



TAXAND

PILLARS 1&2

**TAXAND
WEBINAR**

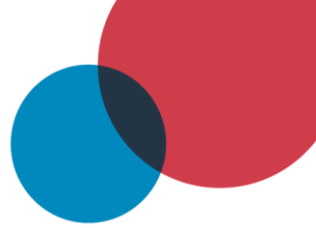
30 November 2020

Your global tax partner

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Webinars

CONTENT

- Timeline
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- Pillar 2
- Questions



TIMELINE



2015

- Oct 2015 – Final Report – Action 1: Addressing the tax challenges of the digital economy

2017

- Nov 2017 – Call for input, comments and public consultation

2018

- March 2018 – Tax challenges arising from the digitalisation interim report
- Oct 2018 – Policy note on tax and digitalisation

2019

- Feb 2019 – Discussion draft released
- March 2019 – Policy brief on tax and digitalisation and consultation
- May 2019 – Programme of work to develop a consensus solution

2019

- June 2019 – G20 leaders welcome the recent progress and endorse the work program developed by the Inclusive Framework
- Oct 2019 – Secretariat Proposal for “Unified Approach under Pillar One

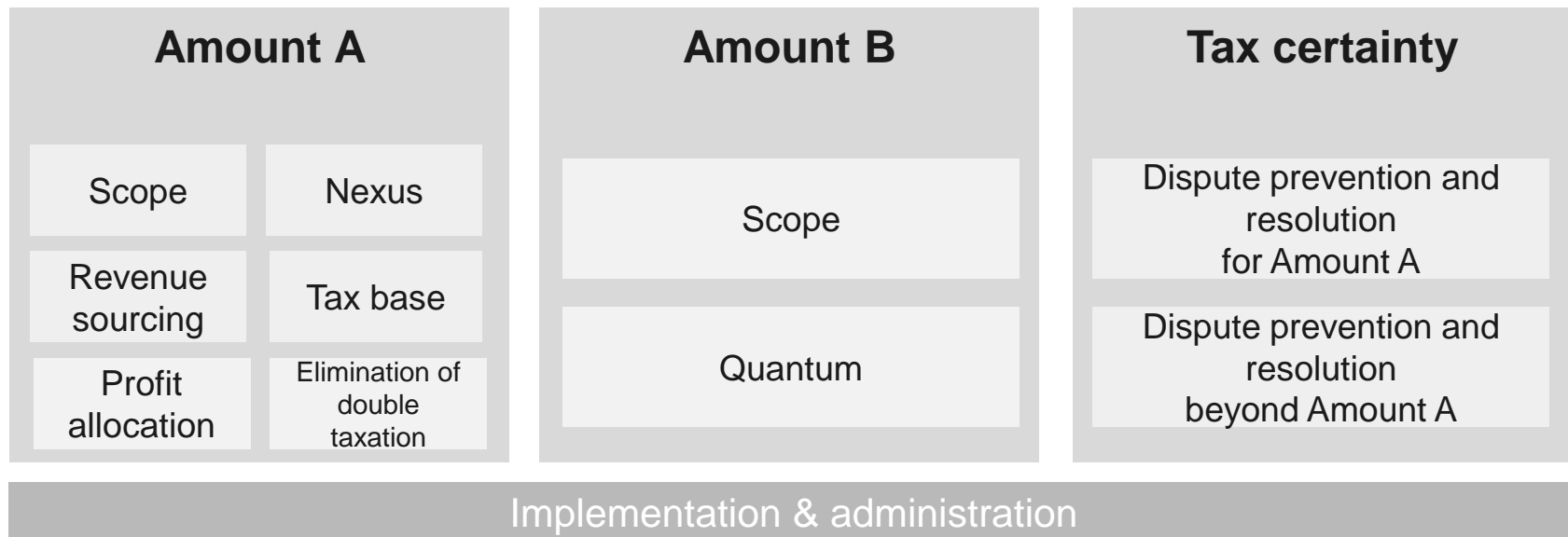
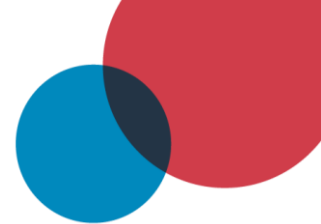
2020

- Feb 2020 – Preliminary economic analysis and impact assessment of Pillar One and Pillar Two
- Feb 2020 – OECD Secretary-General Report to the G20 Finance Ministers
- Oct 2020 – Pillar One and Pillar Two blueprints and launch of the public consultation
- Oct 2020 – Economic impact assessment of the Pillar One and Pillar Two proposals



Pillar 1

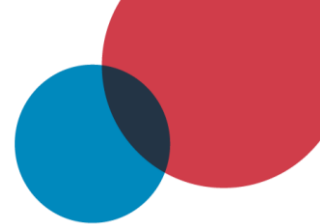
PILLAR ONE - BUILDING BLOCK





Amount A

SCOPE – ADS DEFINITION



AUTOMATED DIGITAL SERVICES is one where:

- ☐ The service is on the positive list; or
- ☐ The service is
 - Automated (i.e. once the system is set up the provision of the service to a particular user requires minimal human involvement on the part of the service provided) and
 - Digital (provided over the internet or an electronic network)
 - Is not on the negative list

