



RECENT TRENDS IN INTERNATIONAL TAX-Focus on BEPS

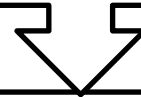
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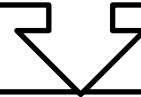
AGENDA



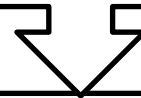
BEPS Overview



Focus on Pillar One and Pillar Two



G7/ Biden proposal for global minimum tax



Recent International tax trends



BEPS Overview

BEPS Overview



- Impetus by the 2008 financial crisis
- October 5, 2015-Final reports for the base erosion and profit-shifting project (BEPS)-15 measures
- BEPS-tax planning strategies used by MNEs that exploit gaps and mismatches in tax rules to avoid paying tax.
- USD 100-240 billion in lost revenue annually

BEPS Overview



Action 1-Tax challenges arising from digitalization

- Aims to identify and address the main challenges due to the digitalization of the economy

Action 2-Neutralising the effects of hybrid mismatch agreements

- Aims to neutralize the effects of hybrid mismatches. Hybrid mismatch arrangements focus on the differences in the tax treatment of an entity or a financial instrument under the laws of two or more countries.

Action 3-Controlled Foreign Company

- Aims to develop recommendations regarding the design and strengthening of controlled foreign company (CFC) rules.
- CFC rules lead to the taxation of income of controlled foreign subsidiaries in the hands of resident shareholders, if certain conditions are met.

Action 4-Limitation on interest deductions

- Aims to limit base erosion involving interest deductions and other financial payments.

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Action 5-Harmful tax practices

- Aims to identify and counter harmful tax practices, taking into account transparency and substance.

Action 6-Prevention of treaty abuse

- The goal is to prevent the granting of treaty benefits in inappropriate circumstances.

Action 7-Permanent Establishment status

- Aims to prevent the artificial avoidance of permanent establishment (PE) status, by redefining the threshold for creating a PE, to prevent BEPS

Action 8-10-Transfer Pricing

- Provide guidance on Transfer Pricing with the goal of aligning transfer pricing outcomes with value creation

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Action 11-BEPS data analysis

- Aims to establish methodologies to collect and analyze data on BEPS and the actions to address it

Action 12-Mandatory disclosure rules

- Aims to provide a framework for the design of mandatory disclosure rules for countries that choose to adopt them.. .

Action 13-Country-by-Country Reporting

- Aims to reexamine and develop rules on transfer pricing documentation, to enhance transparency for tax authorities while taking into account the compliance costs for business.

Action 14-Mutual Agreement Procedure

- The goal of Action 14 is to address obstacles that prevent countries from solving treaty related disputes under MAP.

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- Implementation under the OECD/G20 Inclusive Framework on BEPS.
- 139 members- (23 from Africa)
- Profits are taxed where economic activities are performed and where value is created.
- Monitoring and evaluation by the Inclusive Framework.

BEPS Overview



Next Steps

- Peer reviews of the BEPS Minimum Standards
- Additional signatures and ratification of the Multilateral Instrument
- Measuring the impact of BEPS-Country-by-Country reports
- Addressing the tax challenges arising from digitalisation



OECD Two-Pillar Approach to taxation of the digital economy



2015 BEPS Action 1 Report

- Key recommendations-no specific new digital taxes or permanent establishment rules were recommended.
- The Report called for continued work in this area with a further report to be delivered by 2020.

Introduction



The following documents were released in October 2020;

- Reports on Pillar One and Pillar Two blueprints; and
- Economic impact assessment.

Introduction



Pillar One blueprint

- The blueprint provides a solid foundation for future agreement that would adhere to the concept of net taxation of income, avoid double taxation and be as simple and administrable as possible.

Introduction



Pillar Two blueprint

- The blueprint would provide jurisdictions with the right to “tax back” where other jurisdictions have not exercised their primary taxing rights, or the payment is subject to low levels of taxation.

