KPMG

Tax Alert

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Update on BEPS 2.0 Developments

As part of the ongoing Base Erosion Profit Shifting (BEPS) 2.0 initiative, which in part seeks to tackle the challenges of an increasingly digital economy, the OECD and G20 are collaborating with 135 countries through an Inclusive Framework.

On 31 January 2020, the OECD published a statement ratified by the G20 Inclusive Framework to further explicate the architecture of and provide clarification on Pillars One and Two. Further to this, the OECD provided an economic analysis of the changes through a webcast on 13 February 2020, while G20 discussed the concept during a summit at the end of February 2020.

This Tax Alert provides a summary of these ongoing BEPS 2.0 developments, as well as how Singapore taxpayers could be affected.

Background

The Programme of Work, introduced in May 2019 by the OECD/G20 Inclusive Framework on BEPS (Inclusive Framework), is divided into two pillars:

- **Pillar One** addresses the allocation of taxing rights between jurisdictions and considers various proposals for new profit allocation and nexus rules (*transfer pricing focus*).
- **Pillar Two** (also referred to as the 'Global Anti-Base Erosion' or 'GloBE' proposal) provides jurisdictions with a right to tax where other jurisdictions have not exercised their primary taxing rights, or where the payment is otherwise subject to low levels of effective taxation (*corporate tax focus*).

Following the consultation paper released on 9 October 2019 (for Pillar 1) and on 2 December 2019 (for Pillar 2), the OECD received a multitude of comments from interested parties worldwide.

The current statements are intended to provide more clarity on the current scope and definitions, as well as identify areas for further work.

Pillar One

– revised profit allocation and nexus rules

The OECD reaffirmed that it seeks to introduce a Unified Approach, using amounts A, B and C first introduced during the public consultations in October and covered in our previous Tax Alert Issue 17 | December 2019.

As a shift of fundamental taxation rights, the OECD confirmed that the new nexus will be applied through a multilateral tax treaty signing and ratification by all countries.

Updates to Pillar One

The key elements clarified in the Pillar One statement on 31 January 2020 are as follows:

- The statement clarifies the extension of the scope of measures from the originally-targeted automated digitalized services (e.g. online search engines, social media platforms, cloud computing services, etc.) to also include consumer-facing businesses that sell goods and services such as personal computing products (e.g. software, home appliances, mobile phones, etc.), franchise models (licensing arrangements involving the restaurant and hotel sector), clothes, toiletries, cosmetics, luxury goods, branded foods, refreshments, and automobiles.
- The OECD has extended possible carve-outs. The updated list of industries includes intermediate products/components, extractive industries, commodities, financial services sector (excluding fintech companies) and international traffic/logistics.
- In addition to potential revenue thresholds discussed in the October 2019 proposal, a consideration is being given to a de minimis profit threshold. For automated digitalized businesses, the revenue threshold will be the only test to establish a nexus. For consumer-facing business, the mere selling of goods in the jurisdiction should not bring about a new nexus rule if the multinational company is merely selling consumer goods into a market jurisdiction without a sustained interaction with the market. Therefore, additional factors will have to be considered.

  The OECD acknowledged that future work will be dedicated to determining these possible additional factors, examples of which include the existence of a physical presence of the multinational company in the market jurisdiction or targeted advertising directed at the market jurisdiction.

Insights

The confirmation of the principles with further potential carve-outs show that while the Secretariat is ready to take a more flexible approach, they are nonetheless moving fast to complete the work by the end of 2020 in accordance with their plan.

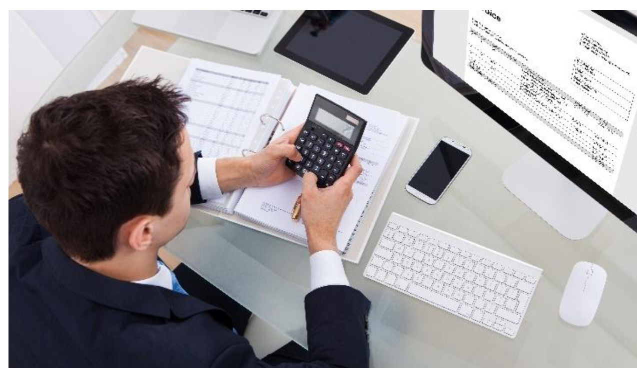
There are still a lot of uncertainties associated with the proposal, including:

- How potential exceptions will be applied to various activities
- The segmentation of group and business line profits (covered and excluded activities)
- How the different degrees of digitalization will be weighted
- What the OECD will determine as the precise criteria for consumer-facing businesses
- The treatment of losses (carry forward of losses)
- The impact on withholding, characterization and other issues
- Permanent establishment concerns.

