KEMENTERIAN KEWANGAN MALAYSIA

PUBLIC CONSULTATION PAPER FOR BUDGET 2023

THE IMPLEMENTATION OF GLOBE RULES IN MALAYSIA

1 AUGUST 2022 | MONDAY

CONSULTATION PAPER

PUBLIC CONSULTATION ON MALAYSIA'S PARTICIPATION IN THE GLOBAL ANTI-BASE EROSION (GLOBE) MODEL RULES (PILLAR TWO) INITIATIVE, INCLUSIVE FRAMEWORK ON BASE EROSION AND PROFIT SHIFTING (BEPS), ORGANISATION FOR ECONOMIC COOPERATION AND DEVELOPMENT (OECD)

As part of efforts to improve the transparency and inclusivity of the nation's annual budget preparation process, the Ministry of Finance (MOF) will continue to publish Public Consultation Papers (PCP). A copy of this public consultation paper can be downloaded on the MOF's official portal **https://budget.mof.gov.my/bajet2023/kertaskonsultasi/**

MOF invites written feedback on the proposals presented in this PCP which can be submitted via the link **https://forms.gle/gL5L7Zd4aS93Uq2s6** latest by **5.00 pm, 15 August 2022**.

The feedback received will be used as a basis for policy consideration by MOF implementing the GloBE Rules in Malaysia. Information pertaining to personal data such as name will not be disclosed if it is clearly stated in the feedback.

Queries or requests for additional information can be submitted via email to: **sec.de@mof.gov.my**.

Tax Division
Ministry of Finance Malaysia

1 August 2022

CONTENT

1.0 INTRODUCTION

1.1 Malaysia has been responsive to the current changes in the internationally agreed tax standards to ensure a competitive environment to attract foreign and domestic direct investment as well as to prevent activities related to cross-border tax evasion. Malaysia joins the OECD Inclusive Framework (IF) as an associate member of Base Erosion and Profit Shifting (BEPS) in 2017 and has implemented the four (4) minimum standards of the BEPS Action Plan, while continuing to review the rest of the Action Plan under Malaysia's domestic laws.

1.2 In view of the high dependency in digitalisation by Multinational Enterprises (MNEs), existing tax policies need to be reviewed to prevent revenue leakage and profit shifting. In addressing these challenges, the Government and OECD are currently discussing the implementation of taxation on the digital economy under the BEPS Action Plan 1 and have agreed to implement the Two-Pillar approach, namely Pillar 1 and Pillar Two. These pillars are expected to be implemented starting 2023.

1.3 Pillar One highlights the allocation of taxing rights and seeks to undertake a review of the profit allocation and nexus rules to a country that was previously subject to the application of the concept of permanent establishment, either through domestic legislation or which has been agreed upon through a bilateral taxation agreement subject to prescribed conditions.

1.4 Pillar Two introduces a minimum effective tax rate at the global level of 15% to ensure a level playing field between countries in attracting foreign direct investment. It aims to prevent harmful tax planning that can lead to tax base leakage and profit transfer to countries with low tax rates subject to conditions.

1.5 Currently Malaysia is reviewing the technical details for implementing the GloBE Rules of both pillars including the possibility of introducing Qualified Domestic Minimum Top-up Tax (QDMTT) under the Pillar Two.

1.6 The OECD Model GloBE Rules which is the main reference for this Public Consultation Paper can be downloaded via the link:

https://www.oecd.org/tax/beps/tax-challenges-arising-from-the-digitalisation-of-the-economy-global-anti-base-erosion-model-rules-pillar-two.htm

1.7 The objectives of this public consultation paper are:

1.7.1 To provide policy insight of GloBE Rules under Pillar Two; and

1.7.2 To gather views and comments of stakeholders, including the adoption of GloBE Rules and any critical implementation issues which may arise in Malaysia.

2.0 PILLAR TWO OVERVIEW

2.1 Summary of the Pillar Two Framework

2.1.1 A new global minimum effective tax rate (ETR) of 15% applying to multinationals (MNEs) with global turnover of at least EUR750 million. This minimum rate will apply in each jurisdiction in which the MNE operates.

2.1.2 For the purpose of tax calculation, an adjusted accounting measure of profit will need to be calculated for a group's operations in each jurisdiction.

2.1.3 If the tax paid by the MNE's Group on profit in a jurisdiction falls below the minimum 15% level, a top-up tax will be imposed to bring the overall taxation profit up to the minimum rate of 15%.

2.1.4 The top-up tax is provided in two elements of GloBE Rules as follows:

a. Income Inclusion Rule (IIR), which imposes top-up tax on a parent company in respect of the low taxed income of a Constituent Entity (CE); and

b. Undertaxed Profits Rule (UTPR), which denies deductions or requires an equivalent adjustment to the extent that the low tax income of a CE is not subject to tax under an IIR.

2.1.5 Pillar Two also includes a treaty-based rule, the Subject to Tax Rule (STTR), which is designed to allow jurisdictions to impose a top-up withholding tax on certain types of outbound payments that are made between related parties and are taxed at a nominal rate of less than 9%. However, STTR is outside the scope of this consultation paper.

2.2 How GloBE Rules will be introduced in Malaysia

2.2.1 GloBE Rules suggested two mechanisms that can be introduced in the tax domestic legislation, namely:

a. Income Inclusion Rule (IIR); and
b. Undertaxed Profits Rule (UTPR).

2.2.2 In addition to the GloBE Rules, Malaysia can also introduce Qualified Domestic Minimum Top-up Tax (QDMTT).

2.2.3 Malaysia is reviewing the technical details including the best way to introduce the GloBE Rules in domestic legislation.

2.3 Income Inclusion Rule (IIR)

2.3.1 Ultimate Parent Entity (UPE) or intermediate parent entity of an MNE Group shall pay top-up tax of the low tax CE for the Financial year at global minimum ETR of 15%.

2.3.2 Top down approach is applied if CE is owned by more than one parent entity in which the IIR is applied.

2.3.3 This application is designed to prevent the over-taxation that would result if multiple countries simultaneously sought to charge the same top up tax.

2.4 Undertaxed Profits Rule (UTPR)

The UTPR allows a top-up tax to be collected in instances where the IIR does not apply. Tax arising under the UTPR can be collected by other group entities regardless of whether these are parent entities. UTPR top-up tax is allocated amongst jurisdictions where the group operates using an allocation key based on employee headcount and the value of tangible assets per jurisdiction, weighted equally.

2.5 Qualified Domestic Minimum Top-up Tax (QDMTT)

Jurisdiction may introduce a QDMTT, which would use the same tax base as the GloBE Rules but take priority against IIR and UTPR in which QDMTT will be sufficient to satisfy the requirements of Pillar Two.

3.0 COMMON APPROACH

Jurisdictions that choose to implement the GloBE Rules must implement them consistently and in line with GloBE Rules. If Malaysia does not implement the rules, Malaysia must accept the application of the GloBE Rules by another in respect of MNEs operating in its jurisdiction.

4.0 SCOPE

4.1 GloBE Rules applies to CEs of MNE Group that has Global Annual Turnover of EUR750 million or more. For companies or group of companies below of the threshold amount, will not be affected and considered as out of scope under the GloBE Rules.

4.2 The global annual turnover in the consolidated Financial Statements of the UPE must be at least two of the four Financial Years immediately preceding the tested Financial Year.

4.3 If one or more of the Financial Years of the MNE Group is of a period other than 12 months, for each of those Financial Years the EUR750

million threshold is adjusted proportionally to correspond with the length of the relevant Financial Year.

4.4 The MNE Group

4.4.1 Group includes at least one entity or PE that is not located in the same jurisdiction of the UPE.

4.4.2 A Group means a collection of entities that are related through ownership or control such that the assets, liabilities, income, expenses and cash flows are included in the Consolidated Financial Statements of the UPE.

4.4.3 If an entity separated/sold from UPE to another UPE, this new UPE is considered as a different Group and subject to this rule if meet the global turnover threshold.

