

Inclusive Framework BEPS Agreement

Update on Pillar Two of BEPS 2.0 – January 2023

Policy Perspectives Update – the Hong Kong SAR



Implementation package of Pillar Two under BEPS 2.0

On 20 December 2022, the OECD published the following three documents relating to the implementation package of Pillar Two under BEPS 2.0:

- 1 [Guidance on safe harbours and penalty relief under the GloBE Rules;](#)
- 2 [Public consultation document on the GloBE Information Return;](#) and
- 3 [Public consultation document on tax certainty for the GloBE Rules.](#)

The OECD's press release on the release of the above documents can be accessed via this [link](#).

The implementation package of Pillar Two

1. Safe harbours and penalty relief

The guidance includes (i) a Transitional Country-by-Country Reporting (CbCR) Safe Harbour, (ii) a framework for developing a potential permanent safe harbour based on "Simplified Calculations" and (iii) a transitional penalty relief regime.

(i) Transitional CbCR Safe Harbour

The objective of this safe harbour is to reduce the compliance burden associated with undertaking the full GloBE effective tax rate (ETR) calculation in respect of "low-risk jurisdictions" in the initial years that the GloBE Rules are in force. Under this safe harbour, the data reported in a **Qualified Country-by-Country (CbC) Report**¹ and **Qualified Financial Statements**² of an MNE group will be used to determine if it can meet any of the following three tests in a given jurisdiction in a Fiscal Year and therefore **the top-up tax** in that jurisdiction **will be deemed as zero**:

- **De minimis test** - the MNE group's total revenue and profit (loss) before income tax in such jurisdiction for the Fiscal Year are less than EUR 10 million and EUR 1 million respectively;
- **Simplified ETR test** - the MNE group has a Simplified ETR³ in such jurisdiction that is not less than an agreed rate⁴; or
- **Routine profits test** - the MNE group's profit (loss) before income tax in such jurisdiction is not greater than the Substance-based Income Exclusion amount as calculated under the GloBE Rules.

The Transitional CbCR Safe Harbour is only applicable during the **Transition Period** - i.e. for Fiscal Years **beginning on or before 31 December 2026**, but not including a Fiscal Year that **ends after 30 June 2028**.

In addition, it operates on a "once out, always out" basis. That is, if an MNE group has not been benefited from the safe harbour with respect to a jurisdiction in a year in which it is subject to the GloBE Rules, the safe harbour would not apply to

¹ Qualified CbC Report means a CbC Report filed using Qualified Financial Statements.

² Qualified Financial Statements include the accounts used to prepare consolidated financial statements of the ultimate parent entity and separate financial statements of each constituent entity prepared using acceptable or authorised accounting standards.

³ The Simplified ETR is calculated by dividing the jurisdiction's income tax expenses as reported in the Qualified Financial Statements (after eliminating any taxes that are not Covered Taxes and uncertain tax positions) by the jurisdiction's profit (loss) before income tax as reported in the Qualified CbC Report.

⁴ The agreed rate is 15% for fiscal years beginning in 2023 and 2024, 16% for fiscal years beginning in 2025 and 17% for fiscal years beginning in 2026.

that jurisdiction in subsequent years, unless the MNE group does not have any constituent entity (CE) in that jurisdiction in the previous year.

Additional special rules apply in respect of joint ventures, certain tax neutral ultimate parent entities, investment entities and net unrealised fair value losses exceeding EUR50 million.

The rules of the safe harbour adjust the application of certain provisions in the GloBE Rules. This includes (a) turning off Article 4.1.5 under which a top-up tax may incur in a jurisdiction in a year with a loss and a permanent difference and (b) allowing for deferral of the transition rules under Article 9.1 for the recognition of deferred tax assets and making elections in relation to tax losses until the safe harbour no longer applies.

An MNE group that qualifies for the Transitional CbCR Safe Harbour in respect of one or more jurisdictions is still subject to the full GloBE Rules in respect of other jurisdictions that do not qualify for the safe harbour. In addition, qualifying for the Transitional CbCR Safe Harbour will not exempt an MNE group from complying with MNE group-wide requirements including preparation of a GloBE Information Return (GIR). For those qualifying jurisdictions, the MNE group would still have to complete the relevant sections of the GIR (to be discussed below) that concern the application of the Transitional CbCR safe harbour in those jurisdictions.

