BEPS 2.0: Pillars One and Two

The Path Ahead

7 October 2022

KPMG in Malaysia

Overview and Commentary

Key Message

"Given the technical nature of the GloBE Rules and the proposed implementation date of 2024, affected MNE groups must ensure that they have a detailed working knowledge of the rules and should consider, amongst others, running simulations to determine the impact of any top-up tax."

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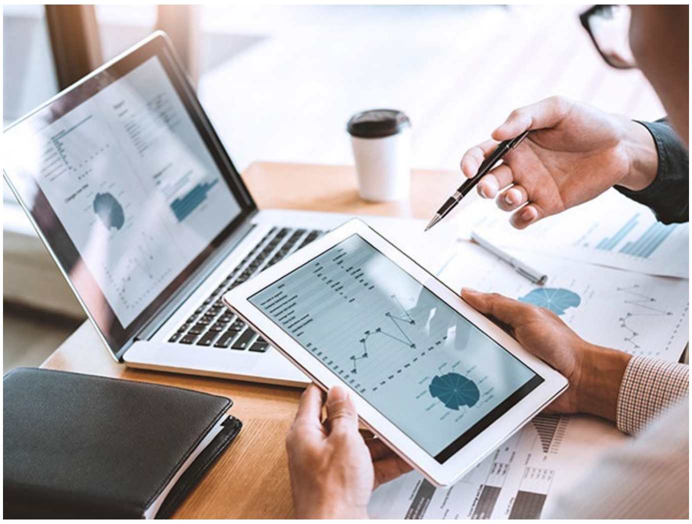


While the 2023 Budget contained a number of proposals, the announcement of the implementation of Pillar Two of the Base Erosion and Profit Shifting ("BEPS") 2.0 initiative had been expected.

In October 2021, more than 135 members of the Organisation for Economic Co-operation and Development ("OECD")/G20 Inclusive Framework on BEPS joined a historic two-pillar solution to reform international taxation rules and to address tax challenges arising from the digitalization of the economy. As the Pillar Two rules, the Global Anti-Base Erosion ("GloBE") Rules, are intended by the OECD to be effective from 2023 (2024 for Pillar One), their introduction is a considerable challenge to both the legislature and affected taxpayers given the timeframe. But what is BEPS Pillars One and Two aimed at and how will it work?

Pillars One and Two

Pillar One contains measures that would impose taxation where a multinational enterprise ("MNE") with a turnover above Euro 20 billion (approximately RM92.3 billion) and a profitability above 10%, derives significant revenue from market jurisdictions but otherwise does not have sufficient nexus with such jurisdictions to be taxable.

Conversely, Pillar Two is applicable to MNEs with an annual global turnover of at least Euro 750 million (approximately RM3.5 billion) and aims to ensure that in-scope MNEs are subject to an effective tax rate ("ETR") of at least 15% in each of the jurisdictions in which they operate. Broadly this will be achieved by imposing a top-up tax on profits arising in a jurisdiction whenever the ETR, determined on a jurisdictional basis, is below 15%.

Given the revenue threshold, Pillar Two is likely to be of more significance to Malaysian businesses than Pillar One and this is reflected in the 2023 Budget announcement.

Effective Tax Rate

The GloBE Rules issued by the OECD in December 2021, as well as its associated commentary released in March 2022 outline a detailed methodology in determining whether MNE groups are in-scope, how ETRs are computed and where necessary, the top-up tax. Notwithstanding the detail, in essence ETRs are computed on a jurisdictional basis by comparing covered taxes as the numerator with GloBE income as the denominator.

The OECD has sought to arrive at a set of rules that will be of universal application rather than being based on the specific tax rules of each country. In this regard, both covered tax and income for GloBE purposes are to a large extent accounting based.

Top-Up Tax

A "top-up" tax will be due to the extent the ETR is less than 15%. The top-up tax reflects the difference between the global minimum tax rate of 15% and the computed ETR.

Once the top-up tax has been computed, the GloBE Rules direct which group entity this should be paid by. The starting point is the ultimate parent entity of the MNE group. Affected MNEs need to ensure that the top-up tax is paid and reported on a timely basis.

Reporting Obligations

In-scope MNE groups will be required to submit an annual GloBE Information Return. Preparation of the return will require the compilation of information from across the MNE group. It is therefore appropriate to review the extent to which accounting systems are able to generate the required data or whether reconfiguration is necessary. This will be a particular challenge for groups that use a variety of different accounting platforms, some of which having legacy accounting systems.

