KPMG ACOR TAX

Pillar One: Profit Allocation and Nexus

Pillar One aligns taxing rights more closely with local market engagement. If multinational consensus on this is not achieved, unilateral digital taxation measures may continue to proliferate.

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Further reading & resources

KPMG report Pillar One

KPMG report taxation of the digitalised economy

KPMG UK digitalised economy portal page

KPMG BEPS 2.0 Model

The Unified Approach

- Pillar One is a set of proposals to revisit tax allocation rules in a changed economy.
- The intention is that a portion of multinationals' **residual profit** (likely to be generated by capital, risk management functions, and/or intellectual property) should be **taxed in the jurisdiction where revenue is sourced**.
- Applies to **Automated Digital Services** (ADS) businesses and **Consumer-Facing Businesses** (CFB). The scope is intended to be broad and covers businesses that are able to profit from **significant and sustained interaction with customers and users** in the market.
- Links taxing rights in respect of these businesses to their **sources of revenue**, which need not depend on physical presence in the jurisdiction.

Market engagement allocation

- **"Amount A":** New taxing right allocates high value profits based on a formula, not necessarily the arm's length position.
- Covers profits earned from activities with an **automated digital** (mainly online) character or **goods / services commonly sold to consumers** (as well as associated IP licences). Specific inclusions and exclusions are proposed.
- Amount A allocated based on **local revenues** (determined via sourcing rules) with double taxation elimination measures.
- **"Amount B":** Standard arm's length remuneration for "baseline" **routine marketing and distribution** activities.
- Alternative Amount B methodologies may be adopted if supported by evidence.

What businesses need to know

- These changes are multinational in scope and technically complex. The effects are likely to be **far-reaching** for many businesses, and the effects **are not yet certain**.
- Scope of covered businesses is not yet final, but it will **not** be limited to **highly digitalised business models**.
- Much of the detail remains to be agreed including **scale thresholds**, how the proposals are intended to apply to **CFB,** how the **Nexus** and **revenue sourcing** rules will operate, and the **US proposal** that departure from the arm's length principle should be on a **safe harbour basis**.
- A period of **open consultation** on the proposals will now follow until 14 December 2020. The OECD has published its global **impact analysis**; potentially affected businesses should consider what these changes could mean for their ETRs.

KPMG ACORTAX

Pillar Two: Global Minimum Taxation

Pillar Two applies where, even after the effect of Pillar One (if any), multinationals are regarded as undertaxed by reference to an agreed minimum level of taxation.

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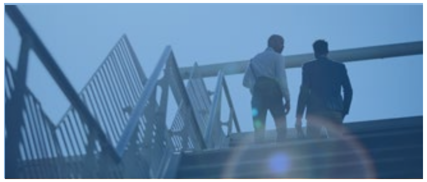
Levelling the playing field

- Pillar Two has **four new rules** granting jurisdictions **additional taxing rights** where other jurisdictions have not exercised their primary taxing rights or income is subject to low rates of tax.
- An **Income Inclusion Rule (IIR)** that would subject foreign income of branches and controlled entities to an agreed minimum tax in the parent jurisdiction.
- An **Undertaxed Payments Rule (UTPR)** that acts as a backstop to the IIR denying deductions or introducing source-based taxation under certain conditions.
- A **Subject to Tax Rule** which complements the UTPR in certain cases.
- A **Switch-over Rule** that applies where a PE is "undertaxed" switching off a treaty based exemption in the head office jurisdiction and replacing it with a credit based method of taxation.

Exclusions and simplifications

- The intention for most practical purposes is that these rules should only apply to MNE Groups with a total consolidated group revenue above **€750 million** or equivalent.
- The rules are designed to focus on "excess income", particularly **intangible-related income,** which is regarded as most susceptible to diversion.
- The proposals therefore include a "**carve-out**" and simple fixed return for **payroll** and certain **tangible asset** costs.
- A further in-principle exclusion may be to recognise tax already imposed under the **US GILTI** regime (still to be agreed).
- To **limit the compliance burden** on low-risk businesses, **simplification options** are proposed which may be based on some or all of CbyCR data, *de minimis* profits, or low local tax risk.



What businesses need to know

- Work on Pillar Two has **greatly advanced** towards consensus, the main areas which still need to be resolved are around simplification measures.
- Pillar Two could have a **significant impact on the effective tax rates** of MNE Groups by itself or in combination with Pillar One.
- Implementation of the rules will involve a combination of **changes to domestic tax laws and bilateral tax treaties** (expected to be via a Multilateral Instrument)
- A period of **open consultation** on the proposals will now follow until 14 December 2020. The OECD has published its global **impact analysis**; potentially affected businesses should consider what these changes could mean for their ETRs.