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International Development in Cross-Border Taxation

Ms Winne Shek

Tax Partner, Global Business Tax Services
Deloitte China

Vice President
The Taxation Institute of Hong Kong

Bio

Winnie Shek
Vice President
The Taxation Institute of Hong Kong

Tax Partner
Global Business Tax Services
Deloitte China

Tel.: +852 2852 1258
Email:
winniewmshek@deloitte.com.hk

Winnie Shek has over 20 years of professional experience in Hong Kong, PRC, and cross-border business and tax advisory services. She is specialized in providing tax and regulatory advice to multinational corporations, State-Owned Enterprises, listed companies as well as high-potential private companies. She has deep experience in all kinds of corporate tax projects, from general tax/regulatory compliance to tax planning and implementation including investment strategies and corporate reorganisations. She is particularly experienced in providing pre-IPO tax solutions to her clients, including identification and cleaning-up of uncertain tax positions, advising the tax implications from pre-IPO restructuring, etc.

In addition, Winnie has diverse experience in resolving contentious issues and disputes with local tax authorities in Hong Kong and the PRC. She is experienced in resolving tax controversies related to related party transactions, inter-company recharges and cross-border payments.

Her broad and extensive client-serving experience covers various industries, including telecom, digital business, consumer products, property development and construction, energy & resources, etc.

Apart from her partner role in Deloitte China, Winnie also serves as a Vice President of the Taxation Institute of Hong Kong (2022-2024). She is also a frequent speaker at various seminar and tax workshop.

Professional Affiliations and Certifications

- Member, Hong Kong Institute of Certified Public Accountants
- Member, the Association of Chartered Certified Accountants
- Member, the Institute of Chartered Accountants in England and Wales
- Fellow Member and Council Member, Taxation Institute of Hong Kong
- Chartered Tax Advisor (TIHK)

Agenda

- Background and Development
- Overview of BEPS 2.0
- Overview of Pillar Two
- The 5-step Approach of GloBE Rules
- Exclusions and Safe Harbours
- Recent Development
- Implementation Status
- Tax Compliance and Accounting Disclosure
- Key Takeaways

Background and Development

July 2013
- The OECD published an **Action Plan** on **Base Erosion and Profit Shifting** (BEPS). This set out 15 BEPS actions

BEPS 1.0

Oct 2015
- The OECE issued **final reports for the 15 BEPS actions**, which fundamentally changed the course of international taxation

Oct 2021
- 137 countries in the OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting (IF) reached **a landmark agreement on a further approach to reform the international tax**
- **Pillar One**
- **Pillar Two**

BEPS 2.0

Dec 2021
- **Model GloBE Rules** published, setting out the operative provisions and definitions of the GloBE Rules

Mar 2022
- Explained the intended outcomes under the GloBE Rules and clarified the meaning of terms with **Commentary to the GloBE Rules – First Edition**

Dec 2022
- Designed transitional **Safe Harbors and Penalty Relief** regime

Feb 2023
- Released **Agreed Administrative Guidance** for the Pillar Two GloBE Rules to ensure coordinated outcomes during implementation and incorporated into a revised Commentary

July 2023
- Consultation on Amount B and identifies aspect require further work

Dec 2023
- Effective in **European Union & United Kingdom**

2024
- Effective in **South Korea, Japan**, etc.

2025
- Effective in Hong Kong, Singapore, etc.

Overview of BEPS

- Base erosion and profit shifting (BEPS)
  - Tax planning strategies that **exploit gaps and mismatches** in tax rules to artificially shift profits to locations with no/low tax rates and no/little economic activity, or to erode tax bases through deductible payments such as interest or royalties.

