Pillar One: Profit allocation and nexus

Pillar One aligns taxing rights more closely with local market engagement. A portion of profits of the largest and most profitable groups is allocated to market jurisdictions.

Inclusive Framework statement

On October 8, 2021, the Inclusive Framework (IF) released an updated statement setting forth the key components for an agreement on a two-pillar solution to address the tax challenges arising from the digitalization of the economy.

Pillar One would:

— Revisit profit allocation and nexus rules for in-scope groups

— Effectuate the view that a portion of an in-scope group’s residual profit (likely to be generated by capital, risk management functions, and/or intellectual property) should be taxed in the end-market jurisdictions where goods or services are used or consumed

— Apply to groups with greater than €20 billion in worldwide revenues and a profitability before tax margin of at least 10% calculated using an averaging mechanism (with intention to reduce the revenue threshold to €10 billion after seven years, contingent on successful implementation)

— Allocate profit to market jurisdictions irrespective of any physical presence in those jurisdictions.

Market allocations

Amount A:

— New taxing right would allocate 25% of profit in excess of 10% of revenue to market jurisdictions based on a formula, not the arm’s-length principle.

— The allocation key is based on the revenue that is sourced (via to-be-developed sourcing rules) to each jurisdiction, but only jurisdictions that are allocated at least €1 million in revenue would receive an allocation (reduced to €250,000 for jurisdictions with GDP less than €40 billion).

— When the residual profits of a group are already taxed in a market jurisdiction, a marketing and distribution profits safe harbor (which may also apply to a broader set of activities) will cap the residual profits allocated to the market jurisdiction.

— Measures to eliminate double taxation and to provide tax certainty are being developed.

Amount B:

— The development of standard remuneration for in-country “baseline” marketing and distribution activities has been deferred pending further technical work, which is expected to be completed by the end of 2022.

What businesses need to know

— These changes may affect groups around the globe, and despite simplification compared to previous proposals, remain technically complex.

— Digital services taxes and other similar measures would be repealed under the agreement (and there is a moratorium on new measures), but identification and timetable are not yet clear.

— Scope of covered businesses has moved far from the originally targeted highly digitalized business models; extractives and regulated financial services are exempt, but other industries are generally in scope.

— The IF statement provided more certainty with respect to Pillar One, but many details remain outstanding.

— The IF aims to finalize a new multilateral convention to implement Pillar 1 in early 2022, which would be open for signature in mid-2022 and take effect beginning in 2023.

More insights

KPMG Report: OECD/G20 Inclusive Framework Agreement on BEPS 2.0 (October 9, 2021)

Inclusive Framework’s Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy (October 8, 2021)

KPMG Report: OECD/G20 Inclusive Framework Agreement on BEPS 2.0 (July 2, 2021)

Inclusive Framework’s Statement on a Two-Pillar Solution (July 1, 2021)
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