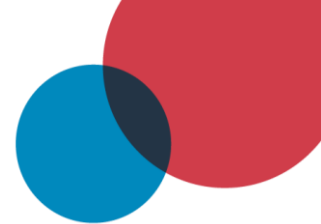
Positive list:

- Online advertising services
- Sale or other alienation of user data
- Online search engines
- Social media platform
- Online intermediation platform
- Digital content services
- Online gaming
- Standardised online teaching services
- Cloud computing services

Negative list:

- Customised professional services
- Customised online teaching services;
- Online sale of goods and services other than ADS
- Revenue from the sale of physical goods, irrespective of network connectivity (IOT)
- Services provided access to the internet or other electronic network

SCOPE – CFB DEFINITION



Consumer-facing business is:

- ❑ A business that supplies goods or services, directly or indirectly, that are of a type commonly sold to consumers, and/or licenses or otherwise exploits intangible property that is connected to the supply of such goods or services

Carve outs: Natural resources, Financial services, Infrastructure and general construction business and international air and shipping business

“Consumer”

- An individual whether or not the direct purchaser who acquires a good or services for personal purposes, rather than for commercial or professional purposes

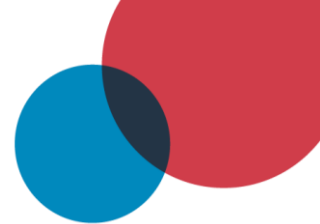
“Of a type commonly”

- The nature of the good or service is such that it is designed for sale to consumer

“Sold to”

- Includes sale, lease, license, rent or delivery, whether directly or indirectly (through a broker, agent, intermediary or representative)

NEXUS



The rationale: Intends to protect the interests of the smaller jurisdiction, and in particular of the developing economies and their desire to benefit from the new taxing right.

The nexus has been set as:

Market revenue threshold + (temporal requirement?)

The features: different for ADS and CFB in each market in each case below 5 million Euro

ATTENTION: for CFB a “+ factor” is needed → “physical presence test” (new PE definition) vs “deemed engagement provision” vs “A&P” test

ADS SOURCING RULE



THE SCOPE: the revenue sourcing rules determine the revenues that would be treated as deriving from a particular marketing jurisdiction. It would be relevant for Scope, Nexus and the Amount A formula

Different sourcing Rules for ADS and CFB

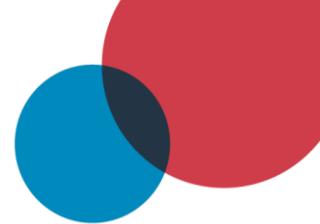
ADS

- Location of the viewer
- Location of the user
- Ordinary residence of the purchaser
- 50/50 split among the seller and purchaser (marketplace)

CFB

- Final delivery of the goods
- Retail storefront or final delivery address
- Enjoyment or use of the services

TAX BASE DETERMINATION



PBT measure based on consolidated financial accounts

Adjustment

- Income tax expenses
- Dividend income and gain or losses arising in connection with shares
- Expenses typically non-deductible (bribes, illegal payments)

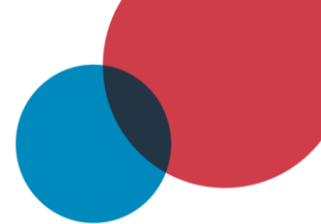
Segmentation

- Break down of revenue among ADS, CFB and out of scope activities
- Amount A computed at group level if the revenue falls below a threshold
- Segmentation hallmarks to determine whether a MNE is required to segment and may rely on disclosed accounting segments

Loss carry-forward

- Computed at group (segment) level (consolidated financial accounts + adjustment)
- Carry forward at group level (no allocation on jurisdictions)
- Transitional regime
- No interaction with domestic regime

PROFIT ALLOCATION



3 step approach

Profitability threshold

- PBT to revenue ratio (in %)
- Need to exactly define the concept of “revenue”

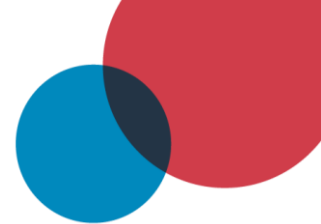
The reallocation percentage

- Only part of the non routine profit should be attributable to amount A

The allocation Key

- In scope revenue derived by each eligible market based on the sourcing rule
- Profit based vs profit margin approach

DOUBLE COUNTING



THE ISSUE: a market jurisdiction may get to tax the same item of residual profit twice; once through an existing taxable presence under TP rules, and again through Amount A.