OECD Two-Pillar Approach

Pillar One



Reallocation of Taxing rights

- Addresses the question of business presence and activities without physical presence.
- Will determine where tax is to be paid and on what basis.
- Will determine what portion of profits could or should be taxed in jurisdictions where customers or users are located.

OECD Two-Pillar Approach

Pillar One



- Going beyond physical presence to determine taxing rights.
- Substantial reallocation of taxing rights across jurisdictions.
- Consider MNE as a group rather than entity-by-entity.
- Allocates some tax base to market jurisdictions based on a formula.

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Pillar One



Amount A

New taxing right

A share of residual profit allocated to market countries using a formulaic approach

In scope businesses only

Amount B

Fixed Baseline return

For marketing and distribution functions based on the arm's length principle

All Businesses

Tax Certainty

Through effective dispute resolution mechanisms

All Businesses

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Pillar One



Scope for Amount A

- Covers businesses that can participate in a “sustained and significant manner” in the economic life of a market country with or without physical presence.
- Two broad groups of businesses;
 - ✓ Automated digital services; and
 - ✓ Consumer-facing businesses.

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Pillar One



▪ Automated digital services

Provided on a standardised basis to larger user base across multiple locations

Online advertising; online search engines; social media platforms, online intermediation platforms; digital content services; online gaming; standardized online teaching services; cloud computing services.

General definition:

Automate:-Once the system is set up the provision of services to a particular user requires minimal human intervention on the part of the service provider

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▪ Consumer-Facing Businesses

Sale of goods and services of a type commonly sold to consumers

Generate revenue from the sale of goods and service of a type commonly sold to consumers

Goods and services would be regularly, repeatedly, or ordinarily supplied to an individual for personal purposes

“Sold to” includes the sale, lease, licence, rent, or delivery, whether directly or indirectly

Exclusions:

- Extractive industries and natural resources, construction, sale and letting of residential property, consumer-facing businesses in the financial services sector, international air, and shipping businesses

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Pillar One



Profit re-allocation-formulaic approach

Profitability threshold-residual profit of the group in excess of agreed profitability threshold

- Based on ratio of profit tax to revenue

Reallocation percentage-An agreed percentage of the residual profit that can be allocated to market countries

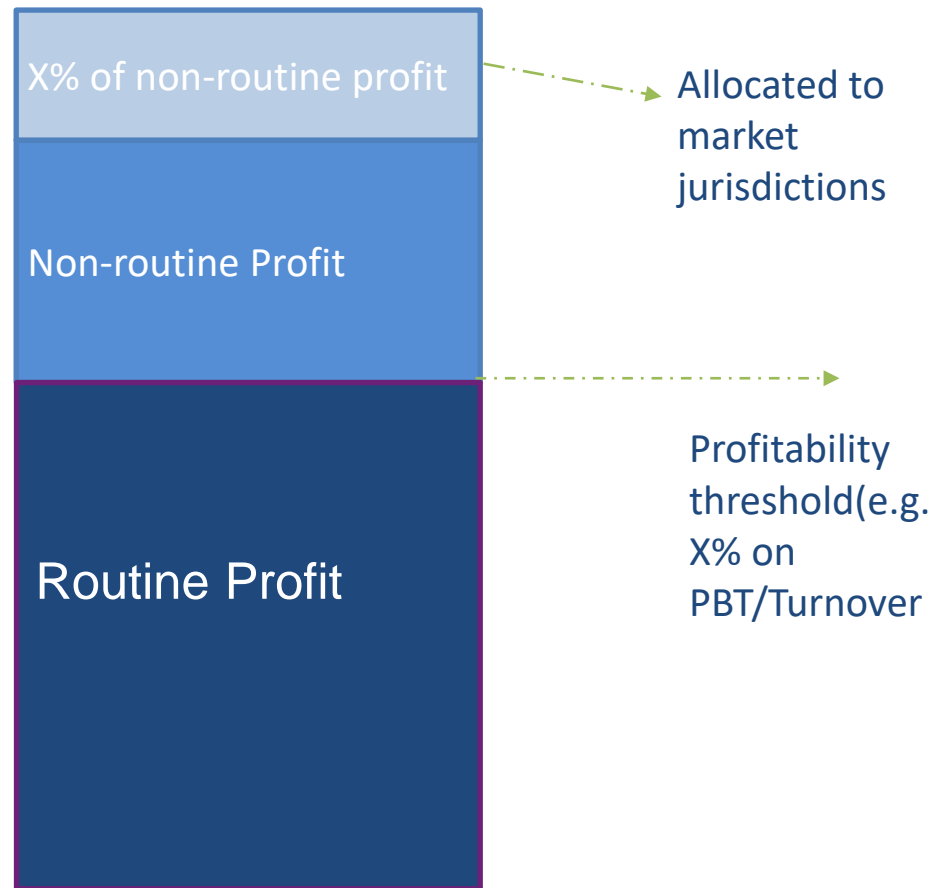
- Remaining profits assumed attributable to activities not targeted by Amount A