4.5 CEs

4.5.1 A CE is any Entity that is included in a Group and any Permanent Establishment (PE) of a Main Entity.

4.5.2 Each entity within the group is treated as a CE. However, there is an exception for PE, which are treated as a separate CE to the entity to which they belong.

4.6 Excluded entities

4.6.1 An Excluded Entity is an Entity that is:

a. a Governmental Entity;
b. an International Organisation;
c. a Non-profit Organisation;
d. a Pension Fund;
e. an Investment Fund that is an Ultimate Parent Entity; or
f. a Real Estate Investment Vehicle that is an Ultimate Parent Entity.

4.6.2 Asset holding companies of an excluded entity are also treated as excluded entities, subject to meeting certain criteria.

4.7 International Shipping exemption

4.7.1 For an MNE Group that has International Shipping Income, each CE's International Shipping Income shall be excluded from the computation of its GloBE Income or Loss.

4.7.2 However, any other types of income that shipping groups may earn will be subject to the GloBE Rules.

Question:

a. Should Malaysia apply GloBE Rules on local MNE Group with Global Annual Turnover of below EUR750 million?

b. Are there any aspects concerning the scope of the Rules, for example the definitions of a Group, a CE or an Excluded Entity, that require further clarification in domestic legislation?

5.0 CALCULATING THE EFFECTIVE TAX RATE

5.1 Pillar Two charges top-up tax where a MNE's excess profits in a jurisdiction are taxed below the minimum 15% rate. ETR calculation involves calculation of the income in a jurisdiction and calculation of the tax on that income. The different components of the ETR calculation are explained in Chapters 3 and 4 of the GloBE Rules.

5.2 The Effective Tax Rate

5.2.1 The ETR for a jurisdiction is the total tax divided by the total profit in that jurisdiction. GloBE Rules provide what taxes can be included in this calculation, which are referred to as 'covered taxes', and how to calculate the profit in the jurisdiction, which is referred to as 'GloBE income'.

5.2.2 In-scope MNEs must calculate their ETRs for each jurisdiction annually. Generally, there are four steps involved in calculating the ETR.

5.3 Step 1: Identifying the CE in a jurisdiction

5.3.1 Identifying the CEs in a jurisdiction is the first step to determine which entities' GloBE income and taxes are included in the jurisdictional ETR calculation since the GloBE Rules calculate the ETR for a jurisdiction as a whole. This ensures that a MNE with a high ETR in a jurisdiction does not suffer a top-up tax because of an isolated low-tax entity whose low level of taxation could be a function of its relationship with other entities in the jurisdiction.

5.3.2 The GloBE Rules determines where an entity is located. Most CEs will be located in the jurisdiction where they are tax resident. If a CE is not tax resident in a jurisdiction, it will be located in the jurisdiction where it was created, for example where it was incorporated.

5.3.3 There are specific rules prescribing where tax transparent entities, like partnerships and PEs are located for the purposes of the ETR calculations and charging provisions.

5.3.4 The GloBE Rules distinguish between transparent entities and their owners. Transparent entities are treated as CEs in the GloBE Rules and are generally treated as 'stateless' entities. This means their ETR is calculated separately and without blending their income or tax with other entities. There is an exception to this rule where the transparent entity is required to apply an IIR, or it is located at the top of the MNE group.

5.3.5 While transparent entities are treated as separate entities and included in the MNE group, there are rules for allocating their income and taxes.

5.3.6 PEs are generally located in the jurisdiction where they are treated as a PE and subject to net basis taxation, but there are rules to address exceptional situations.

5.3.7 The GloBE Rules include a tie-breaker provision if a CE would otherwise be located in more than one jurisdiction.

5.4 Step 2: GloBE income for each CE

5.4.1 The starting point in calculating a CE's GloBE income is the financial accounting profit, which is then subject to adjustments that Inclusive Framework countries agreed are required to reconcile the most important differences between accounting and tax definitions of profit.

5.4.2 There are also rules to ensure appropriate allocation of certain types of income between jurisdictions.

Accounting profit

5.4.3 The calculation of a CE's GloBE income starts from its financial accounting income. The general rule is that this income should be calculated according to the accounting standard of its UPE and therefore reflects the entries which feed into the UPE's consolidated financial statements

5.4.4 This is subject to a requirement that the UPE prepares its accounts under an acceptable accounting standard, or that it adjusts any material differences in its accounting treatment of an item that could result in the MNE obtaining an unfair competitive advantage.

5.4.5 MFRS is not separately listed as an acceptable financial accounting standard under the GloBE Rules. However, since MFRS framework is fully IFRS compliant and equivalent to IFRS, MFRS is an acceptable accounting standard for the purposes of the GloBE Rules.

5.4.6 The GloBE Rules recognise there are situations where it may not be practicable to accurately calculate the entity's accounting profit in the UPE's accounting standard.

5.4.7 In these cases, the MNE is permitted to calculate the entity's income based on the accounting standard it uses to prepare its own financial statements. This is subject to the information being reliable, and an adjustment being made for any permanent differences in excess of EUR 1 million between the entity's accounting standard and the accounting standard of the UPE.

Adjustments to accounting profit

5.4.8 The next step is to make the required adjustments. These adjustments generally reflect significant differences between accounting and tax computation of profit which do not reverse out over time. There are separate rules to address timing differences in when income and expenses are recognised for accounting and tax.

5.4.9 These adjustments include:

a. Adding back covered taxes, and some other amounts of tax, accrued as an expense;
b. Removing dividend income from more than 10% shareholdings or less than 10% shareholdings which are held for more than 12 months;
c. Removing gains or losses from the sale of more than 10% shareholdings;
d. Removing gains and losses in relation to a reorganisation where the gain or loss is deferred for local tax purposes;
e. Adjustments to deal with foreign exchange gains and losses created by differences between the tax and accounting functional currencies; and
f. Adjustments to address differences between the tax and accounting treatment of defined benefit pension schemes.

5.4.10 The remaining adjustments are included in Chapter 3 of the GloBE Rules.

Special rule for incentive tax credits

5.4.11 There is a special rule that prescribes the treatment of government incentives delivered as credits via the tax system. This rule is intended to apply to incentives to engage in certain activities such as research and development.

5.4.12 Where an incentive tax credit is designed so that it must be paid in cash or cash equivalents within four years it can be treated as income for Pillar Two purposes instead of as a reduction to

covered taxes. The policy reason for this is that these types of refundable tax credits share features of government grants which form part of income, and they should be treated in the same way given that they are in effect government support for a certain type of activity that can ultimately be received in cash or cash equivalents. This treatment results in a higher ETR than if the credit is treated as a negative tax. If a tax credit is designed so that it must partially be refunded within four years, it is only treated as income to the extent the refundability design requirement is satisfied. Whether a tax credit is designed so that it must be refunded within four years is determined under the laws of each jurisdiction at the time the credit is granted.

Allocating income between jurisdictions

5.4.13 The GloBE Rules are designed to ensure that MNEs pay tax at a rate of 15% on their profits in each jurisdiction. This means tax imposed at a high rate on profits in one jurisdiction cannot be used to credit low-taxed profits in another jurisdiction. Allocating profits appropriately between jurisdictions is therefore integral to the GloBE Rules.

5.5 Step 3: Determine the taxes paid by CEs

Covered taxes

Corporate income taxes will generally be covered taxes. Withholding taxes and other taxes which are imposed in lieu of a corporate income tax are also covered taxes. Taxes on payroll or sales will not be counted. Malaysia's sales and services tax are not a covered tax, as it is not charged on a measure of income.

Calculating covered taxes for the relevant year

5.5.1 The next step is to determine the quantum of taxes that have been identified as covered taxes. The GloBE Rules look first to the current tax expense recorded in the financial statements to determine the amount of covered taxes that have been paid.

