China Tax Alert

Issue 34, November 2019

OECD consultation on global minimum tax

Regulations discussed in this issue:

- Global Anti-Base Erosion Proposal (Pillar 2) – Public Consultation Document ('Nov 2019 consultation document'), released on the OECD website on 8 November 2019.
- Programme of Work to Develop a Consensus Solution to the Tax Challenges Arising from the Digitalisation of the Economy ('programme of work'), released on the OECD website on 31 May 2019.
- Addressing the Tax Challenges of the Digitalisation of the Economy – Public Consultation Document ('Feb 2019 consultation document'), released on the OECD website on 13 February 2019.

Background

On 8 November 2019 the OECD Secretariat released on their website a public consultation document on the Global Anti-Base Erosion (GloBE) proposal. Comments are due by 2 December, prior to a consultation meeting on 9 December.

GloBE would set a global minimum corporate tax level and is "Pillar 2" of the two pillar solution being developed to tackle the tax challenges of digitalization. It complements the "Pillar 1" proposals, released last month, for new corporate tax standards on nexus and profit attribution rules. GloBE's broad scope would impact on large multinational enterprises (MNEs) across all sectors, and could invalidate MNE group arrangements involving low taxed entities, such as those used for financing, IP holding and trading hub structures. Businesses operating cross-border into and out of China should take this opportunity to give input on the rule design considerations set out in the consultation document.

GloBE proposal

The GloBE proposal was first set out in OECD documents released in January and February 2019, and a detailed programme of work was fixed in May; see China Tax Alert Issue 7 and Issue 17. Various Working Parties (WPs) under the Inclusive Framework (IF) have since worked through the technical design challenges. The proposal is asserted to allow countries to 'tax back' profits of an MNE that have been 'shifted' into low tax countries. This involves:

- A residence country CFC-style 'income inclusion rule', based on the US Global Intangible Low Taxed Income (GILTI) provisions. Where the effective tax rate (ETR) on overseas operations falls under a minimum tax threshold a 'top up tax' is applied;
- A source country 'undertaxed payments' base erosion rule, denying tax deductions on payments to low tax countries.

This could be accompanied by a treaty 'subject to tax' provision allowing higher levels of withholding tax to be applied, and disallowing other treaty benefits. The source country rules would likely be a 'back-up' to the income inclusion rule.

Regulations discussed in this issue:

- Addressing the Tax Challenges of the Digitalisation of the Economy – Policy Note ('Policy Note'), approved by the Inclusive Framework on BEPS (IF) on 23 January 2019 and released on the OECD website on 29 January 2019.
- Interim Report on the Tax Challenges Arising from Digitalisation, prepared by the Task Force on the Digital Economy (TFDE), and released on the OECD website on 16 March 2018 (TFDE Interim Report).
- BEPS Action 1 Report "Addressing the Tax Challenges of the Digital Economy", prepared by the TFDE, released by the OECD on 5 October 2015.

The Nov 2019 consultation document seeks public input on the design of several key aspects of the income inclusion rule:

- Use of financial accounts for determining the tax base. The Secretariat set out the advantages of using the consolidated financial statements of the MNE parent company, and the GAAP to which it is subject. They raise the issue of whether adjustments might be needed where there are significant differences between different GAAP standards, and whether the tax base should be adjusted for certain tax-to-accounting permanent differences (e.g. exclusion of dividend income).
- Choice of mechanism to address tax-to-accounting timing differences (e.g. different pace of asset depreciation for accounting and tax purposes). If these are not addressed then resulting 'volatility' in ETRs could result in the rules applying when not warranted and/or not applying when warranted. Three possible approaches are set out – (i) carry-forward of excess tax/losses, (ii) multi-year averaging, or (iii) deferred tax adjustments. Sample calculations are included in an annex.
- The degree of 'blending' of income which should be allowed. Three options of worldwide, jurisdictional and entity blending are set out, each allowing for the combination of high-taxed and low-taxed income to different degrees. A variety of issues are explored for each (e.g. dealing with branches and partnerships).
- Use of carve-outs and thresholds, whether by industry, company size, substance or other factors.

KPMG observations

Work on the GloBE proposal has now entered the details stage, though many key aspects of the rules (including the level of the minimum tax rate) are still to be determined.

Worldwide blending would allow MNEs to combine the income of their subsidiaries in high-tax and low-tax countries. This would make it more likely that their ETR would rise above the minimum tax threshold and no additional tax would be applied. Jurisdictional or entity blending could, by contrast, lead to more frequent circumstances in which MNE intermediate entities (e.g. treasury, IP and principal companies) would be subject to further tax. For some MNEs this might raise the question of whether these entities are best removed from the corporate structure. Benefits from local tax incentives in jurisdictions of investment could also be neutralized by the income inclusion rule, impacting decisions on capital deployment. It should be noted that the scope of GloBE may extend to all industries, going beyond the consumer-facing business scope of the Pillar 1 rules; see China Tax Alert Issue 29.

The tone of the Secretariat's comments on qualitative, 'facts and circumstances' exclusions (e.g. for entities with substantive operating activities) make it seem less likely that these would be part of the final rules. However, it remains to be seen if quantitative exclusions for substantive activities (e.g. for deemed returns on tangible assets, as in GILTI) might be part of the final rules.

It also remains to be seen how the undertaxed payments rule and subject to tax rule would be designed and interface with the income inclusion rule. It is indicated that these matters would be the subject of a future consultation exercise.

Earlier in 2019 the level of support amongst IF countries for the minimum tax was unclear. However, subsequently, in July 2019, the G7 country finance ministers reached an agreement in principle to pursue the measure, and this has given efforts on GloBE enhanced momentum. It remains to be seen to what degree other IF countries can come to terms with a global minimum tax by 2020, in line with the OECD's planned timeframe.

It is worth noting that, even if GloBE is solely agreed upon as 'best practices', rather than as a 'minimum standard' which all IF jurisdictions must adopt, many countries may still be motivated to adopt it. If a particular country does not adopt the GloBE rules, and so does not subject locally headquartered MNEs to the income inclusion rule, this leaves these MNEs open to the imposition of source country taxation under the subject to tax or undertaxed payments rules. As such, countries may be induced to 'protect' their MNEs by adopting the income inclusion rule.

In order to best understand the impact of these complex rules on tax management, accounting systems, and MNE business and operating structures, close liaison with your KPMG advisor is highly recommended.

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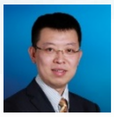

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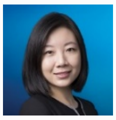

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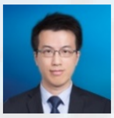

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