Reallocation percentage-An agreed percentage of the residual profit that can be allocated to market countries

- Based on locally sourced in-scope revenues

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Pillar One



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OECD Two-Pillar Approach

Pillar One



Global revenue thresholds

Estimated No. of MNEs groups above global revenue thresholds

Global Revenue Threshold (EUR m)	Estimated No. of MNEs	Estimated No. of MNEs in the ADS and CFB
750	8,000	2,300
1,000	6,800	2,000
2,000	4,100	1,300
5,000	2,000	620
10,000	1,000	350

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Amount B

- Aims to standardize the remuneration of related party distributors that perform baseline marketing and distribution activities in a manner that is aligned with the arm's length principle
- Applied to all business sectors-not subject scope limitations
- Quantum of fixed return is likely to be based on comparable benchmarking analysis under the TNMM method

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Pillar One



Amount B-Positive & Negative list

Positive functions

- Importation/purchase of products for resale
- Development and maintenance of local customer relationships
- Determination or negotiation of pricing
- Processing of orders and contracts with customers
- Management of logistics, warehousing, transportation of products to customers
- General administration functions
- Routine input into demand planning
- Marketing

Negative functions

- Development, enhancement, and maintenance and protection of marketing intangibles
- Strategic sales marketing functions in the local market
- Activities related to the assumption of entrepreneurial risks
- Activities related to the resale of products mainly to government entities and government contractors

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Global minimum tax rate

Estimated No. of MNEs groups above residual profit thresholds

Profitability threshold	Estimated No. of MNEs in scope	Estimated global residual profit (USD Trillion)
8%	990	0.60
10%	780	0.49
15%	430	0.29
20%	240	0.17
25%	150	0.10

