



KPMG report:  
Public consultation  
document on  
Pillar One: Draft  
model rules for  
nexus and  
revenue sourcing

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## Introduction

Following the political agreement reached in October 2021 (the [Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy](#) [PDF 204 KB] or the “October agreement”) by 137 members of the OECD/G20 Inclusive Framework on BEPS, the Organisation for Economic Cooperation and Development (OECD) announced in December 2021 a schedule for public consultations on various aspects of its two-pillar plan to address the tax challenges arising from digitalization and globalization of the economy. Read [TaxNewsFlash](#)

The OECD on 4 February 2022 launched the public consultation by releasing for public comment the first building block of Amount A – [Draft Rules for Nexus and Revenue Sourcing](#) (“Draft Model Rules”).

Comments on the draft are due before 18 February 2022.

The Draft Model Rules are a “working version,” and do not yet reflect Inclusive Framework’s consensus on their substance. Rather, the release is described as reflecting “consensus . . . as a procedural matter that public comments should be sought at this time.”

The public consultation document is structured as a general legislative article that articulates the nexus rules and the sourcing principles at a high level, followed by a schedule that sets out detailed rules for assigning each specified category of revenue to market jurisdictions. The intent of the rules is to source revenue to end-market jurisdictions where goods or services are used or consumed. Both the general article as well as the schedule are intended to be binding on implementing jurisdictions.

A commentary is expected to provide additional guidance on the rules, and footnotes in the draft identify issues to be addressed in the commentary.

## Background and overview

The revenue-sourcing rules are an important building block of Pillar One because they would determine whether an in-scope multinational enterprise (“MNE”) has sufficient nexus to a participating jurisdiction for the jurisdiction to be entitled to any Amount A allocation and, if so, its share of Amount A.

The October agreement provided that an MNE has sufficient nexus to a market jurisdiction if the MNE derives at least €1 million in revenue, or for a jurisdiction with annual GDP less than €40 billion, at least €250,000. The Draft Model Rules reflect this agreement and further explain that the revenue threshold must be satisfied for a period, and if the period is not equal to 12 months, the thresholds would be adjusted proportionally to correspond with the length of the period. These special nexus rules would apply only for purposes of Amount A.

The Draft Model Rules on sourcing revenue would apply to determine whether nexus has been satisfied. Amount A would then be allocated to jurisdictions with nexus using a revenue-based allocation key.

The OECD’s October 2020 [Tax Challenges Arising from Digitalisation – Report on Pillar One Blueprint - Inclusive Framework on BEPS](#) [PDF 4 MB] (“2020 Blueprint”) provided a sourcing principle, or rule, for each category of revenue generated from automated digital services (“ADS”) and consumer facing businesses (“CFB”), supported by a range of specific indicators for applying the sourcing rule that

were subject to a defined hierarchy. In determining which indicator to apply, the 2020 Blueprint generally would have required an MNE to take reasonable steps to obtain the information required by the first indicator before it could move on to the next indicator, which in some cases meant that the MNE would have to change its contractual arrangement with customers to obtain the information.

The 2020 Blueprint included an example for the sale of finished goods to consumers through an independent distributor that stated “the MNE is expected to take reasonable steps to seek a change in the contractual arrangement with the distributor, which would require the distributor to report information on the aggregate number and type of products sold to each jurisdiction (no sensitive commercial information such as pricing information or specific customer addressed would be required).” Further, the 2020 Blueprint acknowledged that these contractual changes may take time to negotiate and come at a cost to the MNE.

The 2020 Blueprint specified that an MNE would not be permitted to use information that is already available, such as market research for management reporting, unless the MNE could demonstrate that it had taken these “reasonable steps” and was unsuccessful.

The expanded scope of Pillar One, as reflected in the October agreement, required the IF to design sourcing rules for categories of revenue not previously in scope, such as for business-to-business (“B2B”) sales of components and B2B services. In addition, MNEs objected to the approach in the 2020 Blueprint as not reflecting the reality that end-user information often would not be available to MNEs, including for sales through independent distributors and B2B services, and that it was not commercially reasonable to require MNEs to collect this information from their customers. In addition, MNEs criticized the hierarchy of indicators as overly prescriptive and burdensome, even in cases when transaction-level data is available.