- BEPS 2.0
  - **Pillar One** – solutions for determining the allocation of taxing rights (Nexus and profit allocation)

  - **Pillar Two** – the design of a system to ensure that MNEs (Groups with revenue of EUR 750 million +) pay a minimum level of tax on profits (Global Minimum Tax)

Two-Pillar Approach to Addressing Tax Challenges of the Digital Economy

Pillar One
Develop new nexus and profit allocation rules for profits derived from Automated Digital Services (ADS) and Consumer Facing Business (CFB)

Expand the taxing rights of market jurisdictions (i.e. jurisdictions where customers or users are located)

Unified Approach

Pillar Two
Develop the global anti-base erosion (GloBE) rules to ensure that multinational enterprises (MNEs) pay a minimum level of tax

Address remaining BEPS challenges where MNEs shift profits to no or very low tax jurisdictions

GloBE Proposal Consensus

Consensus-based long-term solution by mid-2021

Overview of Pillar Two

Pillar Two = **GloBE rules** — *Global Anti-Base Erosion* **+** **Subject to Tax Rule (STTR)**

Income Inclusion Rule (IIR)

Undertaxed Profits Rule (UTPR)

Qualified Domestic Minimum Top-Up Tax (QDMTT)

Minimum tax rate (15%)

Top-up tax

Effective tax rate (ETR)

Tax currently paid

- Pay top-up tax to highest-tier parent jurisdiction

- 'Backstop' if no IIR applying in parent jurisdiction
- Other jurisdictions to deny deductions or make adjustments

- Pay a minimum level of tax to each country in which they operate
- Top-up tax due for a jurisdiction is directly reduced by QDMTT

- Tax treaty-based rule
- Source jurisdiction to impose additional taxation
- On certain related-party payments that have been subject to tax below a minimum rate of 9%
- Taxes paid under STTR – taken into account when calculating the "effective tax rate" under GloBE rules

The 5-Step Approach of the GloBE Rules

1

Determine **scope**

Identify MNE Group within scope (**EUR 750m consolidated revenue test**)

Identify **constituent entities** in scope by:

- Identifying constituent entities.
- Removing any excluded entities.

2

Calculate **GloBE income**

Calculate **GloBE income or loss of each constituent entity by:**

- Determining financial accounting net income or loss.
- Adjusting financial accounting net income or loss to GloBE base.

3

Determine **adjusted covered taxes**

Determine and allocate the **adjusted covered taxes** to constituent entities by:

- Identifying covered taxes.
- Adjusting covered taxes for temporary differences and losses.

4

Calculate **ETR and top-up tax** minus **QDMTT**

Calculate the **effective tax rate and the top-up tax per jurisdiction by:**

- Computing jurisdictional top-up tax for low-tax jurisdictions.
- Determining the top-up tax.

5

Apply **IIR and UTPR**

Apply the **IIR and UTPR** by:

- Identifying the parent liable for the top-up tax under the IIR.
- Allocating the liability for any residual top-up tax through a UTPR adjustment.

1 Step 1: Determine Scope

Scope	Multinational Enterprise **(MNE)** Groups	and its Constituent Entities (CEs)	with a **consolidated group revenue** of at least	**EUR 750m**

Excluded entities

- Investment funds/real estate investment vehicles that are ultimate parent companies
- Pension funds, governmental entities, international organisations, non-profit organisations
- Rules can apply instead to subgroups held by excluded entities

*The GloBE rules will have the status of a **common approach**: (1) Countries are free to implement the rules (2) Implementation needs to be consistent with the general guidelines (3) Countries need to accept the application of the rules by other countries*

2 Step 2: Calculate GloBE Income

Starting Point

Net income/loss determined for a constituent entity recorded in **consolidated financial statements** of the **ultimate parent entity** (before any consolidation adjustments eliminating intragroup transactions)

Adjustments include:

- Net taxes expense (including covered taxes)
- Dividends
- Equity gains/losses
- Revaluation method gains/losses
- Gains/Losses from transfers as part of 'GloBE reorganisation'
- Asymmetric foreign currency gains/losses
- Policy disallowed expenses
- Prior period errors and changes in accounting principles
- Accrued pension expenses
- Intragroup financing expenses without increase in taxable intragroup income

Elections include:

- Stock-based compensation
- Realization method in lieu of FV accounting
- Aggregate asset gain
- Consolidated accounting treatment

3 Step 3: Determine Adjusted Covered Taxes

Adjusted Covered Tax =
Current tax expense (per a/c) + Adjustments + Deferred tax expense (per a/c) + Adjustments

Covered Taxes

- Taxes with respect to income or profits (e.g. income taxes, withholding taxes)
- Includes taxes in lieu of corporate income tax
- Includes **current state taxes**
- Includes **non-refundable tax credits** (e.g. R&D)
- For Controlled Foreign Corporate (CFC) regimes, taxes incurred by shareholders on their share of CFC income are allocated to the constituent entity that earned the income.

