Deloitte TaxMax

Top cross-border tax issues to watch out

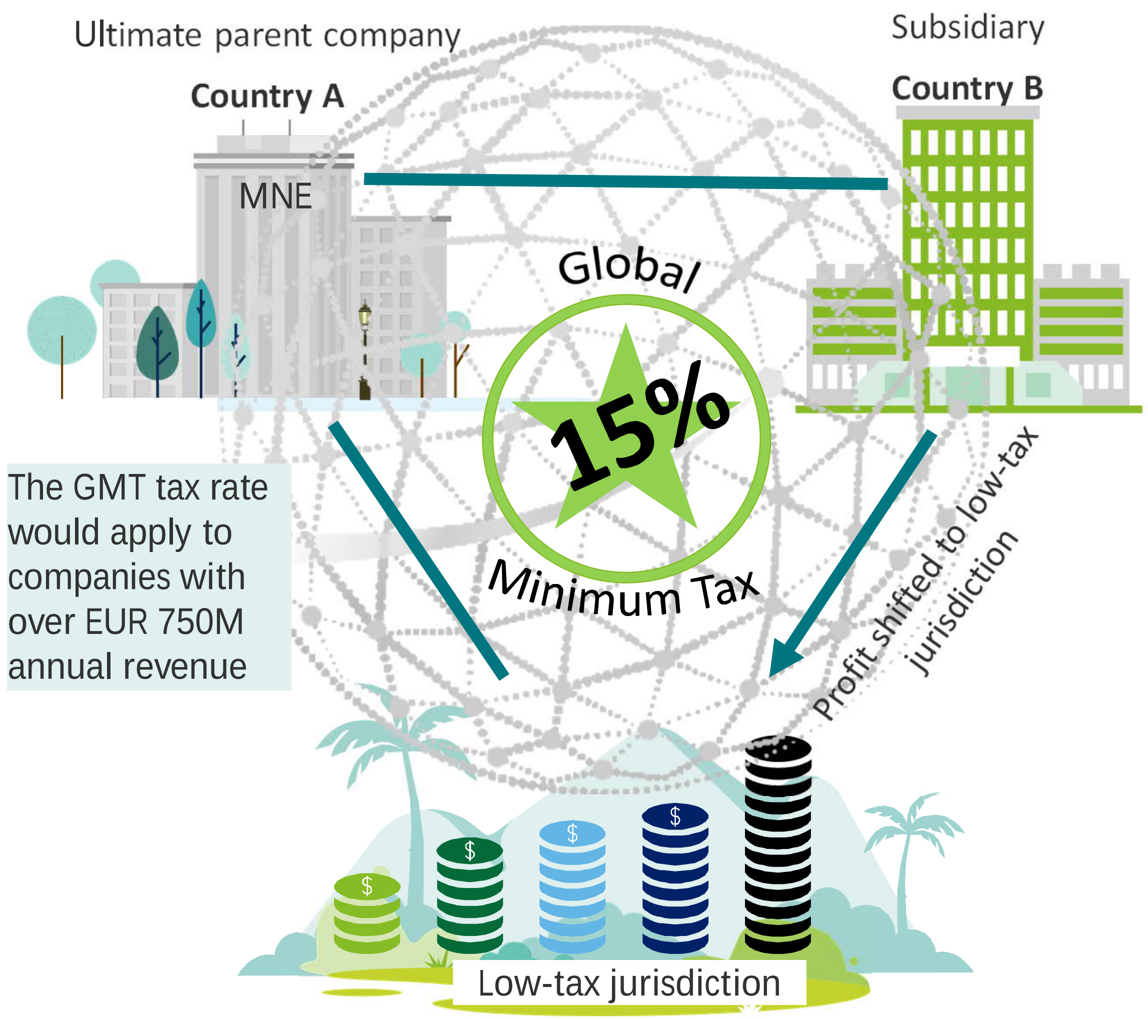
Tan Chia Woon and Ashley Lim | 22 March 2023

MAKING AN IMPACT THAT MATTERS since 1845

Contents

Overview of Global Minimum Tax

Overview of Global Minimum Tax



Source – OECD brochure July 2021 – Addressing the tax challenges arising from the digital economy

With Global Minimum Tax (GMT), wherever you operate (be it in the high tax country, low tax country, tax haven or country that offers tax holiday), you will need to pay a minimum tax of 15%!

Top up to 15% if effective tax rate (ETR) in a country is below 15%.

ETR is calculated with a very complex formula.

What are the Latest Developments on Global Minimum Tax?

Global Minimum Tax — Malaysia's journey so far

December 2021
OECD released the Pillar Two GloBE Model Rules

March 2022
OECD released the commentary to the GloBE model rules

June 2022
Ministry of Finance (MoF) issued a pre-budget statement which shared that Malaysia is currently reviewing the technical details of the GMT

August 2022
MoF published a public consultation paper with regards to the implementation of the GloBE Rules in Malaysia

October 2022
During Budget 2023, the government announced that Malaysia will introduce GMT and plans to implement Qualified Domestic Minimum Top-up Tax in 2024

December 2022
OECD released a Pillar Two Implementation Package including:
- Safe Harbours and Penalty Relief document
- Public consultation papers for the GloBE Information Return and for tax certainty

February 2023
OECD released the Agreed Administrative Guidance for Pillar Two

During the re-tabled Budget 2023, the government reaffirmed Malaysia's commitment to introduce GMT and QDMTT

Global Minimum Tax Implementation in Asia and Oceania

Republic of Korea
- Domestic legislation enacted for IIR & UTPR
- Effective: 1 January 2024 for both IIR & UTPR

Japan
- Draft legislation for IIR
- Finance Bill published for parliament approval
- Effective: 1 April 2024 for IIR

Taiwan
- Announced GMT implementation
- Effective: 1 January 2024 at the earliest

Hong Kong
- Announced implementation of IIR, UTPR and considering QDMTT
- Effective: 2025