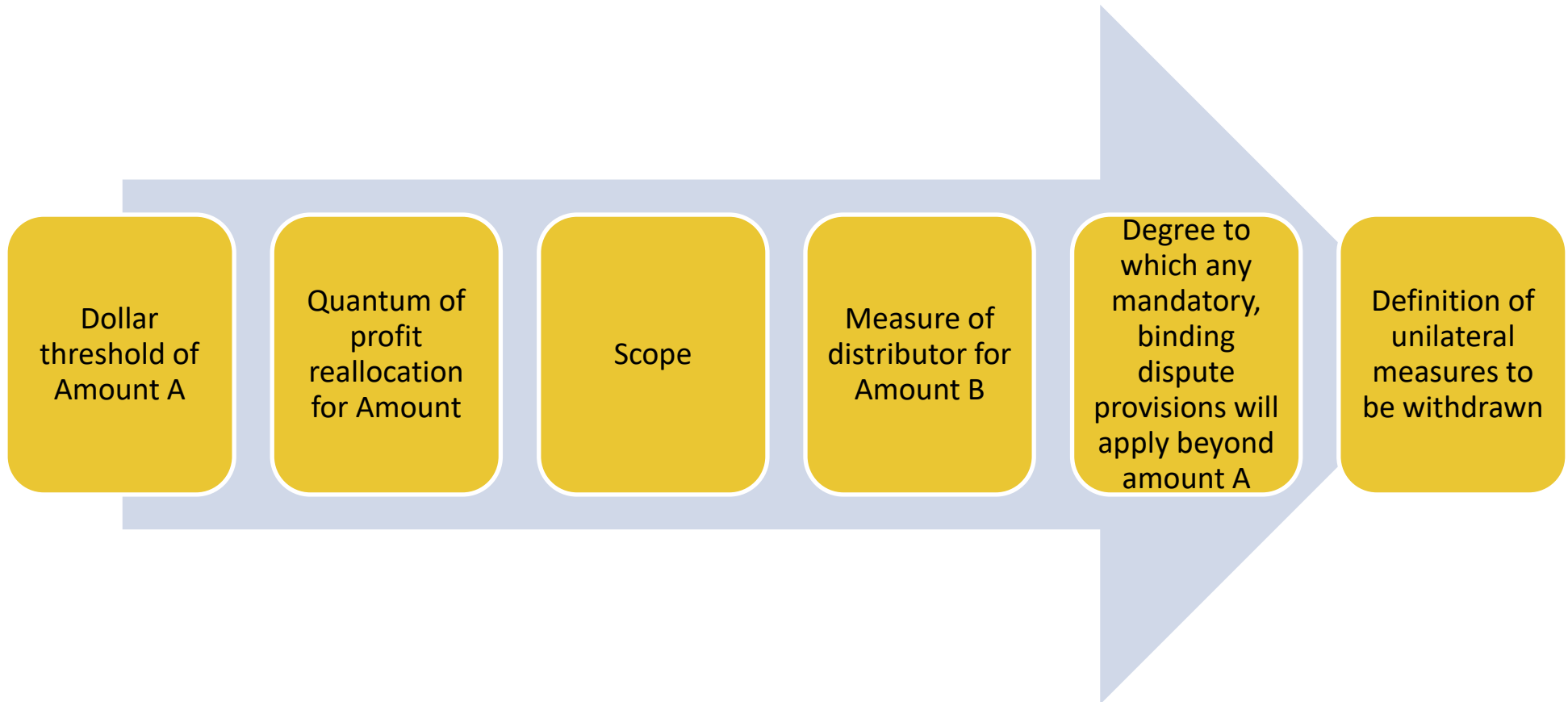
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Pillar One



Key open items-Pillar One



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Pillar Two



Global anti-base erosion (GloBE) proposal

- Rules to permit countries to tax MNEs where income is subject to no or very low taxation
- Will ensure a minimum level of tax is paid by multinational enterprises (MNEs).
- Levels the playing field between traditional and digital companies.

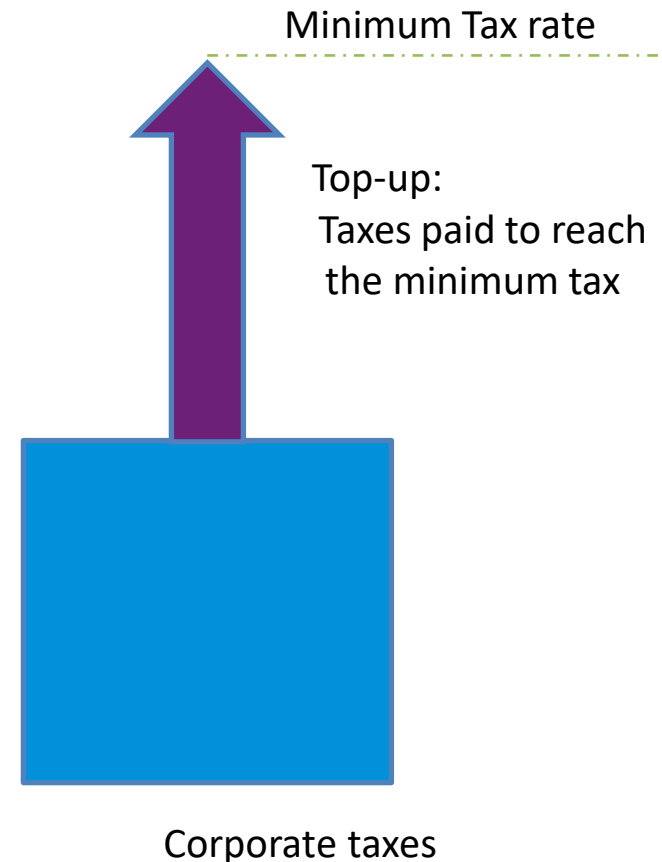
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Pillar Two



