



## BEPS 2.0 is coming – New global tax rules to tackle digitalization challenges and beyond

### Summary

The 137 jurisdictions of the Inclusive Framework on BEPS (IF) have released documents showing substantial progress on a new international tax architecture. The business community have an opportunity to participate in a public consultation on tax rules that will affect all large internationally operating enterprises, their corporate structures and their accounting and tax management systems.

### Background

On 12 October 2020 documents approved by the IF at their meeting on 8-9 October were posted to the OECD website. These included two blueprint documents, totalling 480 pages and setting out highly detailed proposals for the two “Pillars” of the new international tax architecture. This is the product of intense work by the OECD Secretariat and working parties of tax officials from IF member countries under the IF’s 2019 programme of work (see [China Tax Alert 2020 Issue 10](#)). This was accompanied by an economic analysis on the effects of the proposals, a public consultation document, as well as a covering statement setting out the state of play on progress towards IF political agreement. This commits IF jurisdictions to resolving remaining issues and finalize agreement on the new rules by mid-2021. The G20 Finance Ministers meeting on 14 October is expected to endorse the progress so far.

### Key content

The blueprint documents set out highly complex new international tax rules, the details of which will be explored in greater detail in future KPMG publications. As explained in the cover statement, each of the two Pillars looks to address deficiencies of the international tax system that have become increasingly evident in recent years:

- Pillar 1 aims to achieve a reallocation of taxing rights between countries, using a formulaic approach. In the cover statement, the IF countries acknowledge that enterprises can generate profits from participation in a significant/ active and sustained way in the economic life of a jurisdiction, without a need for local physical presence. This is to be reflected in the design of a new nexus rule beyond the permanent establishment threshold. Looking ahead, large enterprises would need to monitor whether they have corporate income tax (CIT) filing and payment obligations in countries where they source revenues, even if they have no staff or office there. A simplified approach to profit attribution for distribution arrangements, and new tax dispute resolution mechanisms are also key elements.
- Pillar 2 aims to ensure that all large internationally operating businesses pay at least a minimum level of tax. Whereas Pillar 1 concerns where tax is paid, Pillar 2 concerns the total level of tax. A complex set of interlinking rules would ensure that a multinational enterprise (MNE) cannot achieve an effective tax rate (ETR) below a certain level (likely between 12-15%, yet to be fixed) in any jurisdiction in which it operates. If it is subject to a lower ETR in a jurisdiction the Pillar 2 rules step in to ‘top up’ the tax paid. Compliance will require overhauls to accounting systems, comprehensive mapping of intra-group related party payments, and other tax management system upgrades.

The cover statement is clear that the IF countries have not yet achieved agreement on either of the Pillars. However, the IF countries identify the aspects of the new rules on which they have achieved ‘convergent’ views, and state that the blueprints offer a solid basis for future agreement. As such, the IF countries have advanced significantly on their position in January 2020, at which stage the proposals were just a ‘basis for negotiation’ and they had solely committed to ‘explore’ pillar rule development.



The new international tax rules being developed within the two pillars are frequently referred to as BEPS 2.0. The original 2013-15 international tax reform is now referred to as BEPS 1.0. In the five years since the BEPS 1.0 deliverables were released, countries around the world have updated their transfer pricing rules, their tax treaties, and their domestic anti-avoidance rules in line with these, and preferential and zero tax regimes have adopted 'substance' requirements to prevent abuse. BEPS 1.0 had at its core the concept that taxing rights should be aligned with the place of 'value creation'. Countries in which value was considered to be created, under a framework that emphasized corporate decision-making and control functions, could tax the allocated profits as they wished. The IF countries, in endorsing the direction of the BEPS 2.0 work in the cover statement, might be viewed as moving beyond the BEPS 1.0 value creation framework. The Pillar 1 rules allocate taxing rights using a new concept of nexus, and formulary allocation provisions, that make no reference to the BEPS 1.0 functions, assets and risks value creation framework. Pillar 2 might also be viewed as overriding taxing outcomes under the BEPS 1.0 value creation framework where this results in low tax outcomes. MNEs around the world have spent the last five years busily modifying their corporate and operating structures, and tax management arrangements, to comply with the BEPS 1.0 requirements. In future, under BEPS 2.0, they may have to revisit some of these efforts.

The two Pillars are at different stages of development. Pillar 1, which as designed impacts consumer facing businesses and digital service businesses, has left many of the key features open to further negotiation, and this is reflected in the broad scope of the public consultation. Work on the Pillar 2 rules (which affect all large enterprises) is highly advanced. This is reflected in the granularity of the rules set out in the blueprint, the clear enumeration of technical design matters that are flagged as "remaining issues", and relative narrowness of the public consultation questions. While there are several important points on which political negotiation is needed, enterprises reading the blueprint may be able to form a view of how the rules will impact their overall tax burden, and assess the need for group restructuring and new tax and accounting systems development. Pillar 2-affected enterprises will have a major systems upgrade undertaking on their hands (Pillar 1 will also require additional systems work).

1. Accounting data preparation: Financial statements for each MNE group entity to be adjusted to group consolidated GAAP, accounting consolidation for all entities in a given jurisdiction, etc.
2. ETR and top up tax calculation: Permanent difference adjustments, attribution of covered taxes to each entity, substance exclusion determination, anti-abuse rules, etc.
3. Tracking loss and tax carry forwards and credits: Pre-regime carry forwards, adjustments for entities entering/exiting MNE group, tracking of creation and use of carry forwards and credits.
4. Application of Pillar 2 tax rules: Determination of which MNE group entities will impose the Pillar 2 top up tax in respect of low taxed group entities, under the complex interlocking rules. Figuring out which group entities, in which countries, should pay the tax requires detailed examination of group minority interests, holding arrangements in the group by founders/funds, comprehensive mapping of all intragroup payments, investments in non-controlled entities, and other factors.

Chinese MNEs within the scope of the rules (likely those above the CBCR revenue threshold) will need to make significant investments in upgrading their accounting and tax management systems to deal with these requirements. They may also find that some existing structures (e.g. aspects of offshore listing arrangements) produce unfavorable tax results and call for restructuring. While the Pillar 2 rules are not yet agreed, the direction of travel is increasingly clear, and some MNEs may choose to start their planning now. Submissions to the public consultation on Pillar 1 and 2 are due by 14 December, with the consultation scheduled for mid-January 2021, and China MNEs should consider points they wish to raise.

## Contact us:



### Xiaoyue Wang

Transfer Pricing Practice Leader  
KPMG China  
T: +86 (10) 8508 7090  
E: xiaoyue.wang@kpmg.com



### Michael Wong

Deal Advisory, M&A Tax Leader  
KPMG China  
T: +86 (10) 8508 7085  
E: michael.wong@kpmg.com



### Conrad Turley

Tax Partner  
KPMG China Tax Centre  
T: +86 (10) 8508 7513  
E: conrad.turley@kpmg.com



### Carol Cheng

Tax Partner  
KPMG China Tax Centre  
T: +86 (10) 8508 7644  
E: carol.y.cheng@kpmg.com