5.5.2 This amount is adjusted, for example to exclude any tax which is paid in respect of income that has been excluded from GloBE income, to exclude current tax accrued in relation to an uncertain tax position, or to add any covered taxes that have been treated as an expense in the accounts.

5.5.3 The remaining adjustments are described in Chapter 4 of the GloBE Rules.

Timing differences

5.5.4 The GloBE Rules also include rules that are designed to address situations where profits are taxed in a different period to when they are recognised in GloBE income. These differences typically arise from differences in when income and expenses are recognised for accounting and tax purposes. For example, capital assets are often depreciated at different rates.

5.5.5 Without rules to address these differences, a MNE could suffer a top-up because it appears to be low-taxed, when actually the income has been taxed in a different period.

5.5.6 The GloBE Rules address this issue using an approach based on deferred tax accounting. Deferred tax accounting is an accounting concept which seeks to match taxes to the period when the income or expenses are recognised for accounting purposes. It does this by shifting the tax expense from the year the tax is paid (or tax deduction received) to the years in which the income or expenditure is recognised in the financial statements.

5.5.7 In the GloBE Rules, this means the covered taxes are adjusted by the CE's deferred tax income or expense in the period.

> ***Example 1: Timing differences***
>
> *A CE pays RM10 of covered taxes and recognises a deferred tax liability of RM5 in the Financial Year. The RM5 is added to the CE's covered taxes to make the numerator RM15. The numerator is then reduced by RM5 when the deferred tax liability unwinds. This reduction offsets the payment of the tax in that period and effectively brings forward that RM5 of tax from that year.*

5.5.8 There are some modifications to an entity's deferred tax accounting used in its financial statements, which ensure the outcomes are appropriate for the GloBE Rules.

Revaluing deferred taxes

5.5.9 The GloBE Rules require the deferred tax expense for financial reporting purposes to be valued at the lower of the minimum rate and the applicable tax rate. This ensures that there is no top-up in respect of the timing difference where the local tax rate is above the minimum rate, without enabling additional upfront credits for DTLs to shelter other exempt income in that year.

Example 2: Revaluing deferred taxes

A CE has a temporary difference between accounting and tax of RM100 for the Financial Year due to immediately expensing an asset under the local tax rules where it is resident. The local tax rate is 24% so the CE recognises a deferred tax liability of RM24 for accounting purposes which increases the deferred tax expense by RM24.

This deferred tax expense must be recast to the minimum rate for GloBE purposes (RM100 temporary difference x 15% = RM15) which means covered taxes can only be increased by RM15 due to deferred tax.

5.5.10 The GloBE Rules also exclude certain types of deferred tax movements. These include deferred tax movements in respect of income or expenses that are excluded from GloBE income and deferred tax from uncertain tax positions.

The recapture

5.5.11 There is a recapture rule for Deferred Tax Liabilities (DTL) which applies when a DTL has not unwound within five years of the Financial Year in which the DTL was originally recognised.

5.5.12 When the recapture applies, the MNE group is required to recompute its ETR in the year the DTL was originally recognised. This ETR is recalculated without the DTL. If the revised ETR results in a top-up, this top-up is added to the top-up in the current year.

5.5.13 Some types of timing difference are exempt from the recapture rule. These include those in respect of:

a. Accelerated depreciation on tangible assets;
b. Fair value accounting; and
c. Research and development expenses.

These timing differences do not need to be recaptured even if it takes longer than five years for the DTL to unwind.

Losses

5.5.14 The timing difference rules also address tax losses. These rules are similarly based on deferred tax accounting, which means covered taxes are reduced in the year the local tax loss arises and a deferred tax asset (DTA) is recognised. Covered taxes are then increased in the year that the loss is utilised, and the DTA unwinds. This is done by taking account of the deferred tax

expense accrued in the financial accounts, which could be a positive or negative figure.

> ***Example 3: Losses***
>
> *A CE has a tax loss and GloBE loss of RM100 in Financial Year 1. The local tax rate is 15% so the CE recognises a loss deferred tax asset in this year of RM15 (RM100 tax loss x 15%).*
>
> *In Financial Year 2, the CE earns RM100 of net income for local tax purposes (before tax losses brought forward) and RM100 of GloBE income. For accounting purposes, there is no current tax expense in Financial Year 2 because the tax loss brought forward of RM100 reduces taxable income to zero, but a deferred tax expense of RM15 is recognised because the loss deferred tax asset is written off when the tax loss is used. The deferred tax expense increases covered taxes by RM15 in Financial Year 2. As a result, there would be no top-up tax in Financial Year 2 (or Financial Year 1)*

5.5.15 As the DTA is based on the tax loss available under the tax rules of the local jurisdiction, there are further rules to ensure the appropriate relief is given.

5.5.16 For example, the DTA could be based on an economic loss which would also be recognised in the GloBE income or loss. These losses are rightly recognised in the GloBE Rules to prevent top-up taxes being applied in a later (profit) year when the MNE has not made an economic profit over time. The loss could also be created by a timing difference between the accounts and the local tax system, in which case the accounting will recognise both a DTA and a DTL.

5.5.17 However, the local tax loss could also be caused by certain features of that jurisdiction's tax rules – for instance, if the jurisdiction exempted certain types of income from tax or provided tax deductions in excess of the cost incurred.

5.5.18 These local tax concessions are not intended to be recognised in the GloBE base and should ordinarily reduce the ETR when there is net GloBE income in the jurisdiction. However, without further rules, they would be incorporated in the GloBE base if they produced a local tax loss and the related DTA could be used for GloBE purposes.

5.5.19 There is consequently a special rule which identifies the amount of loss relief that would have been available in the jurisdiction if the DTA was based on the GloBE base rather than the local tax rules. Any losses in excess of that are deemed to be losses

arising from permanent differences and give rise to an additional top-up for that year.

5.5.20 This ensures that MNEs receive appropriate relief in the GloBE Rules for economic losses and for those created through timing differences, while preventing excessive relief when the loss arises from a permanent difference.

> ***Example 4: Losses and permanent differences***
>
> *An MNE has one CE in a jurisdiction which has a tax rate of 15%. This CE has a GloBE loss for the Financial Year of RM100 but a local tax loss of RM200 because RM100 of income earned is exempt for local tax purposes. The CE recognises a DTA of RM30 (RM200 tax loss x 15% tax rate) in the Financial Year.*
>
> *Absent an adjustment, this DTA would increase covered taxes by RM30 for GloBE purposes (when the tax loss is used in the future), sheltering RM200 of GloBE income. This would not be appropriate because the CE has only suffered an economic loss of RM100. The GloBE Rules address this issue by charging additional top-up tax of RM15 in the Financial Year (that is, in the year there is RM100 of exempt income for local tax purposes).*

5.5.21 There is also an election which allows an MNE to create a DTA for the purposes of the GloBE Rules based on the GloBE loss in the jurisdiction multiplied by the minimum rate. This may be useful for MNEs with operations in zero tax countries, where the MNE would get no benefit under a system based on deferred tax.

Assigning taxes to a jurisdiction

5.5.22 As with the rules allocating income between jurisdictions, the GloBE Rules contain similar rules allocating covered taxes. These generally seek to assign the tax to the jurisdiction so that all of the taxes paid on this income are taken into account.

5.5.23 For example, taxes paid by a (head office) entity on the profits of its PE are assigned to the jurisdiction where the permanent establishment is located. There are similar rules to assign taxes for transparent entities, hybrid entities and reverse hybrids.

5.5.24 Withholding taxes are generally assigned to the CE who recognises the income in its financial accounts rather than the entity that deducts the tax on payment. There is an exception for withholding taxes on dividends paid to other CEs, which also applies to net basis taxes on dividend income. Both of these taxes are assigned to the entity that paid the taxable distribution. The

logic is that these taxes can be seen as an additional tax on the profit of the distributing entity.