Safe harbour

Fixed return for in
country MKT and
distribution activities

Amount A

In country profit of the MNE vs safe

In country profit
below the fixed ratio

Safe harbour not
applicable
(full amount A allocated)

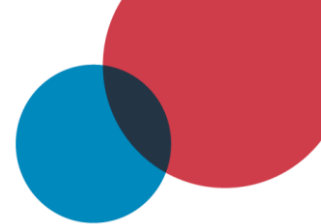
In country profit
below the fixed
return + Amount A

Residual Amount A
allocated

In country profit
above the fixed
return + Amount A

NO residual amount A
to allocate

ELIMINATION OF DOUBLE TAXATION



“Paying Entity”: the company within a group that should relieve the double taxation because earns residual profit in connection with a specific market jurisdiction 4 step process

Activity test

- Identify the entity that make material and sustained contribution to groups' residual profit
- Qualitative assessment based on FAR (master file local file)

Profitability test

- Ensure that the paying entity has the capacity to bear Amount A tax liability
- It should earn residual profit relevant for Amount A relief

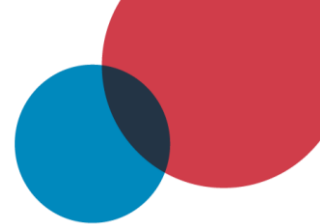
Market connection priority test

- Connection among the activity performed by the entity(s) and the relevant market jurisdiction(s)

Pro rata allocation

- Formulaic approach to allocate the double taxation relief to entity other than the “paying entity”

TRANSFER PRICING ADJUSTMENT



The Issue: transfer pricing adjustment may increase/decrease the profit on a group entity thus modifying its profitability. The TP corresponding adjustment therefore may have an impact on the qualification of the entity as “paying entity” (profitability test)

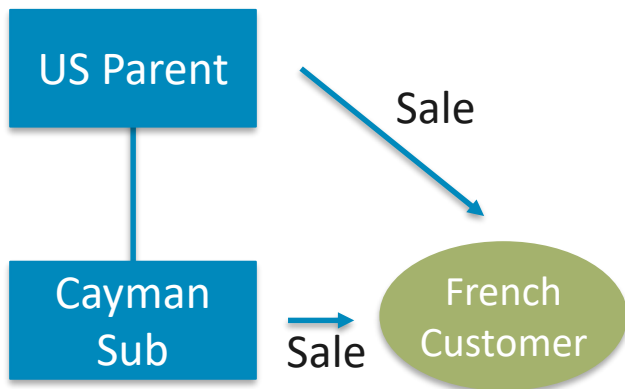
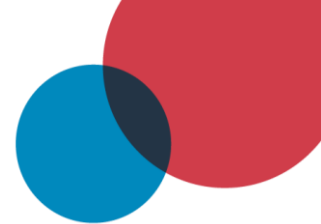
SOLUTIONS

Take into consideration only
“material adjustment”
(amount to be defined)

Changes in profitability that
may have an impact on the
future allocation of Amount A
rather than have a retroactive
effect

ATTENTION!: when an MNE group meets the marketing and distribution profits safe harbour in a given jurisdiction, this should not prevent a therein resident entity to be treated as “paying entity” for other jurisdictions.

US DOUBLE TAXATION PROBLEM

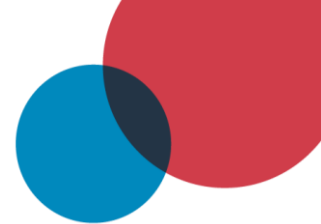


- ❖ US uses credits to reduce double taxation
- ❖ Newly proposed regulations set forth new **jurisdictional nexus** requirement for a foreign tax to be creditable:
 - Income subject to tax must be based on local activities (functions/assets/risks), not local customers or users
 - For services, income must be sourced based on place of performance, not location of service recipient
- ❖ Jurisdictional nexus seems to deny credits, not only for DSTs, but also Amount A
- ❖ Regulations acknowledge changes if US included in Pillar 1 agreement



Amount B

AMOUNT B



The SCOPE: to standardise the remuneration of a related party distributor that performed “baseline marketing and distribution activities” in a manner that is aligned with ALP

Qualitative indicators

Positive list:

- Routine MKT and distribution activities
- No material assets
- Limited risk

Negative list:

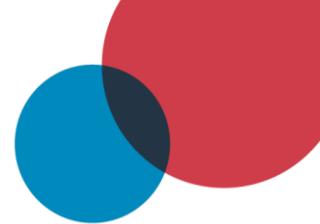
- DEMPE functions
- Strategic MKT and distribution activities
- Economically significant risk

Quantitative indicators

- Setting of quantitative thresholds (to be defined) that are closely linked to typical MKT and distribution activities
- If the thresholds are exceeded most likely the distribution entity performs more than “baseline MKT and distribution activities” that are enumerated in the negative list

ATTENTION!: difficulties in applying the Amount B to multifunctional entities that performed other activities such as R&D manufacturing, back office. Amount B does not apply to commissionaires or sale agents. Very limited scope.

AMOUNT B – QUANTUM



Structure

- Fixed return based on TNMM
- Return on sales as appropriate profit level indicator
- Possible differentiation by region/industry/functional intensity

