KPMG

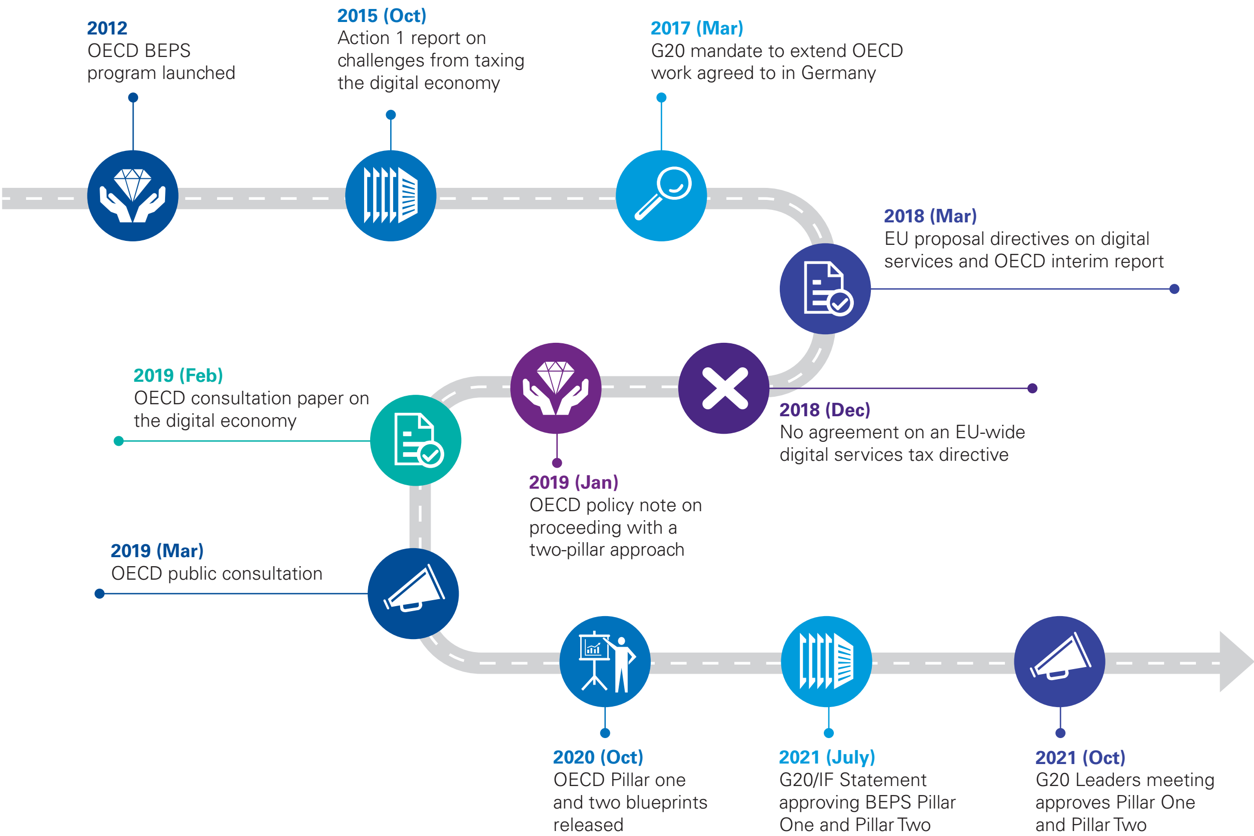
BEPS 2.0: What you need to know

What are the OECD's base erosion and profit shifting (BEPS) initiatives?

Following the financial crisis of 2008/2009 and multiple international revelations about tax evasion and aggressive tax planning, the G20 countries, together with the Organisation for Economic Co-operation and Development (OECD), set out to address the perceived erosion of the tax base (i.e., base erosion) and profit shifting. This resulted in the BEPS 1.0 action plans, published in 2015. In 2016, the OECD/G20 Inclusive Framework (IF) on BEPS was established to ensure interested countries and jurisdictions, including developing economies, could participate on an equal footing in the development of standards on BEPS-related issues while reviewing and monitoring the implementation of the OECD/G20 BEPS project.

While the BEPS 1.0 initiatives led to many changes to the international tax rules to limit profit shifting, some authorities believed that it did not yet adequately address the challenges of the digitalization of the economy. Many countries started to impose unilateral tax measures, including new legislation to tax companies that are active in a jurisdiction via online platforms, online sales, or via other means with the introduction of a digital services tax. The purpose of the BEPS 2.0 project is to consolidate these types of unilateral efforts into a consensus position to help avoid misaligned unilateral efforts and double taxation. The BEPS 2.0 project also aims to ensure that multinational enterprises pay a fair share of tax wherever they operate by introducing a global minimum corporate tax rate that countries can use to protect their tax bases.