Pillar 2: GloBE Proposal-Income Inclusion rule

- GloBE gives countries the right to “tax back” profit that is currently taxed below the minimum rate
- It would operate as a top-up tax up to the minimum rate
- It could be applied either on global MNE profit or jurisdiction-by-jurisdiction
- Members of the Inclusive Framework to set the minimum tax rate

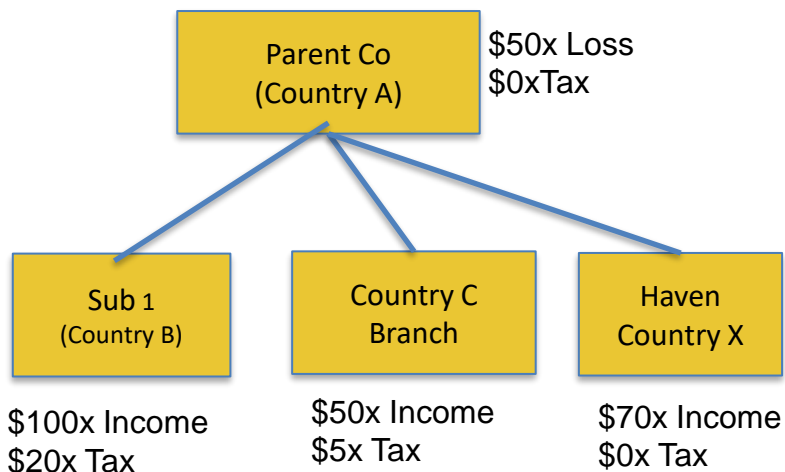


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Pillar Two



Income Inclusion rule (IRR)-Example



*Assume minimum ETR of 12.5% under IRR

- Country A has enacted rules implementing the IIR and the undertaxed payments rule
- Parent Co incurs a <\$50X> loss in Country A and pays \$0x in Country A, prior to application of the IIR
- Sub 1 earns \$100x and pays \$20x of Country B tax
- Country C branch earns \$50x of income and pays \$5x of Country C tax. Country C branch's income is not taxable in Country A under the terms of Country A-Country C treaty
- Haven earns \$70x profit and pays no Country X tax

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Undertaxed payments rule (UTPR)

- UTPR allocates the top-up tax amount between constituent entities in situations where the owner of the constituent entity is not subject to the IRR, either at the ultimate or intermediate parent level
- Income earned at the UPE jurisdiction could be subject to the UTPR in subsidiary jurisdiction if the UPE income is taxed below the minimum ETR.
- The UTPR utilises the same general principles as the IIR , including the determination of “covered taxes” and carve-outs, and other exemptions

Primary allocation key

- Proportionate share of deductible payments made in the year to low-taxed company