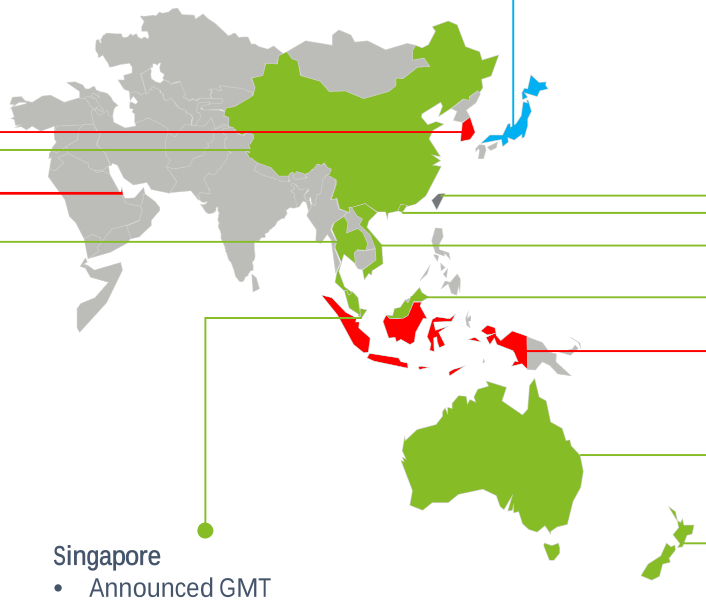
Vietnam
- Confirmed implementation and legislation of GMT
- Established a Special Working Group under the Prime Minister’s Decision No 55/QĐ-TTg on GMT

China
- Launched a public consultation on the IASB Pillar Two Exposure Draft for proposed amendments to IAS 12

Malaysia
- Announced GMT implementation, including QDMTT
- Reaffirmed in the Budget 2023 Touchpoint & National Tax Conference
- Effective: 2024

Qatar
- Introduced provisions for GMT in its corporate tax law; details to be issued in the Executive Regulations

Indonesia
- Issued Regulation No. GR.55/2022 in December 2022 as a legal basis to adopt GMT
- Effective: 2024



Australia
- Launched a public consultation for GMT implementation

Thailand
- Thai cabinet has approved the GMT proposal, QDMTT is expected to be included
- Effective: 2025

Singapore
- Announced GMT implementation, including QDMTT
- Effective: 2025

New Zealand
- Launched a consultation for GMT implementation

- Enacted GMT legislation
- Draft GMT legislation
- European Union (draft GMT legislation)
- African Tax Administration Forum (draft QDMTT legislation for discussion)
- Announced GMT implementation/ GMT public consultation launched

Global Minimum Tax Implementation in Europe and Africa

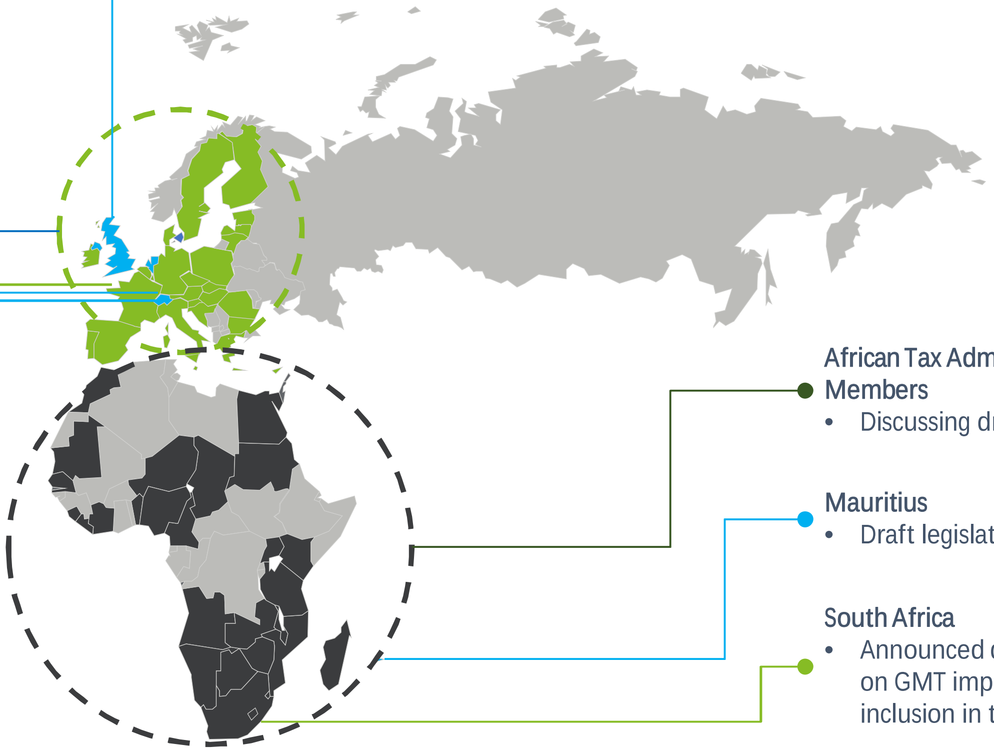
United Kingdom
- Draft legislation for IIR
- Announced implementation for QDMTT
- Effective: 31 December 2023, UTPR 1 year later

European Union (EU)
- The 27 EU member states reached agreement to implement GMT
- Effective: 31 December 2023

Jersey
- Issued a policy paper to inform their study of GMT and launched a public consultation

Switzerland
- Parliament approved the constitutional amendment to implement GMT
- Effective: 1 January 2024

Liechtenstein
- Announced GMT implementation
- Effective: 1 January 2024



African Tax Administration Forum (ATAF) Members
- Discussing draft legislation for QDMTT

Mauritius
- Draft legislation for QDMTT

South Africa
- Announced during Budget 2023 that a draft position on GMT implementation will be published for inclusion in the 2024 Taxation Laws Amendment Bill

- Enacted GMT legislation
- Draft GMT legislation
- European Union (draft GMT legislation)
- African Tax Administration Forum (draft QDMTT legislation for discussion)
- Announced GMT implementation/ GMT public consultation launched

