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Malaysia publishes public consultation paper (PCP) on the implementation of the Global Anti-Base Erosion (GloBE) Rules under Pillar Two of the Base Erosion and Profit Shifting (BEPS) 2.0 initiative

Coverage of this Alert

The release of the PCP by the Malaysian Ministry of Finance (MoF) demonstrates Malaysia's seriousness in implementing Pillar Two of the Organisation for Economic Co-operation and Development's (OECD's) BEPS 2.0 initiative. The PCP highlights key issues and requests feedback on important questions, such as:

- Whether Malaysia should impose the GloBE Rules on Malaysian-headquartered Groups with global annual turnover below the OECD's recommended Pillar Two threshold of EUR750 million
- How the top-up tax provisions should be reflected in Malaysia's domestic tax legislation, including whether the GloBE Rules should be incorporated into the Income Tax Act 1967 (ITA) or in a separate piece of tax legislation
- Timing of implementation
- Impact on tax incentives. On this point, the PCP mentions, for example, the need for Malaysia to assess how other ASEAN countries are addressing tax incentives in light of Pillar Two. The PCP also highlights that Malaysia must establish agile and forward-thinking incentive packages which meet the needs of investors, and that non-tax incentives could complement the reformed tax incentive framework
- Potential introduction of a Qualified Domestic Minimum Top-Up Tax (QDMTT)

With respect to timing, the PCP asks "Is 2023 an acceptable date to implement the GloBE Rules?". 2023 is the OECD's recommended introduction date for the Income Inclusion Rule (IIR) under the GloBE Rules, with the Undertaxed Profits Rule (UTPR) to be introduced a year later. Many countries have in fact announced that they will only implement the IIR in 2024, with the UTPR being introduced in 2025. The fact that the PCP asks whether a 2023 implementation date is acceptable, reiterates that the MOF is not adopting a "wait-and-see" approach with respect to Pillar Two.

As such, if your group of companies operates in more than one country and has more than EUR750 million in global turnover, you need to start taking action now. Impacted companies will need to ensure that boards of directors and senior management are aware of the financial impact and the potential need for investments in systems that can extract the vast amounts of data and perform the calculations needed to comply with Pillar Two requirements. Companies which have not yet begun assessing the impact which Pillar Two will have on their businesses should commence work on this immediately, as the analysis can be complex, the implications to the tax position can be significant and changes to the systems to enable compliance can take a considerable amount of time. Multinational Groups which are enjoying tax incentives, or which are considering applying for tax incentives, in Malaysia should consider the impact which the incentives will have on their blended effective tax rate (ETR) in Malaysia.

The PCP can be accessed at the following link. If you would like to share your feedback with the MoF, please note that this must be furnished by 5 p.m. Malaysian time on 15 August 2022.

Background

On 3 June 2022, the MoF published a Pre-Budget Statement (Statement), which included an announcement that the Government and the OECD were discussing the implementation of the OECD's BEPS 2.0 Two-Pillar approach in Malaysia. The Pillars are as follows:

- Pillar One seeks to re-allocate the taxing rights over part of the profits of multinational groups with annual turnovers exceeding EUR20 billion and profits exceeding 10%, to the jurisdictions in which their customers are located, i.e., market jurisdictions. This is a fundamental change to international tax law. Currently, an entity would generally only pay income tax in a foreign jurisdiction if it has a taxable business presence or permanent establishment in that jurisdiction. With the implementation of Pillar One, the world's largest corporations may end up paying tax in jurisdictions where they do not have a physical presence, such as jurisdictions into which they are selling goods or services through electronic platforms. Whilst there are exclusions for taxpayers in the extractives and regulated financial services industries, groups will need to check whether they qualify for such exclusions.
- Pillar Two seeks to implement a global minimum tax rate of 15% via two interlocking GloBE Rules which will require changes to domestic tax laws. Pillar Two also proposes a tax treaty-based subject to tax rule (STTR), which would apply where certain intra-group cross-border payments are subject to low levels of tax. Details on the STTR have yet to be finalised.

The Statement also stipulated that Malaysia was reviewing the technical details of the two Pillars, including the possibility of introducing the QDMTT under Pillar Two.