5.6 Step 4: Calculate the ETR

5.6.1 The ETR for a jurisdiction is calculated by dividing the total covered taxes for a jurisdiction (the aggregate of covered taxes in Step 3 for each CE) by the total GloBE income in that jurisdiction (the aggregate of the GloBE income or loss in Step 2 for each CE).

> ***Example 5: The ETR calculation***
>
> *An MNE has two CEs in Jurisdiction A. CE 1 has covered taxes of RM6 million and GloBE income of RM80 million for the current Financial Year, and CE 2 has covered taxes of RM4 million and GloBE income of RM20 million. The MNE's ETR for Jurisdiction A is 10% (covered taxes of RM10 million/GloBE income of RM100 million).*
>
> *On a standalone basis, CE 1's ETR is 7.5% (RM6 million/RM80 million) and CE 2's ETR is 20% (RM4 million/RM20 million). CE 1's low ETR is due to tax concessions in Jurisdiction A that apply to its business activity. The GloBE Rules permit outcomes within a jurisdiction to be blended which means CE 2's excess taxes (that is, taxes in excess of 15%) are used to increase the ETR for jurisdiction A.*

5.7 Further special rules for calculating ETRs

5.7.1 There are special rules for calculating the ETR of stateless entities, joint ventures and minority-owned CEs, as follows:

Stateless entities

5.7.2 The ETR is calculated for each individual stateless entity (for example, a reverse hybrid) without any blending with other entities.

Investment entities

5.7.3 The GloBE Rules provides different rules for calculating the ETR of investment entities (that is, investment funds, insurance investment entities and real estate investment entities) which do not qualify as excluded entities.

5.7.4 Investment entities are required to calculate their ETR on a standalone basis without aggregating their results with other CEs in the jurisdiction. There is an exception to this standalone

treatment – where more than one investment entity is located in the jurisdiction their results must be combined to compute the ETR for those entities.

5.7.5 The ETR calculation is also based on the MNE's share of the GloBE income and covered taxes of the investment entity, and therefore excludes any income or taxes which belong to minority shareholders.

5.7.6 The MNE can elect to treat the investment entity as a transparent entity for the purposes of the GloBE where the owner of the investment entity is subject to tax on a mark to market basis on the fair value of its interest in the entity. Where the election is made, the income and any taxes associated with that income will be included in the owner jurisdiction's ETR calculation.

5.7.7 Alternatively, an MNE can elect to apply the Taxable Distribution Method to investment entities. Under this method, an investment entity owner includes distributions it receives of the investment entity's income in its GloBE income, and undistributed income is included in the GloBE income of the investment entity and subject to top-up tax at a rate of 15%. Further details of this method are in Article 7.6 of the GloBE Rules.

Joint ventures

5.7.8 The GloBE Rules also apply to Joint Ventures which are at least 50% owned by the MNE group, unless the Joint Venture is an excluded entity or is itself an MNE group in scope of the GloBE Rules.

5.7.9 Article 6.4 of the GloBE Rules requires the Joint Venture to calculate the ETR and any top-up taxes of its Joint Venture subsidiaries which together are referred to as the JV group. This includes the entities which are consolidated in the Joint Venture's consolidated financial statements or that would be if such statements were prepared.

5.7.10 The profits and taxes of the JV group are not blended with other CEs in the MNE group. The ETR of the JV group is calculated separately from the rest of the MNE group to address the practical challenges both the MNE Group and the Joint Venture would experience in computing a full jurisdictional ETR for entities both within and outside of the JV.

Minority owned CEs

5.7.11 Financial standards can require entities to be consolidated even though the parent has less than 50% of the rights to profits.

5.7.12 For example, a UPE could own 51% of a CE which owns 51% of a second CE, giving the UPE control of the second CE for accounting purposes despite only owning 26%.

5.7.13 The GloBE Rules include special provisions for entities where the ultimate parent holds 30% or less of the ownership rights in an entity it consolidates. These rules require the ETR of these entities and their subsidiaries to be calculated separately from any other CEs in the MNE group.

Question:

a. Any comments or views on incentive tax credit?

b. Any comments on the practicalities of computing a constituent entity's accounting profit?

c. Any views on the rules on Covered Taxes and their assignment?

6.0 CALCULATING THE TOP-UP TAX

6.1 This chapter explains rules for calculating the top-up tax when the ETR in a jurisdiction is below 15% minimum rate and allocating it amongst low tax CEs, which are in Chapter 5 of the GloBE Rules.

6.2 The steps

6.2.1 There are several steps in the top-up tax calculation in the Model Rules:

a. Identify whether there is net GloBE income in a jurisdiction;
b. Calculate the ETR in jurisdictions with net GloBE income to identify low tax jurisdictions;
c. Compute the top-up tax percentage;
d. Calculate the substance-based income exclusion;
e. Deduct the substance-based income exclusion from the net GloBE income in the jurisdiction to determine the excess income;
f. Calculate the top-up tax in the jurisdiction by:

i. multiplying the excess income by the top-up tax percentage;
ii. adding any additional top-up tax calculated in respect of earlier years, and in respect of current year permanent differences when there is a GloBE loss in a jurisdiction, and
iii. subtracting any taxes charged under a Qualified Domestic Minimum Tax in that jurisdiction.

g. Allocate the top-up tax for the jurisdiction among the constituent entities in that jurisdiction.

6.3 Identifying the net GloBE income

6.3.1 The first step is to determine the profit in a jurisdiction. This is calculated by simply adding together the GloBE income and GloBE losses of all the constituent entities in the jurisdiction.

6.3.2 If the result is positive, the ETR will need to be calculated for that jurisdiction. The only exceptions to this are when the jurisdiction qualifies for the de minimis exclusion (which will be the case when the average GloBE revenue (that is, gross income before expenses) and GloBE income (that is, net income) in the jurisdiction for the current and 2 prior years are below RM10 million and RM1 million respectively) or when the jurisdiction qualifies for a GloBE safe harbour (in Chapter 8 of the Model Rules and not yet developed).

6.4 Calculating the ETR

6.4.1 The next step is to calculate the ETR for the jurisdiction following the process discussed in the previous chapter.

6.5 The top-up tax percentage

6.5.1 The top-up tax percentage is calculated when the ETR is below the 15% minimum rate. This is done simply by subtracting the ETR from the minimum rate and represents the additional tax rate that needs to be charged on the low taxed profits to bring the tax on those profits up to the minimum.

Example 6: The top-up tax percentage

This example is a continuation of example 5 in the previous chapter involving a MNE that has two constituent entities in Jurisdiction A. Constituent Entity 1 has covered taxes of RM6 million and GloBE income of RM80 million for the current Financial Year, and Constituent Entity 2 has covered taxes of RM4 million and GloBE income of RM20 million. The MNE's ETR for Jurisdiction A is 10% (covered taxes of RM10 million / GloBE income of RM100 million).

The top-up tax percentage for Jurisdiction A is calculated by subtracting the ETR of 10% from the GloBE tax rate of 15%. This results in a top-up tax percentage for Jurisdiction A of 5%.

6.6 Substance-based income exclusion

6.6.1 The top-up tax percentage is applied to the net GloBE income in the jurisdiction in excess of the substance-based income exclusion.

6.6.2 The substance-based income exclusion is a formulaic carve out which excludes from top-up tax a reasonable return to the level of substance in the jurisdiction. This is based on a percentage of the MNE's payroll costs and tangible assets in the jurisdiction, on the grounds that employment costs and tangible assets tend to be relatively immobile factors of production and are therefore reasonable proxies for substantive economic activities.

The percentage

6.6.3 The substance-based income exclusion, or "carve-out" will be 5% of the carrying value of the payroll costs and tangible assets in the jurisdiction. There is an increased amount in the transition period which begins from 1 January 2023 and lasts for 10 years. In this period, the carve-out for payroll costs is 10% in the first year and then is reduced by 0.2% per year for the first 5 Financial Years and 0.8% per year for the remaining 5 Financial Years.

6.6.4 The carve out for tangible assets is 8% in the first year and then is reduced by 0.2% in the first 5 Financial Years and 0.4% for the remaining 5 Financial Years.