Global Minimum Tax Implementation in the Americas

Mexico
- Announced intention to legislate GMT in 2023
- Effective: 2024

Canada
- Launched public consultation for GMT implementation

United States
- President Joe Biden stated during the United Nations General Assembly in September 2022 that the US champions GMT and will work to see it implemented
- The Agreed Administrative Guidance provided some clarity on the treatment of GILTI taxes for fiscal years on or before 31 December 2025

Bermuda
- Announced that it is examining GMT implementation during its 2023 Budget

British Virgin Islands
- BVI International Tax Authority Director of the BVI stated that they are working with the OECD and the current focus will be on information exchange with jurisdictions introducing the top up tax

- Enacted GMT legislation
- Draft GMT legislation
- European Union (draft GMT legislation)
- African Tax Administration Forum (draft QDMTT legislation for discussion)
- Announced GMT implementation/ GMT public consultation launched

Key Elements of Global Minimum Tax

Steps involved

1. Define the scope
2. Calculate the ETR
   - GloBE Income
   - Covered Taxes
3. Determine the Top-up Tax liability
4. Allocate the top-up tax through the charging provisions
5. Consider special provisions
6. Manage administration and compliance obligations

Pillar Two – Scope

WHO ARE IN SCOPE?

Groups that:

- Operate in at least 2 jurisdictions
- Has annual consolidated group revenue of at least €750 million in at least two of the four immediately preceding fiscal years

ANY EXCLUDED ENTITIES?

Entities being:

- Investment funds/real estate investment vehicles which are ultimate parent entities
- Pension funds, governmental entities, international organisations, non-profit organisations

Rules may apply to other entities/sub-groups within the MNE Group

DE MINIMIS EXCLUSION?

Jurisdictions having:

- Less than €10 million Average GloBE Revenue; and
- Less than €1 million Average GloBE Income or Loss

"Average" referring to a period of 3 years, which is the current and two previous fiscal years

Safe Harbours

Transitional CbCR Safe Harbour Tests	De Minimis Test	The MNE Group reports Total Revenue of less than EUR 10 million and Profit (Loss) before Income Tax of less than EUR 1 million in such jurisdiction on its Qualified CbC Report for the Fiscal Year	Data from CbCR	• Applicable to fiscal years beginning on or before 31 December 2026 but not including fiscal years ending after 30 June 2028 • "Once out, always out" approach • Non-qualifying jurisdictions or the group as a whole are not discharged from GloBE requirements
	or			
	Simplified ETR Test	The MNE Group has a Simplified ETR that is equal to or greater than the Transition Rate in such jurisdiction for the Fiscal Year	Data from financial statements + CbCR	
	or			
	Routine Profits Test	The MNE Group's Profit (Loss) before Income Tax in such jurisdiction is equal to or less than the Substance-based Income Exclusion amount, for constituent entities resident in that jurisdiction under the CbCR, as calculated under the GloBE Rules.	Data from CbCR + GloBE computation	

Permanent Safe Harbours are currently in development

Jurisdictional Blending

Minimum tax rate of 15% on a jurisdictional basis

Country A

A Co

Country 1

B Co

C Co

- B Co: profit 100, tax 10. ETR 10%
- C Co: profit 100, tax 40. ETR 40%
- ETR for Country 1: 25%

No top-up tax

Country 2

D Co

E Co

- D Co: profit 100, tax 15. ETR 15%
- E Co: profit 100, tax 5. ETR 5%
- ETR for Country 2: 10%

Top-up tax applies

1. Qualified Domestic Minimum Top-up Tax (QDMTT)
2. Income Inclusion Rule (IIR)
3. Undertaxed Profits Rule (UTPR)

EURO 750m, MNEs

Countries can apply rules to smaller businesses headquartered in their country

Effective Tax Rate Formula

$$\text{Jurisdictional ETR} = \frac{A}{B}$$

A — Adjusted Covered Taxes for all Constituent Entities in the jurisdiction (Covered Taxes)

B — Net GloBE Income for all Constituent Entities in the jurisdiction (GloBE Income)

Adjustments for GloBE Income or Loss and Adjusted Covered Taxes

GloBE Income or Loss

Starting point:

- Net income/loss determined for a constituent entity in preparing consolidated financial statements of the ultimate parent entity,
- before any consolidation adjustments eliminating intra-group transactions,
- under an Acceptable Accounting Standard

Adjustments to Determine GloBE Income or Loss

a) Net Taxes Expense
b) Excluded Dividends
c) Excluded Equity Gain or Loss
d) Included Revaluation Method Gain or Loss
e) Gain or loss from disposition of assets and liabilities excluded under a GloBE Reorganisation
f) Asymmetric Foreign Currency Gains or Losses
g) Policy Disallowed Expenses
h) Prior Period Errors and Changes in Accounting Principles
i) Accrued Pension Expense

Possible Elections

5-year election
a) Stock-based compensation
b) Realisation principle for assets or liabilities under fair value/impairment accounting
c) Elect into consolidation within a jurisdiction for GloBE purposes
Annual election
d) Aggregate Asset Gain

Other Adjustments

a) Arm's Length Principle consistency on transactions between Constituent Entities
b) Qualified Refundable Tax Credits shall be treated as income
c) Anti-hybrid rule for intragroup financing
d) Insurance company to adjust for policyholder taxes
e) Additional Tier One Capital distribution deductions for banks
f) International Shipping Income and Qualified Ancillary International Shipping Income excluded from GloBE Income

Additions to Covered Taxes

a) Covered Taxes accrued as expense before PBT such as STTR
b) Amount of GloBE Loss Deferred Tax Asset used (where GloBE Loss Election is made)
c) Amount of Covered Taxes paid in relation to uncertain tax position which has been treated as a Reduction to Covered Taxes in a previous year
d) Amount of credit/refund in respect of a Qualified Refundable Tax Credit that is recorded as a reduction to the current tax expense

Reductions to Covered Taxes

a) Amount of current tax expense with respect to excluded income such as Excluded Dividends
b) Amount of credit/refund in respect of a Non-Qualified Refundable Tax Credit that is not recorded as a reduction to the current tax expense
c) Amount of Covered Taxes refunded/credited, except for any Qualified Refundable Tax Credit, to a Constituent Entity that was not treated as an adjustment to current tax expense in the financial accounts
d) Current tax expense in relation to uncertain tax position
e) Amount of current tax expense not expected to be paid within 3 years

Recapture Rule

Where there is a Recaptured Deferred Tax Liability, it shall be treated as a Reduction to Covered Taxes in relation to the fifth preceding Fiscal Year and the ETR + Top-Up Tax shall be recalculated.

