Memo

To	OECD Centre for Tax Policy and Administration
From	KPMG International
cc	Manal Corwin, Washington National Tax Leader, KPMG in the US Chris Morgan, Global Policy Leader, KPMG in the UK
Date	December 14, 2020
Ref	Memo to OECD Centre for Tax Policy and Administration.docx

Comments on OECD Public Consultation Document Reports on the Pillar One and Pillar Two Blueprints

Professionals in the member firms of KPMG International[1] ("KPMG") welcome the opportunity to comment on the OECD's public consultation document entitled "Reports on the Pillar One and Pillar Two Blueprints"[2] released on 12 October 2020 (the "Consultation Document").

The Consultation Document contains many detailed questions. For ease of reading, we have divided our response into thematic headings, cross referencing the question numbers in that document. We have not answered all of the questions, but instead concentrated on those where we consider we can best contribute to the process.

Our responses fall into three areas: simplification measures; measures to minimize double taxation and avoid disputes; and miscellaneous considerations. The specific paragraphs below come within these headings as follows:

Simplification Measures	
Subject Matter/Topic	**Paragraph Reference**
Financial Services Exclusion and Fintech	Pillar One - ¶¶ 5-7
Defining the Domestic Market	Pillar One - ¶ 8

[1] KPMG is a global organization of independent professional services firms providing Audit, Tax and Advisory services. We operate in 147 countries and territories and have more than 200,000 people working in member firms around the world. Each KPMG firm is a legally distinct and separate entity and describes itself as such.

KPMG International Limited is a private English company limited by guarantee. KPMG International Limited and its related entities do not provide services to clients.

[2] OECD (2020), Public Consultation Document – Reports on the Pillar One and Pillar Two Blueprints: Inclusive Framework on BEPS, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, https://www.oecd.org/tax/beps/oecd-g20-inclusive-framework-on-beps-invites-public-input-on-the-reports-on-pillar-one-and-pillar-two-blueprints.htm

© 2020 KPMG LLP, a Delaware limited liability partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved. The KPMG name and logo are trademarks used under license by the independent member firms of the KPMG global organization.

Subject Matter/Topic	Paragraph Reference
Single Factor Test with Higher Threshold for Consumer Facing Businesses	Pillar One - ¶¶ 17-23
Preference for Throwback Approach	Pillar One - ¶ 23
Limitation on the Extent to Which “Reasonable Steps” Are Required for Sourcing Rules	Pillar One - ¶¶ 25-27
Segmentation, Thresholds	Pillar One - ¶ 29
Segmentation, Apportionment of Costs	Pillar One - ¶ 30
Segmentation, Hallmarks and Basis	Pillar One - ¶¶ 32-36
Identifying the Paying Entities	Pillar One - ¶¶ 39-47
Scope of Amount B	Pillar One - ¶¶ 53-58
Coordination of GILTI Rules with GloBE	Pillar Two - ¶ 85
Exclusion of Portfolio Dividends	Pillar Two - ¶¶ 88-90
Pre-GloBE Losses	Pillar Two - ¶ 102
Identification of Low Risk Jurisdictions	Pillar Two - ¶ 113
Materiality Threshold	Pillar Two - ¶ 124

Measures to Minimize Double Taxation and Avoid Disputes	
Subject Matter/Topic	**Paragraph Reference**
Preference for Exemption Method	Pillar One - ¶ 48
Avoiding Disputes about Amount B	Pillar One - ¶¶ 62-66
Early Certainty Process for Amount A, Longer Initial Review Period	Pillar One - ¶ 71
Early Certainty Process for Amount A, Avoiding Delays	Pillar One - ¶¶ 73-74
Early Certainty Process for Amount A, Review Panel	Pillar One - ¶¶ 76-78
Separate in Scope Determination for Amount A	Pillar One - ¶¶ 79-83

Miscellaneous Considerations	
Subject Matter/Topic	**Paragraph Reference**
Amount B, Comments on Achieving Stated Policy Aims	Pillar One ¶ 51
Interaction of Measure Introduced to Comply with BEPS 1.0 and New GloBE Rules	Pillar Two ¶ 115
Simplified IIR Exclusion	Pillar Two ¶¶ 117-118

© 2020 KPMG LLP, a Delaware limited liability partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved. The KPMG name and logo are trademarks used under license by the independent member firms of the KPMG global organization.

Pillar One - Public Consultation Responses

1. Scope of Amount A

Pillar One - Questions I and II

1. We recognize that the issue of scope will be informed by policy and political considerations. Our comments focus on two sub-issues with respect to scope: the proposed exception for financial services, and the *de minimis* foreign in-scope revenue test.

1.1. Financial Services Exclusion and Fintech

2. The Pillar One Blueprint proposes to exclude financial services from the scope of Amount A based in significant part on the regulation to which financial services businesses are subject, and the consequences of that regulation.[3] We support the proposed exclusion. The exclusion is aligned with the policy objective articulated in Pillar One. In addition, as noted in the Pillar One Blueprint, many financial services businesses would not be in scope of Amount A in any event, and the proposed exclusion would promote certainty and simplicity.[4]

3. The Pillar One Blueprint also proposes that whether Fintech is treated as a financial services business (and therefore excluded from the scope of Amount A) be based on the extent of regulation imposed on the relevant business.[5] The Pillar One Blueprint notes that Fintech businesses may be developed either by banks or dedicated Fintech firms, and therefore implicitly recognizes the importance of rules that create a level playing field. It also acknowledges that countries' regulatory regimes governing Fintech are at an early stage of development.[6] Indeed, we note that different jurisdictions sometimes regulate the same activities in different ways.

4. Based on these considerations, the Blueprint appears to suggest a treatment for Fintech based on the activities conducted; if the activity falls into one of the categories that generally is regulated similarly to banking activities (e.g., e-money, payment, credit, full banking), then the activity should be exempt.[7] We agree with this approach, and we recommend that the approach be made explicit and the scope of the excluded activities be specified in greater detail. We support an exclusion based on specified activities, because an approach that instead depends on how particular activities are regulated in particular countries would be unworkable given the difference in regulation across jurisdictions.

5. The Inclusive Framework should determine activities that are in or out of scope, and those activities should be treated similarly in every country, even if they are regulated differently in different jurisdictions.

6. In addition, for purposes of determining whether an activity qualifies for the financial services exemption, a predominant character rule should apply. In other words, the dual category rules discussed at paragraphs 48

[3] OECD (2020), Tax Challenges Arising from Digitalisation – Report on Pillar One Blueprint: Inclusive Framework on BEPS, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, https://doi.org/10.1787/beba0634-en, ¶¶ 124-127.
[4] *Id.* at ¶¶ 122-124.
[5] *Id.* at ¶ 129.
[6] *Id.*
[7] *Id.*

© 2020 KPMG LLP, a Delaware limited liability partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved. The KPMG name and logo are trademarks used under license by the independent member firms of the KPMG global organization.

through 51 of the Blueprint should either not apply or should apply only on a predominant character basis. Consider the example of a taxpayer that provides payment processing services and provides some amount of data analytics to the customer as part of that transaction: because the taxpayer's predominant activity is payment processing services, it should be treated as out of scope. Similarly, if a group's core activities generally qualify for the financial services exemption, any ancillary services that may be automated digital services ("ADS") should not be treated as in scope.

7. A predominant character rule would ease the burden of compliance. If an activity is generally out of scope, it is difficult to isolate pieces of a transaction and allocate the purchase price among those different pieces. Jurisdictions are not likely to get any meaningful amount of revenue from trying to isolate parts of a transaction to allocate the purchase price to minor components (i.e., components that do not comprise the predominant character of the transaction). Similarly, if a taxpayer generally is excluded, but has a small amount of revenue from ADS, Pillar One is a significant compliance burden that will result in only minimal increase to government revenues.

1.2. Defining the Domestic Market

8. Clarification is needed on how the domestic market will be defined for purposes of the *de minimis* in-scope foreign revenue threshold.[8] For instance, would a group that has a parent (but very limited operations) outside of its main market have primarily domestic or primarily foreign revenue? We recommend that a taxpayer should be treated for purposes of this threshold as having its domestic business where the largest share of its revenue is generated. Such a rule would prevent similar taxpayers from being treated differently solely due to differences in legal entity structure.

2. Nexus Determination

Pillar One - Question III

9. To identify market jurisdictions eligible to receive Amount A, the Blueprint outlines a set of proposed nexus rules that would apply to in-scope ADS and consumer-facing businesses ("CFBs"). The proposed nexus rules would be limited in scope – namely, for Amount A allocation purposes only. The proposed Amount A nexus rules are not intended to disturb traditional nexus concepts, which would continue to apply for all other tax (and non-tax) purposes.

10. The Blueprint proposes nexus standards that would apply separately to ADS and CFBs. A higher nexus standard is envisioned for CFBs to account for the comparative differences between ADS and CFBs. Whereas nexus determinations for ADS businesses would be based exclusively on market revenue thresholds, the Blueprint suggests the use of "plus factors" in addition to market revenue thresholds to establish sufficient nexus for CFBs.

11. Among the plus factors considered, the Blueprint identifies physical presence in the form of a subsidiary or permanent establishment ("PE") in the market jurisdiction as the likely plus factor for CFBs. For purposes of identifying PEs in market jurisdictions, the Blueprint considers relying on treaty-based PE concepts, but ultimately rejects this approach given the panoply of PE definitions contained within current treaties, which could

[8] *Id.* at ¶¶ 182-184.

© 2020 KPMG LLP, a Delaware limited liability partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved. The KPMG name and logo are trademarks used under license by the independent member firms of the KPMG global organization.

lead to issues of fairness and distortion. As an alternative, the Blueprint proposes the development of a new "Group-PE" concept based on commonalities between the UN and OECD model income tax conventions as the preferred approach.

