they will only need to perform one computation under the QDMTT regime and be exempt from the application of the GloBE Rules (an exemption method) rather than first performing the QDMTT computation to determine the domestic top-up tax payable and then the GloBE computation under which the domestic top-up tax can be used to set off against the GloBE top-up tax payable (a credit method).

- A **Transitional Undertaxed Profits Rule (UTPR) Safe Harbour**, under which the UTPR top-up tax in respect of the jurisdiction of a company's ultimate parent entity (UPE) **would be deemed as zero** for each Fiscal Year during the transition period if that UPE jurisdiction has a corporate income tax rate of at least 20%. The transition period covers the fiscal years (with not more than 12 months) **commencing on or before 31 December 2025 and ending before 31 December 2026**.
- Guidance on (i) currency conversion rules for performing GloBE calculations, (ii) treatment of tax credits, (iii) application of the substance-based income exclusion (SBIE), and (iv) the design of the QDMTT.

In particular, for the application of the SBIE, the guidance specifies the treatments of **interjurisdictional employees and assets** as follows:

- Where an employee undertakes more than 50% of his/her activities for the MNE Group during the relevant period within the jurisdiction of the CE employer, the CE will be entitled to the full payroll carve-out with respect to that employee.
- Where an employee undertakes 50% or less (say 30%) of his/her activities for the MNE Group during the relevant period within the jurisdiction of the CE employer, the CE will only be entitled to 30% of the payroll carve-out with respect to that employee.
- Similar rules apply to the tangible asset carve-out - the CE owner (or lessee) will be entitled to the full tangible asset carve-out where the tangible asset is located within the jurisdiction of its CE owner (or lessee) more than 50% of the time during the relevant period. Otherwise, the CE owner (or lessee) will only be entitled to

the portion of the tangible asset carve-out in proportion to the time during which the asset is located in the jurisdiction.

## The next steps

The package of deliverables released by the Inclusive Framework on BEPS on 17 July 2023 brings the OECD one-step closer towards the completion of the Two-Pillar Solution under BEPS 2.0. As the next steps, the OECD has indicated the following timeline for the further work to be done on Pillar One and Pillar Two:

- **Amount A under Pillar One** – The Multilateral Convention (MLC) will be open for signature in the second half of 2023, with a signing ceremony to be organised by the end of 2023 and an objective for the MLC to enter into force in 2025.
- **Amount B under Pillar One** – Further work after the consultation to be completed by the end of 2023. The Inclusive Framework plans to approve a final report on Amount B and incorporate key content into the OECD Transfer Pricing Guidelines by January 2024.
- **The STTR under Pillar Two** - A Multilateral Instrument together with an Explanatory Statement will be released and open for signature from 2 October 2023.
- **GIR filing and information exchange under Pillar Two** – The centralised filing requirements and the appropriate mechanisms to allow tax administrations to automatically exchange GloBE information collected will be finalised.

# Contacts

## Global Tax Policy Leadership Group

**David Linke**  
Global Head of Tax & Legal Services  
E: [David.Linke@kpmg.co.uk](mailto:David.Linke@kpmg.co.uk)

**Grant Wardell-Johnson**  
Global Tax Policy Leader and Chair  
E: [Grant.WardellJohnson@kpmg.co.uk](mailto:Grant.WardellJohnson@kpmg.co.uk)

**Manal Corwin**  
Americas Regional Tax Policy Leader  
E: [mcorwin@kpmg.com](mailto:mcorwin@kpmg.com)

**Vinod Kalloe**  
EMA Regional Tax Policy Leader  
E: [kalloe.vinod@kpmg.com](mailto:kalloe.vinod@kpmg.com)

**Conrad Turley**  
Asia Pacific Regional Tax Policy Leader  
E: [conrad.turley@kpmg.com](mailto:conrad.turley@kpmg.com)

**Chris Morgan**  
Responsible Tax Project Leader  
E: [christopher.morgan@kpmg.co.uk](mailto:christopher.morgan@kpmg.co.uk)

## Regional contacts

**John Timpany**  
Head of Tax, Hong Kong SAR  
E: [john.timpany@kpmg.com](mailto:john.timpany@kpmg.com)

**Ivor Morris**  
Hong Kong SAR BEPS 2.0 Project Leader  
E: [ivor.morris@kpmg.com](mailto:ivor.morris@kpmg.com)

**Anita Tsang**  
Hong Kong SAR Tax Policy and Knowledge  
Management Director  
E: [anita.tsang@kpmg.com](mailto:anita.tsang@kpmg.com)

[kpmg.com/cn/socialmedia](https://kpmg.com/cn/socialmedia)



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