Exclusion from Total Deferred Tax Adjustment Amount

a) Deferred tax expense with respect to items excluded from GloBE Income or Loss Computation
b) Deferred tax expense with respect to Disallowed Accruals and Unclaimed Accruals
c) Impact of valuation adjustment or accounting recognition adjustment with respect to a deferred tax asset
d) Deferred tax expense arising from remeasurement with respect to a change in applicable domestic tax rate
e) Amount of deferred tax expense with respect to the generation and use of tax credits

Total Deferred Tax Adjustment Amount

a) Increased by amount of any Disallowed Accrual or Unclaimed Accrual paid during the year
b) Increased by amount of any Recaptured Deferred Tax Liability determined in a preceding year which has been paid during the year
c) Reduced by amount that would be a reduction due to recognition of a loss deferred tax asset for a current year tax loss, where a loss deferred tax asset has not been recognised because the recognition criteria are not met

Special Loss DTA Recast Option

A deferred tax asset recorded at lower than 15% may be recast at 15% if it is attributable to a GloBE Loss. The Total Deferred Tax Adjustment Amount is reduced by the increase in DTA as a result of recasting

Other Adjustments

Any increase or decrease in Covered Taxes recorded in equity/Other Comprehensive Income relating to amounts included in the computation of GloBE Income or Loss that will be subject to tax under local tax rules.

- ➢ To ensure taxes on items included in the Net GloBE Income that are not recorded in current or deferred tax expense are considered.
- ➢ Only applies where the income is subject to tax under local tax rules.

Top-Up Tax Formula

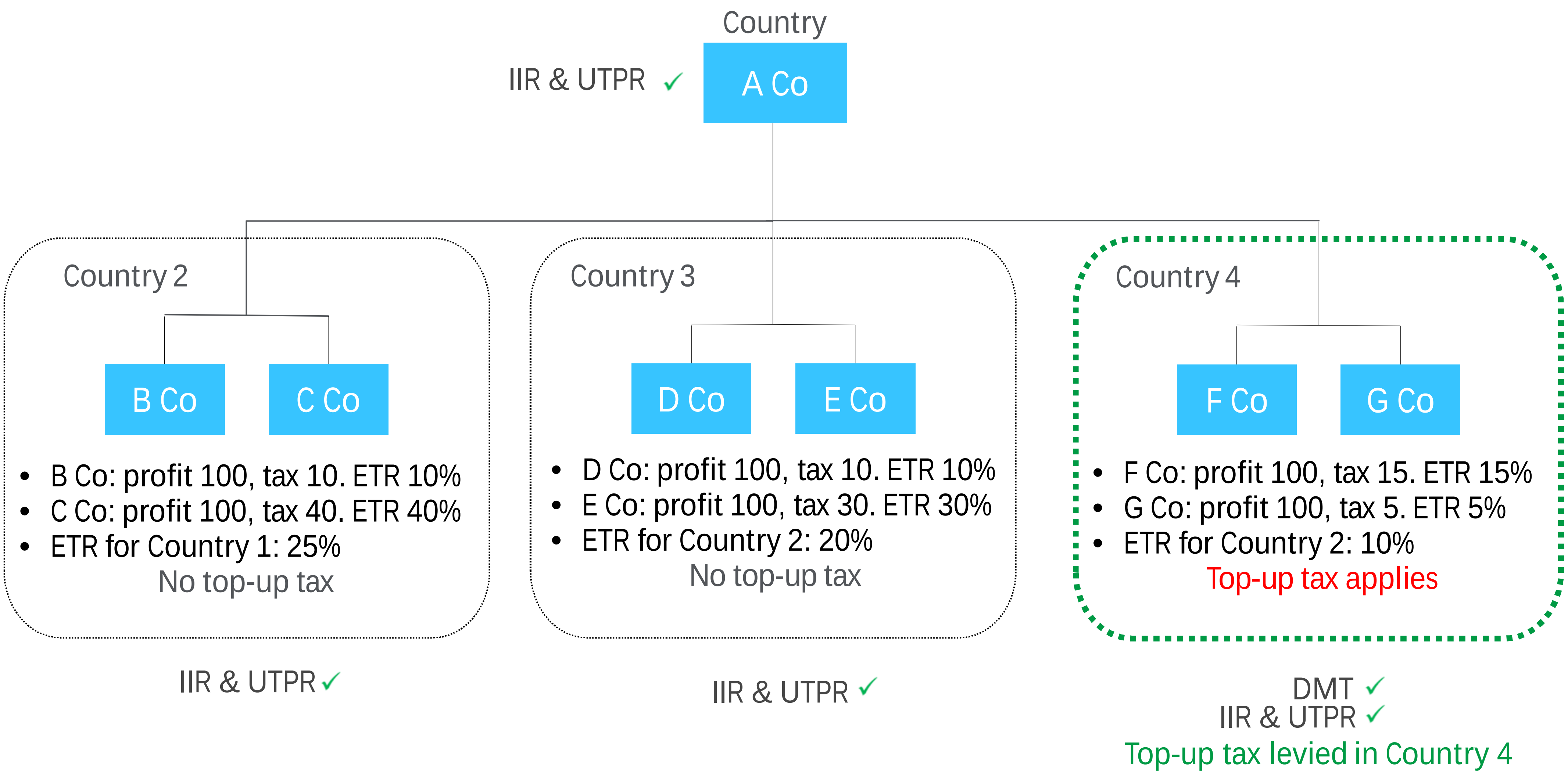
Jurisdictional ETR = $\frac{\text{A: Adjusted Covered Taxes for all Constituent Entities in the jurisdiction (Covered Taxes)}}{\text{B: Net GloBE Income for all Constituent Entities in the jurisdiction (GloBE Income)}}$

