The OECD seeks input on design of the Pillar Two (GloBE) rules

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In brief

On 8 November 2019, the Organisation for Economic Co-operation and Development (OECD) published a public consultation document on the Global Anti-Base Erosion (GloBE) Proposal – Pillar Two under BEPS 2.0 (the GloBE Consultation)[1].

The GloBE Consultation focuses on the income inclusion rule and seeks stakeholders' views on the design of a global minimum tax mechanism. In essence, the GloBE Consultation seeks input on the following three technical design aspects of the GloBE proposal: (1) tax base determination, (2) blending of high-taxed and low-taxed income and (3) carve-outs, thresholds and exclusions.

While this workstream is being delivered under the OECD's "Tax Challenges Arising from the Digitalisation of the Economy" project, the impacts of the GloBE proposal go far beyond highly digitalised businesses and should be heeded by all internationally operating businesses.

Although the detailed rules under Pillar Two have yet to be worked out, multinational groups with cross-border transactions should conduct preliminary impact assessment in terms of prospective tax liability and increased compliance burden under the GloBE proposal. The HKSAR Government may take the opportunity of the GloBE consultation in seeking to carve out tax regimes and treatments that are not regarded as harmful from the scope of the GloBE rules, including the offshore regime, capital gain exemption and the various existing concessionary tax regimes in the Hong Kong tax system, if they believe such carve-outs are important to minimising the impacts of the GloBE rules on Hong Kong.

In detail

The GloBE (Pillar Two) proposal is the second part of the OECD's efforts to develop a two-pronged approach to address the tax challenges arising from business globalisation and digitalisation. The first part being the Pillar One proposal, which addresses the taxing rights between jurisdictions and considers new nexus and profit allocation rules for large "consumer facing" businesses. A public consultation document on the Pillar One proposal was issued on 9 October 2019[2]. For a more detailed discussion of Pillars One and Two set out by the Programme of Work[3] released by the OECD in May 2019 and the implications of Pillar Two for the tax regime and businesses in Hong Kong, please refer to our *Hong Kong Tax News Flash, Issue 8, October 2019*[4].

The GloBE Consultation

The GloBE proposal includes two sets of inter-related rules, namely (1) the income inclusion rule and switch-over rule and (2) the undertaxed payments rule and subject to tax rule. While comments on all aspects of the Programme of Work on Pillar Two are welcome, the GloBE Consultation focuses primarily on the income inclusion rule, which seeks to top up the foreign taxes paid by a multinational group's overseas branches or controlled entities to an agreed minimum rate. Specifically, input on the

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following three technical design aspects of the GloBE proposal are sought: (1) tax base determination, (2) blending of high-taxed and low-taxed income and (3) carve-outs, thresholds and exclusions.

Tax base determination

It is proposed that financial accounts would be the starting point for determining the income base for computing the effective tax rate. But it is an open question whether the financial accounts would be the local accounts of the subsidiaries or the consolidated accounts of the group's ultimate parent entity.

The GloBE Consultation recognises there is a balance to be struck between simplicity and the accuracy of identifying truly low-taxed profits, given the differences between accounting profits and tax bases. For permanent differences that would not even out over time (e.g. non-taxable income or non-deductible expenses), the GloBE Consultation suggests that removing certain amounts as standard could be an appropriate middle ground. For temporary differences that would even out over time (e.g. where profits are recognised in different years for tax and accounting purposes), three options are suggested: carrying forward any excess taxes paid for offset in future years, using IFRS deferred tax accounting standards rather than the cash tax recognised in the financial accounts, or averaging over multiple years.

Blending of high-taxed and low-taxed income

The GloBE Consultation seeks views on the degree of "blending" that should be allowed, which essentially means whether internationally operating groups could consolidate taxes at an entity, jurisdiction, or worldwide basis in order to determine the effective tax rate of their profits. The factors under consideration in this regard include the cost of compliance, the impact on volatility, and the allocation of profits and taxes between entities and jurisdictions.

Carve-outs, thresholds and exclusions

The Programme of Work issued in May 2019 calls for the exploration of carve-outs, including for (1) regimes that are compliant with the standards of BEPS Action 5 on harmful tax practices[5] and other substance-based carve-outs, (2) a return on tangible assets and (3) controlled corporations with related transactions below a certain threshold.

In the GloBE Consultation, no industries or regimes are specifically identified as potential targets for carve-outs, but broad questions are raised for stakeholders to consider, including (1) a qualitative, facts-and-circumstances basis vs an objective and formulaic basis for carve-outs or exclusions, (2) a carve-out for specific sectors or industries, (3) thresholds based on broad criteria such as total revenue or profit, (4) compliance and administration costs for businesses and tax administrations and (5) the potential behavioural impacts that carve-outs may have.