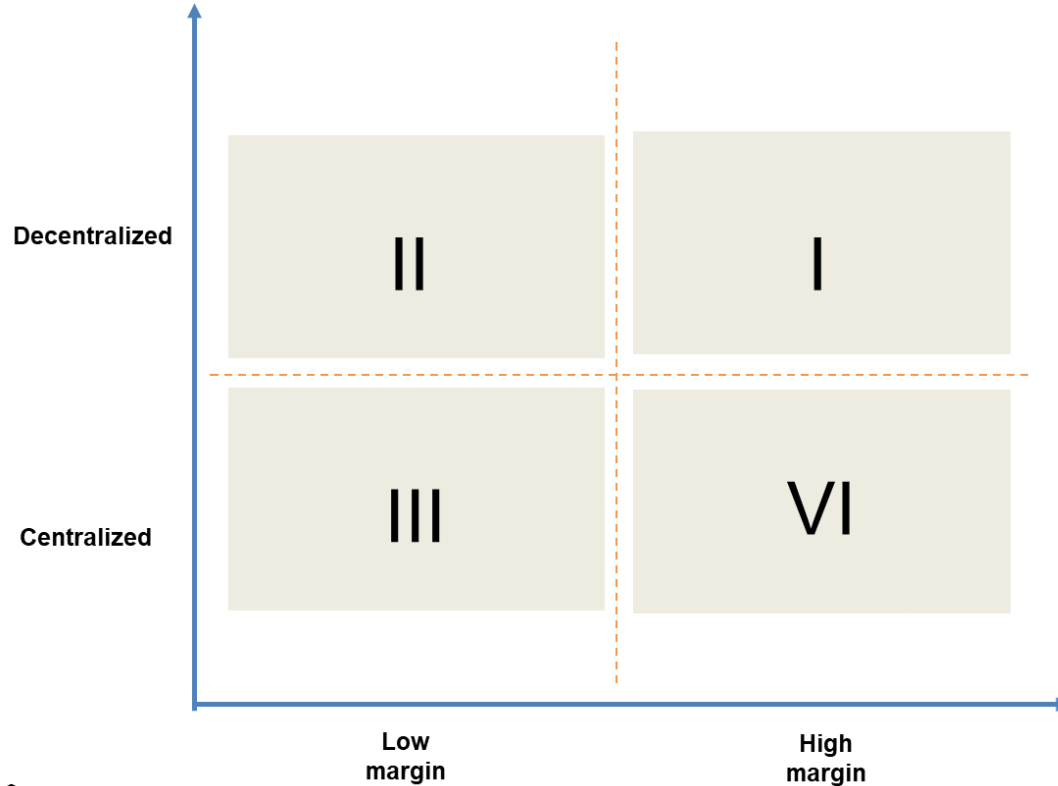
Implementation

- Implementation in the domestic law
- Where there are no treaties a new treaty based dispute resolution relationship may be required
- Guidance to accompany domestic legislation and treaty provision may be required
- Possible extension to commissionaire and sales agent structures



Impact Business Models

IMPACT BUSINESS MODELS





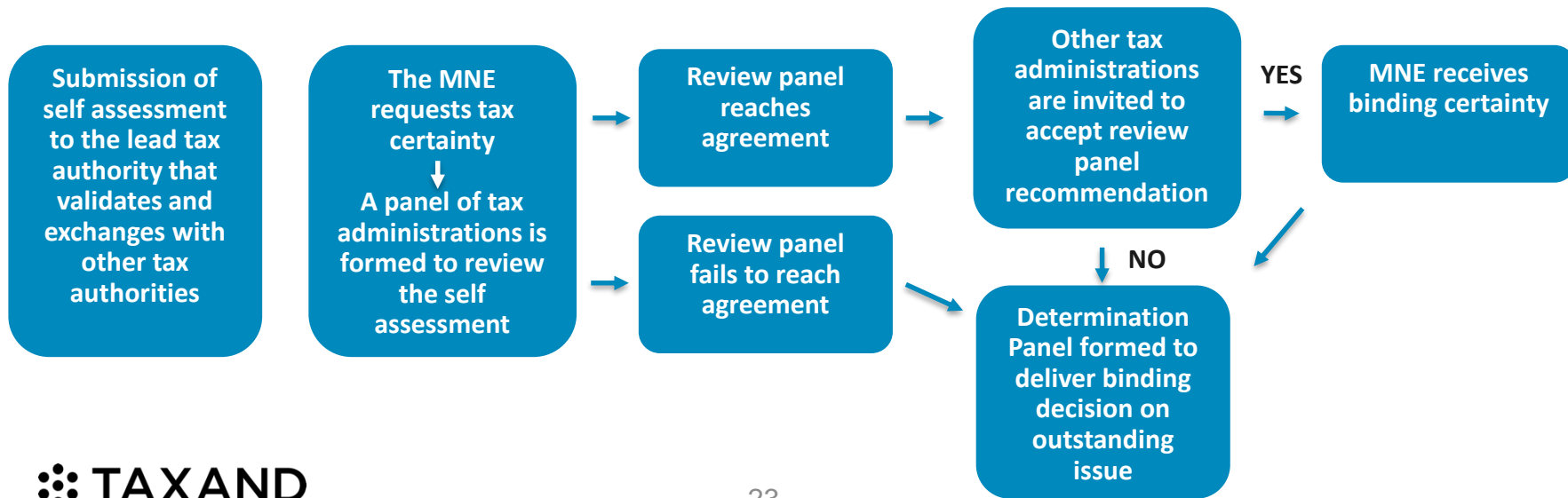
Tax Certainty

TAX CERTAINTY – AMOUNT A



The Issue: impractical if not impossible to allow all affected tax administrations to assess and audit an MNE's calculation and allocation of Amount A

NEW PROCESS REQUIRED



TAX CERTAINTY – BEYOND AMOUNT A



THE ISSUE: some Inclusive Framework members strongly support a mandatory binding dispute resolution mechanism, while others consider that disputes unrelated to Amount A should be resolved through the existing mechanism (MAP + non binding administrative tools)