The [OECD’s statement](#) accompanying the release of the Draft Model Rules indicates an intentional departure from the more prescriptive approach in the 2020 Blueprint “to allow MNEs to, as much as possible, draw on information that they are already collecting and using as they operate their business.” Accordingly, while the Draft Model Rules retain the same basic architecture as the 2020 Blueprint, they make significant changes by no longer prescribing a defined hierarchy for the acceptable indicators and, in some cases, requiring revenue to be sourced using specified allocation keys when, after taking “reasonable steps,” an MNE concludes that no “Reliable Indicators” are available.

## KPMG observation

While the Draft Model Rules eliminate the strict hierarchy of indicators from the 2020 Blueprint, there will be many straightforward cases when it will be obvious which indicator should be applied, such as when an MNE delivers goods directly to a customer or receives reporting on sales to final customers from a distributor. However, as discussed below, it is unclear what types of alternative indicators may be used if an identified indicator is not available. Moreover, while the rules acknowledge that information about end-market sales may not be readily available for certain categories of revenue (e.g., sales through third-party distributors, sales of components, certain B2B services, and certain IP), the rules generally require an MNE to take “reasonable steps” to identify a Reliable Indicator before resorting to one of the specified allocation keys. As discussed further below, it is not at all clear what is expected in terms of attempts by an in-scope MNE to obtain information from their B2B customers in these circumstances.

# General revenue sourcing rules

## Overview

The Draft Model Rules on revenue sourcing retain many of the features of the 2020 Blueprint and expand the guidance to address categories of transactions not previously in scope. Like the 2020 Blueprint, the Draft Model Rules provide a sourcing principle for each type of revenue and a list of specific indicators to apply the principle to identify the jurisdiction of source. However, unlike the 2020 Blueprint, the Draft Model Rules do not impose a hierarchy among the indicators, allow MNEs to use other indicators not specifically listed, and introduce new allocation keys that may be used under certain conditions.

## Transaction-by-transaction approach requires categorizing each transaction

An in-scope MNE must source all revenue, generally on a transaction-by-transaction basis, according to the category of revenue earned from the transaction. The Draft Model Rules provide revenue sourcing guidance specific to the following categories of transactions, several of which are further subdivided:

- Sales of finished goods
- Sales of digital goods
- Sales of components
- The provision of services
- Transactions for the licensing, sale, or other alienation of intangible property or user data
- Transactions involving real property
- Government grants, or
- A catchall for non-customer revenue

Several of these categories are further subdivided. Several new rules have been provided to address ambiguity regarding the categorization of a transaction:

- Transactions containing elements of multiple categories are sourced according to their predominant character based on the substance of the transaction.
- An MNE has the option of sourcing revenue from “Supplementary Transactions” that are incidental to a “Main Transaction” based on the revenue-sourcing rule applicable to the Main Transaction.
- Noncustomer revenue (such as interest earned other than in a lending business) is sourced in proportion to the other revenue for which sourcing rules are provided.

## “Reliable Indicators”

Once a transaction has been categorized, revenue is generally required to be sourced according to one of the “Reliable Indicators” identified for the category. As discussed above, a significant difference between the 2020 Blueprint and the Draft Model Rules is that, while the 2020 Blueprint specified a strict hierarchy for all indicators, the Draft Model Rules allow an MNE to use any of the listed Reliable Indicators, as well as an unlisted indicator that produces results consistent with the relevant sourcing rule and meets one of the listed reliability tests.

An indicator is considered reliable if:

- The MNE relies on the indicator for commercial purposes or to fulfill legal, regulatory or other related obligations,
- The indicator is verified by information provided by a third party that collected the information pursuant to its own commercial, legal, regulatory or other obligations,
- The indicator and one or more other indicators included in the sourcing rule identify the same jurisdiction, or
- The indicator is verified in another manner that is functionally equivalent to the above tests.

Indicators must be used consistently. The Draft Model Rules indicate that the commentary will provide additional guidance on what is meant by “consistently.”