Secondary allocation key

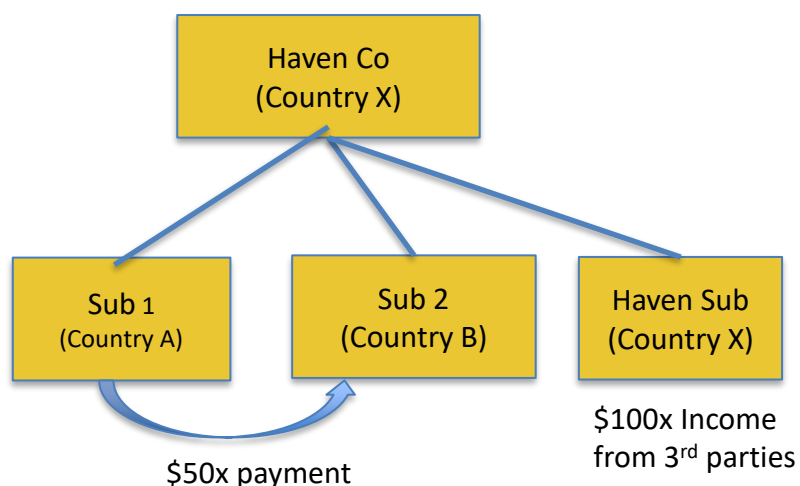
- Net intragroup expenditure of UTPR entity divided by total related party expenditure of all UTPR entities

OECD Two-Pillar Approach

Pillar Two



Undertaxed Payments rule (UTPR)-Example



*Assume minimum ETR of 12.5% under IIR

- Country A and B have adopted pillar Two rules, including IIR and UTPR
- Both Country A and B impose a corporate tax in excess of the minimum IIR ETR
- Country X has no income tax and has not adopted an IIR
- Sub 1 makes a \$50x deductible payment to Sub 2. Sub 2's \$50x is taxable in Country A at a rate exceeding minimum ETR
- Haven Sub incurs \$100x of income from 3rd parties.
- Assume the income from 3rd parties is not subject to the UTPR at the payors
- Under UTPR, the untaxed \$100x of income that Haven Sub is taxed in Country A and Country B based on the relative share of related-party payments made by Sub 1 and Sub 2.
- This is the case even though Haven hub is in the same jurisdiction as the UPE
- Because Sub 1 has made 100% of the related party payments within the group, Sub 1 is liable in Country A for the \$12.5 of tax on the undertaxed payments to Haven Sub

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Pillar Two



Subject to tax rule

Applies in priority to the income inclusion and undertaxed payment rule

- Separate rules on scope , rate calculations and administration
- The minimum tax rate maybe different or lower than the minimum rate for other two pillar rules

Only applies on payments between connected parties

- Based on common control
- Payments to excluded entities (investment funds, government entities e.t.c) will be out of scope

Triggered when the “adjusted nominal tax rate” is below the agreed minimum tax rate

- Based on nominal statutory tax rate applicable to company receiving payment
- Adjusted for features of the local tax system. E.g Preferential regime rates

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Pillar Two



Subject to tax rule contd.

- Rule applies to defined categories of payments including;
 - Interest
 - Royalties
 - Other payments –rent, Franchise fees, Guarantee, brokerage and financing fees
- Subject to materiality thresholds e.g. group size, ratio of covered payments to total expenditure