Top-up Tax (for a jurisdiction) = [Top-up Tax Percentage × Excess Profits] + Additional Current Top-up Tax − Domestic Top-up Tax

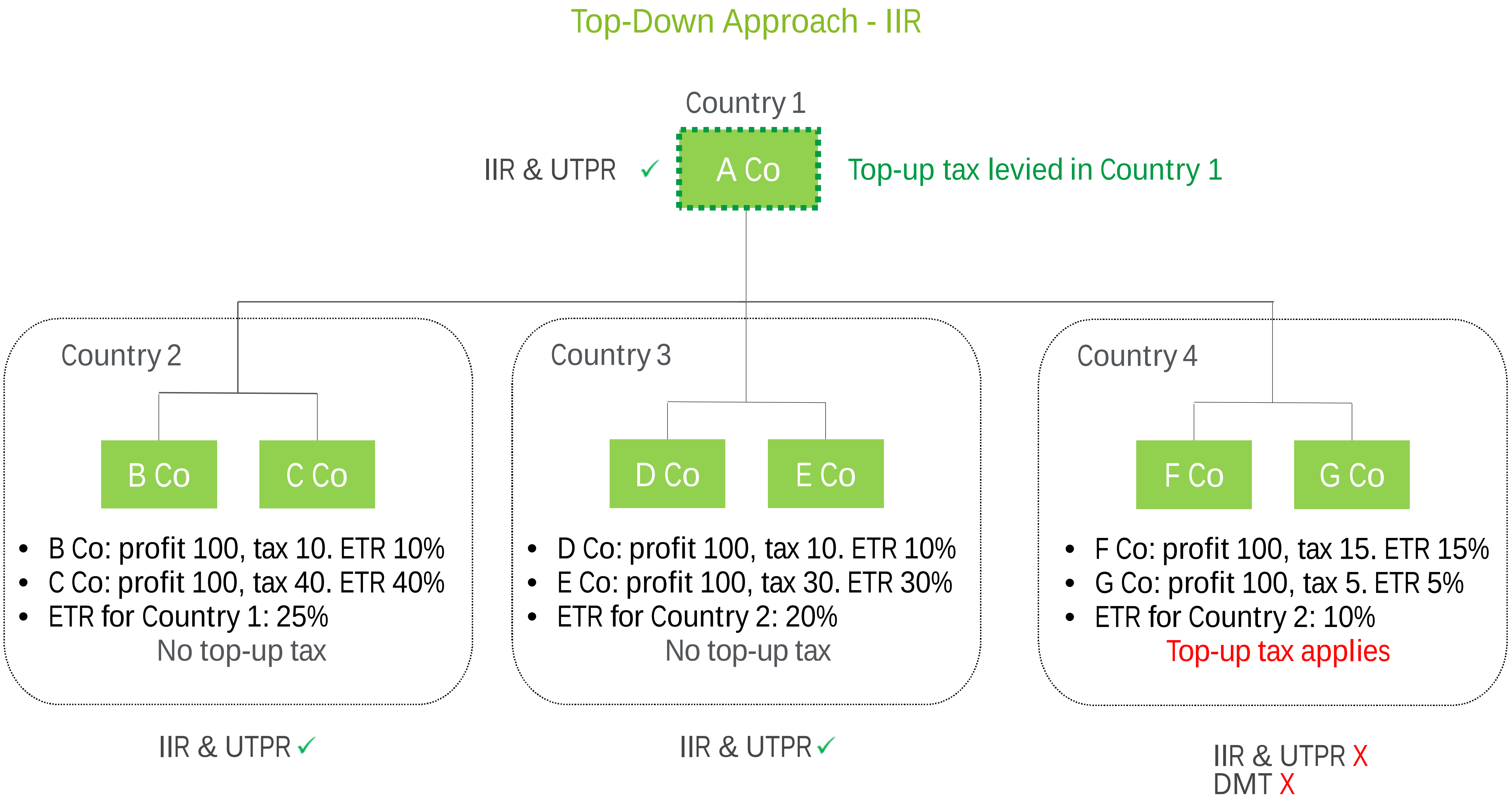
Top-up tax Percentage	15% (minimum rate) – ETR	Substance-based income exclusion	Exclusion of a fixed return on tangible assets and payroll expenses. • Payroll: 10% (to be reduced to 5% over the years). Includes salaries, health insurance, pension contributions, employment taxes and employer social security contributions. Eligible employees include independent contractors. • Tangible assets: 8% (to be reduced to 5%). Includes property, plant and equipment, and natural resources.
Excess profit	Net GloBE Income – Substance-based income exclusion		
Additional current top up tax	Additional top-up tax in respect of a prior period		
Domestic top-up tax	Amount payable domestically, calculated as per the model rules, provided that the country 'does not provide any benefits that are related to such rules'		

How is the Top-Up Tax Imposed?