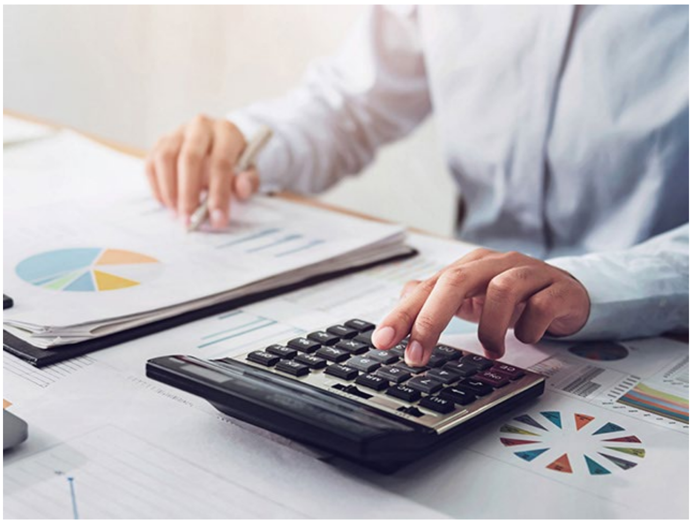
Malaysia

In the 2023 Budget announcements on 7 October 2022, the Honourable Minister of Finance has announced the introduction of a Qualified Domestic Minimum Top-up Tax ("QDMTT") under the GloBE Rules with a targeted implementation date of 2024.

Simply put, the QDMTT is a tax that is applied to Excess Profits of domestic in-scope entities (i.e. Constituent Entities) and operates to increase the domestic tax liability with respect to those profits to the minimum ETR of 15%. The QDMTT will effectively change the order in which jurisdictions are entitled to charge top-up taxes where the ETR of a Constituent Entity falls below 15%; a jurisdiction with a QDMTT becomes the first in line to receive any top-up tax revenue from entities located in its jurisdiction and therefore protecting its tax base.

At this juncture, it remains to be seen how the QDMTT will be implemented in Malaysia. We note that similar proposals are being considered in Singapore, Hong Kong and Switzerland. Given the complexity of Pillar Two, it is hoped that any proposed legislation, administrative guidance and other documents (e.g. reporting forms, mechanism designs, etc.) will be issued as drafts first in order to give affected parties an opportunity to comment. Ideally, the various components could be released in tranches to allow for public input at the earliest opportunity.

A particular issue for Malaysia to address in any proposed legislation is how the Pillar Two requirements will interact with the various tax incentives that Malaysia offers as these significantly reduce ETRs. Based on the OECD's *Tax Incentives and the Global Minimum Corporate Tax: Reconsidering Tax Incentives after the GloBE Rules* published on 6 October 2022, the following are of particular note:



- Affected MNE groups with a greater amount of substance in a given jurisdiction will be less affected than others;
- Tax incentives that are targeted at certain categories of income or expenditure are likely to be less affected by the GloBE Rules than incentives which have been granted on a broad-brush basis, all else equal; and
- Expenditure-based tax incentives that target payroll or tangible assets may be less affected than income-based tax incentives.

What's Next?

While lawmakers, regulators and tax authorities scramble to bring in this new regime, taxpayers are faced with a number of questions. As with any major tax changes, advance planning is the key. Affected MNE groups should consider, amongst others, the following:

- Given the technical nature of the GloBE Rules and the abundance of new terms, MNE groups must ensure that they have a detailed working knowledge of the GloBE Rules;
- The GloBE Rules require the extraction of information to test whether the Euro 750 million threshold is exceeded. The ability to extract this information needs to be addressed. Monitoring will also be required in order to determine when the threshold is exceeded;
- A considerable amount of financial information is required to compute the top-up tax. MNE groups need to confirm that their accounting systems will provide ready access to the requisite information. This is likely to be a particular challenge for groups that have legacy accounting systems following acquisitions; and
- MNE groups should consider running simulations to determine the impact of any top-up tax.

Should you have any questions or require further clarification, please do not hesitate to email or contact any of our Executive Directors, Directors, Associate Directors or Managers whom you are accustomed to dealing with or who are responsible for the tax affairs of your organization.

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