



TaxNewsFlash

Canada

OECD Consultation — Feedback Wanted on Scope of Pillar One

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Large multinational enterprises (MNEs) may want to follow the Organization for Economic Cooperation and Development (OECD)'s latest consultation on its two-pillar approach to address tax challenges from the digitalization of the economy. The OECD has now released a new consultation paper on its draft model rules for domestic legislation on scope, as part of its proposal to ensure certain MNEs pay tax in countries where they have consumer-facing activities but do not have a physical presence. Specifically, the OECD is asking for feedback on draft model rules for scope under "Amount A" of Pillar One. Affected parties are asked to provide comments on these rules by April 20, 2022.

The OECD's release of model rules for scope is the latest in a series of planned public consultations to consider different elements of its Pillar One proposal, on which not all countries have reached consensus. Previously, the OECD sought feedback on draft model nexus and revenue sourcing rules and tax base determinations under Amount A of Pillar One. The OECD further notes that it intends to release draft rules for the exclusions for extractives and regulated financial services for public consultation at a later date.

Background

The OECD first released details of the proposals under review to address challenges of tax and the digital economy in 2019 as part of its base erosion and profit shifting (BEPS) project. Generally, the OECD/G20 Inclusive Framework contemplates tax proposals under two specific "pillars". More than 135 countries and jurisdictions of the OECD/G20 Inclusive Framework (including Canada) agreed to certain key aspects of this approach in October 2021.

The OECD's Pillar One proposal introduces a new mechanism for allocating profit, which applies to MNEs with global revenue above €20 billion and profit before tax above 10% of revenue, with 25% of profit above the 10% threshold (i.e., Amount A) to be reallocated to market jurisdictions. Pillar One also contemplates simplifying the application of the arm's length principle to in-country baseline marketing and distribution activities (Amount B), with further details to be developed. Extractives and regulated financial services are excluded from the scope of these rules. In addition, Pillar One also outlines a proposed approach to mandatory binding dispute prevention and resolution for Amount A.

The OECD is asking for public feedback on various aspects of Pillar One, including in recently closed consultations on draft model nexus and revenue sourcing rules and tax base determinations under "Amount A" of Pillar One (see *TaxNewsFlash-Canada* 2022-04, "[OECD Seeks Feedback on Taxing Rights under Pillar One](#)"). And *TaxNewsFlash-Canada* 2022-07, "[OECD Consultation — Tax Base Calculations under Pillar One](#)".

The OECD/G20 Inclusive Framework also recently published model rules and commentary to help Canada and other jurisdictions to implement changes under Pillar Two of these rules, including that certain MNEs will be subject to a minimum 15% tax rate.

For details, see *TaxNewsFlash-Canada* 2022-13 "[OECD Pillar Two — KPMG Analysis Available Now](#)", *TaxNewsFlash-Canada* 2022-12, "[OECD Offers Guidance on Global Minimum Tax Rules](#)" and *TaxNewsFlash-Canada* 2021-63, "[OECD Releases Model Global Minimum Tax Rules](#)".

Scope under Amount A

The OECD advises that the scope rules are intended to determine whether a multinational group will be in scope of Amount A. In particular, the OECD states the rules are designed to provide that Amount A only applies to large and highly profitable multinational groups and have been drafted to apply in a quantitative manner, such that they are readily administrable and provide certainty as to whether a taxpayer is within scope.

The draft model rules released for comment, which do not reflect consensus among all countries, clarify certain elements of the rules, including:

- Whether an MNE group is in-scope is generally determined by the consolidated financial statements at the Ultimate Parent Entity (UPE) level
- The €20 billion revenue threshold applies to the accounting period that is under consideration
- The MNE group will meet the profit margin threshold if its pre-tax profit margin exceeds 10% for:

- The accounting period under consideration
 - At least two of the four immediately preceding accounting periods, and
 - On an averaged basis across the accounting period under consideration and the four immediately preceding accounting periods
- An excluded entity's revenues and profits would not be part of the revenues of an MNE group, and would not be taken into account in the calculation of the MNE group's pre-tax profit margin (excluded entities generally include a government entity, an international organization, a non-profit organization, a pension fund, and certain investment fund and real estate investment vehicles)
 - Where MNE groups have joint venture arrangements, the revenues reported in the group's consolidated financial statements are adjusted to reflect the group's share of revenues from the joint venture in proportion to its share of profit or loss
 - Certain anti-abuse measures.

The OECD notes several unresolved issues with these rules, including:

- Whether the €20 billion revenue threshold test should also take into account revenue of prior periods or an averaging approach to better manage compliance costs
- Whether the prior period and average tests under the draft profit margin threshold could, alternatively, apply solely as an "entry test" in situations where an MNE group has not previously met the scope thresholds.

The OECD is asking for public comments on how it can achieve its broad policy objective for the scope of the rules without creating excessive compliance costs.

KPMG observations

MNEs and other large Canadian corporations should follow the progress of these rules, since Canada has indicated that it will move forward with a 3% digital services tax (DST) if the tax changes in Pillar One have not come into force by January 1, 2024. Under these proposals, businesses that earn revenue from certain digital services may be liable for the DST, effective for certain revenues earned as of January 1, 2022. For details, see *TaxNewsFlash-Canada* 2021-64, "[Canada Lays Out Digital Tax Proposals for Businesses](#)".

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.

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