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.

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 customer or user is located.
— Applies to Automated Digital Services 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 the arm’s-length principle.
— Covers profits earned from activities with an automated digital (mainly online) character or goods/services commonly sold to consumers (as well as associated IP licenses). Specific inclusions and exclusions are proposed.
— Amount A is 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
— 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, will likely not be limited to highly digitalized 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 U.S. proposal that departure from the arm’s-length principle should be on a safe-harbor basis.
— The OECD invited public comments on the proposals in the form of submissions that were due in December 2020, followed by public consultation meetings, which were held in January 2021. The OECD has published its global impact analysis; potentially affected businesses should consider what these changes could mean for their effective tax rate.

Further insights from KPMG
Pillar One Blueprint Report
Global Summary of Taxation of the Digitalized Economy Developments
Global Tax Reform: BEPS and Tax Transparency as Drivers