2.1. KPMG Comments

12. For the reasons that follow, we do not recommend the creation of a new "Group-PE" standard.

13. First, this approach injects yet another PE definition for global tax authorities and taxpayers to evaluate (in addition to current PE concepts). As the experience of companies and tax authorities around the world has demonstrated, identification and documentation of existing PE concepts can be a significant undertaking subject to much controversy. The addition of a new definition will invite more complexity and confusion to an already complex process.

14. Second, while the new group-PE definition is intended to apply only for the limited purpose of determining Amount A nexus, it may be challenging in practice to avoid the comingling of different PE definitions. Administratively, there is concern regarding the ability of taxpayers and tax authorities to keep the two PE concepts separate when determining their taxable income in a given location (note, the two PE concepts could be relevant for different purposes), which could result in costly errors and miscalculations by both the tax authority and the taxpayer, and inevitably will lead to increased controversy.

15. Additionally, we recognize that use of traditional PE concepts could eliminate some of the issues described above with the new group-PE concept; however, we agree with comments provided in the Blueprint highlighting the shortcomings of using the patchwork of PE concepts that currently exist.

16. Therefore, we recommend against the use of a group-PE or other PE concept as a plus factor for CFBs, as the proposed approach would run counter to the Blueprint's stated objectives of simplicity and administrability.

2.2. Proposed Solution

17. Considering the stated objective of reducing complexity while still achieving policy goals, we propose a single factor test for CFBs also. Given the key distinctions between ADS and CFBs, we recognize that Inclusive Framework members want to apply a higher nexus standard for CFBs. However, instead of adopting new PE concepts that will be difficult to administer, we believe a reasonable tradeoff between simplicity and precision would be to use the significantly higher "deemed engagement" revenue threshold (vs. the proposed thresholds for ADS and CFBs under the market revenue test) as the sole nexus standard for CFBs. Thus, a CFB would only have a taxable nexus for Amount A purposes if it exceeded the higher threshold for revenue from that jurisdiction.

18. The concept of a higher sales threshold was proposed in the Blueprint as one of the potential "plus factors" for CFBs based on the rationale that above a certain level of sales in a given jurisdiction, it is likely that a group would need to establish some physical presence in the market in the form of supporting activities. In essence, CFBs operating above a certain level of sales would have a "deemed" physical presence (and thus nexus) in the market jurisdiction. The use of the Blueprint's "deemed engagement" revenue threshold as the sole means for determining nexus for CFBs would account for the factors noted in the Blueprint for establishing a higher threshold for CFBs (e.g., less engagement with market, etc.), while significantly reducing the administrative complexity when compared to the current Blueprint proposal.

© 2020 KPMG LLP, a Delaware limited liability partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved. The KPMG name and logo are trademarks used under license by the independent member firms of the KPMG global organization.

19. In contrast to PE determinations, which can often result in controversy due to the complexity and inherent ambiguity associated with key definitional terms, revenue thresholds are objective and administrable. A "deemed engagement" market threshold approach can also be established in a way that encourages the types of investment and development activities favored by all jurisdictions. This can be achieved by setting reasonable market thresholds which allow for new businesses to invest and grow (at levels below the threshold) before incurring taxable obligations.

20. Adopting the "deemed engagement" market revenue threshold approach as the sole means for determining nexus for CFBs carries the added benefit of aiding the tax certainty policy aims of Pillar One. To facilitate the self-assessment and exchange of information system for administering Amount A, the Blueprint requires a multinational enterprise ("MNE") to make a determination of eligible market jurisdictions. While a process that would enable jurisdictions to contest these determinations is contemplated, as a general matter only the market jurisdictions identified by the MNE would receive the MNE's self-assessment via exchange of information. If the nexus standard is complex (e.g., if it includes a Group-PE test), it is more likely that some jurisdictions which might consider themselves eligible market jurisdictions are not considered eligible in the MNE's determination. Such jurisdictions would not receive the MNE's Amount A self-assessment, and thus would not have an adequate opportunity to review the MNE's position on Amount A. Rather than require that all of these jurisdictions invoke the separate market jurisdiction determination procedure, the Inclusive Framework should adopt a nexus rule based solely on revenue thresholds, which would entail significant simplification benefits for the administration of Amount A.

21. For purposes of developing the applicable market revenue thresholds, we recommend the adoption of a limited set of revenue thresholds to avoid the administrative burden of tracking market thresholds for every jurisdiction. This approach assumes, however, that some modifications will be required to account for the size of the market jurisdictions.

22. Finally, we note that the Blueprint identifies two possible approaches—the "throwback" approach and the "throw-in" approach—to determine the share of Amount A profit allocated to an eligible market jurisdiction, i.e., a market jurisdiction with nexus. Under the throwback approach, Amount A profits attributable to revenue sourced in ineligible market jurisdictions are not allocated to other eligible market jurisdictions, and instead remain taxed under the existing profit allocation system. Under the throw-in approach, Amount A profits related to revenue sourced in ineligible market jurisdictions are allocated to eligible market jurisdictions.

23. Due to the potentially distortive nature of the throw-in approach coupled with the comparative simplicity of the throwback approach, we believe the only reasonable option is to accept the throwback approach. The throwback approach will be substantially easier to administer since only data on revenue sourced in one eligible jurisdiction would need to be verified to calculate a market-specific Amount A tax liability. Additionally, it will prevent the allocation of revenues to jurisdictions that, as a policy matter, do not have any claim on profits related to revenue sourced in ineligible market jurisdictions. The profits attributable to revenue sourced in ineligible market jurisdictions should instead remain taxed under the existing profit allocation system, which is appropriate since the nexus for those profits remains with the jurisdiction identified under the existing profit allocation system, and not with either the ineligible or eligible market jurisdictions.

© 2020 KPMG LLP, a Delaware limited liability partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved. The KPMG name and logo are trademarks used under license by the independent member firms of the KPMG global organization.

3. Sourcing

Pillar One - Question IV

24. The Blueprint generally takes the approach of setting out a sourcing principle for different types of revenue, coupled with guidance on indicators that can provide relevant information for purposes of applying that sourcing principle.[9] We are concerned that the Blueprint's approach as currently drafted would result in uncertainty about when information is considered to be "unavailable" or "unreliable," including, in particular, what "reasonable steps" a taxpayer must take to obtain information that is otherwise unavailable. Such uncertainty would create risks that tax authorities might substitute their own judgment in place of the approach that a taxpayer concludes would be most accurate in light of its particular business, and could therefore create additional strain on an already challenging tax certainty process. We propose a number of clarifications below to address this uncertainty. In addition, we propose that a taxpayer's determination of the appropriate indicator should be granted a rebuttable presumption of accuracy.

25. The Blueprint provides a hierarchical approach in which a taxpayer can move down the list, past a particular relevant indicator, only if that indicator is unavailable or unreliable.[10] It seems to contemplate that all of the information that exists within an organization is "available" for the purpose of sourcing determinations. However, the reality is that even where information may exist in some form within a multinational organization, there may be operational challenges involved in extracting that information and formatting it in a way that is usable and accessible for tax functions. This issue is further compounded to the extent that information was stored in a particular way in order to comply with legal requirements (e.g., privacy laws). When determining if information is available, taxpayers should thus be able to exercise reasonable judgment about whether they can in fact use existing information in their possession without incurring unreasonable costs or running afoul of legal constraints.

26. Similarly, where a relevant indicator is not currently within a taxpayer's possession, the Blueprint suggests that a taxpayer must take "reasonable steps" to obtain that information.[11] The Blueprint does not, however, clearly set out how far taxpayers need to go to obtain information they don't have, including information that might be held by third parties. There may be business reasons for third party distributors or customers not to pass information to a taxpayer, and we believe that "reasonable steps" with respect to information in the possession of a third party should not require taxpayers to incur significant additional costs or otherwise meaningfully change the overall balance of their third-party commercial transactions.

27. With respect to the above issues, we believe that taxpayers will need to assess the information in their possession to determine which available relevant indicators will be reliable for the purposes of complying with the sourcing principle applicable to a particular type of income. When developing internal controls for that purpose, we do not see significant reason to believe taxpayers would or could choose particular indicators in order to manipulate Amount A allocations. We therefore believe that absent a specific reason to believe that a taxpayer acted in bad faith, it does not make sense to substitute a tax authority's judgment over a taxpayer's judgment regarding the most reliable information available. We therefore believe that the sourcing rules should provide a presumption that a taxpayer's assessment of what information is available and reliable for sourcing purposes would be respected, absent evidence that a taxpayer failed to establish internal controls or that a

[9] *Id.* at ¶ 218-220.
[10] *Id.* at ¶ 220.
[11] *Id.* at ¶ 222.

© 2020 KPMG LLP, a Delaware limited liability partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved. The KPMG name and logo are trademarks used under license by the independent member firms of the KPMG global organization.

taxpayer failed to act in good faith. A rebuttable presumption of this type would reassure taxpayers that their reasonable judgment with respect to their own business would be respected, and could help reduce the extent to which taxpayers felt compelled to resort to the tax certainty process to address sourcing issues.

4. Segmentation for Amount A Tax Base

Pillar One - Question V

28. We agree with and support the Blueprint's proposal that the second step of the segmentation framework apply a revenue threshold to determine when an MNE is required to compute its Amount A tax base on the basis of segmented results ("Step 2"), and recommend that this be done on a safe harbor basis, rather than through a blanket exemption.[12] Applying Step 2 on a safe harbor basis (i.e., allowing a taxpayer to apply Amount A on the basis of segmented results at its election if it is below the threshold) would produce better results in keeping with the purposes of Amount A, and should not affect the administrability of the segmentation framework.

