

Global tax reform

New tax rules for large international companies

Changes in international taxation rules have been gaining momentum significantly in the last ten years, especially due to the OECD's BEPS program, which was first released in 2013. Affected companies see their scope for tax planning restricted and the tax burden increase. At the same time, these companies face new challenges in calculating and declaring their taxes.

New OECD two-pillar model

On 8 October 2021, 136 countries in the OECD and G20's Inclusive Framework on BEPS adopted a new two-pillar model of international taxation. These two pillars are the main drivers of the new international tax rules and consist of measures intended to:

1. Govern where the largest international companies pay tax on their profits.
2. Ensure a minimum tax rate of 15%

This article sets out the most important aspects of the new rules and their implications for companies.

Pillar One – Change in global tax profit allocation

The Pillar One measures are intended to govern how taxes on the profits of the largest companies should be divided among participating states. As the provisions currently stand, Pillar One will affect companies with a global turnover above EUR 20 billion and profitability above 10% (i.e. profit before tax/revenue).

Pillar One has its origins in efforts to regulate taxation of the "digital economy". This was initially driven by the fact that new technologies enable revenues to be generated in a state – through streaming, intermediary platforms and online advertising, for example – without there being a subsidiary or permanent establishment in the respective state. The international rules in place for decades regarding profit allocation for tax purposes fail to cover these new business models. In the absence of a subsidiary or permanent establishment, a market jurisdiction cannot levy taxes on profits, even if a company generates significant turnover on its territory or with users residing there.





However, the type of companies included in the scope of Pillar One has expanded further and further into established industries over time. In the meantime, only a few sectors such as regulated financial services or extractives are exempt from the new rules.

The key feature of the new rules is the allocation of a portion of a group's profit – "Amount A" – to the market jurisdictions. A portion of what is referred to as "residual profit" (profit in excess of the 10% threshold) is to be allocated to the market jurisdictions, with the distribution being proportional to the turnover in these states. Today, this portion of group profit is typically taxed at the company's headquarters or regional headquarters.

Pillar One is intended to replace various planned "digital taxes" (often withholding taxes) that a large number of (market) jurisdictions have on standby. If the introduction of Pillar One fails, the states will implement these new taxes. The states mentioned can also use this as leverage against countries such as the US, which is home to a large number of companies that would be affected by such digital taxes.

While only a small number of Swiss groups are directly affected by Pillar One, there are a considerable number of regional headquarters in Switzerland (often of US groups), which usually collect part of the group-wide residual profit.

Pillar Two – Ensuring global minimum tax of 15%.

Pillar Two contains "model rules", which in turn consist of a large number of regulations designed to ensure that the profit of multinational enterprises is subject to minimum taxation of 15%. The model rules stipulate that companies fall within scope if they have group turnover of EUR 750 million. Currently, it is assumed that around 250 to 300 Swiss companies will be affected. In addition, there are thought to be more than 2,000 subsidiaries of foreign groups in Switzerland.

The rules aim to ensure that the tax burden in each country is at least 15%. The model rules – rather than local legislation – are used to determine both the taxes to be taken into account and the taxable profit. In addition, the model rules also provide for various options for companies, some of which are applicable for several years.

A key element of the model rules is the concept of "qualified domestic minimum top-up tax". It means a country would levy additional taxes on a group if the tax rate in that country comes to less than 15% according to the model rules, i.e. if taxation there would otherwise be low.

If the low taxation is not corrected, taxation rights arise for other countries in which the group is represented. As a matter of priority, one of the countries above the low-tax country in the group structure has the right to fill the tax gap (in what is known as the "income inclusion rule") and levy top-up tax.

If this taxation is omitted, each country that has adopted the global minimum tax into local law (and in which the company is present) also has the right to levy additional taxes (in what is known as the "undertaxed payment rule"). This tax is distributed among the countries





involved in proportion to the number of employees and tangible assets.

The tax burden of a company falling in scope of Pillar Two will in future therefore no longer be based (only) on the respective local tax laws, but will also include additional taxes resulting from application of the global minimum tax.

Timetable

Both Pillar One and Pillar Two were initially on a very ambitious schedule and were originally supposed to be in place, at least partially, by 2023. For Pillar Two, the plan seems to have been pushed back by one year, although individual countries are still considering an introduction in 2023. It is difficult at present to make statements about the timeframe for introduction of Pillar One.

At the same time, Pillar Two is already having an effect, as the model rules contain transitional provisions that are already applicable to transfers of assets between constituent entities from 30 November 2021.

Need for action by companies

Determining the tax burden based on the model rules is highly complex and existing systems and data will not deliver all the necessary answers. Around 150 data points and choices can be derived from the model rules alone. Companies need to safeguard the availability of the required data and information, define responsibilities and processes, and determine technological solutions for their calculations and the annual tax returns.

At the same time, many companies are currently refining their rough initial calculation models in order to better understand the precise impact of Pillar Two on their tax burden.

Pillar One comes with similar challenges in terms of obtaining the information needed to carry out the distribution of the tax base among the market jurisdictions. Companies will also need to simulate the impact on the tax burden of the group.

The schedule for introduction of Pillar One and Pillar Two in the countries relevant to the group must followed carefully as the group's own project plan needs to be closely aligned to it.

Consequences for Switzerland

In June 2023, the Swiss electorate will vote on the introduction of the global minimum tax. Switzerland intends to implement the model rules – including, but not limited to, the qualified domestic minimum top-up tax. The other instruments are also to be introduced.

For large Swiss companies and for many Swiss subsidiaries of foreign groups, the introduction of the global minimum tax will be associated with additional tax costs in Switzerland.

At the same time, the tax substrate of some large Swiss corporations and regional headquarters will be partly reallocated abroad. This will lead to tax losses for Switzerland. It is very difficult to estimate the total impact on tax revenues for Switzerland as a whole and at the cantonal level.

Most of the additional revenues expected from Pillar Two should go to the cantons. Political will has been expressed to use these revenues to increase the attractiveness of Swiss business locations. However, the concrete design of these measures is difficult due to potential clashes between compatibility with the basic principles of Pillar Two, the rules on state aid and free trade, and political acceptance within Switzerland itself.



Outlook

Both Pillar One and Pillar Two have yet to be implemented in many countries. The international consensus for Pillar Two is more advanced than for Pillar One.

Currently, it looks like many countries (including the EU) will only introduce Pillar Two from 1 January 2024 – a year later than originally planned by the OECD. In general, however, it seems that some form of Pillar Two will be implemented.

In the case of Pillar One, it is still entirely possible that the project will fail and that a multitude of different digital taxes will be introduced without any harmonization; this too would pose major challenges for the companies concerned.

The introduction of a qualified domestic minimum top-up tax in most low-tax countries dashes the hopes of high-tax countries regarding realization of additional tax revenues from Pillar Two. As a result, these countries will continue to try to generate additional tax substrate by adjusting transfer prices between countries. Against this background, it will become even more important to consider appropriate risk management as well as the related planning and documentation.



Peter Uebelhart
Partner, Tax

+41 58 249 42 24
puebelhart@kpmg.com

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