

China Tax Alert

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Global minimum tax gains momentum – A recap of key recent developments

Summary :

December 2022 and January 2023 saw a rapid series of developments in relation to the rollout of the OECD-developed 15% global minimum tax. These have implications for businesses operating in China and are set out in this article.

Background

For context, back in October 2021 more than 130 jurisdictions of the OECD-sponsored Inclusive Framework on BEPS, including China, reached a political agreement on the so-called Global Anti-Base Erosion (GloBE) rules. This is the main part of Pillar 2 within the Inclusive Framework's two-pillar solution to reform the international tax rules. While uncertainty surrounds the implementation of Pillar 1, which aims to reallocate taxing rights over MNE profits to market countries, GloBE is forging ahead.

The October 2021 political agreement provided that GloBE would be a 'common approach'. This means that jurisdictions are not obliged to adopt the GloBE rules, but if they do so then they need to implement them in conformance with the OECD's design. Throughout 2022 there was uncertainty on when and if countries would actually push ahead with their GloBE legislation, but towards year-end several important jurisdictions made rapid progress. This is expected to propel GloBE adoption announcements by many countries in the first three months of 2023, meaning that businesses should be monitoring these closely. This alert looks at these and other developments, providing links to relevant KPMG articles.

- GloBE legislation progress in the EU, Japan, Korea, Switzerland and elsewhere
- OECD release of the first tranche of the GloBE implementation framework, including administrative safe harbors and model tax returns needed to put the rules into effect
- IASB release exposure draft on amendments to IAS12 (income taxes) in response to GloBE

Large businesses operating in China, both locally and foreign owned, will be impacted by the GloBE rules. While China has not yet made announcements on planned GloBE rule adoption, the latest developments might be viewed as increasing the likelihood that this will occur in due course.

GloBE-rollout jurisdictional updates

The most notable developments are as follows:

- While political agreement on the **European Union (EU) Minimum Tax Directive** stalled for much of 2022, in December 2022 the EU has achieved a consensus to implement Pillar 2. The Directive must be transposed into member states' national law by the end of 2023, with an effective 2024 start date for the Income Inclusion Rule (IIR) and a 2025 start date for the Undertaxed Profits Rule (UTPR). Some EU countries (e.g., Netherlands) have already released their draft legislation and many others are set to do so in the first quarter of 2023. [Euro Tax Flash from KPMG's EU Tax Centre - KPMG Global \(home.kpmg\)](#)

- On 16 December 2022, **Japan** formally announced its intention to implement Pillar 2, with the IIR applying for income years starting on or after 1 April 2024. Start dates for the UTPR and the domestic minimum tax are yet to be fixed, but there is an expectation it may apply for income years starting on or after 1 April 2025. [OUTLINE OF THE 2023 TAX REFORM PROPOSALS \(assets.kpmg\)](#) [BEPS part from page 13]
- **Korea's** National Assembly passed a tax bill including the Pillar 2 framework on 23 December 2022. This provided that the Pillar 2 provisions would take effect for fiscal years starting on or after 1 January 2024, including both the IIR and the UTPR. With most jurisdictions aiming for a 2025 start for the UTPR, the 2024 start date for the UTPR for Korea is an interesting development. That being said, Korea subsequently deferred the release of its Enforcement Decree, containing the details of the rules, from February to summer 2023. This is seemingly to provide latitude for possible deferral of the UTPR, depending on how other countries proceed on this. An important matter to monitor in the months ahead. <https://assets.kpmg/content/dam/kpmg/kr/pdf/2023/tax-brief/korea-tax-brief-202301-eng-F.pdf> [BEPS comments on page 11]
- The **Swiss** Parliament has approved a Constitutional Amendment to implement the GloBE rules (2024 start date expected). [Swiss parliament approves Pillar Two implementation - KPMG Switzerland \(home.kpmg\)](#).

These join other jurisdictions in Asia-Pacific (Australia, Indonesia, Singapore, Hong Kong, Malaysia, New Zealand) and elsewhere which have already given indications on their intent to adopt the GloBE rules, but have not yet reached the legislative phase. The likelihood of the US moving forward on the GloBE rules looks low in the near term, so US MNEs will likely need to contend with taxation under other countries' GloBE rules.