Payroll costs

6.6.5 The payroll carve out is based on payroll costs on employees and independent contractors that perform activities for the MNE in that jurisdiction.

6.6.6 For this purpose, independent contractors include only natural persons and may include natural persons who are employed by a staffing or employment company but whose daily activities are performed under the direction and control of the MNE. Independent contractors do not include employees of a corporate contractor providing goods or services to constituent entities in the jurisdiction.

6.6.7 The payroll costs include employee benefits that provide a direct personal benefit to the employee like health insurance and pension contributions as well as wages and salary costs. Payroll taxes and social security contributions borne by the employer are also included.

Tangible assets

6.6.8 The tangible asset carve out is based on the average of carrying value (net of accumulated depreciation) of tangible assets in the financial statements. The tangible assets which qualify include property, plant and equipment, natural resources (including land not held for sale, lease or investment) as well as licences for the use of immovable property or exploitation of natural resources. The asset must be located in the jurisdiction of the CE that owns it.

6.6.9 Assets which are leased also qualify, which provides consistency between owned and leased assets. Where an asset is leased from another group member, the asset will only be included in the jurisdiction of the lessee.

6.6.10 There are special rules to determine how the carve-out is allocated for permanent establishments in Article 5.3.6 and for transparent entities in Article 7.4.6.

Example 7: Calculating the substance-based income exclusion

Continuing example 6, CE 1's payroll costs for activities performed in Jurisdiction A is RM30 million for the current Financial Year, and its tangible assets located in Jurisdiction A have an average accounting carrying value for the current Financial Year of RM170 million. Constituent entity 2 has no payroll costs or tangible assets.

The substance-based income exclusion for Jurisdiction A is calculated as follows ((payroll costs of RM30 million x 5%) + (tangible assets of RM170 million x 5%)) = RM10 million. Therefore, RM10 million would be deducted from the MNE's GloBE income for Jurisdiction A for the purposes of calculating the income subject to top-up tax.*

** The carve-out percentages have reduced to 5% in the year of the example.*

6.7 Computing the top-up tax in the jurisdiction

6.7.1 The top-up tax for the jurisdiction is calculated by deducting the substance-based carve out from the Net GloBE income in the jurisdiction and then multiplying the result by the top-up tax percentage.

Example 8: Computing the top-up tax

Continuing example 7, the MNE's top-up tax for Jurisdiction A for the current Financial Year equals RM4.5 million ((net GloBE income of RM100 million – the substance-based carve out of RM10 million) x the top-up tax percentage of 5%)

6.7.2 If an adjustment is made that results in a decrease to the liability for covered taxes in a prior year (for example, when a tax return is reassessed resulting in a reduction to the tax liability for a prior year), the GloBE Rules require the ETR in the earlier year to be recalculated unless the decrease is less than RM1 million, in which case it can be included in the current year. This includes when the recapture rule is applied to deferred tax liabilities which have not unwound within five years. When these recalculations result in an ETR falling below the minimum rate, the additional top-up tax for that year is added to the current year's top-up and charged in the current Financial Year.

Example 9: Decrease in covered taxes for a prior year

*Continuing example 8, CE 2's Jurisdiction A income tax return for a prior year has been reassessed, resulting in a reduction in its local tax liability for the prior year of RM1.2 million but no change in its GloBE income for that year. The Jurisdiction A ETR and top-up tax is recalculated for this prior year resulting in additional GloBE top-up tax for the year of RM1 million.**

This additional top-up tax of RM1 million is added to the RM4.5 million top-up tax for the current Financial Year resulting in total top-up tax for the current Financial Year of RM5.5 million. The GloBE return for the prior Financial Year is not reassessed.

** The reduction in the prior year local tax liability doesn't result in a RM-for-RM increase in top-up tax because of the impact of the substance-based income exclusion in the prior year.*

6.7.3 Some countries may decide to introduce QDMTT to ensure any top-up tax imposed on the profits of a group's domestic entities remains within the jurisdiction. The top-up collected under QDMTT is subtracted directly from the top-up tax charged under the GloBE Rules. This is different from ordinary income taxes, which are included in the ETR calculation. QDMTT reduces any top-up tax on a dollar-for-dollar basis whereas ordinary taxes are diluted by the substance-based income exclusion.

6.7.4 A QDMTT will be qualifying if it imposes an additional top-up tax to domestic entities and the top-up is calculated on the same basis as the GloBE Rules.

6.8 Allocation of a jurisdiction's top-up tax to CEs

6.8.1 The allocation amongst the low tax CEs is necessary to deal with situations where some of the top-up tax is charged to an entity which is not the UPE. For example, if the UPE is not subject to a qualified IIR, the top-up tax may be collected through a combination of the IIR applied at different levels of the group structure and the UTPR (as described in the next chapter). Allocating the top-up tax to individual CEs ensures the different charging rules can be coordinated.

6.8.2 It is also necessary because the IIR is intended to collect top-up tax from a parent entity based on its interest in a low-taxed CE. This means that where a parent applying the IIR does not wholly own a low-taxed CE, it will only bear the cost of its proportional share of top-up tax. Allocating top-up tax to low tax CEs is an important step in achieving this outcome.

6.8.3 The GloBE Rules generally allocate the top-up tax for a jurisdiction between the CEs located in the jurisdiction based on their proportion of the jurisdictional GloBE income.

Example 10: Allocating top-up tax to CEs

Continuing example 9, the total top-up tax for Jurisdiction A for the current Financial Year of RM5.5 million is allocated to each CE located in Jurisdiction A based on its proportion of the net GloBE income for Jurisdiction A.

CE 1 is allocated RM4.4 million (CE 1 GloBE income of RM80 million / jurisdictional GloBE income of RM100 million x top-up tax of RM5.5 million).

CE 2 is allocated RM1.1 million (CE 2 GloBE income of RM20 million / jurisdictional GloBE income of RM100 million x top-up tax of RM5.5 million).

6.8.4 There are special rules to deal with situations when top-up taxes are payable when there is no GloBE income in the jurisdiction, for example when all the top-up tax for the year relates to a recalculation of the ETR from an earlier year.

Questions:

a. Any comments on the special provisions for computing the ETR and top up of investment entities, joint ventures or minority owned constituent entities?

b. Any views on the process for calculating top up tax?

7.0 CHARGING MECHANISM

7.1 This chapter sets out how the IIR and UTPR operate and the rules are contained in Chapter 2 of the GloBE Rules.

7.2 Income Inclusion Rules

7.2.1 The IIR takes the top up tax calculated for a low-taxed CE and then charges this tax on the entity's parent.

7.2.2 Top down approach

i. The basic structure is to follow a top-down approach. This means the UPE jurisdiction will usually have the first priority to collect the top up tax. This priority order is designed to prevent the over-taxation that would result if multiple countries simultaneously sought to charge the same top up tax.

ii. Other jurisdictions cannot generally apply their IIR to other parent entities in the group when the UPE is subject to a qualified IIR. The only exception to this is when minority shareholders hold at least 20% of a parent entity, lower down the group structure. These rules are explained below.

iii. If the UPE is not subject to a qualified IIR, an intermediate parent entity will be charged the IIR. For these purposes, intermediate parent entities are entities that are controlled by the UPE and have an ownership interest in the low-taxed CE. However, investment entities are excluded.

iv. There will also be structures where there are multiple intermediate parents that have an interest in the low-taxed CE.

v. In line with the top-down approach, an Intermediate Parent will not be charged the IIR if it is controlled by another Intermediate Parent which is subject to a qualified IIR.

vi. However, the IIR will not be switched off when the higher Intermediate Parent does not control the lower Intermediate Parent. In this circumstance, the lower Intermediate Parent will charge its IIR, and the higher Intermediate Parent will reduce its share of the top up tax by the tax charged by the lower intermediate parent.

vii. For example, RM100 of top up tax has been calculated for Entity A. Parent A holds 20% of Parent B which holds 100% of Entity A. If Parent A collects the top up, then RM20 of the top up would be collected and the remainder would be taxed under the UTPR. However, if Parent B also applies its IIR the full RM100 of top up is collected so there is no need to apply the IIR. Parent A reduces its RM20 top up to nil because this has already been charged by Parent B.