### KPMG observation

It is not clear what is meant by “functionally equivalent” in the fourth prong, given that the first two tests are similar in that they appear premised on an assumption that indicators with a non-tax purpose are reliable, while the third standard, requiring that another listed indicator provides the same answer, appears premised on an assumption that an indicator is more reliable if its results are corroborated by a second indicator. In addition, the need for a non-tax use as a prerequisite to relying on a single indicator is surprising, given that the rules will in many situations require MNEs to take reasonable steps to collect new information from B2B customers purely for tax purposes, and the MNE will have no reason to know how its customers use that information. Thus, it is unclear whether the reliability test would be satisfied if the MNE modified its business to gain access to an indicator in order to comply with the sourcing rules.

### Allocation keys

To ensure that an MNE sources all revenue for purposes of Amount A, the Draft Model Rules allow revenue for certain categories of transactions to be sourced according to specified allocation keys, as a backstop to the Reliable Indicators discussed above.

In addition, the rules only specifically provide for the use of an allocation key for subcategories of revenue when MNEs may not be able to obtain information regarding where goods or services are ultimately consumed. Thus, the revenue-sourcing rules for an MNE’s direct sales of finished goods to final customers do not include an allocation key. Moreover, and quite notably, an MNE generally can resort to an allocation only if it has taken “reasonable steps” to identify a Reliable Indicator and concluded that no Reliable Indicator is available. The one exception to this requirement is that an allocation key is the sole method of allocating revenue for transportation services. However, as discussed below, if the MNE takes reasonable steps and concludes that no Reliable Indicator is available, allocation keys may be used even where not specifically included in the relevant rule.

Footnote 12 to the Draft Model Rules states that the commentary will provide further guidance on what would be regarded as “reasonable steps” as follows:

*This [guidance] will be tailored and proportionate to the nature of the transaction in question. For example, it is acknowledged that obtaining reliable information on the revenue source for Components, certain B2B services and certain IP will be difficult, because of the commercial operation of those businesses. For example, given that they do not directly transact with the customer in the revenue source jurisdiction as defined in these rule [sic], the Covered Group may be unable to obtain reliable indicators in any circumstance, such as by virtue of competition or*

*privacy reasons. In these cases, the “reasonable steps” must reflect that commercial reality and not impose undue burdens.*

## KPMG observation

While footnote 12 states that future guidance on “reasonable steps” will take into account commercial realities and not impose undue burdens, the cited examples of information not being obtainable due to competition or privacy reasons could imply that, where such concerns are not barriers, “reasonable steps” would require an MNE to request information from its B2B customers.

When permitted, the Draft Model Rules provide specific allocation keys for certain transactions and a “Global Allocation Key” that may be used in the absence of a specific allocation key. The Global Allocation Key would deem revenue to arise in each jurisdiction in proportion to its share of final consumption expenditure (as published by the [United Nations Conference on Trade and Development](#)), except when a jurisdiction is excluded by reason of the “Knock-out Rule.” The Draft Model rules bracket the reference to consumption expenditure and note that other proxies such as GDP are still under consideration for revenue from components and B2B services sold through a reseller.

The Knock-out Rule requires an MNE to eliminate a jurisdiction from the allocation key if the MNE can reasonably assume that revenue did not arise in the jurisdiction. A footnote to the Draft Model Rules indicates that the Knock-out Rule would apply if the MNE has actual knowledge that the good or service is not provided to certain jurisdictions, such as when there is a trade embargo, or the MNE has actual knowledge that the good or service is ultimately consumed in a specific set of jurisdictions, such as when the contract specifies the jurisdictions where the good or service may be used or the customer provides information about the jurisdictions of use.

## KPMG observation

The Draft Model Rules are ambiguous on the degree of certainty an MNE must have in applying the Knock-out rule. While the rule is described as allowing the MNE to make reasonable assumptions, the examples of the scenarios in which the Knock-out Rule would apply indicate that some degree of actual knowledge is required to support the assumption. Hopefully, this will be clarified in the commentary.

Notwithstanding the above, an allocation key must be used when an MNE:

- Used an indicator that is determined not to be a Reliable Indicator by the MNE’s lead tax administration or during the Amount A certainty process and the MNE demonstrates that it does not have any information available to apply a Reliable Indicator;
- Demonstrates it does not have information available to apply a Reliable Indicator and no Allocation Key is provided in the relevant sourcing rule; or
- Did not take reasonable steps to use a Reliable Indicator.