BEPS 2.0 timeline to date



Pillar One is a significant departure from the standard international tax rules of the last 100 years and moves away from the idea that taxation largely requires a physical presence in a country before that country has a right to tax. Pillar One will apply to multinational groups that have more than €20 billion of global turnover (potentially reduced to €10 billion after seven years), and profitability above 10 percent (measured as profits before tax, divided by revenue). More than 100 global groups are likely in scope. For in-scope groups, 25 percent of profits above a 10 percent profit margin (referred to as "Amount A") will be subject to reallocation to market jurisdictions based on a formulary approach.

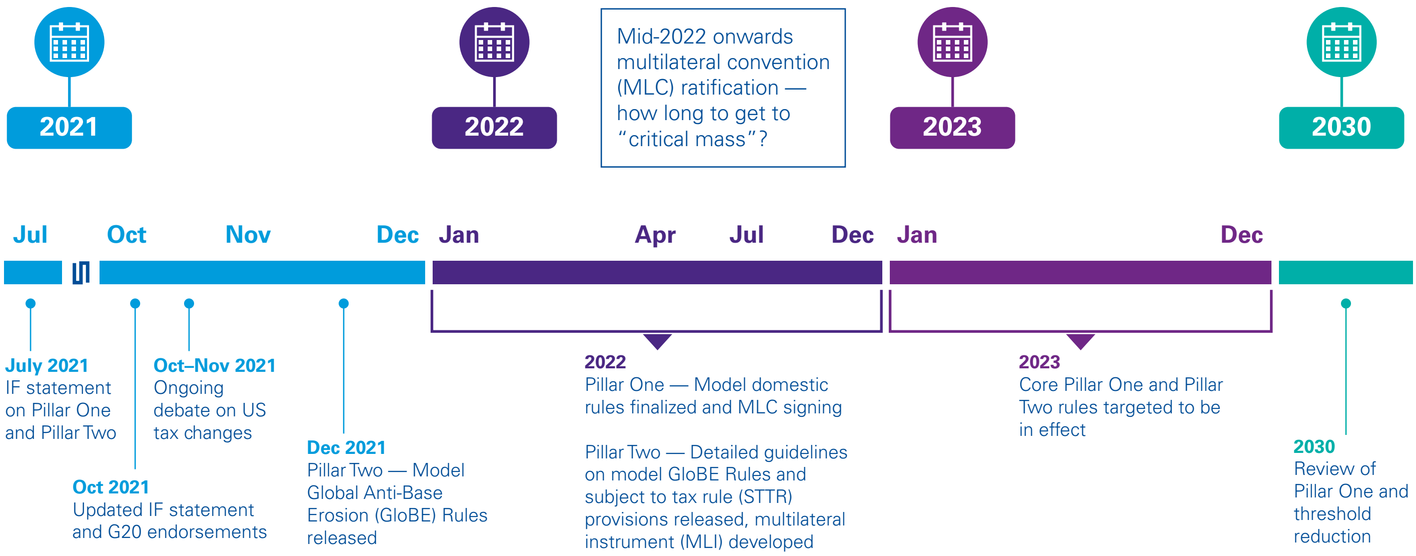
01

02

Pillar Two rules subject thousands of multinational groups around the world to a global minimum tax of 15 percent. Critically, every jurisdiction in which the group has operations will need to be looked at separately to see if its effective tax rate falls under 15 percent. If so, then a top-up tax will need to be calculated and paid. Additionally, specified payments made to related parties and taxed below 9 percent may be subject to new withholding taxes. Pillar Two will apply to multinational groups with revenues of at least €750 million.

The implementation plan included in the Annex targets a 2023 effective date for most aspects of both pillars, with detailed rules to be developed over the coming months. The IF comprises 140 member jurisdictions. The only IF members that have not yet joined in the October 2021 statement are Kenya, Nigeria, Pakistan, and Sri Lanka.

Pillar One and Pillar Two combined timeline



Affected teams and decision factors

CFO/finance director and investor relations

- BEPS 2.0 is not restricted to companies with digital operations and delivery models. There are potentially wide-ranging implications for most multinational groups.
- The potential tax impact could be significant, increasing cash tax cost and reducing earnings per share.

Head of Tax and tax teams

- The process of managing the impacts of BEPS 2.0 are expected to be challenging.
- The proposed rules are complex and novel in many respects. Compliance requirements may be onerous and require new tax records to be kept and maintained. Existing trading models and value chains may no longer be appropriate.