29. To ensure that Step 2 appropriately limits the incidence of required segmentation and achieves the Blueprint's stated aims of increasing simplicity, reducing compliance costs, and promoting administrability,[13] we recommend that the Step 2 threshold should be set at an appropriately high level, and should be phased down from a higher initial level over an introductory period. To account for inflationary effects over time, the minimum threshold should be adjusted on an annual basis to ensure that no more than a set percentage (e.g., 5%) of in-scope MNEs are required to apply segmentation in any year. Such an adjustment mechanism is required to prevent "scope creep" and to ensure that, as suggested in the Blueprint, only a few MNEs should be required to segment their financials.

30. Where an MNE does employ segmentation to compute its Amount A tax base, the Blueprint recognizes the need to allocate central costs among segments, and recommends a rebuttable presumption in favor of using revenue as an allocation key.[14] We agree that a default formulaic rule should apply, though we would stress that MNEs that can reasonably allocate costs on a factual basis should be permitted to do so, and therefore recommend that the default rule be applied on a safe harbor basis rather than through a rebuttable presumption. However, using revenue as the basis for the default approach would result in significant distortions: high-volume, low-margin segments would be allocated an outsized portion of overall costs on the basis of their higher sales, while low-volume, high-margin segments would not be allocated an appropriate share of costs. To address this issue, we recommend that segment gross margin be used as the default allocation key. Using gross margin as the allocation key reflects the reality that MNEs generally incur relatively greater central costs to support high-margin segments than low-margin segments.

31. Below, we have set forth responses to the specific questions regarding segmentation raised in the Consultation Document.

---

[12] *Id.* at ¶¶ 451-52.
[13] *E.g.*, *id.* at ¶ 441.
[14] *Id.* at ¶ 465.

© 2020 KPMG LLP, a Delaware limited liability partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved. The KPMG name and logo are trademarks used under license by the independent member firms of the KPMG global organization.

Question V.a.: Do you consider that hallmarks drawing on IAS 14 constitute an appropriate basis for developing a test to determine whether an MNE group is required to segment? If not, what other options should be considered to identify relevant segments for Amount A purposes?

32. Abandoning mandatory segmentation could provide significant simplification and should be seriously considered. However, if segmentation is imposed on some groups, it should be in very limited circumstances, and should use the group's external financial statement segments. In addition to an overall cap on taxpayers subject to segmentation referenced in para 29 above, additional gating criteria should be put in place to limit segmentation – for example, where group revenue exceeds a threshold, contribution margin variation between reported segments is significant, and in-scope revenue included within a reported segment exceeds a threshold. Where reported segments fail either of the last two criteria, those segments may be grouped.

33. As indicated above, segmentation beyond financial reporting segments, based on IAS 14 or any other hallmark criteria, should not be required in any circumstance. Such a requirement would impose highly subjective measures that are inconsistent with the way that groups track their financial results, and would require arbitrary allocation of both financial reporting segment costs and unallocated group costs. Therefore, segmentation based on in-scope revenue, region or any other basis should not be required.

Question V.b.: Do you consider that existing segments (under financial accounting standards) should be used in the majority of cases as a basis for segmenting the Amount A tax base (for example by using a rebuttable presumption)? If not, what other options should be considered?

34. As stated above, we believe that existing segments that are used for financial reporting purposes should be used in all cases where segmentation is required (taking into account the above recommendations), and that MNEs should not be required to create new segments for purposes of Amount A. Relying on existing external reporting segments yields principled results, and is easily administered. Requiring new segments to be created for Amount A purposes would entail significant compliance burdens, and would force tax administrations to rely on unaudited financial data, undermining the reliability of the Amount A analysis. Moreover, creating new segments would require an MNE to make a large number of subjective judgments, which could be contested during tax administrations' review of the MNE's Amount A computations, resulting in controversy that would not exist if existing segments were used.

35. As the Inclusive Framework gains experience with the administration of the Amount A system, it should monitor whether the framework actually results in a material number of companies being required to devise new segments for Amount A purposes. If experience shows that these rules seldom apply, consideration should be given to eliminating the new segmentation requirement altogether.

Question V.c.: Do you consider that groups should be permitted to calculate Amount A on a geographically segmented basis? If so, what should be the criteria for determining when geographical segmentation is permitted and what those geographic segments should be?

36. We believe that geographical segmentation should be permitted where an MNE's external reporting segments are arranged geographically and the criteria for segmentation are triggered.

Question V.d.: Alternatively, do you consider that MNE groups should be required or permitted in some cases to segment their profits before tax between in-scope activities (i.e., ADS and/or CFB) and out-of-scope activities? If yes, what criteria could be used to determine when this approach to segmentation should be applied as opposed to calculating the Amount A tax base on a consolidated basis?

© 2020 KPMG LLP, a Delaware limited liability partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved. The KPMG name and logo are trademarks used under license by the independent member firms of the KPMG global organization.

37. As noted above, we believe that MNEs should not be required to create new segments for Amount A purposes; therefore, we do not believe that MNEs should be required to segment their profits before tax between in-scope and out-of-scope activities.

5. Elimination of Double Tax

Pillar One - Question VII

5.1. Identifying the Paying Entities

38. Chapter 7 of the Pillar One Blueprint sets out a mechanism to eliminate double taxation that consists of two components: (i) the identification of paying entities within an MNE group or segment; and (ii) the methods to eliminate double taxation.[15] The Blueprint describes the process for identifying the "paying entities" that will bear Amount A tax liability as having up to four steps: (i) an activities test to identify entities that perform activities that make a material and sustained contribution to the group's ability to generate residual profits; (ii) a profitability test to ensure the entities identified have the capacity to bear the Amount A tax liability; (iii) a market connection priority test to allocate Amount A tax liability to entities that have a connection with the market(s) where Amount A is allocated; and (iv) pro rata allocation.[16]

39. This four-step process for identifying the paying entities is unnecessarily complex and may lead to an increase in tax controversies. This process is difficult for companies to implement, and most companies will not want to spend substantial time working through these tests, but will instead look for a simplified approach.

40. Although many companies will be relatively indifferent as to which entities are determined to be "paying entities," this will be an important issue for the jurisdictions required to relieve the double tax. Relieving jurisdictions will want a principled approach to identifying paying entities, but will also want the process to be clear and easy to implement so as to avoid disputes with taxpayers and other relieving or potentially relieving jurisdictions. In the interest of simplifying the process of identifying paying entities and applying a principled approach, KPMG recommends eliminating the activities test, using a fixed return profitability threshold that would approximate the Amount A threshold, and streamlining the market connection priority test while also allowing companies to opt in or out of this test. These changes would greatly simplify the process of identifying paying entities, prevent the problem of residual profit being trapped in nonpaying jurisdictions, and greatly reduce opportunities for disputes involving paying jurisdictions. More detail on these proposals is set out in the following paragraphs.

5.1.1. Activities Test

41. The activities test set out in the Blueprint is ripe for confusion, as the reliance on DEMPE functions will introduce complexity and likely generate disputes. For instance, there may be significant disagreement on exactly which DEMPE subfunction is most applicable as the driver of the residual profit. The DEMPE rules are relatively new, and it is already our experience that countries have different perspectives on applying these rules.

42. In addition, the activities test may result in residual profit being trapped in nonpaying jurisdictions. For instance, IP holding companies which have relatively low levels of DEMPE functions, but in fact are the holders

[15] *Id.* at ¶ 557.
[16] *Id.* at ¶ 560.

© 2020 KPMG LLP, a Delaware limited liability partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved. The KPMG name and logo are trademarks used under license by the independent member firms of the KPMG global organization.

of the residual profit that should be subject to Amount A, may not be identified as paying entities. For these reasons, we propose that the activities test described in the Blueprint as Step 1 of Component 1 be eliminated.

5.1.2. Profitability Test

43. The Blueprint notes that the profitability test could be aligned with the formulaic substance-based carve-out for Pillar Two, which will involve a combined payroll and tangible assets profitability test to exclude a fixed percentage of income from activities within a jurisdiction.[17] For purposes of Amount A, this test would identify entities that earn in excess of a certain fixed return for payroll and tangible assets. Because the profitability threshold for Amount A (e.g., 10% PBT to revenue ratio) should account for a minimum return, we propose that the profitability test for purposes of identifying paying entities should set a fixed return that would approximate that Amount A threshold. This might well entail using a higher mark-up for the Amount A profitability threshold as compared to the Pillar Two carve-out.

5.1.3. Market Connection Priority Test

44. We note that the market connection priority test may be very straightforward to apply in some fact patterns where relevant market jurisdictions can be easily identified. However, this test will be difficult to apply for many large MNEs and may introduce significant complexity and potential for disputes. As noted above, many MNEs will be indifferent to which group entities are paying entities. The tax authorities, however, can be expected to take a strong interest. In particular, it will be in the interest of tax authorities of jurisdictions that contain a paying entity to seek to limit the number of market connections. Fewer market connections under the current Blueprint proposal, assuming there is adequate profit in the remaining paying entities, will mean a smaller allocation of Amount A to the market jurisdictions. This interest of the paying jurisdictions to limit the number of market connections is a recipe for disputes, particularly where the market connection is not the subject of a clear intangible-related intercompany transaction like a royalty. In addition, the Blueprint market connection proposal does not address the circumstance where some market jurisdictions have a clear connection to a paying entity, while others do not.