Economic Analysis & Impact -Pillar One



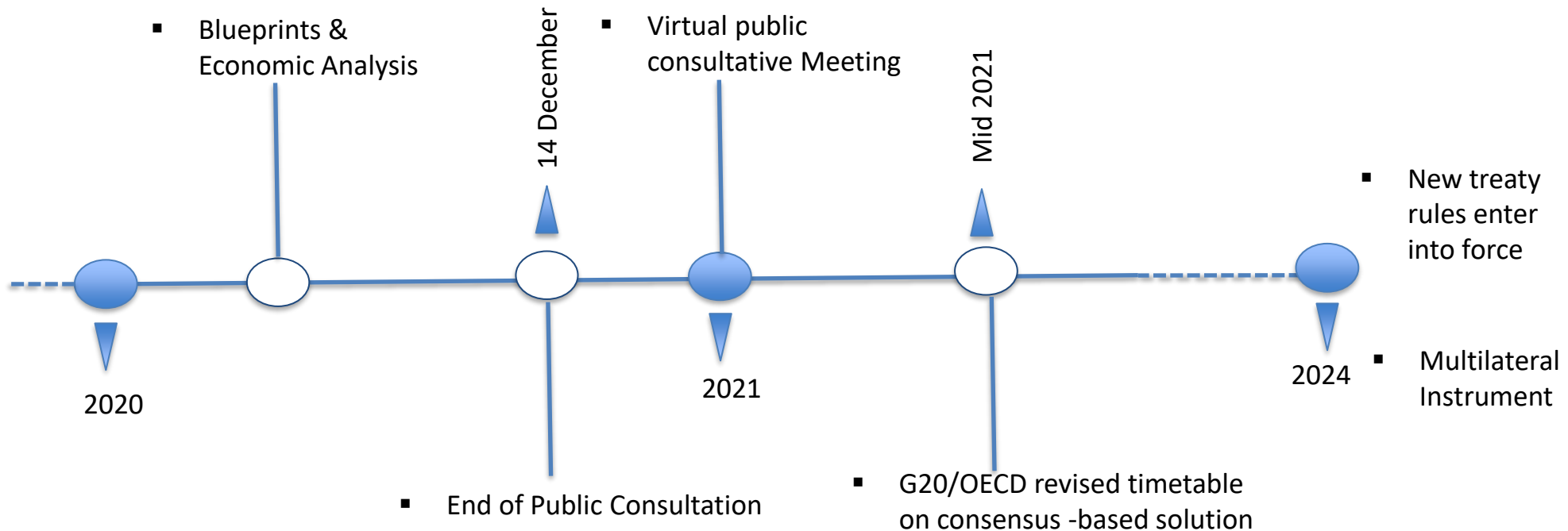
- Increase in global tax revenues.
- On average, low and middle income economies would gain relatively more revenue than advanced economies.
- Investment hubs would experience some loss in tax revenues.
- USD 100 billion could be redistributed to market jurisdictions.

Economic Analysis & Impact -Pillar Two



- Significant increased in amount of additional revenues.
- Up to 4% of global corporate income tax revenues, or USD 100 billion of revenue gains annually.
- Reduced tax rate differentials between jurisdictions.
- Reduction on the incentive for MNEs to shift profits.

Next Steps-Key dates



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G7/ Biden proposal for global minimum tax

Introduction



- Agreement entered into on 5 June 2021 by the G7 Finance Ministers.
- Designed to address the tax challenges of the digitalisation and the globalisation of the economy.
- Ensure that MNEs pay their fair share of tax in the countries they do business.

Introduction



Pillar One

Payment of taxes in the countries of operations.

MNEs with at least a 10% profit margin – 20% of any profit above the 10% margin reallocated

Pillar Two

Global minimum rate of at least 15%.

Further discussion at the G20 Financial Ministers & Central Bank Governors meeting in July.

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Recent International Tax Trends

Unilateral Measures-Digital Services Tax



- Arose due to concerns about the digital economy.
- Delays in a multilateral solution.
- 50% of European OECD countries have either announced, proposed, or implemented DST.
- Retaliatory threats from the US.

Unilateral Measures-Digital Services Tax



Europe

- Austria-5%
- France-3%
- Hungary-7.5%*
- Italy-3%
- Poland-1.5%
- Spain-3%
- Turkey-7.5%
- United Kingdom-2%

Other countries

- Brazil-1% to 3%
- India-6%,2%
- Kenya-1.5%
- Taiwan
- Indonesia
- Vietnam
- Malaysia

Exchange of information



- Under the auspice of the Global forum on transparency of information for tax purposes
- 32 African countries out of 162 members
- Capacity building initiatives
- In 2020-Two African countries identified nearly EUR 35 million
- Since 2009-over EUR 1.2 billion of additional revenues identified by African countries

Questions & Answers



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