Domestic Minimum Top-Up Tax

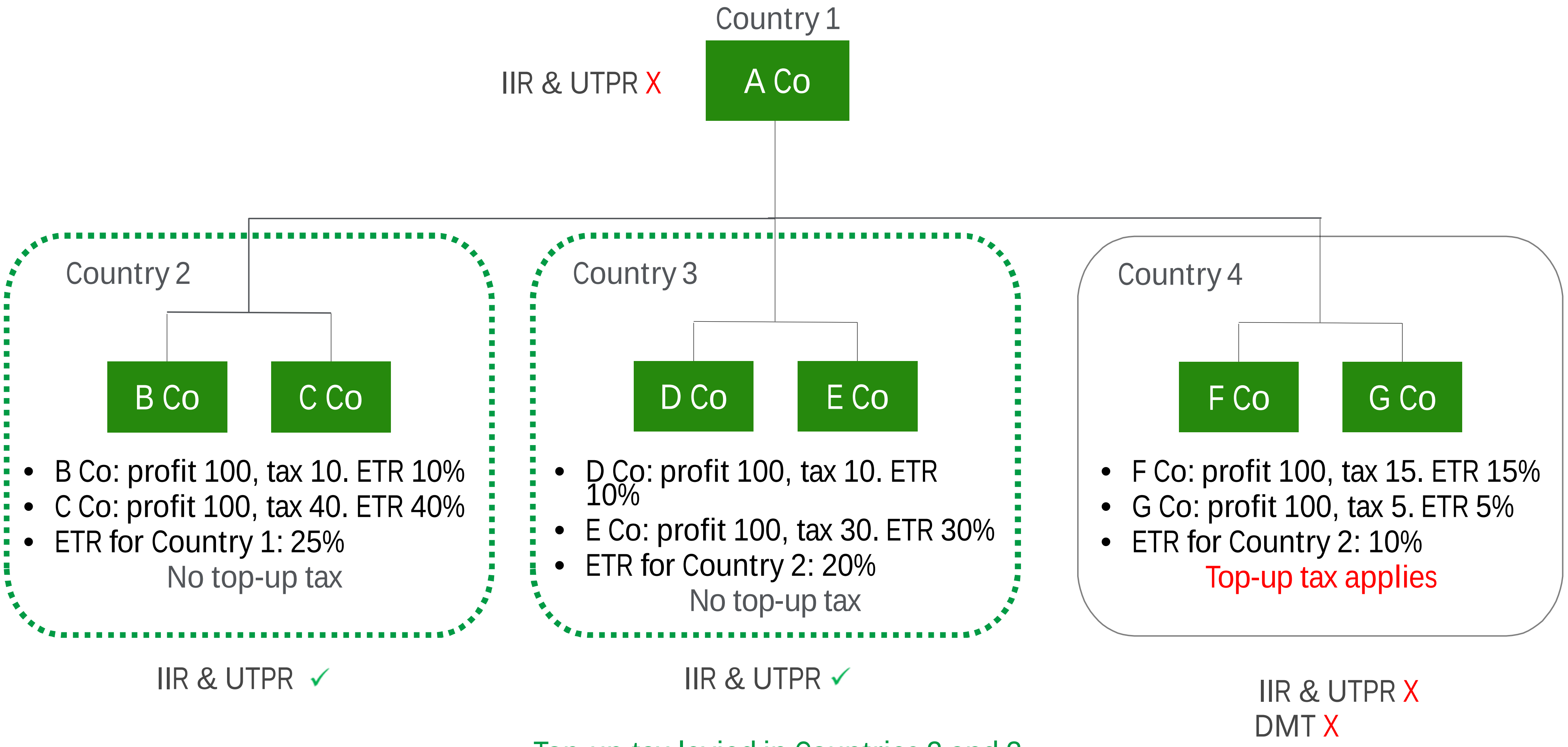


How is the Top-Up Tax Imposed?



How is the Top-Up Tax Imposed?

Backstop - UTPR

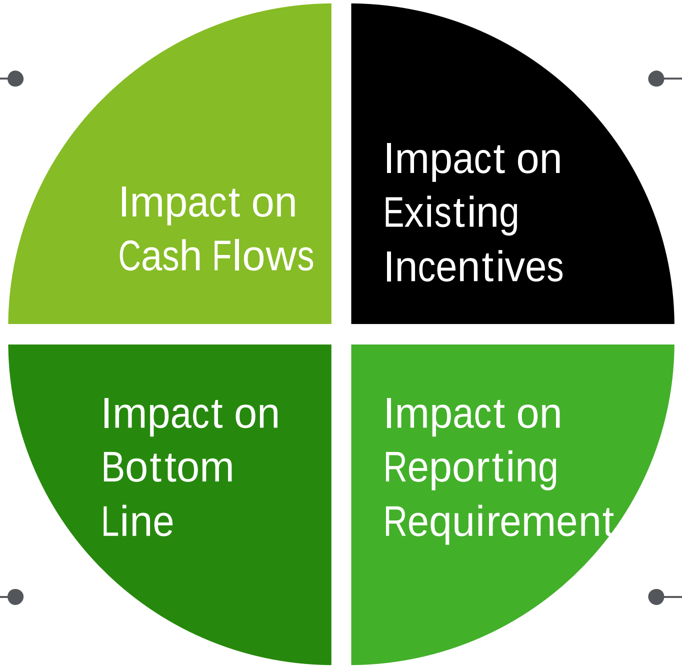


Top-up tax levied in Countries 2 and 3

What is the Impact on Businesses?