45. While the precise identity of all connected markets to a particular paying jurisdiction might be difficult to determine, there is an important circumstance where the lack of market connections could lead to unfair results for the paying jurisdiction. Consider the case where an entrepreneurial entity with residual profit operates only in its own jurisdiction but would be allocated Amount A tax liability in the absence of a market connection test. The tax authority of that jurisdiction may object to the elimination of the market connection priority test because the potential paying entity's profits arise from the entity's operations in that market, and not from a connection to other markets.

46. To avoid disputes while accounting for the circumstance of the isolated entrepreneur, we propose a simplified market connection test. The simplified market connection test would ask whether an entity that has been identified as a potential paying entity has a market connection to any market jurisdiction other than its own. If so, it would be deemed to be a paying entity for all market jurisdictions, and would bear Amount A tax liability on a pro rata basis along with any other paying entities that have at least one market connection outside their own jurisdiction.

47. Finally, we propose allowing taxpayers that wish to work through the complexity of the full market connection priority test to so elect. This would allow taxpayers with fact patterns that provide clear connections between all market jurisdictions to a single paying jurisdiction to follow the Blueprint's current proposal.

[17] *Id.* at ¶ 594.

© 2020 KPMG LLP, a Delaware limited liability partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved. The KPMG name and logo are trademarks used under license by the independent member firms of the KPMG global organization.

Presumably, taxpayers with such clear fact patterns would be less likely to end up in disputes involving the identification of the paying jurisdictions. Our combined proposed simplified market connection test and taxpayer election to use a full market connection priority test will significantly reduce the administrative burden of tracing all market connections while maintaining a principled approach to addressing the isolated entrepreneur circumstance.

5.2. Mechanism for Eliminating Double Tax

48. With regards to the mechanism for eliminating double taxation, KPMG proposes the use of the exemption method exclusively, rather than the use of the credit method or the ability to choose between the two methods. As acknowledged in the Blueprint, the crediting system would involve significant complexity. A unified tax credit mechanism would be difficult to integrate with existing tax treaty and domestic rules regarding tax crediting. In addition, most taxpayers are likely to prefer the use of the exemption method. Many tax authorities may also favor the exemption method due to the ease of administration.

5.3. Transfer Pricing Adjustments

49. As the Blueprint notes, transfer pricing audit adjustments may impact a paying entity's Amount A tax liability. The Blueprint offers several suggestions on how to account for these transfer pricing adjustments. We agree with the Blueprint's proposal of recognizing transfer pricing audit adjustments that impact Amount A only prospectively, for example by adjusting the future Amount A tax liability of a paying entity based on a transfer pricing adjustment for a past period.

6. Amount B

Pillar One - Question IX

50. The principal aim of the Amount B framework is to simplify the administration of transfer pricing rules, lower compliance costs, increase tax certainty, and reduce the amount of controversies or disputes involving routine distribution arrangements by standardizing intercompany pricing for "baseline marketing and distribution activities" in a manner that "approximates results determined in accordance with the arm's-length principle." This will be achieved by assigning a fixed or prescriptive market-based return established through comparable company benchmarking analyses for in-scope routine distribution activities.[18]

51. KPMG strongly supports these stated goals of Amount B. As discussed in our detailed comments below, we believe that these goals are best advanced by:

- Keeping the scope of Amount B limited to fact patterns where standardized compensation consistent with the arm's length standard is readily established;
- Implementing Amount B as a rebuttable presumption, with a clarified, clear and convincing standard for rebuttal and recognition of the interests of the counter-party tax authority, as well as the taxpayer, in achieving an approximate arm's length result; and

[18] *Id.* at ¶ 651.

© 2020 KPMG LLP, a Delaware limited liability partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved. The KPMG name and logo are trademarks used under license by the independent member firms of the KPMG global organization.

— Providing for the possibility of advance certainty on applicability of Amount B, potentially via existing unilateral and multilateral advanced pricing agreement ("APA") mechanisms.

Question IX.a.: Do you consider that Amount B should be narrow in its scope or should it take on a broader scope? What are the advantages or disadvantages of a narrow or broader scope?

52. The Blueprint considers a number of variations to the Amount B framework that address the critical issues of scope and quantum. Specifically, the Blueprint cites interest from members of the Inclusive Framework to expand the scope of baseline activities covered by this first iteration of Amount B.[19] We believe that any expansion of scope, at least in the initial implementation, beyond routine buy/sell distribution arrangements would be inconsistent with the stated goals of tax administration simplification and dispute reduction.

53. In our view, even the narrow scope approach to Amount B must address significant administrative and technical challenges, some of which we discuss in these comments. An expanded scope would not only demand significant additional upfront technical work, but would add new dimensions for disputes and substantially increase the frequency of results deviating materially from arm's length results, thus defeating the purposes of Amount B.

54. With a limited scope for Amount B, disputes will be restricted to whether or not an entity falls within the scope of Amount B. With an expanded scope, the determination of the Amount B quantum would necessarily become more complex, owing to (at a minimum) a proliferation of factors for determining the applicable Amount B for an in-scope entity. Disputes would then arise regarding the correct determination and application of those factors to a particular case.

55. KPMG believes that a limited scope for Amount B application could achieve the goals of increased simplicity, while limiting disputes for the substantial number of enterprises falling within such limited scope definition of baseline marketing and distribution activities. An expansion of scope would lose the advantages so gained, and simply push existing complexity and disputes into a new and untested framework. However, if a limited initial scope of Amount B proves successful, expansion of scope to additional activities should be considered.

56. Our concerns extend to the discussion in the Blueprint of issues arising from entities that engage in marketing and distribution functions included on the positive list, but at low levels of intensity. KPMG strongly believes that such fact patterns cannot be ignored; applying a return on sales derived from higher-functioning comparables would lead to results that are grossly distortive of arm's length outcomes for low intensity fact patterns. The Blueprint suggests that this issue could be addressed by including adjustments for functional intensity in the determination of Amount B.[20] KPMG believes that such an approach would defeat the goals of simplicity and dispute reduction, for the reasons discussed above. We suggest an alternative approach, whereby the list of negative indicators is expanded to include qualitative and quantitative indicators identifying cases of low functional intensity, or other factors where a standardized return on sales might lead to a result substantially in excess of an arm's length return.

57. One such indicator should be the share of system profit (on average over a multi-year period) that would be allocated to the distribution entity under a standardized return on sales. As appropriate, system profit would be determined based on the business segment or segments relevant to the distribution entity. A high share would be a negative indicator, as it indicates that the Amount B standard return may be inappropriate and

---

[19] *Id.* at ¶ 655.
[20] *Id.* at ¶ 664, footnote 134.

© 2020 KPMG LLP, a Delaware limited liability partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved. The KPMG name and logo are trademarks used under license by the independent member firms of the KPMG global organization.

because it would leave insufficient, non-arm's length returns to other functions in other jurisdictions. Another indicator could be the sales to operating expense ratio. For this indicator, a high value could indicate either low functional intensity or a very high value (and potentially high profit) product – in either case, indicating that a prescriptive Amount B return would not be appropriate. Thus, the scope of Amount B would be limited to the many straightforward cases where a standardized return is appropriate and leave out of scope those cases where the standard Amount B is likely to deviate substantially from arm's length pricing.

58. KPMG believes that historical returns of an entity are not an appropriate negative indicator, contrary to the suggestion mentioned in the Blueprint.[21] Historic returns alone do not establish any facts relevant to the determination of whether the entity's functions, assets, and risks are limited to the Amount B baseline standards. Fair and equitable treatment of taxpayers requires that all taxpayers meeting the Amount B factual eligibility requirements be covered by Amount B regardless of historic returns. Alternatively, if historic high returns are so used, consistency and equity require the inclusion of historic low returns as an indicator that the entity's arm's length return should be below Amount B.

59. While we support the use of quantitative indicators where appropriate, we would caution against the overreliance on any one factor to reach characterization conclusions, as quantitative indicators, when viewed in isolation, can often lead to inaccurate conclusions or results if not interpreted properly. For example, the fact that a routine distributor has significant inventory write-downs on its books does not always mean that the entity bears material inventory risk, as those write-downs may be offset via a transfer pricing policy that provides the entity with a targeted margin and therefore effectively reimburses the entity of the write-downs.

Question IX.e.: Do you consider that Amount B will be effective in reducing disputes? If not, why?

60. KPMG applauds the OECD's objective to reduce disputes regarding arm's length pricing of transactions that involve entities performing baseline marketing and distribution functions. KPMG notes, as discussed above, that this objective must be balanced against the need to avoid results that deviate substantially from arm's length pricing. We believe that further guidance is required to achieve this objective.

61. Disputes related to Amount B may arise with respect to:

- whether or not an entity is "in-scope" for Amount B based on application of the positive and negative lists;
- whether a more appropriate method should be used to establish arm's length pricing for an otherwise in-scope entity, overcoming a "rebuttable presumption"; or
- how Amount B should be specifically determined for an in-scope entity, to the extent that the amount itself is affected by various factors (e.g., determination of relevant industry, application of adjustments, etc.).

62. With respect to the second item, KPMG believes it essential that Amount B be implemented as a rebuttable presumption[22] to preclude results that are not approximately arm's length and are therefore in conflict

[21] *Id.* at ¶ 678, footnote 142.
[22] *Id.* at ¶ 688.

© 2020 KPMG LLP, a Delaware limited liability partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved. The KPMG name and logo are trademarks used under license by the independent member firms of the KPMG global organization.

with domestic and treaty law.[23] KPMG acknowledges that establishing Amount B as a rebuttable presumption could create further opportunities for dispute when compared with mandatory application for eligible entities. However, we strongly believe that a mandatory application approach (i.e., no rebuttable presumption) would invariably lead to instances where results deviate substantially from arm's length pricing due to the inherent limitations on any practical list of positive and negative factors to account for the wide variety of business circumstances and factors impacting arm's length pricing. Adopting a rebuttable presumption mechanism to address instances where Amount B would substantially deviate from arm's length pricing is not only necessary to achieve the OECD's policy objective of aligning with the arm's length principle, but also to prevent conflict with existing domestic law and tax treaties.