## KPMG observation

The Draft Model Rules appear to require the use of an allocation key for MNEs that do not take reasonable steps to identify a Reliable Indicator, even if the failure is intentional. While this result

would be contrary to the policy objective of the revenue sourcing rules, there would seem to be no alternative in this case. The Draft Model Rules refer to work on the administration of Amount A, including the development of penalties for non-compliance. The potential for penalties in certain circumstances, as discussed below, further highlights the need for clear guidance on what will be considered “reasonable steps.”

### KPMG observation

It appears that the lead tax administration for an MNE would be able to determine that the MNE’s use of a particular indicator was not reliable without the need to reach consensus with other tax administrations, although it is not clear whether the MNE would then need to demonstrate that it did not have information to apply a different Reliable Indicator to both the lead and other tax administrations before it could apply an Allocation Key.

### KPMG observation

When no allocation key is provided for a relevant sourcing rule, an MNE would need to apply the Global Allocation Key. It may be preferable in this circumstance to allow an MNE to present an alternative Allocation Key that may better approximate the market jurisdictions for its revenue based on information available to the MNE. The tax certainty process for Amount A could be used to reach an agreement to apply an Allocation Key not described in the Draft Model Rules.

## Category-specific revenue sourcing rules

As noted above, the Draft Model Rules include Reliable Indicators for all categories of potential revenue. The statement accompanying the release of the Draft Model Rules acknowledges particular challenges for sales through independent distributors, component sales, and B2B services, and the Draft Model Rules elaborate on the Reliable Indicators for these categories and supplement them with specified allocation keys. These categories are described below, as well as the rules for intangible property.

### Sales of finished goods through independent distributors

As in the 2020 Blueprint, revenue from finished goods sold to an independent distributor is deemed to arise in the jurisdiction where the goods are ultimately delivered to the final customer. For this purpose, the rules allow the location of an independent distributor to be used as a Reliable Indicator only when the independent distributor is either contractually restricted to selling goods in that jurisdiction or it is otherwise reasonable to assume that the independent distributor only sells goods in its jurisdiction.

Commentary will provide guidance on when it would be reasonable to assume that an independent distributor is in the same jurisdiction as the final customer. For example, this may include language, packaging, shipping costs, independent third-party databases, warranty registrations, and electronic activations.

## KPMG observation

Because there is no general ability to rely on the location of an independent distributor, identifying a Reliable Indicator may require obtaining reporting from the distributor. This will put pressure on the guidance regarding the intended scope of “reasonable steps” when current distribution agreements do not require such reporting.

An allocation key may be used if, after taking reasonable steps, there is no Reliable Indicator for a particular sale. When legal or commercial reasons demonstrate that a portion of revenue arises in a particular region, the MNE would allocate that revenue using the “Regional Allocation Key.” The Regional Allocation Key deems revenue to arise in each jurisdiction in the region in proportion to its share of final consumption expenditure from the prior calendar year.

Any revenue that is not sourced using a Reliable Indicator or Regional Allocation Key (“Tail-End Revenue”) is allocated using the “Low Income Jurisdiction Allocation Key.” Under the Low Income Jurisdiction Allocation Key, Tail-End Revenue is deemed to arise in a “Low Income Jurisdiction” in proportion to its share of final consumption expenditure. A Low Income Jurisdiction is a jurisdiction that the World Bank identifies as a low-income or lower-middle economy for the period.

The Draft Model Rules provide that an MNE with Tail-End Revenue of 5% or more must take reasonable steps to reduce the Tail-End Revenue arising in later periods. An MNE that does not take such steps within two periods after the first period in which the Tail-End Revenue was 5% or more may be subject to penalties for failure to comply.

## KPMG observation

The Draft Model Rules do not provide the rationale for using a proxy based on Low Income Jurisdictions as opposed to the Global Allocation Key for allocating Tail-End Revenue, but prior comments from the Secretariat suggested a concern that the use of imprecise indicators to allocate revenue from independent distributors may under-allocate revenue to small jurisdictions where distributors are less likely to have a presence. The definition of Low Income Jurisdiction, however, includes some large jurisdictions where MNEs (especially the largest and most profitable MNEs) would be expected to have developed distribution networks. For example, the definition would currently include India and Indonesia, both G20 countries, as Low Income Jurisdictions. Further, as currently drafted, Tail-End Revenue could be allocated to a Low Income Jurisdiction even if income is also allocated to the Low Income Jurisdiction using a Reliable Indicator or the regional allocation key.