Covered taxes and exclusions

Exclusions

- Indirect taxes, excise, payroll and property taxes
- Fines, penalties, interest, or similar charges re payments of tax liabilities
- Taxes related to items excluded from GloBE income.
- Any amounts relating to 'uncertain tax treatments/positions' until paid
- Accrued taxes not expected to be paid within three years.

3 Step 3: Determine Adjusted Covered Taxes

Adjusted Covered Tax =
Current tax expense (per a/c) + Adjustments + Deferred tax expense (per a/c) + Adjustments

Total Deferred Tax Adjustment Amount: Deferred tax expense accrued in constituent entity's financial accounts capped at 15 percent.

Adjustments

Exclusions	• Deferred tax expense on items excluded from computation of model rules tax base (e.g. pension, stock option). • Deferred tax expenses on 'uncertain tax treatments/positions'. • Impact of valuation/accounting recognition adjustment of a deferred tax asset. • Deferred tax expense on re-measurement due to a change in domestic tax rate. • Deferred tax expense on generation and use of tax credits. • Deferred tax expense related to income or asset sales subject to transition rules.
Recapture rule	Deferred tax liability accrued but not reversed within 5 years must be recaptured, with certain exceptions
Losses	• Reduction for a deferred tax asset not recognized because recognition criteria are not met. • Deferred tax asset on a loss (as calculated under the model rules) recast at 15% if recorded at a lower rate. **Simplified approach if net 'GloBE loss' in a country – by election** 15% of value of the loss (as calculated under the model rules) available for offset against future profits in that country.

Step 4: Calculate ETR and Top-up Tax Minus QDMTT

Effective tax rate (per jurisdiction) = Aggregated **adjusted covered taxes** for all constituent entities / Aggregated **tax base** for all constituent entities **(GloBE income)**

Jurisdictional top-up tax* = Top-up tax % x excess profit – Additional current top-up tax – Qualified domestic top-up tax (QDMTT)

Top-up tax % = Minimum rate (i.e. 15%) – Jurisdictional ETR

Excess profit = GloBE Income – Substance Based Income Exclusion

*At the election of the Filing Constituent Entity, the Top-up Tax for a jurisdiction is deemed to be zero when the constituent entities located in the jurisdiction are eligible for the **QDMTT Safe Harbour**.

5 Step 5: Apply IIR and UTPR

QDMTT — Constituent Entity (CE) pays the domestic top-up tax in its jurisdiction

If no such domestic top-up tax…

IIR — Ultimate Parent Entity (UPE) pays the top-up tax in its jurisdiction

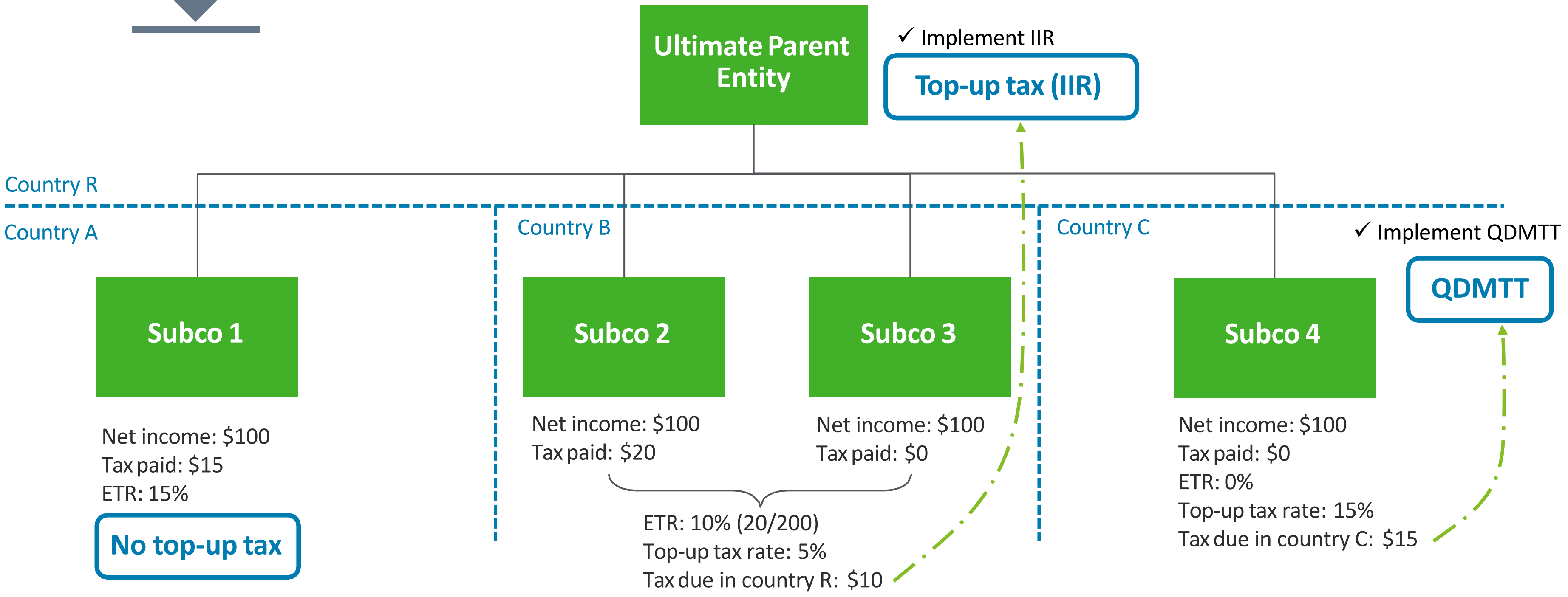
If UPE jurisdiction does not impose IIR…

