Base Erosion and Profit Shifting (“BEPS”) 2.0

13 October, 2019

On 9 October 2019, the Organization for Economic Cooperation and Development (“OECD”) published a public consultation document for external stakeholders to provide input relating to the “Unified Approach” for profit allocation rules under Pillar One of the BEPS 2.0 workplan. BEPS 2.0 which is the buzzword for international tax framework reform, is OECD’s further work on BEPS Action 1 on addressing the tax challenges raised by digitalisation.

In a nutshell, BEPS 2.0 sets a scope for the companies that would be covered by the new proposed rules, define how much business they must do in a country (in a form of domestic sales where customers or users are located rather than physical business presence) to be taxable there, and finally determine how much profit can be taxed there, which will no longer be based on applying arm’s length principle to tax profits attributable to economic activity and substance. This creates a shift from the current framework of allocating profits and taxing value where it is created, moving instead toward taxation where value is exploited or consumed.

It is a common misconception that the proposals contemplated under BEPS 2.0 affect only digital businesses. The proposals are wide-ranging and will affect Multinational Enterprises (“MNEs”) across industries, without regard to their level of engagement in the digital economy.

The proposals under the BEPS 2.0 encompasses two pillars which are inter-linked:

Pillar One: Revised Profit Allocation and Nexus Rules seeks to allocate more taxing rights to the jurisdiction where the customers or users are located and to expand the nexus rules in the absence of physical presence in a market. The OECD public consultation document discusses three proposals for a global consensus in order to achieve the “Unified Approach”, namely the user participation proposal, the marketing intangibles proposal and the significant economic presence proposal. The developments of these will be discussed in separate alerts as we progress in the coming weeks.

Pillar Two: Global Anti-base Erosion Proposal involves two sets of interlocking rules (i.e. income inclusion rule and a tax on base eroding payments) that are intended to work together to counteract risks of BEPS from structures that continue to shift profits to low or no-tax entities. It provides countries with a right to “tax back” where other jurisdictions have not exercised their primary taxing rights or a payment is otherwise subject to low levels of effective taxation. Pillar Two is intended to ensure that a minimum level of tax is imposed on all business income. As such, it is expected to put significant pressure on no or only nominal tax jurisdictions and preferential tax regimes.

BEPS 2.0 proposals are expected to have impact on Bahrain, as country and on companies doing business in Bahrain. Depending on the size of user-facing activities in Bahrain, Bahrain could lose out on potential significant tax revenue that could be collected under the profit allocation rules proposed under “Pillar One” of the BEPS 2.0, not unless Bahrain introduces a wider corporate income tax regime. In addition, the proposal under “Pillar Two” of the BEPS 2.0 would ultimately challenge and disrupt MNE’s international tax planning, the objective of which, is to minimize the effective tax rate of the MNE.

Taxpayers should to start revisiting their global structure for assessing, simulating and evaluating the potential impact of these far-reaching changes, sooner rather than later.

You may reach out to our local team of tax experts should you need any clarifications or assistance with regard to your tax affairs be it domestic or cross-border.

For more information, please contact us.

Philippe Norré
Partner
T: +973 17201400
E: pnorre@kpmg.com
KPMG Fakhro

Ali AlMahroos
Senior Manager
T: +973 17201459
E: aalmahroos@kpmg.com
KPMG Fakhro

Nik Faiziman Affandi
Manager
T: +973 17201457
E: naffandi@kpmg.com
KPMG Fakhro