63. KPMG recognizes that the threshold for rebuttal under the rebuttable presumption approach will need to be set at a relatively high level. For example, rebuttal could require clear and convincing evidence that another transfer pricing method would be the most appropriate to use under the arm's length principle and would lead to substantially different results. However, KPMG is concerned that the current language of the Blueprint could be taken to suggest that only the availability of a sufficiently reliable CUP would be sufficient to overcome the presumption. We recommend additional examples – for example, unusual business facts not captured on the positive or negative lists that would make alternative comparables to those used in establishing Amount B clearly more appropriate.

64. With respect to the potential for disputes regarding the applicable quantum of Amount B, as discussed above, KPMG strongly recommends that the scope for such disputes should be minimized by maintaining a limited scope for Amount B, so that application for eligible entities is straightforward and not subject to substantial disputable judgment. We further recommend that Amount B be implemented as a range, such that any in-scope entity with results within that range would be protected from adjustment. We believe use of an appropriate limited range is essential for maintaining a reasonable administrative burden on taxpayers.

65. Disputes regarding the applicability of Amount B will be reduced to the extent that the OECD provides additional clarity regarding the positive and negative lists, as well as the standards for overcoming a rebuttable presumption. However, the most important and useful mechanism for avoiding disputes will be the availability of advance certainty. KPMG suggests that the OECD provide additional guidance and recommendations in this regard, noting that such mechanism could build off of existing successful practices.

66. In this regard:

- The OECD should clearly recognize the interests of the counter-party taxing jurisdictions for the relevant transactions. Substantial deviations from arm's length pricing created by misapplication of Amount B could create either double taxation for taxpayers or non-arm's length returns being recognized in the counter-party jurisdictions.

- Thus, where double tax treaties exist, the counter-party jurisdictions necessarily have an interest in determining the applicability of Amount B including whether a more appropriate method is available, overcoming the rebuttable presumption. The OECD should explicitly recognize this, including modifying the statement placing the burden of proof on the taxpayer to overcome the rebuttable presumption to recognize that the counter-party tax authority might dispute the applicability of Amount B, in connection

[23] *Id.* at ¶ 654.

© 2020 KPMG LLP, a Delaware limited liability partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved. The KPMG name and logo are trademarks used under license by the independent member firms of the KPMG global organization.

with a mutual agreement procedure ("MAP") proceeding, and would have the burden of proof in that circumstance.

— The OECD should explicitly endorse the consideration of Amount B applicability in future APA and MAP proceedings. The Blueprint currently includes an Amount B override for pre-existing APAs. New APAs will be an important mechanism to provide advance certainty to taxpayers and tax authorities regarding application of the Amount B guidance. The OECD should endorse this mechanism (and could encourage use of the "rebuttable presumption" standard in relevant multilateral APAs).

— The OECD should consider recommending a simplified APA procedure or similar streamlined advance certainty procedures (which could be unilateral or multilateral) specifically on the question of eligibility for Amount B.

7. Tax Certainty Process

Pillar One - Questions XI & XII

Question XI.a.: What do you consider will be the key challenges in the early tax certainty process described in the Blueprint and how do you think would they best be addressed?

67. The Blueprint reflects commendable progress on an early certainty process that will prevent and resolve disputes on Amount A. However, we believe that the issues identified below may pose key challenges and hamper the effectiveness and administrability of the process, and we have proposed solutions to address these challenges. These responses should also be taken into account in connection with Question XI.c, as the recommendations below would encourage participation by MNE groups to seek advance certainty, while failure to adopt these recommendations would discourage participation and undermine the administration of Amount A.

7.1. Early Certainty Process

68. Administrability is central to the viability of the Amount A system. The overall success of the early certainty process depends on the ability of tax administrations and MNEs to successfully resolve a significant volume of lower-risk cases at the initial review stage, without the need for resource-intensive and lengthy panel reviews that would create backlogs and increase strain on the process. Because the lead tax administration ("LTA") will generally be the tax administration of the jurisdiction of an MNE's ultimate parent,[24] and because most in-scope MNEs are parented in a relatively small number of jurisdictions, a relatively small number of LTAs would be responsible for a disproportionate number of initial reviews. We believe the timing for the initial review process should reflect this.

69. The Blueprint currently indicates that the timeframe for an initial review could be three months, with a possible three-month extension.[25] This is likely inadequate to allow the small number of LTAs responsible for the majority of MNEs to conduct initial reviews. If these LTAs forgo initial reviews due to time constraints, the entire system may be overburdened with mandatory review panels that would not have been required if the LTAs had had sufficient opportunity to conduct initial reviews. This harms all affected tax administrations ("ATAs"),

[24] *Id.* at ¶ 718.
[25] *Id.* at ¶¶ 738-39.

© 2020 KPMG LLP, a Delaware limited liability partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved. The KPMG name and logo are trademarks used under license by the independent member firms of the KPMG global organization.

which would then have to engage in the more intensive review panel process despite the absence of material risk, as well as MNEs, which would incur heightened compliance costs and experience delays in obtaining certainty.

70. This problem is likely to be exacerbated in early years, when more MNEs are likely to resort to the certainty process and when initial reviews will be critical to ensuring that the system functions smoothly for these and for later years. If cases go to the review/determination panel stage, they will generally require multiple years to complete, which impedes the ability of tax administrations to effectively deal with cases relating to those later years and risks compounding the associated delays.

71. The desire to complete initial reviews expeditiously is laudable, but we consider that the system as a whole would benefit from allowing a longer period for initial reviews (e.g., 18, rather than 15, months after the end of the fiscal year, which would provide 6 months for review where a jurisdiction's self-assessment return deadline is 12 months after the end of the year).[26] By extending the timeline for initial reviews, we believe that overall resolution timeframes would decrease. The exchange of self-assessment returns and documentation packages with ATAs should be timed to align with this extended period.

7.2. Other Timing Considerations

72. There are also other key challenges related to timing. The lack of time limits for the review[27] and determination[28] panels in the current Blueprint reflects a commendable desire to provide flexibility, but also creates room for dilatory and abusive behavior. In our experience with tax treaties that provide mandatory arbitration as a backstop to MAP, while once arbitration is triggered there are procedural guardrails against delay, some tax authorities (either unilaterally or together with the opposing tax authority) exploit procedural rules to keep cases from going to arbitration in the first place, which frustrates the intent of the underlying tax treaties and prevents cases from reaching resolution. While we hope that the multilateral nature of the Amount A early certainty process would discourage the use of these tactics, we believe that this is a significant point of concern for MNEs, and that participation in the early certainty process would be encouraged if safeguards were implemented to prevent the use of dilatory and potentially abusive tactics that frustrate the interests and legitimate expectations of MNEs and other tax administrations alike.

73. Therefore, we propose that the Blueprint should provide binding time limits for both the review and determination panels, as well as for the commencement of the review panel. These limits would apply unless waived by the MNE prior to the expiration of the time limit in question; if a binding time limit is waived, the panels should proceed to resolve the case as they deem appropriate, without the need for a fixed time frame. This would retain the flexibility reflected in the current Blueprint, while guarding against undue delay. Importantly, we believe that MNEs opting into the early certainty process would be genuinely interested in reaching resolution at the earliest possible stage, and therefore would be willing to waive the mandatory time frames in cases where it is clear that the panel is actively working on the case and is progressing towards a resolution. This would ensure that the prescribed binding time limits would not stymie actual progress.

74. Similarly, we believe that the iterative process of working with ATAs to resolve any objections to the review panel's recommendations is valuable.[29] Many cases could be resolved at this stage without the need for a

---

[26] *Cf. id.* at ¶ 738.
[27] *Id.* at ¶ 758 (noting that "[i]t is expected that any panel review that extends to [12 months] from the start date should be brought to an end," without actually requiring that the review panel conclude).
[28] *Id.* at ¶ 775 (providing that "[t]o the extent possible, the determination panel should seek to reach a decision within [six months] following referral," without specifying an actual time limit).
[29] *Id.* at ¶ 766.

© 2020 KPMG LLP, a Delaware limited liability partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved. The KPMG name and logo are trademarks used under license by the independent member firms of the KPMG global organization.

determination panel. Again, however, there is the potential for inappropriate delay. We recommend that the iterative process be limited to three cycles of objections and responses. Additional cycles could be conducted with the MNE's consent for each such additional cycle. Again, we believe that MNEs will approach the early certainty process in a spirit of good faith and collaboration, and will willingly consent to additional objection and response cycles where actual progress is being made. However, ATAs should not be permitted to stave off the determination panel through repeated objections that are not progressing the case. Where objections continue to be submitted and the MNE, after three cycles (or more, if the process has already been extended), does not believe that resolution at this stage is likely, the determination panel process should commence.

7.3. Preference for a Review Panel

75. The Blueprint currently indicates that a review panel could be required if either a set number of ATAs, currently tentatively pegged at three or more, express a preference for a panel, or if a certain percentage of all ATAs express such a preference without articulating a specific reason to constitute a review panel.[30] We regard this as problematic for a number of reasons.

76. Many cases will involve large numbers of ATAs. In such cases, three ATAs would represent a small minority, and should not be allowed to require a panel on the basis of a mere preference, given the substantial administrative burdens this would impose on the other ATAs and on the MNE. The efficient implementation of the early certainty system requires some risk-tiering. While we agree that any ATA should be permitted to require panel review where it has specific, articulated concerns with an MNE's self-assessment, a small number of ATAs should not be able to force other tax administrations to route resources better used elsewhere to a case in which no ATA has identified any actual concerns.