## KPMG observation

It is unclear what would happen if, despite an MNE’s reasonable efforts, it is unable to reduce its Tail-End Revenue below 5%. It is also unclear what policy supports imposing a penalty for failing to take reasonable steps to reduce Tail-End Revenue, given the OECD’s acknowledgement that MNEs often do not have access to information regarding the location of the final customer for goods sold through independent distributors and the suggestion that, as discussed above, an indicator obtained solely for purpose of applying the rules may not be considered a Reliable Indicator.



## Sales of components

As with finished goods sold through an independent distributor, revenue from selling a component is deemed to arise in the jurisdiction where the finished good into which the component is incorporated is delivered to the final customer. For this purpose, a component means a tangible good or a digital good sold to a business customer for incorporation into another good for sale.

The Reliable Indicators for sourcing revenue from components are identical to those from sales through independent distributors, except that the focus is on where the finished goods that incorporate the component are delivered to final customers as reported to the MNE. Thus, components sold through an independent distributor can be sourced to the location of the independent distributor only if it is reasonable to assume that the independent distributor is located in the jurisdiction where the finished good is delivered to the final customer. To the extent an MNE has taken reasonable steps to identify a Reliable Indicator and concluded that none is available, the remaining revenue would be allocated using the Global Allocation Key as modified by the Knock-out Rule.

### KPMG observation

MNEs may have significant challenges identifying reliable indicators when a component passes through manufacturing and supply chains involving multiple unrelated parties before being incorporated into a finished good. This may mean that, as a practical matter, most component sales will be allocated using the Global Allocation Key.

### KPMG observation

It is unclear how MNEs should categorize products that can be sold both as components and finished goods, such as nails or tires. MNEs would need to know how their business customers intend to use these types of goods which may be burdensome. While the Reliable Indicators for sales of finished goods through independent distributors and sales of components are the same, in circumstances where there is no Reliable Indicator, the consequences are potentially very different. If the transaction is categorized as a component sale, the MNE must apply the Global Allocation Key, whereas if it is categorized as a sale of a finished good, the MNE applies the Regional Allocation Key to the extent it is reliable and then the Low Income Jurisdiction Allocation Key, and is potentially subject to penalties depending on the size of its Tail-End Revenue and steps to reduce it.

## B2B services

The Draft Model Rules provide that revenue from B2B services is deemed to arise in the place of use of the B2B service. For this purpose, MNEs generally must use information regarding the place of use as provided by the customer or in the contract or other commercial documentation unless another Reliable Indicator exists. However, billing address or the place of the customer's incorporation may be used in limited circumstances.

Whether an MNE can use billing address or the customer's place of incorporation as another Reliable Indicator generally depends on whether the business customer is a "Large Business Customer." A

Large Business Customer is a customer with a total invoice for the fiscal year above a certain threshold that is required to file a country-by-country report (i.e., a member of a group with consolidated revenue exceeding €750 million).

The total invoice threshold amount is still under consideration, but the Draft Model Rules indicate that it will be between €1 million and €3 million. The Draft Model Rules contemplate that the commentary will clarify the reasonable steps an MNE must take to confirm whether a business is a large business customer and suggests in a footnote that such reasonable steps could require the MNE to ask its customer if it meets the definition.

In the case of B2B services provided to a customer that is not a Large Business Customer, the Draft Model Rules deem the billing address of the business customer to be a Reliable Indicator unless the MNE has actual knowledge that the billing address is not the place of use of the B2B service. If there is no other Reliable Indicator available, the Draft Model Rules deem the place of incorporation of the ultimate parent entity (“UPE”) of such customer to be a Reliable Indicator. The use of an allocation key is not specifically permitted for customers that are not Large Business Customers.

For Large Business Customers, billing address is only a Reliable Indicator if the MNE can demonstrate that billing address in fact is reliable to source revenue to the place of use. The Draft Model Rules suggest that this would be an option in relatively limited situations such as where a Large Business Customer only has a presence in one jurisdiction.

An MNE that, after taking reasonable steps, fails to identify a Reliable Indicator for a Large Business Customer, must take reasonable steps to obtain the jurisdictional breakdown of the customer’s headcount in order allocate revenue using a “Headcount Allocation Key.” The Headcount Allocation Key deems revenue to arise in each jurisdiction in proportion to its share of employee headcount of the Large Business Customer as reported in its most recently filed country-by-country report.