POSSIBLE SOLUTION

**MNEs in scope of
Amount A**

Innovative
mandatory and
binding resolution
process for TP and
PE matters

Other taxpayers

Improving of the
existing dispute
resolution
procedures
including MAP

Amount B

Mandate binding
dispute resolution as
a last resort method
if the existing
procedures fail

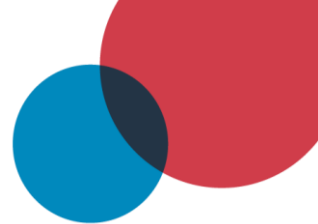
**Developing
economies**

Commit to an
elective binding
dispute resolution
mechanism if
unable to resolve a
MAP case in a
defined period



Pillar 2

INTRODUCTION – PILLAR 2 BUILDING BLOCS



1. Income Inclusion Rule (IIR)

- Broad CFC rule
- Supplemented by switch-over regulations

2. Untertaxed Payments Rule (UTP)

- Limitation to (partially) deduct business expenses

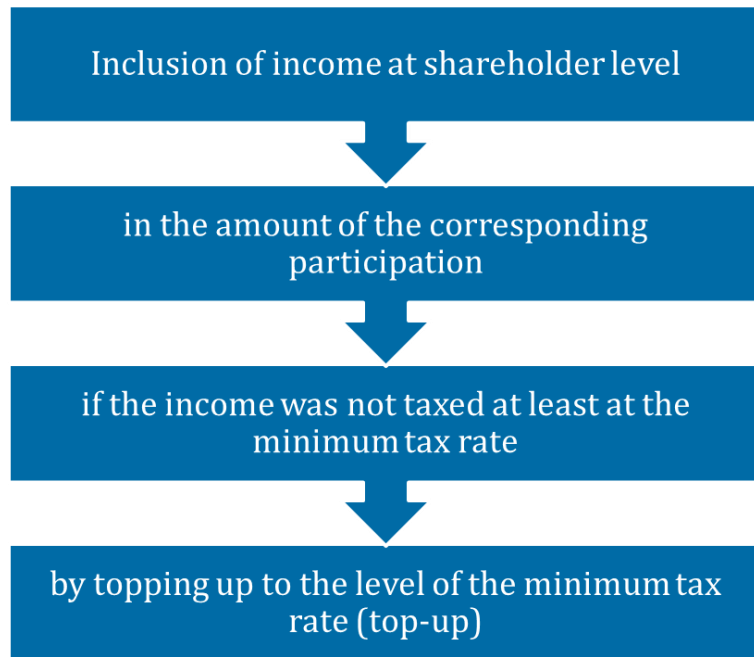
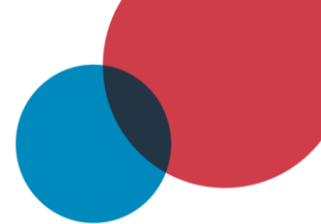
3. Subject to Tax Rule (STTR)

- Subject-to-tax-regulation (STTR) – withholding tax to protect local tax base



A. Income Inclusion Rule (IIR)

INCOME INCLUSION RULE (IRR)



Approach

- Scope of application - qualitative and quantitative
- Jurisdictional blending - challenges with transparent legal entities and operating sites
- Determination of the effective tax rate
 - Assessment basis
 - Covered taxes
 - Losses and temporary differences
- Carve-outs for substance
- Rule order within the IIR and calculation of calculation of top-up tax

SCOPE AND JURISDICTIONAL BLENDING



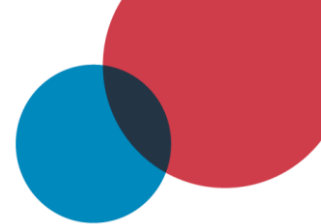
Scope: International Companies

- Definition of MNE from Action Point 13 - CbC Reporting - Final Report as source for interpretation
 - a company consists of at least two legal entities in two different countries or of one legal entity and a permanent establishment in another country
 - Parent company (UPE) is the company that directly or indirectly holds an interest in the other business units to such an extent that it must/should report the sales of these units in consolidated financial statements
- Exceptions for investment funds, pension funds, state investment funds, public law entities, international organizations and non-profit
- CbC threshold of EUR 750 million total sales based on total sales of previous year
- Work on abuse regulations to avoid artificial fragmentation

Jurisdictional blending

- Effective minimum tax burden is determined by looking at taxes paid per jurisdiction
 - Determination of all profits attributable to one jurisdiction (transactions between affiliated companies or with permanent establishments are to be taken into account except if they take place between legal entities/units within the same jurisdiction)
 - Determination of covered taxes (all income taxes including CFC and WHT as well as local taxes such as business tax; no taxes on gross income like VAT and DSTs)

DETERMINATION OF EFFECTIVE TAX



Determination of tax base

- Based on recognized accounting principles (IFRS, certain domestic GAAPs) at the UPE level, starting with profit (or loss) before tax
- Adjustments for tax purposes, e.g. no recognition of dividends and capital gains, no deduction of taxes, fines, bribes, etc.