77. We believe that the option to constitute a panel based on a mere preference should be eliminated entirely. The option to constitute a panel based on a specific concern identified by a single ATA is more than sufficient to safeguard the ATAs' interests. Moreover, requiring ATAs to identify specific concerns would improve the process overall, by providing a discrete set of issues as a starting point for the review panel, and by increasing the likelihood that review panel determinations would be acceptable to the ATAs. If no ATA identifies a specific concern, the review panel will lose the benefit of the ATAs' initial inspections of the MNE's self-assessment, and the case will likely take longer to resolve with the ATAs following the development of the review panel's recommendations, as the review panel will have at best a poor sense of the other ATAs' concerns.

78. If the preference option is retained, safeguards should be added to require those ATAs that express a mere preference for a panel to participate actively in the process (whether or not they constitute part of the panel itself). This would dissuade ATAs that lack the time and resources to review an MNE's self-assessment from requesting a panel as a prophylactic measure. Tax administrations requesting a panel should not be "armchair auditors"; that is, they should not be able to use the preference option to require other ATAs to do their work for them. Rather, if the option to express a preference for a panel is retained at all, they should have to commit to active engagement.

[30] *Id.* at ¶ 743.

© 2020 KPMG LLP, a Delaware limited liability partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved. The KPMG name and logo are trademarks used under license by the independent member firms of the KPMG global organization.

Responses to Question XI.d.: Do you consider that a separate process to determine whether an MNE group is within scope of Amount A would be beneficial, or that in practice this is unlikely to be used?

79. We believe that a separate process to determine whether an MNE is within the scope of Amount A would be beneficial, and that it would be likely to be used, particularly in the first years in which Amount A applies and subsequent to material business restructurings. This process should also be available to provide certainty as to whether specific segments of an MNE are in scope.

80. A separate in-scope process would provide efficiency gains by allowing MNEs that believe they are out of scope to gain certainty much earlier than they could under the early certainty process. This benefits the MNEs via quick resolution and the elimination of any need to respond to inquiries that will ultimately be irrelevant if the MNE is determined to be out of scope during the regular early certainty process. Similarly, it will benefit ATAs by reducing the strains on the early certainty process.

81. However, coordination measures will need to be adopted to ensure that the in-scope process works appropriately in conjunction with the early certainty process. When an MNE enters into the in-scope process, the date for the exchange of the MNE's self-assessment return with the ATAs should be delayed until after the conclusion of the in-scope process.[31] MNEs that believe they are out of scope, but which are determined via the in-scope process to be in scope, will require more time to prepare a meaningful self-assessment return and associated documentation reflecting the MNE's in-scope status. Self-assessment returns and documentation packages prepared and exchanged without the benefit of this additional time will result in more delays, as it is less likely that such a self-assessment return and documentation package would receive the LTA's imprimatur in the initial review. Moreover, self-assessment returns and documentation prepared subsequent to the in-scope process would provide a more helpful starting point for a review panel. Providing additional time here should actually expedite overall resolution timeframes.

82. In addition, a fixed time limit for the in-scope process would help ensure an appropriate transition from the in-scope process to the exchange and review of the self-assessment return. If no conclusion is reached prior to the expiration of the time limit, scope issues would be addressed in the regular early certainty process. As with the time limit proposal outlined above in response to question XI.a, this time limit should apply at the option of the MNE, and could be waived by the MNE where the case was nearing completion, as transitioning a nearly complete case on which actual progress was being made to the early certainty process would result in delay and administrative inconvenience with no benefit.

83. We believe the in-scope process will convey significant benefits and are concerned that the consultation document appears to indicate that the Inclusive Framework is considering dispensing with this separate process. If the in-scope process is eliminated, the Inclusive Framework should commit to providing expedited resolution on scope issues. In that case, we would recommend that at each stage of the early certainty process (i.e., initial review, review panel, review of panel recommendations by ATAs, and determination panel), the decision maker should be required to first address and conclude on scope before moving on to other issues.

[31] *Cf. id.* at ¶ 725.

© 2020 KPMG LLP, a Delaware limited liability partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved. The KPMG name and logo are trademarks used under license by the independent member firms of the KPMG global organization.

Pillar Two - Public Consultation Responses

1. GILTI Co-Existence

Pillar Two - Question I

84. As the Pillar Two Blueprint notes, the Inclusive Framework has recognized that an agreement on the co-existence of the global intangible low-taxed income ("GILTI") and the Global Anti-Base Erosion ("GloBE") rules will be essential to political agreement on Pillar Two. The shared purpose of the GILTI and GloBE regimes, the fact that GILTI formed a fundamental part in supporting the momentum behind the GloBE regime, and the challenges involved in changing GILTI given its relatively recent enactment as part of major U.S. tax reform, all lead us to believe that this co-existence should take the form of treating GILTI as a qualifying income inclusion rule ("IIR").

85. Even if GILTI is treated as a compliant IIR, however, some technical issues remain to be addressed. In particular, as the Blueprint notes, the Inclusive Framework will need to determine how to coordinate the GloBE rules with the application of GILTI in the case of U.S. intermediary parent companies of foreign groups headquartered in countries that themselves apply an IIR. The top-down approach taken in the Blueprint would require an IIR imposed in an intermediate jurisdiction to defer to an IIR imposed in an ultimate parent company jurisdiction. The challenges of modifying the GILTI rules, however, suggest that this approach is impractical. It does not appear realistic, however, to expect the jurisdictions of ultimate parent entities to abandon application of their own IIRs in favor of the GILTI regime.

86. It appears reasonable instead to treat tax imposed under the GILTI regime applicable to an intermediate U.S. holding company as tax under a controlled foreign company ("CFC") regime for purposes of applying the GloBE rules. For this purpose, because GILTI income may reflect a combination of tested income from entities around the world, an allocation mechanism would be needed to assign any net tax paid on GILTI income to an appropriate CFC jurisdiction. The mechanism should be designed so that GILTI taxes are appropriately allocated to the jurisdictions giving rise to the liability.

2. Scope of the GloBE Rules

Pillar Two - Question II

2.1 Treatment of Investment Funds under the GloBE Rules

87. KPMG agrees with the objective to preserve tax neutrality in respect of investments made through investment funds by excluding investment funds from the scope of the GloBE rules. However, the current definition of an investment fund as an excluded entity does not seem to address situations with controlled investment funds. In our view, the proposed carve-out rules for investment funds should be further refined in consultation with representatives of the asset management industry to ensure that the GloBE rules will not apply in scenarios where investment funds are consolidated into an MNE group's financial statements. Examples are insurance groups that hold substantial interests in investment funds and asset managers that have a seed capital position in the fund they manage to encourage other investors to invest in the fund.

© 2020 KPMG LLP, a Delaware limited liability partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved. The KPMG name and logo are trademarks used under license by the independent member firms of the KPMG global organization.

3. Calculating the ETR under the GloBE Rules

Pillar Two - Question III

3.1 Treatment of Dividends and Gains from Disposition of Stock in a Corporation

88. The Blueprint proposes that portfolio dividends and gains should be included in the GloBE tax base; this is an exception to the general dividend exclusion rule. The principal reasons given for this are that some Inclusive Framework jurisdictions only exempt dividends if the shareholder owns a certain percentage of the equity interests in the distributing corporation, and that a number of Inclusive Framework jurisdictions do not extend a dividend/gains exemption to securities trading activity – these jurisdictions will tax these dividends/gains. The Blueprint also notes that where dividends/gains are excluded from the GloBE tax base then the corresponding taxes need to be excluded, and expenses associated with portfolio investment/securities trading may also need to be excluded. The Blueprint notes that work is to continue on identifying the share ownership threshold for identifying portfolio dividends/gains, on the possibility of different rules for domestic and foreign source dividends, and on rules to exclude expenses allocable to excluded income.

89. The public consultation document makes clear that a core focus of the continuing work is on simplifications, and on the reduction of rule implementation costs and complexity. The suggestions that might be made on portfolio dividends/gains depend on the degree of simplification being sought.

90. The simplest approach may be simply to exclude all portfolio dividends from the GloBE tax base, without needing to exclude associated expenses. This might be viewed as consistent with the policy goal of avoiding double taxation, which could arise regardless of the size of the shareholding. It would avoid permanent differences arising for the jurisdictions that exempt portfolio dividends/gains on shareholdings of all sizes. It may well also be the case that many listed companies, in which portfolio investments are held, are themselves subject to the GloBE rules.

91. Such an approach would do away with the complexities of needing to differentiate between domestic and foreign dividends; clearly countries that exempt all domestic dividends may push for special treatment (i.e., align the Pillar Two approach to local tax treatment) to avoid permanent differences between the domestic and GloBE tax bases. It would also avoid the need to track and allocate expenses associated with different sizes of shareholdings, and with foreign vs. domestic shareholdings. It would further avoid the need to create additional rules and compliance requirements to fully integrate the taxation of portfolio dividends/gains with other elements of the GloBE rules (e.g., carry-forwards for pre-regime losses on portfolio stock dealings, or acquisition/disposal of constituent entities).

92. If the intent is not to simplify to this extent, then consideration might be given to, at a minimum, not making adjustments for expenses, to avoid this layer of complexity. For the ownership threshold, the Blueprint notes that a survey will be made of existing participation exemptions in Inclusive Framework jurisdictions. Quite a lot of jurisdictions use either 5% or 10%; this might then argue in favor of using 5% to limit the number of jurisdictions for which permanent difference issues would arise. However, this would still not address the issues arising for jurisdictions that exempt all domestic dividends.