If the MNE is unable to obtain the headcount information needed to apply the Headcount Allocation Key, revenue is deemed to arise in each jurisdiction according to the “Aggregate Headcount Allocation Key.” The Aggregate Headcount Key would be derived from the aggregated country-by-country reporting statistics of the jurisdiction of which the UPE of the Large Business Customer is resident or, if unavailable, an alternative aggregate headcount statistics measure. In either case, the aggregate statistics would be published by the OECD or made available on an online portal to be used for Amount A filing purposes.

The Draft Model Rules indicate that the commentary would explain that if the UPE of a Large Business Customer is in a jurisdiction with less than a de minimis number of country-by-country report filers, a separate proxy will be provided to protect taxpayer confidentiality. This proxy could allocate a significant portion of revenue to the headquarters jurisdiction and a portion using regionally aggregated statistics. In all cases, the use of an allocation key would be subject to the Knock-out Rule.

## KPMG observation

It is unclear what “reasonable steps” would suffice for an MNE to demonstrate that it is unable to obtain the jurisdictional breakdown of its customer’s headcount. While the exercise may be straightforward with respect to Large Business Customers that may eventually be subject to public country-by-country reporting, such public reporting is not yet required in any jurisdiction. It has been noted, however, that the European Union published a directive in December 2021 that would require EU Member States to transpose “public” country-by-country reporting rules for certain undertakings and branches in their domestic law by June 22, 2023.

## Licensing, sale or other alienation of intangible property and user data

Like the rule provided in the 2020 Blueprint, revenue from intangible property<sup>1</sup> that supports the provision of a service is generally sourced to the place of use of that service, as determined using the relevant indicators for that service. In all other cases, revenue from intangible property is sourced based on the location of the final customer of the related goods (including copyrighted works). For instance, when intangible property relates to finished goods, Reliable Indicators include the place of delivery of the finished goods to the final consumer or the retail storefront selling the finished goods. To the extent no Reliable Indicator is available after the MNE has taken reasonable steps to identify one, the remaining revenue would be allocated using the Global Allocation Key as modified by the Knock-out Rule.

Revenue derived from the licensing, sale or other alienation of user data is sourced to the location of the user that is the subject of the data being transferred. The Reliable Indicators to determine the location of the user include the user profile information, the geolocation of the user's device and the IP address of the user's device.

### KPMG observation

The specified Reliable Indicators for intangible property generally follow the rules provided for sales or services provided to consumers and do not specifically reference the rules related to B2B transactions. Accordingly, there may be some ambiguity as to which Reliable Indicators are appropriate for sourcing intangible property in situations when the immediate licensee sells the goods to an independent distributor or uses the intangible property to provide a B2B service.

## What's next?

Comments on the Public Consultation Document are due before 18 February 2022. The Secretariat has not provided a timeline for providing the related commentary on the nexus and revenue sourcing rules. The background note to the Draft Model Rules also states that the revenue sourcing rules will be supported by detailed record-keeping requirements to facilitate a systematic review of the MNE's approach to revenue sourcing, without requiring the retention of transaction-level data. An MNE will need to demonstrate that it has clear internal controls on its approach to revenue sourcing, including the data sources.

It is expected that these administrative issues will be addressed further in standardized documentation requirements developed in collaboration with tax administrations and businesses. In the meantime, in-scope MNEs need to be thinking about the data sources presently available to comply with the revenue sourcing rules and any potential changes they would require to business processes.

The Inclusive Framework is expected to release additional Secretariat working documents in the coming months on the other building blocks of Amount A, with the consultation documents on the tax base,

<sup>1</sup> Defined for purposes of Pillar One to mean property that is not in tangible form and that is capable of being owned or controlled for use in commercial activities but does not include financial assets, digital goods, user data or computer programs that benefit from the WIPO protections for computer programs. It includes copyrights, trademarks, tradenames, logos, designs, patents, know-how and trade secrets.

sectoral exclusions, and tax certainty expected in the near term. A public consultation document for Amount B under Pillar One is expected to be issued in mid-2022, and the public consultation on the implementation framework for Pillar Two will be launched later this month, with a consultation event to follow in March 2022.

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