7.2.3 The split ownership rules

i. The split ownership rules are an exception to the IIR's general top-down approach. Under the GloBE Rules, an intermediate parent entity that is more than 20% owned by minority investors outside the MNE group is called a partially-owned parent entity (POPE). The POPE definition is satisfied even if minority investors indirectly own more than 20% of the ownership interests in the parent entity. A parent entity owned by a POPE will therefore usually also be a POPE.

ii. POPEs have the priority rights to apply the IIR notwithstanding the general top-down approach. The reason for this is that, where there are substantial minority interests, some amount of the top-up tax would not be collected at all if the IIR were only applied by parent entities higher up the ownership structure.

Example 11: Partially-owned parent entities (POPEs)

The amount of top-up tax calculated for an MNE's LTCE is RM100. The UPE indirectly owns the LTCE through A Co. The UPE owns 60% of A Co and A Co owns 100% of the LTCE.

Under the GloBE Rules, A Co (and not the UPE) would apply the IIR and pay RM100 of top-up tax. By charging all the top-up tax to A Co, the top-up tax is effectively borne 60% by the UPE and 40% by the minority shareholders.

If this were not the case and only the UPE applied the IIR, the UPE would only be charged RM60 of the top-up tax based on its allocable share. The remaining RM40 would not be collected under either the UTPR or the IIR.

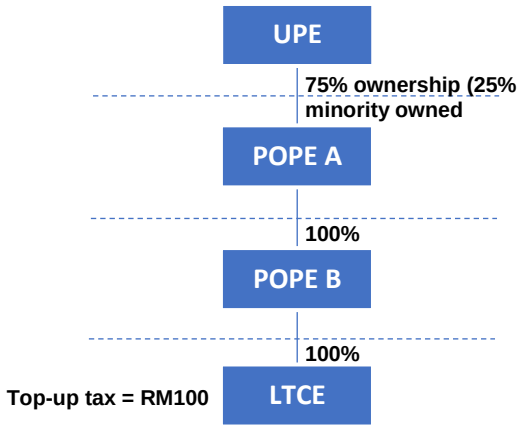
iii. The ordering rules for POPEs require a lower-tier POPE to switch off its IIR only if it is wholly-owned by a higher POPE which is subject to the IIR.

Example 12: POPE rules and corresponding tax reductions

The amount of top-up tax calculated for an MNE's LTCE is RM100. The UPE indirectly owns the LTCE through a chain of POPEs. The UPE directly owns 75% of POPE A, with the remaining 25% held by minority investors outside the MNE group. POPE A directly owns POPE B (ownership percentage varies under the two examples below). POPE B directly owns 100% of the LTCE.

POPE A owns 100% of POPE B

If POPE B is 100% owned by POPE A, POPE A would apply the IIR and be charged RM100 of top-up tax. POPE B would not be required to apply the IIR.



POPE A owns 90% of POPE B, with remaining 10% owned by outside investors

If POPE B is only 90% owned by POPE A, both POPEs would apply the IIR.

POPE B would be charged RM100 of top-up tax. POPE A would also apply the IIR but its top-up tax liability will be reduced to zero by the amount of tax charged to POPE B.

iv. As noted above, if a parent entity further down the group structure has applied the IIR, the liability of any parent further up the group applying the IIR must be reduced. The amount of the reduction is the top-up tax paid by the lower parent under an IIR multiplied by the higher parent's ownership

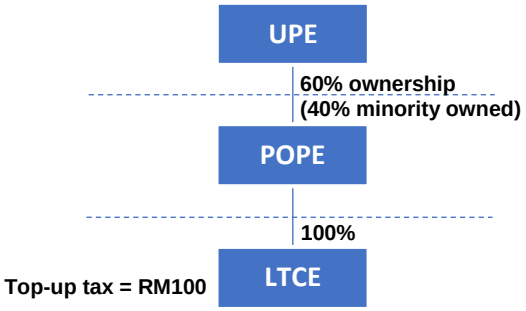
interests in the low taxed entity held indirectly through that lower parent. So for example if the lower parent pays top-up tax of RM100 in respect of a low tax entity and the higher parent indirectly holds a 60% ownership interest in that same low taxed entity through the lower parent, then the amount of the reduction is RM100 x 60% = RM60.

Example 13: Reduction for top-up tax charged to lower parent

The amount of top-up tax calculated for an MNE's LTCE is RM100.

The UPE indirectly owns the LTCE through a POPE

Assume the POPE directly owns 100% of the LTCE, and the UPE directly owns 60% of the POPE, with the remaining 40% held by minority investors outside the group.

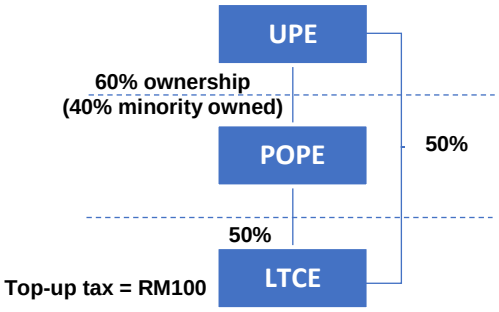


Both the UPE and the POPE apply the IIR:

- *The POPE's allocable share of the top-up tax is RM100.*
- *The UPE's allocable share is initially RM60 but this is reduced by the top-up tax paid by the POPE multiplied by the UPE's ownership interest in the LTCE held indirectly through the POPE. This reduction equals RM60 (RM100 x 60% = RM60), meaning the UPE has zero allocable share. This is appropriate because the top-up tax has already been fully charged to the POPE.*

The UPE owns the LTCE both directly and indirectly through a POPE

Assume the POPE owns 50% of the LTCE, and the UPE owns the other 50%. AS above, the UPE also directly owns 60% of the POPE with the remaining 40% held by minority investors outside the group.



Again, both the UPE and the POPE apply the IIR:

- *The POPE's allocable share of the top-up tax is RM50.*
- *The UPE's allocable share is initially RM80, being RM50 from its direct interest in the LTCE plus RM30 from its indirect interest through the POPE (60% x RM50 = RM30). The UPE reduces its top-up tax liability by RM30 to RM50, as the $30 from its indirect interest through the POPE has already been charged to the POPE.*
- *The result is that the full RM100 of top-up tax is collected.*

7.3 Undertaxed profit rule

7.3.1 The UTPR is the second charging mechanism in the GloBE Rules. Like the IIR, it starts from the calculation of top up tax for each jurisdiction, under the rules explained in Chapters 5 to 6. However, it allocates the top up between jurisdictions in which the group has CEs based on where the group's tangible assets and employees are located instead of by ownership. This top up will then be charged on the CEs in the jurisdiction. The GloBE Rules do not prescribe how this is tax is brought into charge.

7.3.2 The UTPR primarily functions as a back-up rule to the IIR. It is to ensure that top up tax is paid in respect of a low-taxed CE when its parent entities are located in a jurisdiction that do not impose an IIR.

7.3.3 However, the UTPR is also intended to ensure that low taxed entities in the ultimate parent's jurisdiction are also subject to top up taxation, to prevent distortions and level playing field concerns that could arise from such entities being outside of the GloBE Rules.

7.3.4 Interaction with the IIR

i. The GloBE Rules provide rules which are designed to give the IIR priority over the UTPR in charging low-taxed profits outside of the UPE jurisdiction.

ii. These rules work by disapplying the UTPR when the UPE is subject to a qualified IIR, or when all of the interests in the low-taxed CE are held by parent entities which are subject to a qualified IIR.

iii. However, the UTPR will apply when all of the interests of a low-taxed CE are not held by Parent Entities which are subject to a qualified IIR. However, the top up tax collected under the UTPR is reduced by the amount which is charged under an IIR. This ensures the IIR still takes priority.

iv. For example, if the total top up tax for the low-taxed CE is RM100, but RM60 of that is charged under an IIR, the top up tax which is allocated under the UTPR will be RM40.