KPMG observations:

- Of the three tests, the Simplified ETR test will most likely deliver meaning simplification for large MNE groups as the De minimis test and the Routine profits test would only provide limited relief for jurisdictions with a large scale or profitable business operation.
- Under the Simplified ETR test, complex adjustments and the associated tracking requirements contained in the full GloBE calculation, such as recasting deferred taxes at 15% as applicable and tracking of deferred tax liabilities that do not reverse within five years, are not required.
- The guidance does not include the details of the much anticipated Qualified Domestic Minimum Top-up Tax (QDMTT) safe harbour (i.e. the Income Inclusion Rule (IIR) and the Undertaxed Profit Rule (UTPR) would be deactivated in respect of a jurisdiction with a QDMTT regime). The document indicates that the Inclusive Framework on BEPS will consider such a safe harbour as part of its future work on the Administrative Guidance on the QDMTT, without a specific timeline.

(ii) Permanent Simplified Calculations Safe Harbour

The document also includes a framework for developing a potential Permanent Simplified Calculations Safe Harbour.

Similar to the Transitional CbCR Safe Harbour, if a jurisdiction meets any of the De minimis test, Simplified ETR test or Routine profits test, it will qualify for the permanent safe harbour and the **current year top-up tax** in that jurisdiction **will be deemed as zero**.

The differences between the Transitional CbCR Safe Harbour and the permanent safe harbour include:

- the transitional safe harbour only requires the application of the De minimis test to the current period instead of the current period and two prior periods as required under the permanent de minimus exclusion under the GloBE Rules;
- under the permanent safe harbour, only the current year top-up tax is deemed as zero, any additional top-up tax (such as that arising from a recalculation of a prior year's top-up tax or under Article 4.1.5) is not reduced; and
- instead of applying the data reported in a Qualified CbC Report, Simplified Income Calculation, Simplified Revenue Calculation and Simplified Tax Calculation will be adopted to determine whether any of the above three tests is met.

The aforesaid simplified calculations have yet to be developed and will be set out in the Administrative Guidance of the GloBE Rules to be issued.

The permanent safe harbour also includes a simplified calculation for Non-Material Constituent Entities⁵ – i.e. allowing an MNE group to base its GloBE calculation for such entities on data (revenue and taxes) determined according to the OECD's CbCR guidance. The methodology for the simplified calculation is subject to review by the Inclusive Framework.

⁵ These are entities that are not consolidated on a line-by-line basis in a MNE group's consolidated financial statements solely by virtue of size or materiality.

Again, qualifying for the permanent safe harbour on a jurisdictional basis would not exclude an MNE group from complying with the group-wide GloBE requirements but the compliance requirements would be streamlined for jurisdictions that qualify for the permanent safe harbour.

KPMG observations:

While not stated explicitly, the document seems to suggest that the Inclusive Framework has not considered a CbC report as the basis for the permanent safe harbour. If that is the case, it is likely to be challenging to identify alternative data sources or computations that deliver meaningful simplification under the permanent safe harbour.

(iii) Transitional Penalty Relief

The Transitional Penalty Relief provides that during the Transition Period, no penalties or sanctions should apply in connection with the filing of a GIR where a tax administration considers that an MNE group has taken “reasonable measures” to ensure the correct application of the GloBE Rules.

The term “reasonable measures” is not defined but the document suggests that the “reasonable measures” test should be considered as met when an MNE group has: (a) put in place the appropriate systems to understand and comply with the rules in good faith, (b) made errors attributable to unfamiliarity with the rules in the initial implementation period and (c) applies the rules in a manner that reflects a reasonable interpretation of an unclear rule, etc.

However, the proposed penalty relief regime is just a “common understanding” between Inclusive Framework members rather than a legally binder commitment.

2. GloBE Information Return

The GloBE Rules provides for the development of a standardised GIR covering all the data points that tax administrations will require to evaluate the correctness of a CE’s GloBE tax liability and perform an appropriate risk assessment.