IIR — Next jurisdiction in the ownership chain (intermediate parent entities) pay the top-up tax

If no jurisdiction with intermediate parent entities imposes an IIR…

UTPR — CEs in other jurisdictions pay the top-up tax (allocated based on the ratio of tangible assets and payroll in their jurisdictions)

5 Step 5: Apply IIR and UTPR



Exclusions and Safe Harbours

Exclusion

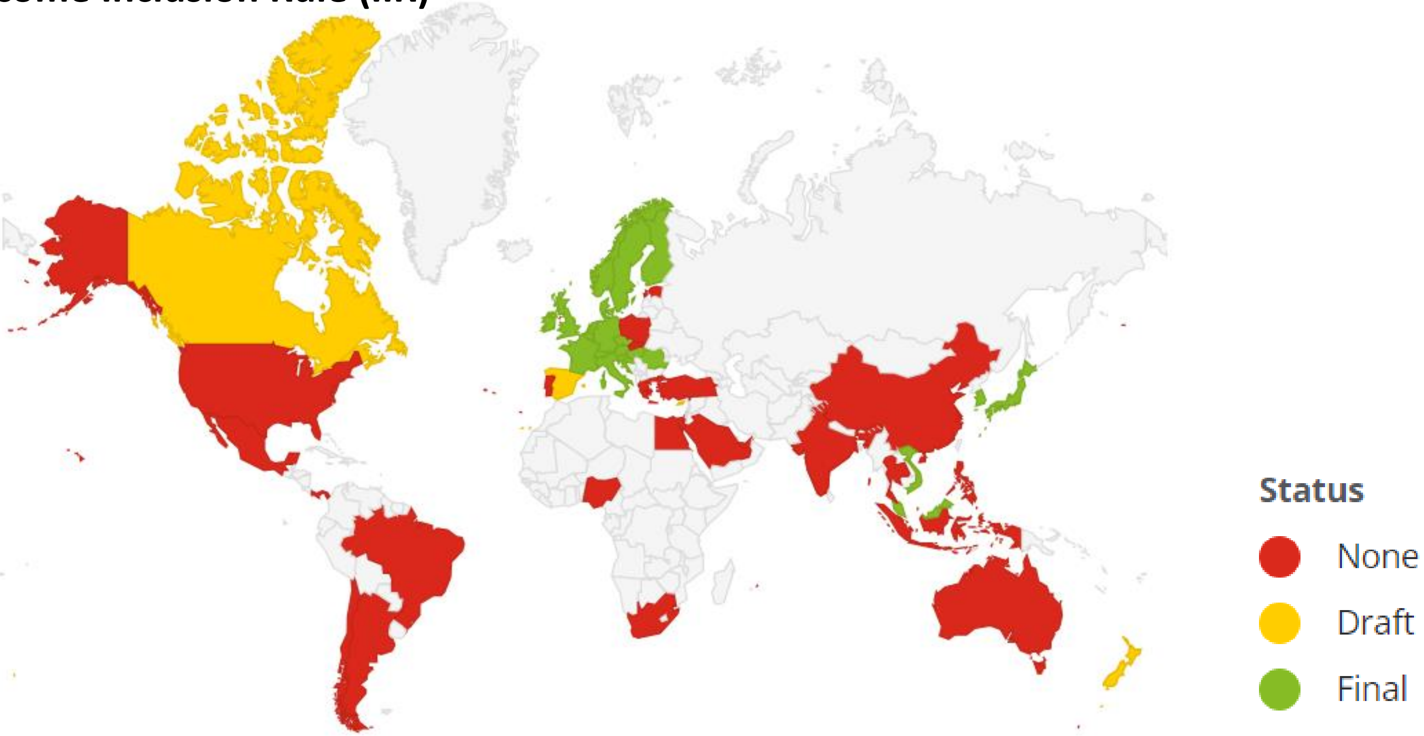
De minimis exclusion
Exclusion from UTPR in initial phase of international activity