While some clarification has been provided on Amounts A, B and C, additional work remains to be done such as determining the quantum, potential new rights of taxation, treaty considerations, defining the baseline activities covered and benchmarking the industry approved ratios, etc.

In parallel, during the meeting of G20 on 21 February 2020, US Secretary of the Treasury Mr Steven Mnuchin confirmed his nation's commitment to the initiative, but also re-iterated that the US is proposing an additional opt-out mechanism where companies may choose to pay a certain amount of tax without detailed calculation. Hence, further changes are possible.

The rules will also represent an additional compliance burden for the companies in scope. The OECD will have to manage the compliance rules at an international level to achieve reliability and consistency of information at minimal cost for taxpayers.



As an indication of a potential approach, companies can refer to the discussion document '*Model Rules for Reporting by Platform Operators with Respect to Sellers in the Sharing and Gig Economy'*, which was published by the OECD on 19 February 2020. Although the rules shared in this document are not part of the BEPS 2.0 project as they merely aim to increase the transparency of revenues earned by individuals and companies selling their services via digital platforms, they already require platform operations to disclose their revenue streams, commissions and locations of users and sellers. Similar information can later be used by tax authorities to apply the Pillar One principles as well.

The BEPS 2.0 proposals can have implications for Singapore in a number of ways. The transfer pricing changes in Pillar One of the proposals seek to allocate greater taxing rights to jurisdictions where the consumer is based, and there is concern that Singapore will lose out on revenue given its relatively small population.

Singapore is a part of the Inclusive Framework working group and the authorities are actively engaged in the discussion of the new rules. The additional potential carve-out is a positive signal for the financial sector and energy companies located in Singapore. However, the country is likely to face certain challenges with these proposals. Please see Tax Alert Issue 04 | March 2020 for our detailed analysis of the potential impact of these proposals on Singapore's economy and anticipated changes in the local legislation.

As for the taxpayers, we strongly recommend multi-nationals, especially those with global or regional principal structures in Singapore, to perform a stress test/impact analysis of how the Pillar One proposals would impact their taxing obligations around the world. Primarily, this would likely lead to a situation where more tax is paid in countries where the customers or users are based (including locations where no taxable presence even exists). This will likely result in a significant change in group's effective tax rate (ETR) and cash flow, as well as an increase in tax compliance obligations.

It is clear that the new rules will go far beyond digitalized businesses. At the same time, the OECD have demonstrated that they are ready to listen to various industries and consider justified carve-outs from the rules. Should your company conclude that it might be unfairly caught by the new rules, there is still time to express these concerns either directly to the OECD, through local governmental groups or industry representation.

Pillar Two

– global anti-base erosion proposals

Under the 'income inclusion rule', the income of a foreign branch or controlled entity can be taxed at the parent company level if that income was subject to tax at an effective tax rate (ETR) below a minimum rate (effectively a "top-up" tax to the globally-agreed minimum tax rate in the parent company's jurisdiction). The amount of the minimum tax rate is still to be decided.

This income inclusion rule will be supported by:

- an 'undertaxed payments rule' to deny a deduction or impose tax for payments not subject to tax in the recipient jurisdiction at or above the globally agreed minimum rate
- a 'subject-to-tax rule', designed to ensure that treaty benefits (such as lower withholding tax rates) are only granted if the item of income is subject to tax at or above the globally-agreed minimum rate
- a 'switch-over rule', designed to ensure that residence countries can elect to use the 'credit method' instead of the 'exemption method' where the profits attributable to a permanent establishment (PE) or income derived from immovable property are subject to tax below the minimum rate.

Updates to Pillar Two

The 31January 2020 paper provides very little updates on Pillar Two.

