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Canada

# OECD Clarifies Global Minimum Tax Plan for 2023

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Certain large multinational companies may soon be subject to international tax changes including a minimum 15% global corporate income tax rate. The Organization for Economic Cooperation and Development (OECD) has announced that Canada and 135 other countries and jurisdictions of the OECD/G20 Inclusive Framework have finalized several key aspects of a framework intended to reform the international tax system. These details were included in a statement released on October 8, 2021 that confirms that certain multinational enterprises (MNE) will be subject to a minimum 15% tax rate and clarifies other details of the OECD's two-pillar approach to address tax challenges arising from the digitalization of the economy.

As these rules are intended to be effective starting in 2023, businesses should prepare for these upcoming changes by monitoring developments and the timing of legislative proposals in different jurisdictions. In addition, affected MNEs should model the potential impacts of these complex changes and evaluate conflicts with existing domestic rules to prevent double taxation or other inadvertent issues.

**Background**
The OECD released details of the proposals under review to address challenges of tax and the digital economy in a program of work in 2019 as part of its base erosion and profit shifting (BEPS) project. Generally, the OECD/G20 Inclusive Framework looks at tax proposals under two specific "pillars". The first pillar focuses on the allocation of taxing rights, including nexus issues. These proposals typically allocate more taxing rights to market or user jurisdictions where value is created through businesses' participation in the user or market jurisdiction that is not recognized in the current framework for allocating profits. The second pillar focuses on ensuring multinational

entities pay a minimum rate of tax. The OECD released two detailed reports, which it calls “blueprints”, on its proposed two-pillar approach on October 12, 2020. For details, see *TaxNewsFlash-Canada* 2020-77, “Digital Economy — OECD Releases Taxation Blueprints”.

Previously, on July 1, 2021, the OECD/G20 Inclusive Framework said 130 of its member countries, including Canada, agreed on a framework to reform international tax rules under a two-pillar approach. Specifically, these member countries supported a minimum global corporate income tax rate of at least 15% on a country-by-country basis under Pillar Two and addressed key political questions and design features of Pillar One and Two.

For details, see *TaxNewsFlash-Canada* 2021-32, “Minimum Global Corporate Tax Rate Gains Support” and *TaxNewsFlash-Canada* 2021-38, “Global Minimum Tax Expected in 2023”.

The OECD/G20 Inclusive Framework released an updated statement on October 8, 2021 (see *TaxNewsFlash-Canada* 2021-47, “OECD Moves Forward with 15% Global Minimum Tax for 2023”).

## Pillar One

MNEs with global revenue above €20 billion and profit before tax above 10% of revenue will be covered by the new rules under Pillar One, according to the OECD, with 25% of profit above the 10% threshold to be reallocated to market jurisdictions. The OECD notes that taxing rights on more than U.S. $125 billion of profit are expected to be reallocated to market jurisdictions each year. Extractives and regulated financial services are excluded from the scope of these rules.

The statement confirms previously announced details of Pillar One and clarifies additional aspects including:

- An averaging mechanism will be used to determine whether MNEs will meet the thresholds for Amount A to apply
- Amount A will be equal to 25% of an MNE’s residual profit (from 20-30% of MNE’s residual profits in the previous statement)
- Jurisdictions from which €1 million or more revenue are earned will receive an allocation under Amount A (reduced to €250,000 for jurisdictions with less than €40 billion in GDP)
- A marketing and distribution profits safe harbour will cap the residual profits allocated to a market jurisdiction through Amount A, where the residual profits of

an in-scope group are already taxed in a market jurisdiction (details of the cap are yet to be determined)

- Countries have committed to enact legislation and ratify a proposed Multilateral Convention on Amount A within the context of their legislative process

- Jurisdictions will be subject to mandatory binding arbitration with only a limited number of less developed countries permitted to use an elective mechanism

- Proposal details for Amount B which deals with standard remuneration for in-country baseline marketing and distribution activities will be developed in 2022

- No new Digital Services Taxes or other similar measures will be enacted and imposed on any company until the earlier of December 31, 2023 or the coming into force of the Multilateral Convention.

**KPMG observations**
The statement does not provide additional detail on specific adjustments to financial accounts or the loss carry forward mechanism that are used to measure the profit (or loss) of an MNE.

According to the statement, it appears that segmentation would apply if an MNE did not meet the profitability threshold on a consolidated basis, and a segment of that MNE (as reported for financial statement purposes) exceeded both the revenue and profitability thresholds. It is still not clear, however, whether segmentation would also apply if an MNE meets the profitability threshold on an overall basis and also has one or more disclosed segments that meets the thresholds.