Accounting and financial reporting teams

- A great deal of data, including non-financial information, will be required from across the group, some of which may be difficult to gather and analyze. Existing information systems may not be appropriate.
- Financial segmentation may not align with existing financial statements.
- The interaction with other taxes (withholding taxes, for instance) may affect invoicing, cash flows and reporting.

Questions and insights

Relevant to

Have you considered the impact of the proposals on your tax profile?

The OECD expects the BEPS 2.0 proposals to increase global company income taxes by US$150 billion per year, principally through the introduction of Pillar Two. Under Pillar One, taxing rights on more than US$125 billion of profit are expected to be reallocated to market jurisdictions each year. Many organizations are now modeling the impact of the proposals on their existing tax profile to assess which locations in their geographical footprint will be subject to a higher tax burden. Organizations are also ensuring investor relations teams are fully aware of the impact of the proposals on group performance indicators.

- CFO/finance director and investor relations
- Head of Tax and tax teams

Have you assessed how your accounting function and systems will manage the data?

Pillar One's revenue sourcing rules are likely to be highly prescriptive. Some of the data requirements are likely to be difficult to gather and will require careful handling to manage potential data security concerns. Pillar Two may require significant additional compliance activity to compute the effective tax rate and covered taxes. Businesses should ensure that sufficient human and technological resources are in place to comply.

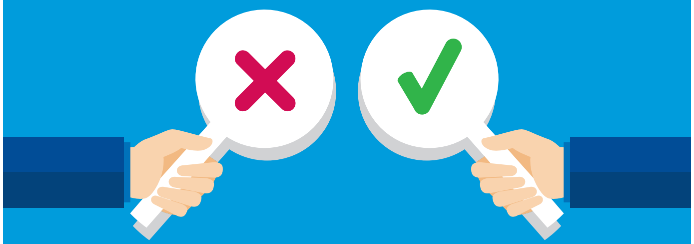
- Head of Tax and tax teams
- Accounting and financial reporting teams

Are you affected by the US GILTI rules?

One area of debate has been the scope and mechanism to manage the interaction of the US global intangible low-taxed income (GILTI) rules with Pillar Two. Areas of complexity and concerns of double taxation remain.

- Head of Tax and tax teams
- Accounting and financial reporting teams

Objection handling



1 "Why does this matter for my company?" "Will there really be an agreed upon position?"

There is a great deal of political momentum behind the proposals. Although they are not implemented, much progress has been made and there is a strong desire for a multilateral solution. Both developed and developing countries are seeking change. Should OECD/G20 IF negotiations fail, finance ministers have made it clear that public pressure will require unilateral digital services taxes to be maintained and extended.

2 "It is too costly to unwind our structure?"

In some cases, the upfront cost of unwinding or modifying a group structure will be less than the tax at risk under these proposals. Structures may also need to be revised to continue to qualify for tax benefits. Existing tax authority rulings/ advance pricing agreements that may work under the current structure may no longer remain in force or be effective under BEPS 2.0. Some foresee an increase in international tax disputes. The proposals for relieving double taxation have drawn some comments and concerns. Some view them as problematic and unlikely to be effective in all situations. At present, there remains a possibility that double taxation will arise in many cases. Along with additional tax costs, the risk of reputational damage may be a factor.

3 "Our structure already has substance in key jurisdictions."

"We have dealt with BEPS already."

In contrast to the focus of the original BEPS project, BEPS 2.0 may give rise to additional taxation even when a company's trading structure is supported by substance. Particularly in connection with Pillar One, the arm's-length principle is not the determinant of taxing rights. With taxation no longer dependent on physical presence, substantial liabilities may arise even though the group structure has aligned substance with taxable income. Under Pillar Two, operations in low-tax countries may reduce the group's overall effective tax rate below the agreed threshold. The proposals may also affect a multinational's plans for its capital structure, location of research and development activities, and ownership and management of any resulting intellectual property, among other concerns.

Our proposition

What KPMG can offer

- We can help organizations understand, evaluate, and communicate appropriate responses to BEPS 2.0.
- We can provide customized high-level or detailed analysis with the KPMG BEPS 2.0 Model tool.
- Using our joint tax and legal capability, we can recommend and implement desired changes to group, capital, and/or intangible structures.
- We can provide a coordinated approach with accounting advisory services to help address systems- and data-related issues.

KPMG BEPS 2.0 Model tool

- Using the proprietary KPMG BEPS 2.0 Model tool, we can aid discussions with key decision makers. The tool produces numerical outcomes based on financial data (or reasonable assumptions) and visual outputs (such as graphs and charts) to map out the impact on effective tax rate and cash taxes under various scenarios.
- Note: The tool itself cannot be shared with clients. Only the outputs it produces can be shared.