Following the above, on 1 August 2022, the MoF published a PCP on the implementation of the GloBE Rules under Pillar Two in Malaysia. The stated objectives of the PCP are to:

- Provide policy insights on the GloBE Rules under Pillar Two, and
- Gather views and comments from stakeholders on the adoption of the GloBE Rules, including any critical implementation issues which may arise in Malaysia

Note that the PCP does not discuss Pillar One and does not discuss the STTR under Pillar Two.

We have included the questions raised by the MoF in the PCP within the yellow boxes below, so if you wanted to quickly see the questions before reading the rest of this alert, please look for these boxes.

Overview of Pillar Two

Pillar Two introduces new global minimum tax rules for MNEs at an agreed rate of 15%. This minimum rate will apply in each jurisdiction in which the MNE operates. The minimum tax is calculated based on financial statements and relies on two main components: profits and taxes paid. If an MNE's excess profits (as calculated based on GloBE principles) in a jurisdiction are taxed below the minimum 15% rate, a top-up tax will be imposed.

Pillar Two primarily consists of two interlocking rules, together referred to as the GloBE Rules, each of which would require implementation into the domestic law:

i) IIR, which imposes a top-up tax on a parent entity with respect to a low-taxed income of a constituent entity (CE)
ii) UTPR, if the low-taxed income of a CE is not subject to top-up tax under the IIR

Pillar Two also includes the STTR, which is a treaty-based rule that allows source jurisdictions to override preferential treaty withholding tax rates on certain related party payments that are subject to tax below 9%.

As mentioned earlier, Malaysia is currently reviewing the technical details for implementing the GloBE Rules and the possibility of introducing the QDMTT, which would allow Malaysia to impose a 15% minimum tax, using Pillar Two principles, on in-scope groups which have an ETR of below 15% in Malaysia. The QDMTT will apply in priority to the IIR and UTPR.

Common approach

The GloBE Rules are designed as a common approach, which means that Malaysia is not required to adopt the GloBE Rules, but if it chooses to do so, then it should implement and administer the Rules in a way that is consistent with the Model Rules. Malaysia is also required to accept the application of the GloBE Rules by other jurisdictions.

Scope

The GloBE Rules apply to CEs of MNE groups with global annual turnover of EUR750 million or more in two out of the four financial years immediately preceding the tested financial year.

An "excluded entity" is an entity that is:
a. A governmental entity,
b. An international organization,
c. A non-profit organization,
d. A pension fund,
e. An investment fund that is an ultimate parent entity (UPE), or
f. A real estate investment vehicle that is a UPE

Asset holding companies of an excluded entity are also treated as excluded entities, subject to conditions.

It is important to note that in calculating whether the EUR750 million group revenue threshold is met (i.e., to determine whether an MNE Group falls within the scope of the GloBE Rules), the income of excluded entities, as well as international shipping income which is discussed below, must still be taken into account.

Questions:
1. Should Malaysia apply the GloBE Rules on local MNE Groups with global annual turnovers below EUR750m?
2. Are there any aspects concerning the scope of the Rules (e.g., the definitions of "Group", "CE" or "excluded entity") that require further clarification in the domestic legislation?

Calculating the ETR and top-up tax

In cases where the ETR of a jurisdiction is below the agreed minimum rate of 15%, the difference results in a top-up tax percentage which is applied to the jurisdictional income to determine the total amount of top-up tax. The top-up tax is pro-rated among the CEs located in that jurisdiction and then charged to the CEs liable for any top-up tax.

The ETR for a jurisdiction is the total tax divided by the total profit in that jurisdiction. The GloBE Rules specify the taxes that can be included in the calculation (i.e., covered taxes) and the method of calculating the profit in the jurisdiction (i.e., GloBE income). In-scope MNEs are required to calculate their ETRs for each jurisdiction annually. The PCP explains and provides examples to demonstrate the four steps involved in calculating the ETR as outlined below:

Step 1: Identify the CE in a jurisdiction
Step 2: Calculate the GloBE income for each CE
Step 3: Determine the taxes paid by the CEs
Step 4: Calculate the ETR

For an MNE Group with international shipping income, each CE's international shipping income (as well as the expenses and taxes associated with such income) will be excluded for the computation of its GloBE income or loss.

Specific clarifications in relation to Malaysia are as follows:

- Financial statements must be prepared based on acceptable financial accounting standards. The Malaysian Financial Reporting Standards (MFRS) are not separately listed as an acceptable financial accounting standard under the GloBe Rules. However, since MFRS is fully compliant with and equivalent to the International Financial Reporting Standards (IFRS), MFRS should be an acceptable financial accounting standard
- Malaysia's sales and services taxes do not qualify as "covered taxes" for the purposes of calculating the ETR.