What is next?

Interested parties can submit their comments on the GloBE Consultation no later than 2 December 2019. A public consultation meeting will then be held in Paris on 9 December 2019. The OECD will seek agreement among the members of the Inclusive Framework on the basic architecture of the proposed changes in January 2020 so that more detailed technical work on the mechanics of both Pillars One and Two can take place throughout 2020. It is worth to note that the rate of tax to which profits in scope must be topped up remains a key challenge for the Inclusive Framework to agree, but it is not being addressed as part of the current consultation.

The takeaway

While this workstream is being delivered under the OECD's "Tax Challenges Arising from the Digitalisation of the Economy" project, the impacts of the GloBE proposal go far beyond highly digitalised businesses as it seeks to address more fundamental concerns that the BEPS Project did not provide an adequate solution to the risks of activities and profits being moved to low (or no) tax jurisdictions. The potential impacts should be heeded by all internationally operating businesses.

Although the detailed rules under Pillar Two have yet to be worked out, the reform to the Hong Kong tax system brought by BEPS 2.0 can be substantial. Multinational groups with cross-border transactions should monitor the future developments in this area, communicate their concerns and views to the OECD and governments, conduct preliminary impact assessment in terms of prospective tax liability and increased compliance burden, and formulate a plan to deal with the potential changes required (e.g. restructuring the business operations or relocating the businesses among different jurisdictions).

The HKSAR Government may take the opportunity of the GloBE consultation in seeking to carve out tax regimes and treatments that are not regarded as harmful from the scope of the GloBE rules, including the offshore regime, capital gain exemption and the various existing concessionary tax regimes in the Hong Kong tax system, if they believe such carve-outs are important to minimising the impacts of the GloBE rules on Hong Kong.

Endnotes

1. The GloBE Consultation can be accessed via this link:
https://www.oecd.org/tax/beps/public-consultation-document-global-anti-base-erosion-proposal-pillar-two.pdf.pdf
2. The second OECD public consultation document on Pillar One can be accessed via this link:
http://www.oecd.org/tax/beps/public-consultation-document-secretariat-proposal-unified-approach-pillar-one.pdf
3. The OECD Programme of Work can be accessed via this link:
http://www.oecd.org/tax/beps/programme-of-work-to-develop-a-consensus-solution-to-the-tax-challenges-arising-from-the-digitalisation-of-the-economy.htm
4. Hong Kong Tax News Flash, Issue 8, October 2019 can be accessed via this link:
https://www.pwccn.com/en/tax/publications/intl-tax-newsflash-appendix-1.pdf
5. The latest BEPS Action 5 peer review results can be accessed via this link:
https://www.oecd.org/tax/beps/harmful-tax-practices-peer-review-results-on-preferential-regimes.pdf

Let's talk

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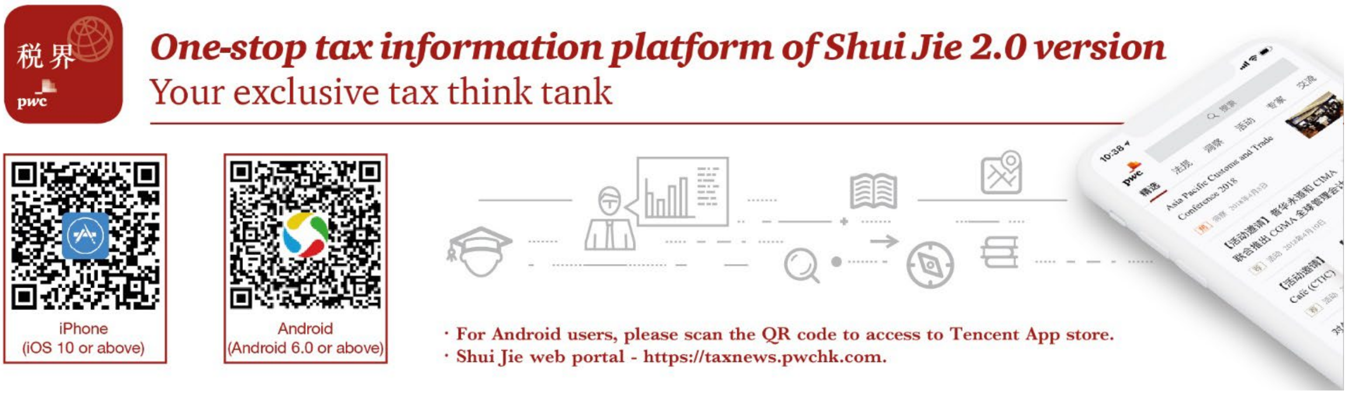

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