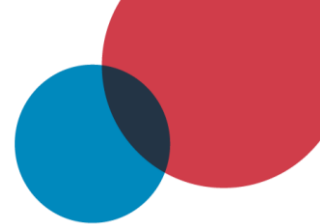
Allocation of income and taxes paid

- Income allocation is regularly determined by residence in accordance with Art. 4 DBA-MA (place of organisation, management) or by profit distribution principles for permanent establishments
- Qualification conflicts regarding transparent legal entities
- Application of the tie-breaker rules for dual residency
- **Consideration of Amount A under Pillar 1**

Losses

- Losses carried forward (even before the introduction of the GloBE regulations) should generally be taken into account
- No time limit on loss carryforwards under GloBE (shadow accounts)
- Set off only in jurisdiction in which losses originate (but applicable to all entities in one jurisdiction)
- Consideration only if minimum taxation was not reached

VOLATILITY AND CARVE-OUTS FOR SUBSTANCE



Volatility – setting off temporary differences

- IIR tax credit in cases where top-up tax was paid and the tax burden exceeds the minimum tax in subsequent years
- IIR tax credits can be used across borders (partial global blending)
- Local tax imputation carryforward - jurisdiction-specific only
- Subsequent adjustments e.g. due to BP have to be taken into account

Payroll costs and return on tangible assets

- Payroll costs, including wages and social security costs
- Allocation to jurisdiction where employees exercise their works, even if costs are borne in another jurisdiction
- Notional depreciation expense for or consumption of property, plant and equipment
- No consideration for expenditures for R&D, Action point 5 regimes or other substance carve-outs

Allowance in form of a fixed percentage on the above mentioned sizes

- Fixed percentage general or industry-specific
- TNMM or
- Profit comparison method
- No carry forward for carve-out amounts

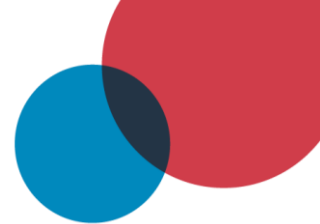
POSSIBLE SIMPLIFICATIONS



Four approaches

- Country-by-country reporting ETR safe-harbour with high effective tax burden
- De minimis profit exclusion
- Multi-year effect on single ETR calculation
- Tax administration guidance

CO-EXISTENCE WITH US “GILTI” REGIME

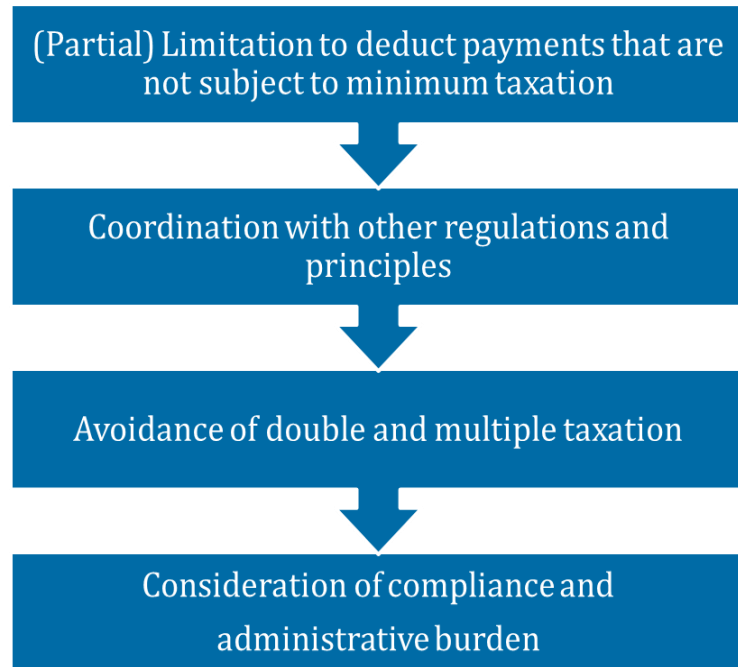


- ❖ US law imposes a 10.5% minimum tax on GILTI income
- ❖ “GILTI” is a US shareholder’s pro rata portion of aggregate CFC income (not top-up tax) in excess of a 10% return on tangible assets
- ❖ Pillar 2 Blueprint would treat GILTI as a qualified IIR
- ❖ President-Elect Biden proposes to broaden GILTI tax:
 - Double the effective tax rate from 10.5% to 21%
 - Eliminate the exemption for tangible assets
 - Compute GILTI and its foreign tax credits on a country-by-country basis (similar to GloBE)
- ❖ President-Elect Biden may not have political support for this proposal



B. Undertaxed Payment Rule (UTP)

UNDERTAXED PAYMENT RULE (UTP)



Approach

- Priority of application of the IIR
- Determination of the effective tax burden as under IIR
- Calculation of UTP limitation of deductions
- Allocation of scope of UTP

RULE ORDER, SCOPE AND EXTENT



Priority of IIR

- UTP does not apply if the paying entity is controlled by a UPE (or other entity) located in a country with a robust IIR
- If the IIR is applied at the level of a subholding, the scope of the IIR is extended to non-controlling entities - income is included in the amount of the actual participation (example 6.3.1)
- Application of UTP only if no inclusion in IIR is possible