Safe Harbour

Transitional CbCR safe harbour
Transitional UTPR safe harbour
QDMTT safe harhour

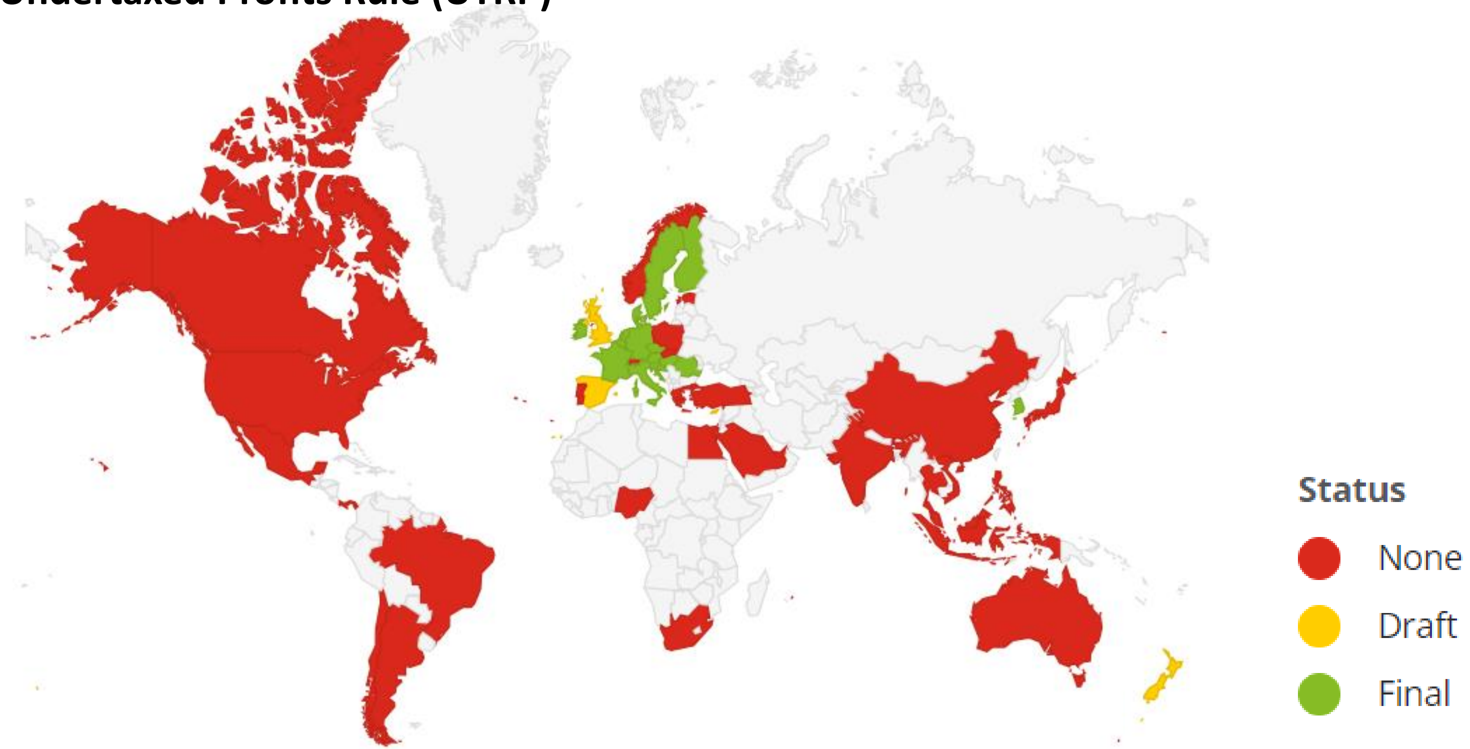
Recent Development

Income Inclusion Rule (IIR)



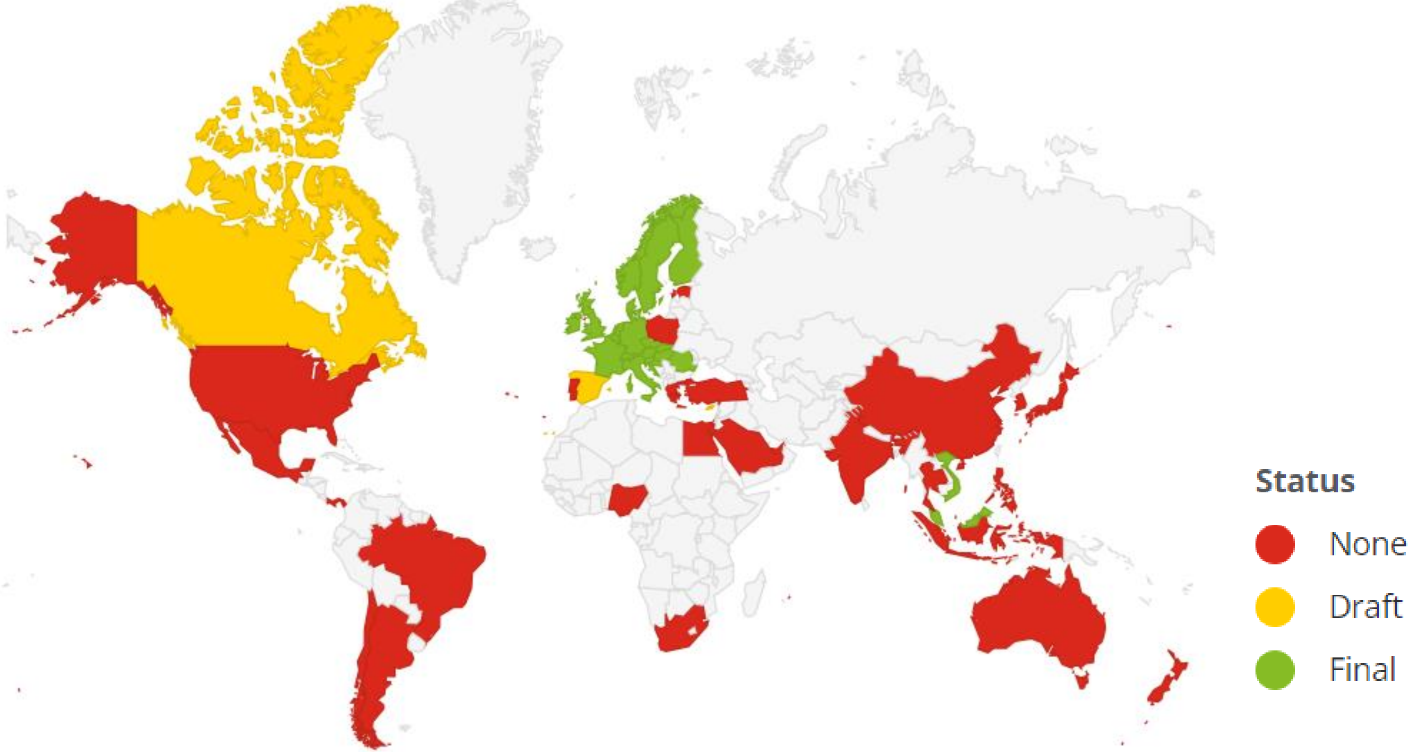
Recent Development

Undertaxed Profits Rule (UTRP)



Recent Development

Qualified domestic top-up tax (QDMTT)



Implementation Status

As of September 2023

European Union: Unanimous agreement reached on Dec 15 2022 to implement Pillar Two, to take effect in 2024, and the UTPR to take effect in 2025.