© 2020 KPMG LLP, a Delaware limited liability partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved. The KPMG name and logo are trademarks used under license by the independent member firms of the KPMG global organization.

3.2 Tier 1 Capital Instruments for Banks and Insurers

93. Banks and insurers often issue Tier 1 capital instruments. Such instruments are issued in order to raise long-term funding and to reduce the issuer's cost of capital. Commercially and legally, these are subordinated fixed interest rate loans, frequently issued as quoted securities on external markets, but they are treated as capital for regulatory purposes and accounted for as equity, such that coupon payments are accounted for as dividends, and therefore not included in profit before tax.

94. Therefore, such Tier 1 capital instruments give rise to a mismatch as the cost would not be taken into account in the denominator, but the tax relief is considered in the numerator. Thus, they lower the effective tax rate and would generate top-up tax, despite several jurisdictions clearly legislating that the coupon is tax deductible to the payer, as well as taxable to the payee. Hence, an adjustment in computing GloBE income should be allowed for the coupon payments to avoid negating the deduction arising in the paying jurisdiction.

3.3 Covered Taxes – U.S. Federal Excise Tax ("FET") on Insurance and Reinsurance Premiums

95. U.S. FET is a tax levied at 4% on insurance premiums and 1% on reinsurance premiums paid by those with U.S. risks to non-U.S. insurers.

96. It should be confirmed that U.S. FET is a covered tax. The rationale for this is as follows:

- U.S. FET is an alternative for U.S. federal income tax. An insurer with a U.S. branch can elect to subject U.S. risks insured elsewhere in the entity to full U.S. federal income tax, in which case U.S. FET is not due on those premiums.
- U.S. FET is included within the United States of America's core taxation treaties, which relate to income tax matters, with those taxation treaties providing for exemptions from U.S. FET (subject to certain conditions being met).

3.4 Absence of Covered Tax Where a CFC's Profits are Sheltered by Brought-Forward Tax Losses of the Parent Company

97. There is a risk of double taxation where there is a CFC (or entity that is subject to a regime similar to CFC rules) and the parent company of the CFC offsets the income of the CFC automatically with brought-forward losses. Under the Blueprint, no covered tax would be allocated to the CFC in this situation, even though there is an economic taxation of the CFC's profits by way of utilization of tax losses that would otherwise shelter future onshore profits from taxation. We therefore propose that the use of tax losses in such a situation is treated as covered taxes allocated to the CFC (or similarly).

3.5 Allocation of "Cross-Jurisdictional" Taxes (Particularly, Anti-Avoidance Rule)

98. With regard to the Blueprint proposals on allocation of covered taxes to jurisdictions, including cross-jurisdictional taxes, these seem to make sense and give effect to the jurisdictional blending approach. We do not have specific observations on the use and design of anti-avoidance rules, though clearly regard would need to be had to the potential complexities for the design of the carry-forward rules that could result.

© 2020 KPMG LLP, a Delaware limited liability partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved. The KPMG name and logo are trademarks used under license by the independent member firms of the KPMG global organization.

4. Carry-forwards and Carve-out

Pillar Two - Question IV

4.1 Treatment of Pre-GloBE Losses and Excess Taxes under the Carry-Forward Approach

99. The Blueprint outlines carry-forward mechanisms for losses and excess taxes, which are intended to address temporary differences as a result of differences in the timing of the recognition of income and expense under financial accounting and tax rules. The Blueprint further notes that transitional rules are needed to address how these mechanisms will apply in the case of an MNE group becoming subject to the GloBE rules for the first time. This can happen either when the GloBE rules are first brought into effect in a jurisdiction in which an MNE group operates, or at some subsequent date when a smaller MNE group first exceeds the consolidated revenue threshold.

100. Without an appropriate transition mechanism to take into account losses and excess taxes paid in years prior to the first date of application of the rules to an MNE group, an MNE group may appear to have artificially high income or artificially low taxes, resulting in the inappropriate application of the top-up tax. One option to address this would be to apply the GloBE rules retroactively to some or all previous years in order to arrive at an opening balance for loss carryforwards or local tax carryforwards. Presumably for the sake of administrability, the Blueprint suggests that for this purpose, a start date for the transitional period would need to be identified, and the opening balance for carryforwards would be computed as though the GloBE rules had applied during the period between that start date and the first application of the GloBE rules to an MNE group. Even this approach, however, would require application of a complicated set of rules to periods prior to the effective date, potentially imposing a substantial administrative burden.

101. The Blueprint therefore suggests that a simplified method could be developed to produce results that reasonably approximate a full calculation of opening balances with less complexity and administrative burden. While we would of course support the development of mechanisms that would simplify the GloBE calculation and reduce administrative burden during the transition period, we believe the carry-forward regime could benefit more generally from finding a better balance between administrability and technical accuracy, and that strong consideration should be given to making any simplification measures that can be identified with respect to pre-regime attributes available more generally in the application of the GloBE rules.

102. In any case, while theoretically the "right" answer would be for taxpayers to take into account losses and excess taxes for their entire history, we recognize that for the sake of administrability, tax authorities may prefer to identify a fixed point at which the transition period would start. Any such transition period should be elective, however, to minimize the extent to which taxpayers are required to incur the cost of applying the GloBE regime to pre-effective date years. For taxpayers that do elect to apply such an approach, the transition period should permit the incorporation of pre-regime losses and excess taxes for at least [5] years preceding the date on which an MNE group is first subject to the GloBE rules.

4.2.1 Timing Issues for Insurers

103. Insurers in particular are subject to local taxation rules that may result in timing differences that extend well beyond the 7-year timeframe that the blueprint envisages as a lookback period to calculate IIR tax credit and local tax credit carryforwards.

© 2020 KPMG LLP, a Delaware limited liability partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved. The KPMG name and logo are trademarks used under license by the independent member firms of the KPMG global organization.

104. For example, many European countries require insurers, especially those insuring the highest risks, to make transfers to tax deductible equalization reserves. This is a regulatory requirement, not a tax election, in order to ensure that the insurer has sufficient capital to meet future claims payments and such reserves must be maintained well beyond the 7-year timeframe proposed (e.g., 15 or 30 years in Germany, and 12 years in France). Such reserves cannot be distributed as dividends to shareholders. Because such transfers are not recognized under either IFRS 17, the IFRS insurance accounting standard, or U.S. GAAP, there is a timing mismatch of greater than 7 years.

105. Life assurance policies are written to last many years and frequently decades. A pension annuity taken out by a 60-year-old now may still be paying out 40 years later. There is little consistency between the accounting requirements for such policies in many countries.

106. As these examples illustrate, timing differences often exist through natural commercial activities in insurers that last considerably longer than the 7-year timeframe envisaged by the Blueprint. Therefore, a longer timeframe is more appropriate for insurance companies to avoid the risk of top-up tax being due in circumstances where there is no genuine under-taxation.

107. Solutions to these issues for insurers could include:

- Extending the lookback period for identifying IIR tax credits and the carryforward for local tax credits and IIR tax credits for insurers from 7 years to a significantly longer period, e.g., 20 years.
- Enabling insurers to compute their GloBE income based on the tax or regulatory measure of profit before tax for each jurisdiction.

5. Simplification Options

Pillar Two - Question V

108. The Blueprint notes that the Inclusive Framework has explored several potential simplification measures, but has not yet decided which measures to adopt in the final design of the GloBE rules. Measures considered include (i) a country-by-country reporting (“CbCR”) effective tax rate (“ETR”) safe harbor; (ii) a de minimis profit exclusion; (iii) permitting a single jurisdictional ETR calculation to cover multiple years; and (iv) tax administrative guidance to identify low-risk jurisdictions.

109. The ability to rely on an ETR calculation based on CbCR information as a safe harbor has intuitive appeal to the extent that it permits taxpayers to rely on information they already are required to collect. As described in the Blueprint, however, the substantial number of adjustments required in order to use the CbCR information makes it unclear whether the safe harbor would provide meaningful simplification. In addition, we are concerned by suggestions in the Blueprint that some of the adjustments required by the CbCR ETR safe harbor may be incorporated into the CbcR rules. If such changes would not be necessary other than for purposes of the GloBE regime, any reduction in administrative burden in the GloBE rules would appear to be offset by an increase in complexity in the CbCR rules.

110. The de minimis profit exclusion could reduce administrative burden for some MNE groups operating in a very large number of countries, particularly to the extent that MNE groups are permitted to rely on existing CbCR data without modification to calculate pre-tax profit for purposes of determining the jurisdictions in which profits

© 2020 KPMG LLP, a Delaware limited liability partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved. The KPMG name and logo are trademarks used under license by the independent member firms of the KPMG global organization.

exceed the minimum threshold. We would therefore favor exploring such an approach further as one of several options. The amount of simplification such an approach provides seems relatively limited, however, particularly to the extent that significant adjustments to CbCR data are required.

111. In terms of how to structure the de minimis profit exclusion, an exemption for small jurisdictions based on a percentage (e.g., 2.5%) of income would work effectively in many years, but in years in which global losses are incurred, no jurisdictions would be excluded. Therefore, we would recommend that the 2.5% threshold be used in combination with a numerical threshold. For example, the exclusion could apply to all jurisdictions with pre-tax income of less than the greater of EUR 2,000,000 or 2.5% of global income. This would also be consistent with the numerical thresholds proposed for Pillar One.

112. Permitting an MNE group with a relatively high jurisdictional ETR to rely on that ETR for a period of years, similarly, appears to be of limited utility, given that it would require calculation of an ETR at least once in every jurisdiction every few years. The utility of this would be further reduced to the extent that taxpayers are required to perform the calculation on the basis of data from multiple years to avoid distortion.