Determination of scope

- Rule 1: Entities or units that make payments directly to a low-taxed entity
- Rule 2: Entities or units that indirectly finance payments to a low-taxed entity by calculating the net intra-group expenditure

Determination of extent

- For the application of the first rule, the direct payments of an entity to a low-taxed entity are set in proportion to all payments from affiliates to that low-taxed entity
- For the application of the 2nd rule, the units with a net intra-group expenditure are identified and the top-up tax is allocated pro rata based on the ratio of intercompany income and deductible expenses (see example 7.4.3.B)



**C. Subject to
Tax Rule
(STTR)**

SUBJECT TO TAX RULE (STTR)



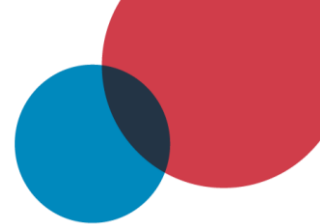
- Introduction of taxation rights in national law and corresponding adjustments in double taxation agreements

- allow the levying of withholding tax

- if a payment is not subject to minimum taxation at the recipient

Approach and open questions

- No priority of application of the IIR
- Calculation of the minimum effective tax within the UTP
- Allocation of tax burden

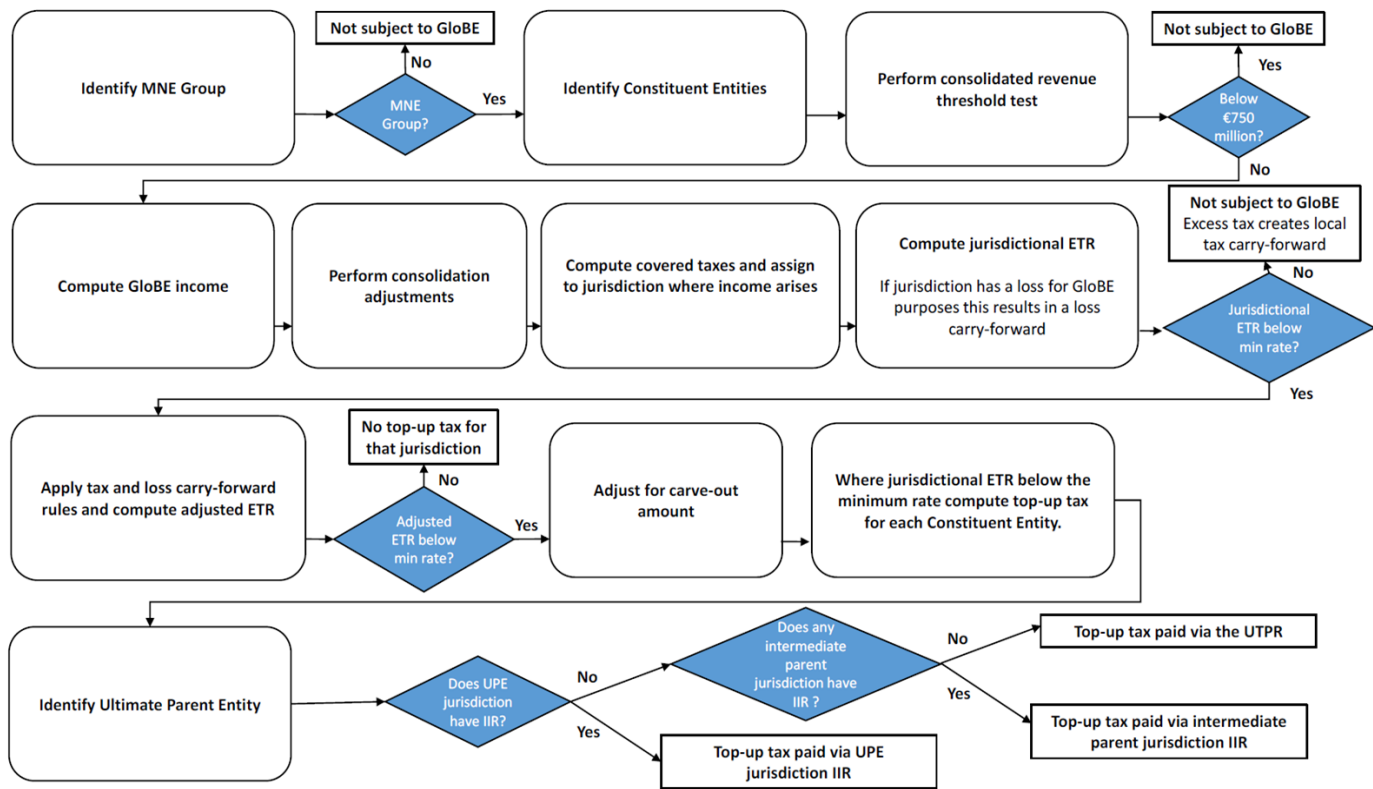


Protection of local tax base

- No limitation to EUR 750 million required (under discussion)
- Payment to affiliated companies (or permanent establishments)
 - whose income in the recipient state is subject to a nominal tax rate below the minimum tax rate to be determined
 - for certain categories of payments (e.g. interest and royalties, but also franchise payments, insurance premiums, remuneration for marketing or other internal services) that are not significantly based on the functionality of the payee
- Potential exception for payments that result in a small margin for the recipient
- Minimum threshold (safe harbour for low amounts of intercompany payments - fixed amount or ratio to third-party payments)
- Authorization to withhold taxes on payments!