Why Impact Assessment on Global Minimum Tax is Crucial

- Evaluation of cash repatriation strategy
- Foreign exchange risk exposure



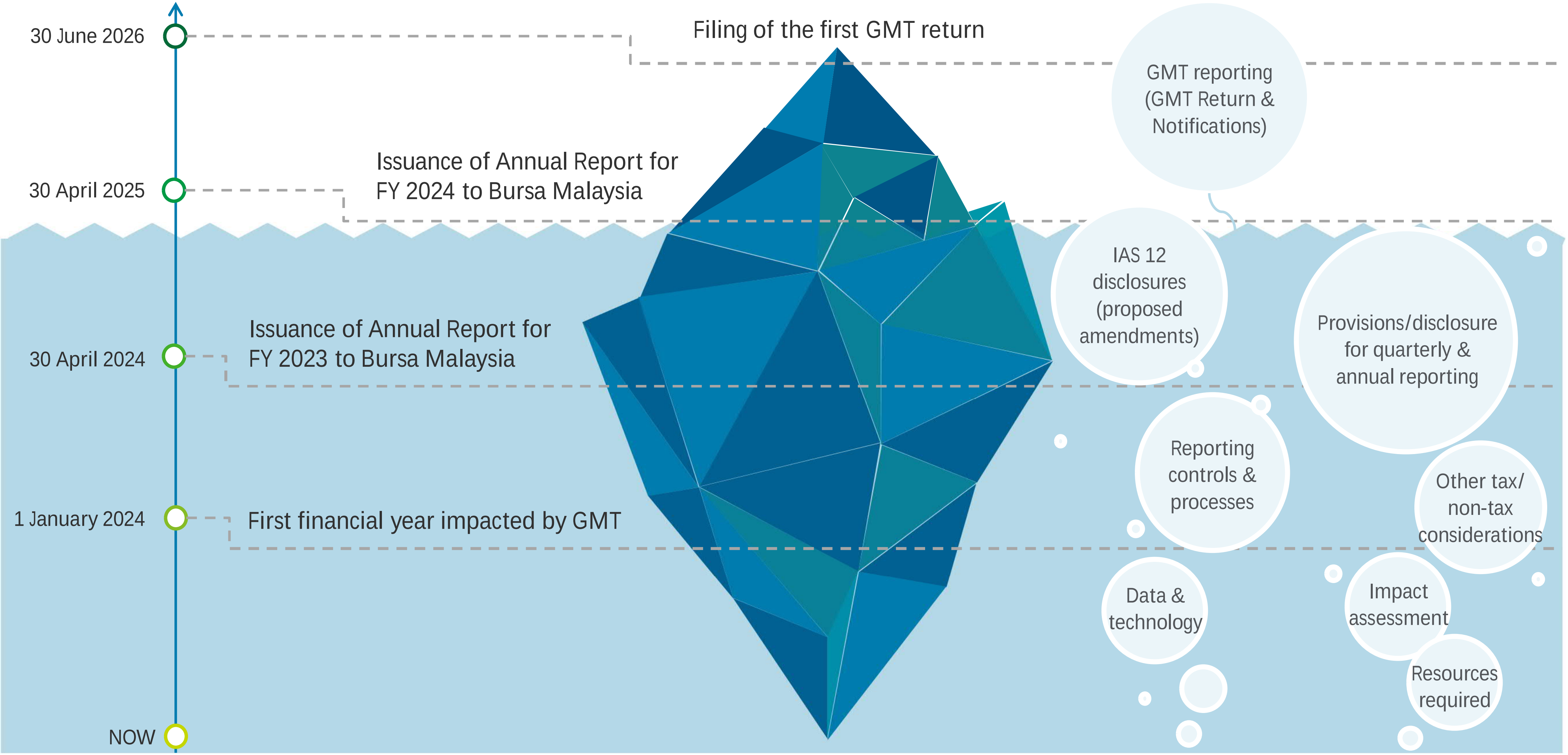
- Are the existing tax incentives still relevant?
- Is there a need to renegotiate with investment authorities?

- Adverse impact on dividend payout
- Pricing
- Disclosure on the impact of GMT

- Readiness of system?
- Additional resources?

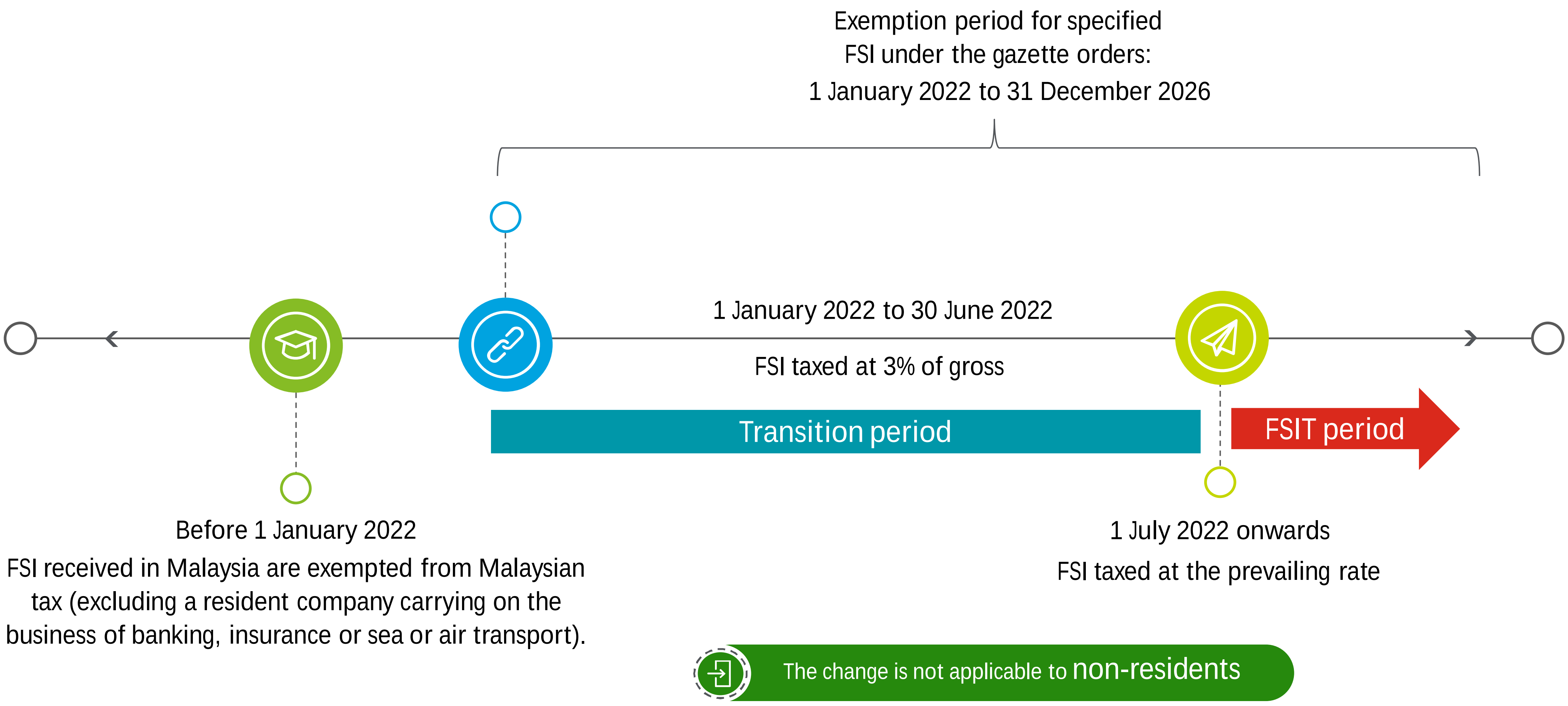
What is Next for Business?