United Kingdom: UK enacted the Finance (No. 2) Act 2023 to implement IIR and QDMTT and released draft legislation for UTPR. IIR and QDMTT are expected to apply for accounting periods beginning on or after Dec 31 2023. UPTR is expected to apply for accounting periods beginning on or after Dec 31 2024.

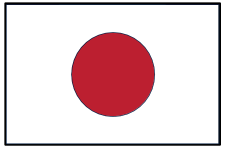
Netherlands: The parliamentary finance committee has approved the Pillar Two implementation bill. IIR and QDMTT are expected to apply for financial years starting on or after Dec 31 2023. The UTPR is expected to take effect one year later.

Germany: German Cabinet approved draft global minimum tax legislation. IIR and QDMTT are expected to apply after Dec 31 2023. UTPR is expected to apply after Dec 31 2024.

Switzerland: Swiss electorate approved the compulsory constitutional referendum on introducing the OECD/G20 minimum tax. The Minimum Taxation Ordinance is expected to enter into force on Jan 1 2024.

Liechtenstein: Government approves draft Bill implementing Minimum Global Taxation. The IIR and QDMTT are expected to take effect Jan 1 2024. The UTPR is expected to take effect Jan 1 2025.

South Korea: Tax revision bill passed by National Assembly on Dec 23 2022. Income Inclusion Rule, the UTPR, and a global minimum tax effective Jan 1 2024. Recently deferred UTPR to Jan 1 2025.



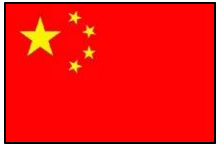
Japan: Japan enacted a Pillar Two Income Inclusion Rule from Apr 1 2024. Authorities are considering including the UTPR and QDMTT in future legislation.

Implementation Status

As of September 2023

Australia: Confirmed Pillar Two implementation with effect from Jan 1 2024 (IIR/QDMTT) and Jan 1 2025 (Undertaxed Profits Rule). Targeted consultation launched.

Hong Kong: Hong Kong would implement the GloBE rules and QDMTT from 2025.

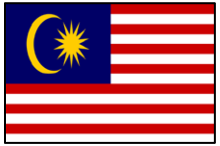


China: No such provisions have been announced.

India: No discussion regarding Pillar Two was included in the FY2023-24 budget.

Indonesia: Indonesia issued Government Regulation No. 55/2022 which included reference to the implementation of a global minimum tax. Indonesia is planning to implement the Pillar Two GloBE Rules from 2024.

Singapore: Intention to implement GloBE rules and domestic top-up tax from businesses' financial year starting on or after 1 Jan 2025.