Special rules apply to the calculation of ETR for stateless entities, joint ventures and minority-owned CEs.

The PCP also explains and provides examples to demonstrate the steps involved in calculating and allocating the top-up tax when the ETR in a jurisdiction is below the 15% minimum rate, as outlined below:

Step 1: Identify if there is net GloBE income in a jurisdiction
Step 2: Calculate the ETR in the jurisdiction with net GloBE income to identify low-tax jurisdictions
Step 3: Compute the top-up tax percentage
Step 4: Calculate the substance-based income exclusion based on GloBE principles. Put simply, this exclusion will reduce the amount of undertaxed income in a particular jurisdiction which is subject to the top-up tax, based on a percentage of payroll costs and a percentage of the carrying value of tangible assets in that jurisdiction
Step 5: Deduct the substance-based income exclusion from the net GloBE income in the jurisdiction to determine the "excess income"
Step 6: Calculate the top-up tax in the jurisdiction by:
(i) Multiplying the excess income by the top-up tax percentage
(ii) Adding any additional top-up tax calculated in respect of earlier years, and in respect of current year permanent differences when there is a GloBE loss in a jurisdiction, and
(iii) Subtracting any taxes charged under a QDMTT in that jurisdiction
Step 7: Allocate the top-up tax for the jurisdiction among the CEs in that jurisdiction

Questions:
3. Any comments or views on incentive tax credit?
4. Any comments on the practicalities of computing a CE's accounting profit?
5. Any views on the rules on "covered taxes" and their assignment?
6. Any comments on the special provisions that apply to the computation of ETR and the top-up tax for stateless entities, joint ventures, and minority-owned CEs?
7. Any views on the process to calculate top-up taxes?

Charging mechanism

The PCP explains, and provides examples on, the rules for determining which entity of an MNE Group is liable to any top-up tax and the portion of such top-up tax that is charged to such entity. The mechanics of the IIR and UTPR are elaborated in this section.

Broadly, the IIR will impose a top-up tax on a UPE based on its interests in the CEs located in jurisdictions where the ETR is less than 15%. Where the UPE does not collect the IIR, the intermediate parent entity below the UPE will collect the IIR, via a "top down" approach.

The UTPR allows a top-up tax to be collected where the IIR does not apply. Tax arising under the UTPR can be collected by group entities regardless of whether they are parent entities. The UTPR will be allocated based on a proportion of the number of employees and value of tangible assets in each relevant jurisdiction.

This section also discusses how split-ownerships and minority interests are to be dealt with.

Questions:

8. Any comments on how the IIR and UTPR provisions should be reflected in the domestic legislation whilst respecting the agreed outcomes in the GloBE Rules?
9. Any views on how information or administration challenges with the split ownership rules could be addressed in the implementation framework?
10. Any other comments on the charging mechanism?

Transitional rules

The PCP outlines certain transitional rules that apply where an MNE Group enters within the scope of the GloBE Rules in a jurisdiction for the first time. The transitional rules include:

- Treatment of losses and other timing differences which arose before the MNE Group entered the Pillar Two regime
- Extended deadline for filing obligations in the transitional year (i.e., filing deadline increased to 18 months from the end of the accounting period of the group's consolidated accounts in this first year)
- Higher percentage to be applied in the calculation of the substance-based income exclusion during the transitional period
- An exclusion from the UTPR for MNE Groups that are in the initial phase of their international activity

Question:

11. Any views on how the transitional rules would apply (e.g., are there any uncertainties around how the Rules would operate that could be further clarified in the domestic law?)?

Simplification

Simplified reporting obligations will apply to businesses in jurisdictions where the risk of its ETR being below the 15% minimum rate is low. In instances where a business qualifies for an agreed safe harbor, an MNE group would only need to provide a computation to prove that they are eligible for the simplification (i.e., the MNE Group should not need to produce a full calculation of the ETR for CEs in a safe harbor jurisdiction).

To achieve this, there are ongoing discussions surrounding the use of a simplified ETR calculation based on the data of an MNE's Country-by-Country Reporting (CbCR). The trade-off between accuracy and simplicity however needs to be assessed carefully, as GloBE income could differ significantly from the income reflected in CbCR filings.