Annex A1 of the consultation document **sets out the data points** (around 200 data points for each jurisdiction) **required to compute an MNE group’s GloBE tax liability**, which are sorted into the following four sections: (i) General information; (ii) Corporate structure; (iii) ETR computation and Top-up Tax computation and (iv) Top-up Tax allocation and attribution.

Annex A2 contains **explanatory guidance on the data points and the interpretation of the GIR**.

MNE groups may not be required to provide all of the data points set out in Annex A1. In this regard, inputs are sought on (i) the information to be collected, calculated, reported and exchanged under the GIR, (ii) possible simplifications of the ETR calculation that could be incorporated into the GIR and (iii) situations where an MNE Group should not be required to collect all data points or could provide alternative data points.

The document also indicates that the information provided in the GIR may share with the jurisdictions implementing the GloBE Rules and that work on developing a centralised filing requirement and appropriate mechanisms to allow tax administrations to automatically exchange the GloBE information collected is still on-going.

3. Tax certainty

The consultation document discusses various **Dispute Prevention Mechanisms** and **Dispute Resolution Mechanisms** for achieving tax certainty under the GloBE Rules. It outlines the expected next steps in connection with the development of these mechanisms and identifies a number of areas where stakeholder inputs are sought.

(i) Dispute prevention mechanisms

The document identifies the GloBE Model Rules, Commentary and Administrative Guidance as the primary way to promote consistency of interpretation and prevent disputes. A significant dispute prevention mechanism is the multilateral review process, which will review the GloBE Rules implemented by a jurisdiction to determine whether they are in line with the GloBE Model Rules.

The other mechanisms identified are: (a) a coordinated approach to assessing risks related to the GloBE Rules across different jurisdictions and a coordinated program for the GloBE purposes and (b) bilateral or multilateral and binding certainty mechanisms (e.g. a mechanism similar to Advance Pricing Arrangement).

(ii) Dispute resolution mechanisms

The document proposes that the dispute resolution mechanisms could build on the basic elements of the existing Mutual Agreement Procedure where an MNE group could submit a request to a competent authority in a jurisdiction where actions in that jurisdiction are potentially not in line with the GloBE Rules. The competent authority in that jurisdiction would then be empowered to resolve the dispute with the competent authorities of the other jurisdictions concerned.

The consultation document also discusses (1) the nature of disputes covered, (2) the basis for resolving disputes and (3) the legal instruments available for the resolution mechanism (e.g. a Multilateral Convention, a Convention on Mutual Administrative Assistance in Tax Matters, bilateral tax treaties and domestic law provisions).

What's next

The consultation documents on the GIR and tax certainty were released for seeking public comments and do not reflect the final views or consensus of the members of the Inclusive Framework. Interest parties are invited to submit their comments no later than **3 February 2023**.

Not included in this release is the Administrative Guidance on the GloBE Rules, which is expected to be released in early 2023. Work is also underway on the subject-to-tax rule and its implementing multilateral instrument.

Hong Kong business considerations

A few notable points from the guidance on the safe harbours and the consultation document on the GIR include:

- If Hong Kong (and considerable number of foreign jurisdictions) are going to implement the IRR in 2024, the Transitional CbCR Safe Harbour will provide relief for MNE groups with a December fiscal year end for three years (i.e. 2024, 2025 and 2026). However, since it is unlikely that an MNE group will qualify for the safe harbour in every jurisdiction in which it operates, these MNE groups will still have to establish the appropriate process and system to perform the full GloBE calculation in respect of the non-qualifying jurisdictions by 2024.
- As all three tests under the Transitional CbCR Safe Harbour rely on the data in a CbC report, the correctness of the CbC report will have greater significance for those MNE groups applying the safe harbour. These groups may wish to review the rigorousness of their existing process of preparing the report and the accuracy of the data in the report.
- Although Annex 1 of the consultation document on the GIR only set out the possible data points that an MNE group may need to collect and does not necessarily represent the final form of the GIR, it is expected that the GIR should include all the data points tax administrations would require to evaluate an MNE group's application of the GloBE Rules. This would involve substantial amount of data and impose a significant compliance burden on the in-scope MNE groups. Affected business groups should consider taking the opportunity of the OECD's public consultation to voice out their concerns and submit their recommendations on how the GIR can be simplified or the related compliance burden can be reduced.

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