113. In contrast with the previous three options, producing administrative guidance that would create a presumption that an MNE group's ETR in identified low-risk jurisdictions exceeds the agreed minimum rate has by far the greatest potential to meaningfully simplify compliance with the GloBE regime. While reaching agreement on an objective review process to make such a determination appears challenging at best, the simplification that could be achieved by such an approach is potentially substantial in that it could entirely eliminate the need to perform the complicated GloBE ETR calculations for some jurisdictions. We would therefore strongly encourage the Inclusive Framework to pursue such an approach.

6. Income Inclusion and Switch-over Rules

Pillar Two - Question VI

114. We set out below our answers to specific questions.

a. Top-Down Approach

1. *Do you have any comments on the detailed approach outlined in the report for designing and implementing a top-down income inclusion rule?*

115. The OECD recommended several anti-BEPS rules in the BEPS 2015 Final Reports, such as the CFC rules in the BEPS Action 3 Report and the hybrid mismatch rules in the BEPS Action 2 Report. These rules have been implemented in many countries, including in the EU, where they have been implemented in a coherent and coordinated manner through the Anti-Tax Avoidance Directive. Many companies have spent time and money complying with these rules and consideration should be given to how they take priority over the Pillar Two rules.

c. Split-Ownership

2. *What would be an appropriate minority ownership percentage to use when applying such a rule and what impact would the rule then have on common multinational group structures?*

© 2020 KPMG LLP, a Delaware limited liability partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved. The KPMG name and logo are trademarks used under license by the independent member firms of the KPMG global organization.

116. Where the split-ownership rule applies, it adds significant administrative burden and undermines the simplicity and efficacy gains of the top-down approach. We therefore believe that it would ideally be limited in its scope of application to particular situations identified as likely to involve abuse. We believe that the 10% threshold suggested in paragraphs 442-443 of the Report on the Pillar Two Blueprint (meaning that the minority ownership rules would apply when the minority shareholders hold more than 10% of the equity interests) should be considered an absolute minimum.

8. Special Rules for Associates, Joint Ventures, and Orphan Entities

Pillar Two - Question VIII

117. The Blueprint notes that further technical work is being undertaken so that the final rule is comprehensive and effective, does not create undue compliance burdens, and is coordinated with the other GloBE rules. A number of areas requiring consideration are particularly notable:

- The Simplified IIR exclusion, as currently described, may be inadequate to avoid double taxation. As described, it applies for investments in an entity or arrangement organized in a jurisdiction that has adopted the GloBE rules. However, would this cover the case of an investment in a lower tier entity of another MNE group, where the UPE of that group applies GloBE but the lower tier entity's jurisdiction does not apply the GloBE rules? The lower tier entity could be subject to GloBE tax via the Parent's IIR, or could be subject to undertaxed payments rule ("UTPR") on payments received from another group entity, or indeed on payments to this lower tier entity from another MNE to which the orphan entity rule applies. If the investment in this entity were not to be excluded from the Simplified IIR, double tax would arise. It appears that some additional work is needed to cover such scenarios.

- It is indicated that the Simplified IIR would apply at the level of the UPE. This leads to the somewhat odd result that where the UPE indirectly holds 20% in a given company, the UPE jurisdiction has taxing rights over the company, whereas if the UPE indirectly holds 89% in the company, the taxing rights might drop down to the level of a partially owned intermediate parent under the split ownership rules. It may be that the rules determining which entity has the Simplified IIR taxing rights will be further adjusted; rules developed in this space will clearly need to take into account rule interactions arising in scenarios in which GILTI is applied by a U.S. UPE or intermediate parent.

- The Blueprint notes that the Simplified IIR top-up tax calculation will differ from the general IIR calculation in that deferred tax numbers will be used, global blending will be used, and there will be no substance exclusion. A further difference is that dividend and capital gains income of the investee would still be in scope for the Simplified IIR, in cases where this might be excluded under the general IIR. This could reduce the ETR (and raise the top-up tax amount) where the investee avails itself of participation exemption rules.

118. Given the focus in the public consultation document on potential simplifications, further thought might be given to whether the objectives behind the Simplified IIR could be achieved in a manner creating less complexity for MNEs applying the GloBE rules. In justifying the Simplified IIR, the Blueprint refers to scenarios of concern where MNEs have made specific arrangements to limit their GloBE exposures. This suggests that the Simplified IIR is not intended to alter the focus and intent of GloBE as a mechanism to ensure that MNE groups (i.e., the entities within the group) pay a minimum level of tax, but is simply intended to deal with potential structuring to circumvent the GloBE rules. If this is the case, perhaps rules more targeted at such structuring cases would be

© 2020 KPMG LLP, a Delaware limited liability partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved. The KPMG name and logo are trademarks used under license by the independent member firms of the KPMG global organization.

preferable, significantly reducing the number of MNEs that need to deal with the related complexity. Alternatively, perhaps the Inclusive Framework agreement on GloBE might initially not include the Simplified IIR. Rather, a decision to do so could be made later if, on Inclusive Framework review, it was found that structuring to circumvent the GloBE rules was frequently occurring in practice.

9. Subject to Tax Rule

Pillar Two - Question IX

119. The subject to tax rule ("STTR") acts as a way for a country to preserve its right to impose gross-basis withholding taxes in situations in which a recipient is not considered sufficiently taxed on a payment it receives. This rule represents a significant departure from the way bilateral tax treaties have traditionally worked. Applied on a broad basis, it appears possible that such an approach would meaningfully change the balance of treaty benefits negotiated between two jurisdictions.

120. We believe, as a result, that while countries are of course free to adopt an STTR either bilaterally or through multilateral agreement, requiring the STTR to be adopted as a minimum standard would not be appropriate. Instead, if the STTR is included in a multilateral agreement, each country should have the ability to opt in or out, and bilateral tax treaties should be modified to include an STTR only if both parties agree to its inclusion. In all other cases, the STTR should be left to bilateral negotiation.

a. Covered Payments and Low-Return Exclusion

121. The STTR applies to a broad range of payments, including interest, royalties, and several types of services fees. Income from the provision of services will in many cases be associated with significant expense, with the result that a gross-basis tax runs the risk of creating over-taxation relative to net income. This issue is addressed only partially by the proposed exclusion of low-margin payments. We would recommend either narrowing the scope of payments or ensuring that the top-up rate is low enough to minimize the risk that it would result in a high rate on net income.

122. For example, in the case of insurance and reinsurance premiums and interest paid to banks that have themselves borrowed to provide the funding, the underlying costs (e.g., claims, commissions, and interest payable) will be very large relative to, and may even exceed, the gross receipts from these payments. If it is appropriate to apply the STTR to such payments at all, the STTR rate should be set at a sufficiently low rate to ensure the STTR does not produce a worse outcome for a treaty jurisdiction than the IIR or UTPR for an offshore zero-tax jurisdiction.

b. Materiality Threshold

123. The inclusion of a materiality threshold would ensure that the STTR applied to payments involving the most significant BEPS risks, while limiting administrative and compliance burdens for both the taxpayer and the tax authorities. Therefore, we believe that including such a threshold is appropriate.

124. In our opinion, a threshold based on the size of the MNE would be in line with BEPS Action 13 (CbCR) and would be easier to administer and apply than the other suggested approaches.

© 2020 KPMG LLP, a Delaware limited liability partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved. The KPMG name and logo are trademarks used under license by the independent member firms of the KPMG global organization.

c. Administrative Considerations.

2. *Do you have other suggestions to minimize the administrative burden and to facilitate the collection of the top-up tax?*

125. The Pillar Two rules should be designed in such a way that the tax position resulting from the application of those rules can be ascertained before an MNE needs to prepare its financial statements, since the tax position should be included in those statements.

KPMG Contacts	Firm	E-mail
Stephen Blough	KPMG in the US	sblough@kpmg.com
Manal Corwin	KPMG in the US	mcorwin@kpmg.com
Jesse Eggert	KPMG in the US	jeggert@kpmg.com
Sean Foley	KPMG in the US	sffoley@kpmg.com
Matthew Herrington	KPMG in the UK	matthew.herrington@kpmg.co.uk
Mark Martin	KPMG in the US	mrmartin@kpmg.com
Christopher Morgan	KPMG in the UK	christopher.morgan@kpmg.co.uk
Jack O’Meara	KPMG in the US	jomeara@kpmg.com
Michael Plowgian	KPMG in the US	mplowgian@kpmg.com
Prita Subramanian	KPMG in the US	psubramanian@kpmg.com
Conrad Turley	KPMG in China	conrad.turley@kpmg.com
Robert Van der Jagt	KPMG in the Netherlands	vanderjagt.robert@kpmg.com
Grant Wardell-Johnson	KPMG in Australia	gwardelljohn@kpmg.com.au
Brett Weaver	KPMG in the US	baweaver@kpmg.com
Tom Zollo	KPMG in the US	tzollo@kpmg.com

© 2020 KPMG LLP, a Delaware limited liability partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved. The KPMG name and logo are trademarks used under license by the independent member firms of the KPMG global organization.

The information contained herein is not intended to be “written advice concerning one or more Federal tax matters” subject to the requirements of section 10.37(a)(2) of Treasury Department Circular 230.

The information contained herein is of a general nature and based on authorities that are subject to change. Applicability of the information to specific situations should be determined through consultation with your tax adviser.

© 2020 KPMG LLP, a Delaware limited liability partnership and a member firm of the KPMG global organization of independent member firms affiliated with KPMG International Limited, a private English company limited by guarantee. All rights reserved. The KPMG name and logo are trademarks used under license by the independent member firms of the KPMG global organization.