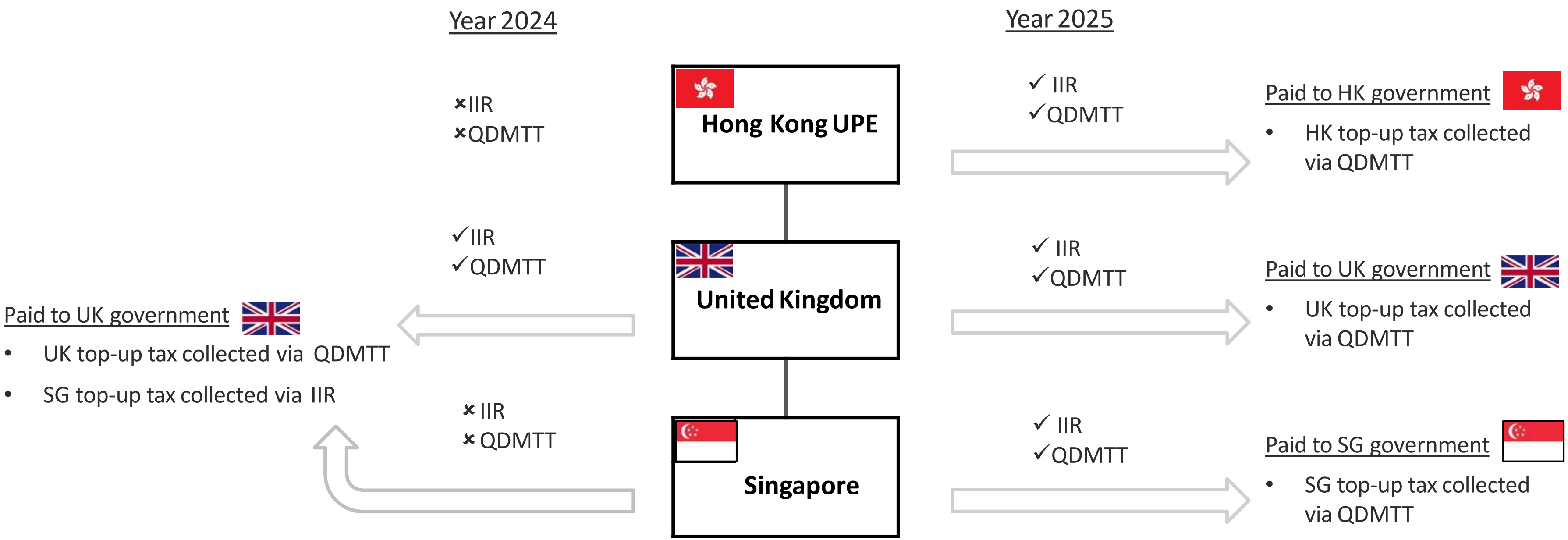


Malaysia: Intention to implement Pillar Two, including a domestic minimum tax and QDMTT, announced as part of 2023 Budget.

United States: Uncertain status with regard to implementation.

Implementation Status

Hong Kong headquartered MNE groups



Implementation Status

UK, Europe, Korea and Japan headquartered MNE groups

Year 2024

UK/EU/KR/JP UPE
✓ IIR
✓ QDMTT

Hong Kong
✗ IIR
✗ QDMTT

APAC
✗ IIR
✗ QDMTT

Paid to UK/EU/KR/JP government

- UK/EU/KR/JP top-up tax collected via QDMTT
- HK and APAC's top-up tax collected via IIR

Year 2025

UK/EU/KR/JP UPE
✓ IIR
✓ QDMTT

Paid to UK/EU/KR/JP government

- UK/EU/KR/JP top-up tax collected via QDMTT

Hong Kong
✓ IIR
✓ QDMTT

Paid to HK government

- HK top-up tax collected via QDMTT

APAC
✓ IIR
✓ QDMTT

Paid to own government

- Own top-up tax collected via QDMTT

Implementation Status

US headquartered MNE groups

Assuming US does not implement IIR in 2024, the entire MNE group will not be subject to top-up tax in 2024.

Year 2024	Entity	Year 2025	
× IIR × QDMTT	**US UPE**	? IIR ? QDMTT	
× IIR × QDMTT	**Hong Kong**	✓ IIR ✓ QDMTT	Paid to HK government HK top-up tax collected via QDMTT
× IIR × QDMTT	**APAC**	✓ IIR ✓ QDMTT	Paid to own government Own top-up tax collected via QDMTT

Tax Compliance

GloBE Information Return

Information required	A **standard template** that includes: • Group members – tax identification numbers • Corporate structure • Elections • 'Information necessary to compute' effective tax rate for each country and top-up tax allocated to each country/ group member
Due date	• **15 months** after the last day of the accounting period, extended to **18 months** for group's first return
Filing with tax administration	• **Ultimate parent entity** files with local tax authority • Local tax authority **exchanges with other tax authorities** where a qualifying agreement in place • Local filing required where no exchange relationship in place
Notifications	• Each constituent entity must **notify its local tax authority** of the group member filing the return/ which country it is located in • Another group entity in the same country can be appointed

Safe harbours may be considered

Key Takeaways

- GloBE Rules are a complex ruleset that will require a significant investment of time to analyse the technical points and data requirements.
- Different implementation timeline for different jurisdictions may affect MNE group's tax exposure and accounting disclosure requirements.
- Assess the Company's exposure to Pillar Two and applicability of Safe Harbours.
- Identify higher-risk jurisdictions and blueprint the data requirements and processes to perform required GloBE calculations.
- Be prepared for the GloBE/QDMTT calculations and tax review / compliance work.

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