7.3.5 Allocating the tax

i. The UTPR uses an allocation key to allocate the top-up tax due to be collected under the UTPR between the jurisdictions in which the group has CEs and which have implemented a qualified UTPR.

ii. The allocation is calculated at a jurisdictional level and allocates the top up based on the proportion of the tangible assets and number of employees in each UTPR jurisdiction.

iii. If 5 jurisdictions implement the UTPR and 4 of those jurisdictions have 25% of the group's tangible assets and employees and the fifth has 0%, the first four jurisdictions would each be allocated 25% of the top up.

iv. There are equal weights for the asset and employee factors.

v. The data for this calculation can be taken from the MNE's CBC report, which will minimise the additional compliance burdens on MNEs and improve coordination by basing the calculation on existing, readily available, and objective data.

7.3.6 Bringing the tax into charge

i. The GloBE Rules do not prescribe how a jurisdiction should bring the UTPR top up tax allocated to it into charge. This is left to jurisdictions to decide domestically but the outcome must be to produce an additional cash tax expense in that jurisdiction equal to the top up allocated to it.

ii. The GloBE Rules set the first approach for UTPR by denying Income Tax deduction on payments made by CEs. The second approach would be to introduce a new charge based

on the top up allocated to the jurisdiction. This charge would be capped by reference to the payments made by CEs in order to meet the 'equivalent adjustment' requirements in the GloBE Rules.

7.3.7 Carrying forward the remaining top up

i. Depending on the approach taken above, there may be circumstances when the above adjustment is not sufficient to collect the full top up that is allocated to the jurisdiction.

ii. This could be the case where there are insufficient payments in the jurisdictions or where the group is loss-making in the jurisdiction. In this case, the GloBE Rules require the uncollected portion of the top up to be carried forward, to be collected in the next year.

iii. When there are insufficient deductions to collect the top up, there will be a further adjustment in the second year to collect the remaining top up.

iv. There would be no further adjustment if there were sufficient deductions, but losses meant the adjustment was unable to produce an additional cash tax liability equal to the top up. In this case, the adjustment in the first year will already be enough to collect the right amount of top up over time because the taxpayer will no longer be able to carry forward that loss to offset their profits in subsequent years.

v. The GloBE Rules contain a provision which prevents future top ups being allocated to a jurisdiction which has carried forward some of its top up from an earlier year. In this case, this jurisdiction would be removed from the allocation key.

Questions:

a. Any comments on how the IIR and UTPR provisions should be reflected in domestic legislation while respecting the agreed outcomes in the GloBE Rules?

b. Any views on how information or administration challenges with the split ownership rules could be addressed in the implementation framework?

c. Any other comments on Charging Mechanism?

8.0 TRANSITION RULES

8.1 The GloBE Rules provides special rules that will apply for a period of time when groups first enter the regime. These rules govern the treatment of losses and other timing differences between accounting and taxable profits that span the commencement date.

8.2 The rules also provide higher levels of profits subject to the substance carve out and a lower ownership threshold for portfolio dividends during the transition period. Groups will have a longer filing deadline in the first year of entering the regime.

8.3 Losses and timing differences

8.3.1 Losses and other timing differences which began before a group enters the Pillar Two regime will generally be treated as though Pillar Two were in place at the time that the losses were incurred, or the timing differences began.

8.3.2 Losses and other timing differences which arose in low tax jurisdictions must be recast to the statutory rate of the jurisdiction, unless the group can demonstrate that a loss would have arisen under the GloBE Rules, in which case it may be recast to the minimum rate. This aligns with the ordinary treatment of losses and timing differences in the rules.

8.3.3 Losses in zero tax jurisdictions which are made before the rules come into effect will not be brought into the regime. Once the rules are in place, a group may make an election to ensure that future losses are brought into the ETR calculation.

8.3.4 In order to prevent tax motivated restructuring in response to the publication of the GloBE Rules, there are special rules to deal with deferred tax assets incurred and asset transfers taking place after 30 November 2021.

8.4 Filing obligations in the transitional year

In the first year in which a group comes within scope of the rules the filing deadline will be increased to 18 months from the end of the accounting period for the group's consolidated accounts. This is intended to allow groups some additional time to set up the necessary compliance processes and systems when they first enter the regime.

8.5 Substance based carve out

The carve out percentages will be higher during the transition period, tapering down to the normal rates over a ten-year period.

8.6 Groups in their initial phase of international expansion

There is temporary relief of five years as in the UTPR will not apply to groups which are in the initial phase of expanding internationally. This applies when the group:

a. operates in no more than six jurisdictions; and
b. holds less than EUR50 million of tangible assets outside of the country in which it has the largest tangible asset base.

Question:

a. Any views on how rules on the transition rules work including whether there are any uncertainties around how the rules operate that could be further clarified in domestic law?

9.0 SIMPLIFICATION

9.1 There would be simplified reporting obligations for businesses in jurisdictions where there is a low risk that the ETR would be below the minimum rate.

9.2 Where a business qualifies for an agreed safe harbour, the MNE group would not need to provide the full ETR calculation for that jurisdiction but would provide a simpler computation to evidence that they were eligible for this simplification.

9.3 Country-by-Country Reporting (CbCR) Safe Harbour

9.3.1 There have previously been discussions about using a simplified ETR calculation based on data in a MNE's CbCR to approximate the risk the full GloBE ETR is below the minimum rate.

9.3.2 This would work by starting from the profit and accrued taxes the MNE reports for a jurisdiction in the CbCR. This data would be used to calculate an ETR.

9.3.3 The group would qualify for the safe harbour when this ETR is above a certain CbCR safe harbour minimum rate. This could be higher than the 15% minimum rate in the GloBE Rules to reflect the risk that the CbCR ETR is different because of differences in how the GloBE income and adjusted covered taxes are calculated.

9.3.4 There is an important policy design question whether that risk should be addressed through increasing this rate premium over 15% or whether there should also be adjustments to the CbCR

figures to bring the ETR calculation closer into line with how the GloBE ETR is calculated.

9.3.5 There is a trade-off between accuracy and simplicity. Increasing the number of adjustments reduces the risk that a MNE inappropriately qualifies for the safe harbour. Equally, it reduces the risk a MNE is inappropriately excluded from the safe harbour.

9.3.6 However, it also increases the complexity of the calculation, and therefore reduces some of the simplification benefits the safe harbour is intended to provide.

9.3.7 The adjustments that would be made could broadly be split into two categories.

9.3.8 The first would mirror some of the adjustments made to GloBE income. For example, the CbCR profit could be adjusted where this includes gains and losses on disposals of participation shareholdings, so the figure more accurately represents the profit in the GloBE base (and in most cases also the taxable profit in the local tax jurisdiction).

9.3.9 These adjustments wouldn't necessarily need to reflect all of the adjustments in the GloBE Rules but could identify those which are most impactful or are most likely to lead to the ETR being inappropriately inflated.

9.3.10 The second category would be intended to reflect timing differences and bring the CbCR ETR closer into line with the outcomes achieved by the timing differences rules.

9.3.11 Without these adjustments, a taxpayer could have a low ETR in the CbCR even though this low ETR is simply a consequence of the taxpayer having used losses from earlier years to offset its profits.

Questions:

a. **Any views on a CbCR based safe harbour and how it should be designed?**

b. **Any views on the timing differences within a CbCR safe harbour design?**

c. **Any views on how the rules should address when a business moves from the safe harbour into the main Pillar Two regime?**

10.0 THE IMPLEMENTATION OF GLOBE RULES IN MALAYSIA

10.1 The Inclusive Framework has agreed that the GloBE Rules are a common approach where jurisdictions that choose to implement the GloBE Rules must implement them in line with the Pillar Two agreement. The effectiveness of the GloBE Rules also depends on a high degree of consistency in the implementation in different jurisdictions to avoid a high risk of double taxation or double non-taxation.