China tax policymakers have, as yet, given no public indication on plans for China to adopt the GloBE rules. However, this may become more likely as other countries firm up on their implementation plans. For example, take the implications of possible Korean UTPR application from 2024 for a Chinese group:

- If China does not adopt IIR and UTPR from 2024, a Chinese group, with low taxed entities in China and elsewhere, and in possession of a Korean subsidiary, would end up paying GloBE top up tax to Korea from 2024, in respect of those low taxed entities.
- If, however, China adopts a qualified domestic minimum tax (QDMTT) based on the GloBE rules by 2024, then China, rather than Korea, would at least collect the top up tax on the **China entities**.
- If China were to adopt IIR (alongside) from 2024, then the top up tax that China would potentially lose to Korea would be further limited. In relation to a group with a China top parent entity, China would collect the top up tax on the China operations and on low taxed overseas operations. To note though, the analysis differs for listed Chinese groups with Cayman or HK ultimate holding companies – top up tax on group low taxed entities could be paid to HK in such instances.

OECD releases first tranche of the Pillar 2 Implementation Framework

On 20 December 2022, the OECD released the first tranche of the GloBE implementation framework. This includes the compliance safe harbours (transitional and permanent – the transitional ones are issued as final), the draft GloBE Information Return template and explanatory notes (issued for consultation), and the dispute resolution mechanisms (issued for consultation). This was then followed on 2 February 2023 by the release of a series of 26 items of administrative guidance (AG). (See KPMG publication: [GloBE Updated Administrative Guidance](#))

The safe harbours are of high importance to businesses. Where an MNE needs to do the full GloBE effective tax rate (ETR) calculations, for all the jurisdictions in which it operates, the compliance costs would be very high due to the variety and complexity of the data collection and processing work. The safe harbours look to limit the workload involved.

There are 3 main transitional safe harbours, which deem the top up tax to be zero:

- **Simplified ETR test** - The Simplified ETR for a jurisdiction is calculated using the financial statements of the entities in a jurisdiction, together with CbC Report information. The ETR numerator is the income tax expense per the financial statements (so covering current and deferred tax), adjusted to remove uncertain tax positions and tax types that do not qualify as "Covered Taxes" for GloBE purposes. The ETR denominator is the Profit (Loss) before Income Tax in the "Qualified" CbC Report. If the Simplified ETR exceeds the Transition Rate for a year then the safe harbour applies. The Transition Rate varies in the Transition Period. For the 2023 and 2024 years it is 15%. It is 16% for the 2025 year and 17% for fiscal years beginning in 2026.

- Routine profits test - This test applies if the amount of the Substance-based Income Exclusion (a markup on payroll and tangible assets, reflecting a routine return) is greater than the jurisdiction's Profit or Loss before Income Tax in the Qualified CbC Report
- The de minimis exclusion – Total Revenue of less than €10 million and Profit (Loss) before Income Tax of less than €1 million in the Qualified CbC Report for the Fiscal Year

The Transitional CbCR Safe Harbor rules will only apply for Fiscal Years beginning on or before 31 December 2026 but will not include Fiscal Years that end after 30 June 2028. Following this, the transitional safe harbours are no longer available, and the permanent safe harbours (still in development) will need to be assessed to see if they can be of use.

One interesting point to highlight is that while the adoption of CbC Report data based safe harbour relief can potentially reduce the workload associated with GloBE calculation for many groups to a great extent, given the simplification of the calculation (i.e., almost no further adjustment of the CbC Report data to align with GloBE rules), pressure is back on how errors that may be contained in CbC Report, or accounting treatments of certain transactions as reflected in the financial statements can now have direct impact on a group's GloBE top up tax computation during the three years.

The GloBE Information Return data requirements list runs to 22 pages, with an additional 40+ pages of explanatory notes. It requires a number of detailed disclosures for the various ETR adjustments on a jurisdictional basis, as well as details on an entity-by-entity basis. It is already apparent that, for many MNEs, the return could run to thousands of pages.