Timeline for December Year-Ended Companies



Changes in the Tax Landscape for Foreign-Sourced Income

Overview of the Malaysian FSI Regime



Exemption Orders Relating to Specified FSI

Exemption

Income Tax (Exemption) (No. 5) Order 2022
[P. U. (A) 234/2022]

Income Tax (Exemption) (No. 6) Order 2022
[P. U. (A) 235/2022]

All Types of FSI
Received by Individuals, except for individuals carrying on a partnership business in Malaysia

Dividend Income
Received by:
- Individual carrying on a partnership business in Malaysia
- Limited liability partnership
- Company

Income Tax (Exemption)(No. 6) Order 2022

Income Tax (Exemption) (No. 6) Order 2022 [P. U. (A) 235/2022]

Qualifying person

A person resident in Malaysia who is:
a) an individual who has dividend income received in Malaysia from outside Malaysia in relation to a partnership business in Malaysia;
b) a limited liability partnership which is registered under the Limited Liability Partnerships Act 2012; or
c) a company which is incorporated or registered under the Companies Act 2016

Subject to tax

Headline tax of at least 15%

The dividend income:
a) have been subjected to tax of a similar character to income tax under the law of the territory where the income arises; and
b) the highest rate of tax of a similar character to income tax charged under the law of the territory which the income arises at that time is not less than 15%

P. U. (A) 235/2022 - Conditions to qualify for FSI exemption under the Revised Guidelines

Subject to tax

Dividend income is regarded to have been subject to foreign tax if:

(a) subjected to income tax or WHT in the country of origin; or
(b) subjected to "underlying tax", i.e. the income tax paid or payable in the country of origin related to the underlying profit arising from operating income in the country of origin where the income after tax is used to pay dividends; or
(c) not subjected to tax in the country of origin as the foreign source dividend income is paid out of underlying profit which is not subjected to tax in the country of origin due to:
  - unabsorbed losses or capital allowance;
  - arising from capital gains;
  - enjoyed tax incentives in compliance with substantive requirements in the country; or
  - tax regulations under the tax consolidation regime In the country of origin.

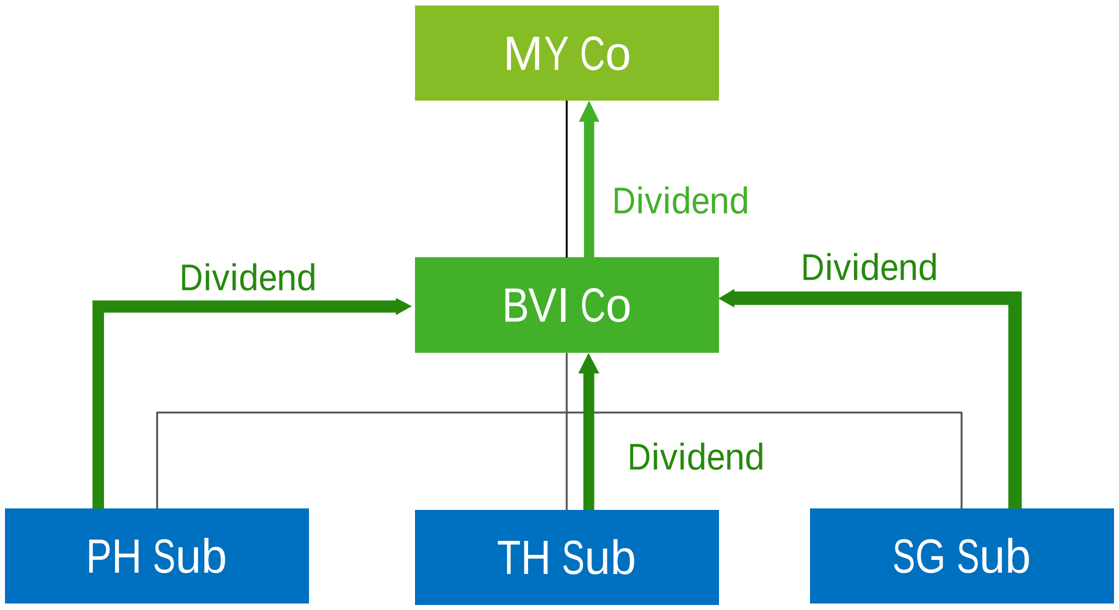
Headline tax of at least 15%

The foreign country headline tax rate refers to the highest corporate tax rate in the country of origin in the year the dividend is taxed in the foreign country, and the rate need not necessarily be the actual tax rate imposed on the foreign dividend income.

Comply with economic substance

A qualifying person will be deemed to have met the economic substance requirement if it has:
- Employed an adequate number of employees with the necessary qualifications to carry out the specified economic activities in Malaysia; and
- Incurred an adequate amount of operating expenditure for carrying out the specified economic activities in Malaysia.

Illustration: Exemption Granted Only on 1 Tier



Abbreviations

MY – Malaysia

BVI – British Virgin Islands

PH – Philippines

TH – Thailand

SG – Singapore

Facts

- The headline tax rates in Philippines, Thailand and Singapore are above 15%.
- PH Sub, TH Sub and SG Sub pay dividends to BVI Co, whereby tax has been imposed on the profits from which the dividends are paid in the respective countries.
- BVI Co pays dividend to MY Co. No corporate tax is imposed on the dividend income received by BVI Co and no withholding tax is imposed on the dividend payment to MY Co.
- Assumption: MY Co has complied with the economic substance requirements

Issues

- Dividend from BVI Co to MY Co – not exempted
- BVI Co is not subject to tax (no underlying tax paid)
- Eliminate BVI Co? Replacing BVI Co with other jurisdiction?