10.2 Adopting the GloBE Rules will require incorporation of the rules into Malaysian law, using one of the following options:

10.2.1 The GloBE Rules are incorporated into Malaysian Income Tax Act, with adaptations in limited areas, for example, to reflect concepts in Malaysian law; or

10.2.2 Adoption of GloBE Rules through subsidiary legislation. This would require enabling provision in the Income Tax Act 1967, followed by the GloBE Rules in the subsidiary legislation.

Questions:

a. How should Malaysia incorporate the GloBE Rules into domestic legislation?

b. Is 2023 is an acceptable date to implement the GloBE Rules?

c. Any other comments on the adoption of the GloBE Rules in Malaysia?

11.0 TAX INCENTIVES: THE WAY FORWARD

11.1 As the developing jurisdiction, tax incentives are one of the measures to attract FDIs into Malaysia, particularly investment in high value-added industries. Pillar 2 is designed to ensure a level playing field between countries in attracting foreign direct investment where MNEs would have to pay at least minimum 15% of ETR. Therefore, there is the need for Malaysia to review its tax incentives to ensure more consolidated and targeted incentives, based on quality investment and huge spill over to the economy.

11.2 To implement tax incentives as well as adopting to the GloBE Rules, the key considerations to be taken by the Government are as follows:

a. Establish agile and forward-looking incentive packages that meet the needs of investors;

b. Strengthen incentive monitoring/compliance as well as establishing automated and centralised data collection systems;

c. Identify profile of investors prior to the tax incentives negotiations;

d. Explore the viability of a domestic top-up tax;

e. Analyse approaches adopted by other ASEAN countries and undertake comprehensive study on the impact of Pillar 2; and

f. Consider other non-tax incentives to complement the reformed tax incentive framework.

Questions:

a. Any suggestions on how Malaysia could incorporate its current incentive schemes into the framework of the GloBE Rules to ensure the incentives remain relevant to attract FDIs?

12.0 UNDERTAXED PROFITS RULE IMPLEMENTATION IN MALAYSIA

12.1 The GloBE Rules do not prescribe how tax allocated to a jurisdiction by the UTPR should be brought to charge. This is up to the jurisdiction in so long as the outcome produces an additional tax in that jurisdiction equal to the top-up tax allocated to it.

12.2 While the top-up tax allocated to a jurisdiction will be charged to the MNE's CEs in that jurisdiction, an MNE may have multiple CEs and countries are free to determine how that liability is allocated and charged between them.

Option 1: Denying a deduction

12.2.1 The first approach which is set out in the GloBE Rules would be to deny an income tax deduction on otherwise deductible expenses of the MNE group.

12.2.2 The top-up tax allocated to Malaysia would be converted to denied deductions by dividing the top-up tax allocated to Malaysia by the income tax rate. For example, a top-up tax liability of RM1,000 would be converted into denial of a deduction for RM4,166 of otherwise deductible expenditure, in the year the top-up tax relates to. This would cap the top-up tax based on the total deductions of the entity. If deductions in that year were less than RM4,166, the shortfall would be carried forward and used to reduce deductions in the next year.

12.2.3 As the top-up is allocated for the jurisdiction as a whole, there would need to be rules to specify how the MNE should apply the adjustment when there are multiple entities within Malaysia.

12.2.4 This could be achieved by specifying that the deductions should be denied first in the CE in the group with the highest taxable income (ignoring any deduction denial) and then continue on to the CE with the next highest taxable income if that is still insufficient to collect the tax and so on.

Example 14: Ordering of denied deductions under UTPR

An MNE has its UPE in a jurisdiction that does not have an IIR. Top-up tax of RM100 has been allocated to Malaysia under the UTPR for the MNE's 2030 Financial Year.

At a 24% company tax rate, the RM100 of top-up tax converts to RM416 of denied deductions (RM100 / 0.24).

The MNE has 3 Malaysia subsidiaries. Before denying any deductions under the UTPR, the subs have the following gross income, deductions and taxable income:

- *Sub A has gross income of RM300, deductions of RM250 and taxable income of RM50*
- *Sub B has gross income of RM140, deductions of RM100 and taxable income of RM40*
- *Sub C has gross income of RM200, deductions of RM170 and taxable income of RM30*

If Malaysia chose to collect tax under the UTPR by denying deductions, first in the CE with the highest taxable income (and so on), Sub A would be denied deductions of RM250, Sub B would be denied deductions of RM100 and Sub C would be denied deductions of RM66.

Option 2: Separate tax liability

12.2.5 The second approach would be to treat the GloBE calculation and any resulting tax liability as a separate tax liability independent of income tax. This would apply to the UTPR as well as the IIR.

12.2.6 The tax would be a joint and several liability of all Malaysia CEs.

12.2.7 In relation to the UTPR, this charge would still be capped by reference to deductions in order to meet the "equivalent adjustment" requirements in the GloBE Rules. But it will be capped by the total deductions claimed by all Malaysia CEs.

Questions:

a. Any comments on how top-up tax allocated to Malaysia under the UTPR should be brought to charge?

13.0 QUALIFIED DOMESTIC MINIMUM TOP-UP TAX

13.1 As part of the Pillar Two implementation process, Malaysia is exploring the idea of introducing a QDMTT in Malaysia.

13.2 Under QDMTT, rather than allowing a foreign jurisdiction to charge top up taxes to any low-taxed profits of a group's entities in Malaysia, Malaysia would instead impose that top-up tax. While this goes beyond the requirements in the GloBE Rules, those rules contemplate countries introducing QDMTT alongside Pillar Two.

13.3 The introduction of QDMTT in domestic legislation would ensure that any top-up tax on Malaysia's economic activities and profits remain in Malaysia.

13.4 QDMTT could also reduce compliance burdens on Malaysia's UPEs by preventing them from being subject to the UTPR in multiple countries in respect of their Malaysia domestic operations.

13.5 Interaction with Pillar Two:

13.5.1 The GloBE Rules reduce the amount of top up tax that is due to be collected under the IIR or UTPR by the amount of tax charged under a QDMTT. This means the tax under Malaysia QDMTT would directly reduce any top up taxes charged by another country under either the IIR or the UTPR.

13.5.2 This treatment only applies to domestic minimum taxes which are qualified. These are top up taxes which are based on the GloBE Rules and which are designed to collect the same top up that would otherwise be collected under Pillar Two.

13.5.3 Where a domestic minimum tax is not qualified because it is not closely based on the GloBE Rules, it would be treated as a covered tax instead and be included in the ETR calculation for the jurisdiction.

13.5.4 This would mean the tax on the income which is excluded from the Globe base through the substance carve out would be disregarded, meaning the tax rate would have to be higher to fully

cover the top up tax which would be charged under the IIR or UTPR.

13.5.5 QDMTT should be designed to match the scope of the GloBE Rules. Therefore, preference would be to restrict a QDMTT to groups which have over EUR750 million of global consolidated revenue in line with the GloBE Rules.

Questions:

a. Would QDMTT help to reduce compliance costs for businesses?

b. Should the QDMTT only apply to groups with over EUR750 million of revenue?

c. Any comments on the policy design of the QDMTT?

14.0 CONCLUSION

In conclusion, Malaysia is fully committed to adhere to the internationally agreed tax standards and best tax practices around the world. Priority is given to meet our obligation at the OECD level as OECD is the focal international body that sets and monitors the implementation of such standards in cross border tax issues.

By having GloBE Rules adopted in Malaysian tax legislation, it will tackle the remaining BEPS issues in Malaysia and broaden Malaysia's tax base and taxing rights as well as it will remain Malaysia's competitiveness in attracting foreign direct investment (FDI).