Legal entity simplification

- If the group structure and value chain are no longer appropriate, we can assist with restructuring. Our tax and legal teams are experienced at working together to help groups restructure. For example:
  - Collapsing complex holding structures may simplify reporting, helping to provide cost savings and reduce tax risk for the corporate group.
  - Factors to consider include the location of risk management and control functions, the group's principal markets, and tax system characteristics.

Communication with stakeholders

- We can prepare a board paper setting out expected impacts of BEPS 2.0 using model outputs.
- We can assist with engagement with the C-suite/audit committee.
- We can provide tax and legal support with:
  - Fast-moving international tax and transfer pricing issues
  - DST and other taxes, withholding tax
  - Intangible property (IP) and research and development (R&D) considerations.

Data and systems considerations

The IF announcement indicates that the BEPS 2.0 rules will commence at the beginning of 2023, which sets a very challenging timeline for multinational enterprise (MNE) groups to be ready to comply with these new obligations. The complexity of the rules means that there are several data and systems issues that will need to be addressed by MNE groups to ensure their compliance with the rules.

Understanding the sources of the data, the level of detail embedded in the source systems, and the structure in which the data can can be maintained will be critical. Many MNE groups will need implementation assistance in bringing together the necessary data, transforming it, carrying out tax computations and producing structured and tax-tailored information in standard and adaptable forms (to address country variations). This process is akin to managing the underlying piping in a building; it is necessary for effective ETR modeling and efficient compliance.

Identifying the data sources for Pillar One

The below diagram outlines the various information sources and calculations required to complete a calculation under Pillar One of the BEPS 2.0 proposals:

Scope

- Global turnover >€20 billion (potentially reducing to €10 billion over seven years)
- Extractive industry and regulated financial services exclusions
- Profit before tax >10% of revenue

Nexus

- >€1 million of revenue from jurisdiction
- >€250,000 of revenue from jurisdictions with GDP <€40 billion

Quantum

- 25% of residual profits (i.e., profit above 10% of revenue)

Allocation keys

- Sourcing to jurisdiction where goods or services are 'used or consumed'
- Intermediary tracing rules

Calculation

- Loss carryforward
- Marketing and distribution profits safe harbor
- Double taxation elimination — exemption or credit method
- Amount B application to marketing and distribution activities

Key data sources

- Consolidated financial statements
- Sales revenues from each jurisdiction and GDP data on smaller jurisdictions
- Tax returns; tax losses; tax payments
- Tracing to determine place of use or consumption, such as:
  - Geolocation of user or IP address
  - User billing address
  - Mobile country code
  - User residency
  - Place of final delivery

Identifying the data sources for Pillar Two

The below diagram outlines the various information sources and calculations required to complete a calculation under Pillar Two of the BEPS 2.0 proposals:

Scope
- Consolidated group >€750M threshold (with discretion for income inclusion rule (IIR) below threshold)
- Investment funds that are ultimate parent companies, holding vehicles, and pension funds excluded
- Government, international and nonprofits excluded
- Tax transparent entities
- Shipping income exclusion

ETR calculation
- Covered taxes
- Financial accounting income

Adjustments & carve-outs
- Carryforward losses?
- Timing differences?
- De minimis exclusion carve out
- Carve out for mark-up on tangible assets (8%) and payroll (10%) initially and 5% after 10 years

  Distribution tax systems

Computation
- ETR ≥15% minimum rate
- Allocation of top-up tax
- Simplification measures
- Undertaxed payment rule (UTPR) — allocation of top-up tax
- Apply STTR minimum rate >9%

Data sources
- Consolidated financial statements
- Financial statements of subsidiaries in group GAAP
- Tax returns; tax losses; tax payments; tax rates from jurisdictions where revenue is earned
- Revenue line items and mark-ups — tangible assets; payroll; related-party payments; interest; royalties
- Amounts not taxed

How KPMG can help

The BEPS 2.0 Pillar One and Pillar Two proposals are complex with outcomes that are often counterintuitive and continually changing as the move toward consensus continues. KPMG professionals can help you assess the possible impacts to your organization. Examples include:

- What information will I need to collate?
- How do I get that information?
- How does this change my assessment of substance in various countries?
- How will this affect my current APAs and tax rulings?
- How do I communicate impacts and needs to my stakeholders?
- To which parts of our business will these rules apply?

KPMG professionals understand the difficulties in anticipating and communicating the potential impacts of the OECD/G20 IF proposals, as well as the many and wide-ranging possible unilateral proposals. By combining KPMG technology investments with our professionals' abilities to interpret the output and make recommendations that are specific to you and your objectives, we can help you stay ahead of the implications of these initiatives. We can help you identify potential impacts and responses, develop communications plans, and help empower you to support your organization's current and future actions.

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