Questions:

12. Any views on a CbCR-based safe harbor and how it should be designed?
13. Any views on the timing differences within a CbCR safe harbor design?
14. Any views on how the rules should address the situation where a business transitions from a safe harbor to the Pillar Two regime?

The implementation of GloBE Rules in Malaysia

The adoption of the GloBE Rules will require the incorporation of the Rules into the Malaysian legislation, by:

- Incorporating the GloBE Rules into the Income Tax Act 1967, with limited adaptations, or
- Adopting the GloBE Rules through subsidiary legislation

Questions:

15. How should Malaysia incorporate the GloBE Rules into the domestic legislation?
16. Is 2023 an acceptable date to implement the GloBE Rules?
17. Any other comments on the adoption of the GloBE Rules in Malaysia?

Tax incentives: The way forward

With Pillar Two designed to ensure a level playing field between countries in attracting foreign direct investments (FDIs), the PCP also highlights the need for Malaysia to review its tax incentives to ensure more consolidated and targeted incentives.

Question:

18. Any suggestions on how Malaysia can incorporate its current incentive schemes into the framework for the GloBE Rules to ensure that the incentives remain relevant to attract FDIs?

UTPR implementation in Malaysia

As highlighted earlier, tax arising under the UTPR can be collected by group entities regardless of whether they are parent entities.

However, the GloBE Rules do not prescribe how tax allocated to a jurisdiction under the UTPR should be brought to tax. In a scenario where an MNE has multiple CEs in Malaysia, it is up to Malaysia to determine how the liability is to be allocated and charged between the CEs. The two options contemplated are as follows:

Option 1: Denying an income tax deduction on otherwise deductible expenses of the MNE group, with rules specifying how the MNE should apply the adjustment when there are multiple entities within Malaysia

Option 2: Treating the tax liability as a separate tax liability independent of income tax. In such a case, the tax liability will be a joint and several liability of all the CEs in Malaysia

Question:

19. Any comments on how top-up tax allocated to Malaysia under the UTPR should be brought to charge?

QDMTT

The introduction of QDMTT in the domestic legislation will ensure that any top-up tax on economic activities undertaken in Malaysia and profits generated in Malaysia, will remain in Malaysia. It could also potentially reduce the compliance burdens on Malaysia's UPEs, by preventing them from being subject to UTPR in multiple countries in respect of their Malaysian domestic operations.

Essentially, the GloBE Model Rules provide that the QDMTT will be directly creditable against tax liabilities otherwise arising under an IIR or UTPR. In other words, any top-up tax in respect of undertaxed Malaysian profits will simply be paid in Malaysia instead of having to be potentially be paid in multiple countries.
It is important to note that this treatment only applies to domestic minimum taxes which are qualified (i.e., which are based on the GloBE Rules and designed to collect the same top-up tax which would otherwise be collected under Pillar Two).

As the QDMTT should be designed to match the scope of the GloBE Rules, the preference would be to restrict the QDMTT to groups with global annual turnovers of EUR750 million as well.

Questions:

20. Would the QDMTT help reduce compliance costs for businesses?
21. Should the QDMTT apply only to groups with revenues exceeding EUR750 million?
22. Any comments on the policy design of the QDMTT?

Takeaways

With the release of the PCP, Malaysia reiterates its commitment to adhere to internationally agreed tax standards. Malaysia is also of the view that the adoption of the GloBE Rules will assist in tackling the remaining BEPS issues in Malaysia, broadening Malaysia's tax base and protecting its taxing rights over profits generated here, whilst ensuring that our country continues to be attractive to foreign investors.

Should Malaysia proceed to implement GloBE Rules in 2023, ahead of many other countries that have shifted implementation timetables by at least a year to 2024, in-scope MNE groups may have a top-up tax exposure in Malaysia on their worldwide low-taxed profits sooner than anticipated. Companies which have not yet begun assessing the impact the GloBE Rules will have on their business should commence work on this immediately.

Stakeholders are encouraged to participate in the PCP, particularly on a potential 2023 implementation timeline. Feedback can be submitted through the following link until **5 p.m., 15 August 2022**. The MoF will consider the feedback obtained through the PCP, when implementing the GloBE Rules in Malaysia.

Question: 23. Any other comments or suggestions for the implementation of GloBE Rules in Malaysia?

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