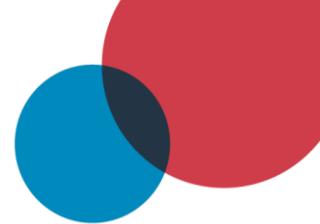
D. GloBE Flowchart





D. Pillar Two Opportunities

PILLAR TWO OPPORTUNITIES



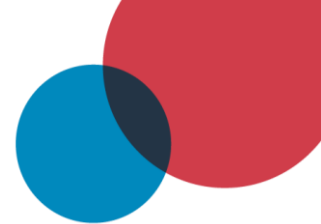
Purge of domestic law – abolition of local anti abuse rules

- Abolition or limitation of domestic CfC rules to extreme fraudulent cases to avoid extensive need for shadow accounting
- Abolition or limitation of provisions targeting double dip structures [§ 4i German Income Tax Act, § 14 Abs. 3 Corporate Income Tax Act, US Internal Revenue Code §§245A(e) and 267A]
- Domestic interest and license barrier rules could be substituted by STTR
- Simplification of procedures that include a main benefit test by lowering requirements
- Limit the operation of the US Base Erosion and Anti-abuse Tax (BEAT) in respect of payments to entities that are subject to the IIR

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E. Next Steps

NEXT STEPS



14 December 2020 – deadline for written submissions to the public hearing



January 2021 - virtual public hearing



By mid 2021 - implementation of further suggestions and development of technical issues



Final agreement?



Q & A

An abstract graphic consisting of four overlapping circles. A large yellow circle is on the left. To its right is a blue circle. Below the yellow circle is a red circle. The blue and red circles overlap each other, and their intersection with the yellow circle creates darker shades of green and dark blue. The text "SPEAKER PROFILES" is centered within the yellow circle in white, bold, sans-serif capital letters.

SPEAKER PROFILES

SPEAKER PROFILE



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Nadia is partner for international tax with Flick Gocke Schaumburg in Hamburg and Düsseldorf. She is a trained lawyer and tax advisor and advises clients in all aspects of national and international tax law with a focus of cross-border restructuring, pre- and post-merger integration and provides support in domestic and international tax audits.

During her secondment to the tax department of the OECD Nadia led the Joint Audit project 2018/2019 and was involved in the work on BEPS Pillar two.

Nadia lectures classes at the Master's program at the University of Cologne on procedural law. She is a member of the International Fiscal Association and the Steuerrechtswissenschaftlichen Vereinigung Heidelberg e.V.

SPEAKER PROFILE



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Jimmie is a partner with Taxand Netherlands and a core member of the global Taxand Energy service line and Transfer Pricing service line.

Jimmie specialises in the energy sector, covering aspects relating to oil and gas, suppliers and contractors, electricity, alternative resources and renewables. He advises on corporate tax issues and heads the Dutch Transfer Pricing practice, providing functional and economic analysis, profit allocation and advance pricing arrangements with the tax authorities. He also assists with domestic and international matters such as tax control frameworks, setting up and analysing new businesses and joint ventures, and optimising existing business structures.

He is a member of the Dutch Bar, the Dutch Associations of Tax Advisors, and the International Fiscal Association. He is also a representative for the Dutch Association of Suppliers in the Oil and Gas Industry, and a member of the Dutch Association of Energy Law and Society of Petroleum Engineers.

SPEAKER PROFILE



Paolo Ruggiero

LED Taxand Italy

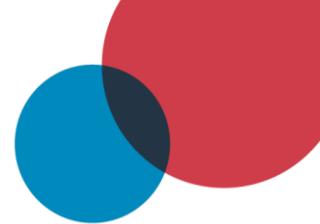
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Paolo is a Partner at LED Taxand which is Taxand Italy. He has a degree in Economics (università Commerciale Luigi Bocconi Milano) and an advanced LL.M in International Taxation from the Leiden University (NL).

He began his career in 2000 in a Milan boutique tax firm (Studio Mayr). Later he moved to Italian tax firm, Di Tanno e Associati and in 2008 and Fantozzi & Associati in 2013, where he became a Junior Partner. Paolo joined LED Taxand in January 2018.

Paolo has more than 15 years of experience that he gained particularly in International taxation. He mainly focuses on private equity and real estate transactions, as well as international tax planning merger and acquisitions. He is also the author of several publications on international tax matters.

SPEAKER PROFILE



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Chris Kotarba (“Chris K”) is a Managing Director with Alvarez & Marsal Taxand in San Jose. He specialises in international tax and his primary areas of concentration are planning, structuring, and transfer pricing, both outbound and inbound, for multinational companies of all sizes. He has worked with clients across various industries, including technology (both software and hardware), pharma, medical devices, and financial services.

Prior to joining A&M, Chris K spent eight years as an attorney with DLA Piper in Palo Alto. He led over a dozen global expansion and other corporate restructuring projects as well as developed a focus for US companies with Asian operations and closed a high-profile joint venture in China. In addition, he helped companies onshore their IP to the US, both permanently and temporarily. He was also briefly seconded to DLA Piper’s Hong Kong office, where he worked with Asian companies expanding to the US.