BEPS 2.0: Consultation on Pillar One Draft Rules for Nexus and Revenue Sourcing

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Introduction

The Organisation for Economic Cooperation and Development (OECD) has released draft model rules for public consultation, covering elements of Pillar One of the BEPS 2.0 Inclusive Framework.

Pillar One is the reallocation of taxing rights to market jurisdictions in relation to a portion of the income of the largest, most profitable multinational enterprises (MNEs), excluding those in the extractive and regulated financial services sectors. The initial Pillar One threshold is global consolidated accounting revenue exceeding 20 billion euros with profit margin above 10%.

KMPG Perspective: Very few Asia Pacific (ASPAC) MNEs are expected to exceed this 20 billion-euro/10% profit margin threshold. However, many ASPAC regional subsidiaries of in-scope MNEs will likely have a significant role to play in fulfilling data collection requirements.

The OECD intends to release further tranches of Pillar One Model Rules over the coming months.

Source rules

The draft model rules cover the revenue sourcing concepts applicable to the application of taxing rights to market jurisdictions as well as associated nexus rules. The revenue sourcing rules will determine whether an MNE has exceeded the nexus revenue threshold in any given market jurisdiction.

Revenues

A key element of these rules is the identification of revenue. The consultation document notes that "Revenues" is a defined term and refers to revenue derived from third parties (after the exclusion of revenue derived from Extractive and Regulated Financial Services) but does not include definitions of these key terms.

Taxable nexus

The nexus test operates solely for the purpose of determining whether the MNE is subject to Pillar One in the relevant market jurisdiction and does not impact other criteria relevant to any pre-existing taxable presence.

The proposed nexus threshold is 1 million euros of revenue sourced (using the revenue sourcing rules) from the jurisdiction (or 250 million euros if the gross domestic product of the jurisdiction is less than 40 billion euros). The purpose of the nexus threshold is to try and keep compliance costs proportionate with the tax dollars being reallocated, while at the same time not excluding the developing world from receiving any additional tax revenue.

Revenue sourcing

Revenue sourcing is at the core of the work in-scope MNEs will have to undertake when identifying how to reallocate profits to market jurisdictions.

Importantly, the rules propose that an MNE should source revenue on a transaction-by-transaction basis. That is, it must identify the destination of each item sold rather than the jurisdiction of the invoice.

The draft model rules also set out criteria to be used when establishing the source of revenue from each transaction. The process is tailored to the category of revenue earned. For example, the source of the sale of goods might be based on the location of delivery whereas advertising might be based on the location of the viewer (and not who paid for the advertising).

Data sources

To address how to allocate revenues in a reliable and compliant manner, the draft model rules introduce the concept of a Reliable Indicator (RI) for determining the source of revenue from each transaction.

The OECD has stated that it will in due course release commentary on applying and identifying RIs (and expectations around reasonable steps taken to identify and apply the RIs). It appears that an RI could include an indicator that the MNE relies on for commercial purposes or to fulfil other legal or regulatory obligations. A process that an MNE had in place to manage its indirect tax compliance or to meet its geographic financial reporting requirements might be capable of being an RI. A process could also be an RI if it was verified by information which a third party had collected for its own commercial or regulatory compliance purposes.

Where an MNE cannot identify a reasonable RI, and the sourcing rules for that category of revenue allow it, the MNE may apply one or more Allocation Keys in determining the source of its revenue. The Allocation Keys are an attempt to arrive at a reasonable allocation, where better information is not available, but in some cases result in a relatively remote proxy. For example, the Global Allocation Key would allocate revenue between jurisdictions based on their share of the aggregate final consumption expenditure of those jurisdictions, as published by the United Nations. It is reasonable to expect that tax authorities will strongly encourage MNEs to implement an RI for each category of revenue they derive.

What next?

The OECD is only accepting written submissions on these elements of the draft model rules until 18 February 2022. If you have comments that you would like to share with the OECD, please contact one of the authors as soon as possible.

The OECD emphasises that none of the content of the draft model rules is yet settled. Once an agreement is reached, the model rules will be written into a multilateral convention which would amend the nominated bilateral tax agreements between signatory jurisdictions. The OECD will also provide a template for how jurisdictions will give effect to the multilateral convention through their domestic legislation.

If you would like to discuss the application of these draft Pillar One rules or BEPS2.0 in general, please contact your local KPMG representative. You may also reach out to Dean Rolfe, Head of International Tax, Asia Pacific, or Conrad Turley, Head of Taxation Policy, Asia Pacific.

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