The paper states that progress on key issues is advancing at a fast pace, but that significant work remains to reach a final agreement on the concept.

For the specific measures, it notes the following:

- For the income inclusion rule, the objective would be to limit adjustments for permanent differences to reduce complexity and compliance costs. The work will explore the use of principle-based criteria, including materiality and commonality, to reduce the relevant permanent differences. The paper also highlights the further work being done on carve-outs, noting that some jurisdictions have pushed for exclusions for regimes compliant with BEPS Action Five on harmful tax practices and other substance-based carve-outs.
- For the undertaxed payment rule, subject to tax rule and switch-over rule, there is limited update. However, the paper does stress the focus on simplicity in the design of these rules.

Insights

The potential carve-out for regimes compliant with BEPS Action Five would be beneficial for protecting Singapore's incentive regimes. However, it is likely that there will be push-back on such a carve-out from more influential countries.

In the absence of a carve-out, Singapore may be required to increase its incentive rates (which could impact the nation's attractiveness), or replace tax rate-based incentives with cash grants to attract or grow operations in Singapore.

There is still no further indication on how territorial regimes will be treated under the measures, nor whether capital gains would be carved out. In the absence of any carve-out or adjustment mechanism, this could encourage Singapore to move towards a residence-based taxation regime (rather than let another country exercise taxing rights over income that Singapore treats as exempt). Such a move would increase the tax and compliance burden on Singapore-based companies, and could further reduce Singapore's attractiveness as a regional headquarters location.

To protect its hub status, Singapore should continue to pursue a broad mix of policy tools, including enhancing its tax competitiveness in new ways to encourage businesses to generate substantive economic activities in Singapore.

It is clear there is a still a lot of work to be done on Pillar Two. The focus of the OECD for now is getting the broad principles in place, with the details to be worked out later.

Anticipated economic impact of BEPS 2.0

The preliminary results of an economic analysis with impact assessment of implementing Pillars One and Two were discussed on 13 February 2020.

A summary of the findings are as follows:

- The OECD estimated a net global CIT revenue increase of up to 4% (approximately USD 100 billion annually) as a result of implementing Pillars One and Two, along with a significant reduction in profit sharing. The revenue gains are also seen as broadly similar across high-, middle- and low-income economies, as a share of corporate tax revenues.
- Based on the preliminary economic analysis using country by country data from 2016, the OECD estimated a potential decrease in tax revenue of 0% to 5% for investment hubs such as Singapore.
- Using a forward-looking effective tax rate framework to assess the effect on a stylized investment project with profit shifting behavior incorporated, the OECD conducted a firm-level analysis and has determined a small increase in the effective tax rates, with the biggest impact on MNEs headquartered in investment hubs[1] (similar to the revenue analysis).
- However, all results are preliminary and subject to changes based on updates in assumptions of parameters and reform design, which could change going forward.

How we can help

KPMG in Singapore welcomes the opportunity to discuss how the BEPS 2.0 guidelines and measures may impact your business.

Taxpayers should consider modelling the outcome of the unified approach to evaluate the potential impact on their business and effective tax rate. The modelling exercise could also help to identify some of the practical challenges of applying the proposed approach. KPMG has developed a BEPS 2.0 toolkit which can help model the cash tax and ETR impact of Pillar One and Two, as a means to facilitate discussions between different stakeholders in MNCs.

Although implementation of any final proposal is still some time away, planning for potential outcomes needs to start now.

We are happy to introduce the KPMG Digital Economy Tax Tracker mobile app, which now includes the first round of BEPS 2.0 developments. Around 60 jurisdictions are covered currently in this app, with more on the horizon.

The KPMG Digital Economy Tax Tracker app is free to download on the Apple App Store or Google Play (search for 'Digital Economy Tax Tracker'), and is best viewed on mobile phones.

[1]The OECD defines investment hubs as jurisdictions with inward FDI above 150% of GDP.

About KPMG Tax Alert

KPMG Tax Alert highlights the latest tax developments, impending change to laws or regulations, current practices and potential problem areas that may impact your company. As certain issues discussed herein are time sensitive it is advisable to make plans accordingly.

