A New Era in Tax

A Step Towards Global Minimum Tax

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KPMG in Malaysia

Overview and Commentary

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Key Message

"Malaysia plans to introduce the Global Minimum Tax in Year 2025. This may come as good news for many in-scope MNEs as it gives sufficient time for in-scope MNEs to prepare and plan for the implementation of the Global Minimum Tax.

However, despite the additional breathing space, in-scope MNEs should not undermine the work that needs to be done. The time for action is now."

A Global Tax Reform

The year 2021 has seen an unprecedented event where over 136 countries, including Malaysia, agreed to adopt a two-pillar approach which reforms the international tax rules to address the tax challenges of today's digitalized and globalized economy. Since then, the Organisation for Economic Co-operation and Development ("OECD") has released numerous publications and announcements centering on Pillar Two, also known as the Global Anti-Base Erosion Pillar Two rules ("GloBE Rules"). The GloBE Rules ensure that large multinational enterprises ("MNEs") pay a Global Minimum Tax ("GMT") of 15% wherever they operate.

Many developed nations such as the United Kingdom, Japan and Korea will take the lead to implement the GloBE Rules in 2024, while our neighboring countries such as Singapore, Thailand and Hong Kong will defer the implementation of GloBE Rules to 2025.

It is announced in the tabling of 2024 Budget that Malaysia plans to introduce GMT in 2025. This may come as good news for many in-scope MNEs as it would give in-scope MNEs sufficient time to equip themselves with the necessary knowledge and resources for the implementation of the GloBE Rules.

While the draft tax legislation on GloBE Rules have yet to be released, it is expected that the legislation would be largely aligned with the OECD's Model GloBE Rules, the associated Commentary, Administrative Guidance and the recent Global Minimum Tax Implementation Handbook which serve as guiding principles on the implementation of the GloBE Rules.

Overview of the GloBE Rules

Based on the GloBE Rules, MNEs with an annual global revenue of EUR750 million (approximately RM3.7 billion) or more in at least two out of four immediately preceding fiscal years would be in-scope and subject to the GloBE Rules. Broadly, in-scope MNEs are required to compute the Effective Tax Rate ("ETR") for each jurisdiction that they operate in. The formula to calculate the jurisdictional ETR is as follows:-

$$\text{Jurisdictional ETR} = \frac{\text{Covered taxes for a Jurisdiction}}{\text{GloBE Income for a Jurisdiction}}$$

The Covered Taxes (numerator) and GloBE Income (denominator) are essentially income taxes and financial accounting income recorded in the financial statements that are subjected to a series of adjustments under the GloBE Rules.

Top-up Tax will be due if the Jurisdictional ETR is less than 15%. The Top-up Tax for a jurisdiction is computed by applying the shortfall rate (i.e. the minimum tax rate of 15% less the Jurisdictional ETR) on Excess Profits, that is the GloBE Income after deducting Substance Based Income Exclusion ("SBIE"). SBIE is a substance carve-out calculated based on a percentage of payroll cost and tangible assets to be excluded from Top-up Tax.

Top-up Tax will be collected based on the following order of priority:-

Top-up Tax Collection Mechanisms		
1	Qualified Domestic Minimum Top-up Tax ("QDMTT")	Under the QDMTT, Top-up Tax will be collected by the local jurisdiction where the entity operates, provided that the local jurisdiction implements QDMTT.
2	Income Inclusion Rule ("IIR")	Under the IIR, Top-up Tax will be collected by the jurisdiction of the parent entity, to the extent that it has not been collected under the QDMTT in the jurisdictions where its foreign subsidiaries operate.
3	Under Taxed Profits Rule ("UTPR")	UTPR is a backstop rule to account for any residual Top-up Tax not collected under the QDMTT and IIR.

Implementation of GloBE Rules in Malaysia

Based on the 2024 Budget and the official website of the Malaysian Inland Revenue Board ("MIRB"), Malaysia intends to adopt the GMT and Domestic Top-up Tax based on the Model GloBE Rules in 2025. Adopting the QDMTT will certainly be a welcomed move as this would allow Malaysia to collect Top-up Tax generated locally thus protecting our tax base.

Nevertheless, it is important to bear in mind that for QDMTT to be considered as "qualified", the design of the QDMTT must be closely aligned with the GloBE Rules and must provide for outcomes consistent with the GloBE Rules. Any variations to the QDMTT should not produce a lower tax liability when compared with the GloBE Rules. Otherwise, the QDMTT may be disqualified and be treated as part of the Covered Tax to determine the ETR instead of being credited against Top-up Tax for IIR purposes.

A peer review process will be undertaken to determine whether a jurisdiction's QDMTT is "qualified". As such, careful consideration must be given by the Government in the design of QDMTT.

The concept of QDMTT Safe Harbour is also introduced by the OECD such that Top-up Tax is only computed once at the QDMTT level. Although there are additional requirements to be met to qualify as a QDMTT Safe Harbour jurisdiction, it is hoped that the Government would consider the adoption of QDMTT Safe Harbour to ease the compliance burden of in-scope MNEs in Malaysia.

Future of Tax Incentives

Tax incentives have always played an important role in attracting foreign direct investments and encouraging growth in targeted sectors and industries in Malaysia. With the introduction of GMT, there are many concerns as to whether tax incentives would now be rendered ineffective. While out-of-scope MNEs or domestic groups may not be affected, in-scope MNEs that enjoy tax incentives in Malaysia may now be required to pay Top-up Tax. This would nullify the tax incentives enjoyed by these affected MNEs despite having made commitments that are often attached to the tax incentives.

Hence, it is important that the Government evaluate the relevance of the current tax incentive landscape in light of GloBE Rules and consider introducing tax incentives that are more effective in a post-GloBE Rules environment. Some of the suggested areas for consideration are amongst others, indirect tax related incentives, expenditure-based tax incentives and grants that are attached with commitments such as payroll and tangible assets investments. Nevertheless, the Government should consider carefully on the design of tax incentives such that it would not jeopardise the QDMTT status.

The Path Ahead

As with any major tax changes, advance planning is key. Despite that the GMT will only be introduced in 2025, in-scope MNEs should not undermine the work that needs to be done to prepare for the implementation of GloBE Rules. The time for action is now.

MNEs should consider the following, amongst other:-

- Given the complexity and technical nature of the GloBE Rules, MNE groups should assess whether they are in-scope and ensure that they have a detailed working knowledge of the GloBE Rules;
- Given the extensive data points required for the calculation of ETR and Top-up Tax as well as disclosure in GloBE Information Return, it is important for in-scope MNEs to assess whether these data are readily available in their system and the measure to close the data gap.

- To consider the impact of GloBE Rule on accounting disclosures in view of recent update on the International Accounting Standards, IAS 12.
- For in-scope MNEs enjoying tax incentives in Malaysia, to assess the potential impact of the GloBE Rules on the current tax incentives and start engaging with tax advisors and relevant authorities to discuss on any alternatives, where applicable.
- Although the implementation of GloBE Rules in Malaysia is in 2025, as some countries will be adopting the GloBE Rules in 2024, it is crucial for MNEs operating in Malaysia to consider whether their foreign parent entity are subject to GloBE Rules as they may still be required by their foreign parent entity to provide relevant information and quantify the Top-up Tax in Malaysia on behalf of their foreign parent entity.

It is hoped that the draft legislation on GMT will be released to the public for consultation soon and to facilitate in-scope MNEs in their planning for the journey ahead.

Should you have any questions or require further clarification, please do not hesitate to email or contact any of our Executive Directors whom you are accustomed to dealing with or who are responsible for the tax affairs of your organization.

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