The AG, running to 109 pages, looks to tackle some of the most difficult GloBE technical issues. Taken together with the AG, the GloBE rules and guidance now come to 456 pages and this will continue to steadily rise in future as further AG items are released.

Of particular importance is the framework set for countries on designing a QDMTT. The indications are that most countries will eventually adopt QDMTTs, and it is likely that the bulk of GloBE top up tax will be collected via QDMTTs. Other AG items of special note relate to the transitional rules, the deemed MNE rule (which could impact wealthy families), and the interaction of CFC rules with the GloBE rules. The AG also aims to deal with various quirky interactions of the GloBE rules with accounting treatments.

KPMG International [has prepared a document](#) which provides a summary of the key features of the GloBE releases.

Further work will be needed at OECD level to finalise the model return, the dispute resolution procedures, and the permanent safe harbours.

Exposure draft on IAS 12 amendments for Pillar 2 released

On 9 January 2023, the IASB released an Exposure Draft with proposed amendments to IAS 12, the IFRS accounting standard on income taxes. This sets out a temporary exception for accounting for deferred taxes in respect of GloBE taxes (including QDMTTs). To note, calculating deferred tax in respect of GloBE taxes could constitute a very complex exercise, due to various technical factors and potential circular calculations, so the exemption is welcomed by business.

An MNE which applies the exclusion must make additional disclosures for periods in which the Pillar 2 legislation is enacted or substantively enacted in one of its jurisdictions of operation but is not yet in effect.

- information about GloBE/QDMTT legislation enacted or substantively enacted in jurisdictions in which the MNE operates.
- the jurisdictions in which the MNE's average ETR (calculated as specified in IAS 12) for the current period is below 15%. The entity would also disclose the accounting profit and tax expense for these low tax jurisdictions in aggregate, as well as the resulting weighted average ETR for these low tax jurisdictions.
- whether the assessments that the entity has made, in preparing to comply with Pillar Two legislation, indicate that there are jurisdictions:
 - for which an ETR less than 15% was calculated under IAS12 rules but which might, in fact, not be exposed to GloBE tax; or
 - for which an ETR more than 15% was calculated under IAS12 rules but which might, in fact, be exposed to GloBE tax.

The additional disclosures would apply for annual reporting periods beginning on or after 1 January 2023. Once GloBE top up tax applies to the MNE it must disclose, in the financial statements, the current tax expense arising from GloBE/QDMTT tax.

The exposure draft consultation runs to 10 March 2023, and the IASB plans to complete the IAS12 amendments in the second quarter of 2023. The accounting regulators in jurisdictions whose accounting standards are conformed to IFRS or closely follow IFRS in key aspects, will need to confirm/endorse/assess the IASB's IAS12 amendments – no information is yet available on their time plans.

KPMG has released a [web article](#) and [talkbook](#) in relation to the release. It should also be noted that the US accounting regulators have recently also issued guidance – similar to the IASB they provide that deferred tax need not be calculated in respect of GloBE tax.

China considerations

As noted above, China tax policymakers have, as yet, given no public indication on plans for China to adopt the GloBE rules. However, both China-headquartered MNEs and foreign MNEs with China operations will start to see the effect of GloBE tax on their operations, including those in China, from 2024. While relevant tax filings likely will not be needed before 2025, accounting disclosure requirements may hit much sooner. MNEs around the world are already upgrading their accounting and tax management systems, reassessing their corporate structures and use of incentives, and communicating with stakeholders on possible impacts.

Businesses with China operations would be well advised to consider the GloBE impacts on their businesses and take appropriate actions. It should be borne in mind that, even if China does not adopt the GloBE rules, these businesses will feel the impact of the tax and compliance burdens under the rules. Furthermore, in order to avoid unintended negative impacts of GloBE rules, many remedial actions do need to be completed before the GloBE regime come into effect, i.e., need to be completed before 2024. KPMG experts in GloBE taxation are happy to assist on impact assessment, system upgrades and accounting implications.

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