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Authors

Felicia Chia
Partner
T: +65 6213 2525
E: fchia@kpmg.com.sg

Lee Jingyi
Partner
T: +65 6213 3785
E: jingyilee@kpmg.com.sg

Alia Lum
Partner
T: +65 6213 3203
E: alum1@kpmg.com.sg

Denis Philippov
Director, Transfer Pricing
T: +65 6213 2528
E: denisphilippov@kpmg.com.sg

Contact us

Tay Hong Beng
Partner
Head of Tax
T: +65 6213 2565
E: hongbengtay@kpmg.com.sg

Ajay K Sanganeria
Partner
Deputy Head of Tax
T: +65 6213 2292
E: asanganeria@kpmg.com.sg

BANKING & INSURANCE

Alan Lau
Partner
T: +65 6213 2027
E: alanlau@kpmg.com.sg

REAL ESTATE & ASSET MANAGEMENT

Teo Wee Hwee
Partner
T: +65 6213 2166
E: weehweeteo@kpmg.com.sg

Agnes Lo
Partner
T: +65 6213 2976
E: agneslo1@kpmg.com.sg

Anulekha Samant
Partner
T: +65 6213 3595
E: asamant@kpmg.com.sg

Leonard Ong
Partner
T: +65 6213 2038
E: leonardong@kpmg.com.sg

ENERGY, TECHNOLOGY, MEDIA & TELECOMMUNICATION

Gordon Lawson
Partner
T: +65 6213 2864
E: glawson1@kpmg.com.sg

Larry Sim
Partner
T: +65 6213 2261
E: larrysim@kpmg.com.sg

Lim Li Peng
Partner
T: +65 6213 3709
E: lipenglim@kpmg.com.sg

Contact us

INFRASTRUCTURE, GOVERNMENT & HEALTHCARE

Chiu Wu Hong
Partner
T: +65 6213 2569
E: wchiu@kpmg.com.sg

Gan Kwee Lian
Partner
T: +65 6213 2546
E: kweeliangan@kpmg.com.sg

Toh Boon Ngee
Partner
T: +65 6213 2052
E: btoh@kpmg.com.sg

CONSUMER & RETAIL

Tan Chee Wei
Partner
T: +65 6213 2470
E: cheeweitan@kpmg.com.sg

CORPORATE TAX PLANNING & COMPLIANCE

Mak Oi Leng
Partner
T: +65 6213 7319
E: omak@kpmg.com.sg

Pauline Koh
Partner
T: +65 6213 2815
E: paulinekoh@kpmg.com.sg

PERSONAL TAX & GLOBAL MOBILITY SERVICES

Anna Low
Partner
T: +65 6213 2547
E: alow@kpmg.com.sg

Dennis McEvoy
Partner
T: +65 6213 2645
E: dennismcevoy@kpmg.com.sg

GOODS AND SERVICES TAX

Lam Kok Shang
Partner
T: +65 6213 2596
E: kokshanglam@kpmg.com.sg

Gan Hwee Leng
Partner
T: +65 6213 2813
E: hweelenggan@kpmg.com.sg

TRANSFER PRICING

Felicia Chia
Partner
T: +65 6213 2525
E: fchia@kpmg.com.sg

Lee Jingyi
Partner
T: +65 6213 3785
E: jingyilee@kpmg.com.sg

Contact us

PROPERTY TAX & DISPUTE MANAGEMENT

Leung Yew Kwong
Principal Consultant
T: +65 6213 2877
E: yewkwongleung@kpmg.com.sg

R&D & GRANTS CONSULTING

Harvey Koenig
Partner
T: +65 6213 7383
E: harveykoenig@kpmg.com.sg

TAX TRANSFORMATION & GOVERNANCE

Alia Lum
Partner
T: +65 6213 3203
E: alum1@kpmg.com.sg

US TAX SERVICES

Daniel Joe
Partner
T: +65 6213 2626
E: danieljoe@kpmg.com.sg

TAX – DEALS, M&A

Adam Rees
Principal Advisor
T: +65 6213 2961
E: adamrees@kpmg.com.sg

KPMG
16 Raffles Quay #22-00
Hong Leong Building
Singapore 048581
T: +65 6213 3388
F: +65 6220 9419
E: tax@kpmg.com.sg

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