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What Multinational Enterprises Should Know About BEPS 2.0

Contact Persons:

Datuk D P Naban
Senior Partner
Tax, SST & Customs Practice
☎ +603 6209 5405
✉ naban@rdslawpartners.com

S Saravana Kumar
Partner
Tax, SST & Customs Practice
☎ +603 6209 5404
✉ sara@rdslawpartners.com

In October 2021, the Organisation for Economic Co-operation and Development (OECD) updated the Base Erosion and Profit Shifting (BEPS) 2.0 position – which is better known now as the Two-Pillar Solution to address tax challenges arising from the digital economy. BEPS 2.0 is expected to bring a significant deviation from the present tax rules by offering market jurisdictions new taxing rights over Multinational Enterprises (MNEs).

However, there is a downside to this as BEPS 2.0 may potentially cause reporting and compliance hurdles to the MNEs.

Brief Background Of BEPS 1.0

BEPS 1.0 consisting of 15 Action Plans was published in 2015 to equip governments in the respective jurisdictions with domestic and international instruments to address tax avoidance and ensure that profits generated consequent to economic activities are taxed.

In 2017, Malaysia joined the OECD's "Inclusive Framework on BEPS", which led to several notable developments on the domestic transfer pricing landscape.

Whilst the implementation of BEPS 1.0 resulted in many positive changes to the international tax rules tackling profit shifting and tax avoidance, its initiatives remain limited. One apparent limitation of BEPS 1.0 is that it does not comprehensively address digital transactions, which are increasingly common in the current society with the convenient accessibility of digital platforms.

Therefore, BEPS 2.0 was introduced to look further in relation to the tax challenges resulting from the digitalisation of economy.

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Pillar One

Under Pillar One, it is pertinent to note that only large MNEs with a global turnover above €20 billion and profitability above 10% that are known as the 'in-scope companies' will be impacted. Further, contingent on successful implementation of this proposal, the turnover threshold is expected to be lowered to €10 billion after 7 years, which is in 2031. It is expected that Malaysia's tax revenue has a high potential to increase following the implementation of this proposal.

Pillar One aims to eliminate the possibility of double taxation. For instance, if an in-scope MNE has already been taxed on its residual profits, then the residual profit allocated to the market jurisdiction will be capped through Amount A. As such, in-scope MNEs may avoid double taxation for Amount A.

In addition, in-scope MNEs can avoid issues related to Amount A such as disputes on business profits and transfer pricing. However, in the absence of a coordinated global agreement, it is of no surprise that double taxation issues will arise in countries that have introduced digital services taxes and applied Pillar One elements through their own local domestic legislation.

Another eminent issue that may arise consequent to the implementation of Pillar One is the difficulty in forming a global agreement. An agreement that is agreeable to many nations around the world, in regard to their taxation which in many countries is the ultimate source of revenue, would definitely be challenging. This would pose as one of the biggest issues with the implementation of this proposal.

Pillar One also introduces under Amount B, a simplified and streamlined approach to the application of the arm's length principle, focusing mainly on the low-capacity countries.

Nevertheless, due to the high turnover threshold and with Amount B proposal focusing on the needs of low-capacity countries, MNEs in Malaysia are less likely to be impacted by Pillar One that is targeted to be implemented in 2023. At this juncture, it does appear that the primary goal of Amount B's workstream is to develop baseline marketing and distribution

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efforts. Be that as it may, it is still unclear of the form Amount B solution will take and that has not been elaborated in the latest statement.

Pillar Two

On the other hand, Pillar Two should be the focus of Malaysian taxpayers compared to Pillar One as Pillar Two targets MNEs with a global annual revenue above €750 million and Pillar Two introduces a global minimum tax (GMT) at 15% in respect of the global income of MNEs. Pillar Two in this regard, is significantly departing from the present global tax framework by introducing a minimum tax rate to be imposed on MNEs.

Notably, under Pillar Two, it is possible that a parent entity be imposed a top-up tax in respect of the low taxed income of its subsidiaries when its subsidiaries do not meet the minimum tax of at least 15%.

Therefore, Malaysian subsidiaries of large MNEs that are currently enjoying the tax benefits of paying concessionary tax rates that are far below 15% are expected to be impacted by Pillar Two. Similarly, Malaysian-based MNEs with overseas subsidiaries that are enjoying low tax rates overseas could be subjected to a top-up tax in Malaysia following the implementation of Pillar Two.

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Budget 2023 – Public Consultation Paper (PCP)

On 1.8.2022, the Ministry of Finance (MOF) published the Budget 2023 PCP in relation to Malaysia's involvement in the implementation of Global Anti-Base Erosion (GloBe) Model Rules (Pillar Two) as well as the Framework on BEPS. The objectives of this PCP were to invite the private sectors, businesses and tax experts to provide feedback; and to provide insights to the GloBE Rules under Pillar Two.

The PCP highlighted that the GloBE Rules will be introduced in Malaysia, namely the Income Inclusion Rule (IIR) and the Undertaxed Profit Rule (UTPR). In addition to the GloBE Rules, Malaysia may also introduce Qualified Domestic Minimum Top-up Tax (QDMTT).

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✉ naban@rdslawpartners.com

S Saravana Kumar
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✉ sara@rdslawpartners.com



By implementing the GloBE Rules in Malaysia, it is expected to broaden Malaysia's tax base and taxing rights. Most importantly, it will tackle the remaining BEPS issues in Malaysia as well as remaining Malaysia's competitiveness in attracting foreign direct investment.

Commentary

The GMT is expected to surround with complexity or even carry an overwhelming position for the MNEs. Despite the MOF's pre-budget statement showing that Malaysia acknowledges BEPS 2.0, there are still many uncertainties that remain at this juncture as to whether Malaysia will eventually implement BEPS 2.0 or perhaps when will Malaysia enforce GMT.

It is no surprise that Malaysia is fully committed to adhere to the internationally agreed tax standard. The PCP also stated that even if Malaysia does not implement the GloBE Rules, the application of the GloBE Rules by another in respect of MNEs operating in its jurisdiction ought to be accepted.

All in all, Pillar Two is expected to make an aggressive shift in tax matters in Malaysia. MNEs should keep an eye on the tax developments in Malaysia and start to assess the possible impact of BEPS 2.0 to their organisation. This is especially so when the domestic law is not drafted well or not in cognizance of the OECD spirit in introducing BEPS and the resulting various tax principles.

Authored by Edyn Gan Ee Ling, pupil-in-chamber from the firm's Tax, SST and Custom department.

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