Canada recently noted that it intends to move ahead with legislation finalizing the enactment of a 3% Digital Services Tax (DST) by January 1, 2022, as it previously proposed in the 2021 federal budget. Canada says that, if the Multilateral Convention implementing Pillar One has not come into force as of 2024, it will impose the DST as of January 1, 2024 on revenues earned as of January 1, 2022. Although draft legislation for the DST is still pending, affected businesses may want to track the potential DST beginning in 2022 and determine any related financial statement impact, in the event a Multilateral Convention does not come into force as of 2024.

## Pillar Two

Pillar Two introduces a global minimum corporate tax rate set at 15%. The new minimum tax rate will apply to companies with revenue above €750 million and is estimated to generate around U.S. $150 billion in additional global tax revenues annually. The OECD states that further benefits will also arise from the stabilization of the international tax system and the increased tax certainty for taxpayers and tax administrations. Government entities, international organizations, non-profit organizations, pension funds or investment funds that are Ultimate Parent Entities of an MNE group or any holding companies used by such entities, organizations or funds are excluded from the scope of Pillar Two. International shipping income is also excluded from Pillar Two.

The statement confirms previously announced details of Pillar Two and clarifies additional aspects including:

- The agreed global minimum tax rate is 15% (previously, countries agreed that it would be "at least 15%")
- Inclusive Framework members are not required to adopt Pillar Two, but must accept the application of the rules by other members
- Inclusive Framework members that adopt rules under Pillar Two must implement and administer the rules consistently with the agreement
- An exclusion from the Undertaxed Payment Rule (UTPR) for MNEs will apply in the "initial phase of their international activity", where it meets certain conditions
- A formulaic substance carve-out would exclude certain income from the rules, determined as a mark-up of 8% for tangible assets and 10% for payroll, tapering down over a 10-year period to 5% for both
- A *de minimis* exclusion will apply for jurisdictions where the MNE has revenues of less than €10 million and profits of less than €1 million
- The implementation framework will include safe harbors
- Inclusive Framework member jurisdictions that apply nominal corporate income tax rates below the subject-to-tax rule minimum rate to interest, royalties and certain other payments would incorporate this rule into their bilateral treaties with developing Inclusive Framework members when requested to do so
- The taxing right under the subject-to-tax rule will be limited to the difference between the tax rate on the payment and 9% (previously countries agreed that it would be between 7.5% and 9%)
- The U.S. global intangible low-taxed income (GILTI) regime will co-exist with the rules under Pillar Two
- There will be no top-up tax liability for existing distribution tax systems (i.e., systems that defer tax on corporate profits until they are distributed) if earnings are distributed within four years and taxed at or above the minimum level (previously countries agreed on a three to four-year grace period).

## Next steps

The statement includes a detailed implementation plan that states that the countries intend to sign a multilateral convention during 2022, with effective implementation in 2023. The convention, which is already under development, will be used to implement the newly agreed taxing right under Pillar One and remove all existing digital service taxes and other unilateral measures. The OECD also indicates it will develop model rules for bringing Pillar Two into domestic legislation during 2022, to be effective in 2023 (2024 for the UTPR).

The OECD notes that, 136 countries and jurisdictions of the 140 members of the OECD/G20 Inclusive Framework (including all OECD and G20 countries) have agreed that certain MNEs will be subject a minimum 15% tax rate and these other international tax reforms, now that Estonia, Hungary, and Ireland have joined the agreement. Of the remaining Inclusive Framework members, Kenya, Nigeria, Pakistan and Sri Lanka have not yet joined the agreement.

**KPMG observations**

Large multinational companies should consider whether they may be affected by the OECD's two-pillar approach. In particular, given the ambitious timeline for implementation, MNEs should monitor developments related to this approach, which will be important to the operation and impact of the new rules. In addition, due to the complexity of these rules, MNEs should use appropriate assessment tools to model impacts and evaluate interdependencies to prevent double taxation or other inadvertent effects. MNEs will need to understand the relevant timelines and requirements of the various legislative and parliamentary processes in different jurisdictions and track when domestic laws will come into effect. MNEs should also consider whether these new measures may interact with other international tax proposals in Canada's 2021 federal budget, such as new anti-hybrid rules and interest deductibility limitations which are expected to apply beginning in 2022 and 2023.

Despite the welcome clarity provided by the new statement, there are several unresolved issues within the OECD's two-pillar approach. Specifically, more details are expected on certain design aspects including the definition of MNE group, a foreign de minimis revenue exclusion and the mandatory and binding dispute resolution mechanism under Pillar One, along with more on the safe harbor design and other technical design features under Pillar Two. The implementation plan contemplates consultation with stakeholders, but does not commit to another public consultation.

For further details on the OECD announcement, see a recent alert from KPMG's U.S. member firm, "KPMG report: OECD/G20 Inclusive Framework agreement on BEPS 2.0".

## We can help

Your KPMG adviser can help you assess the effect of the OECD's proposals on your business and provide guidance on how this might impact you going forward.

For more information, contact your KPMG adviser, or one of the following tax professionals:

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