

Global Tax Reform: What It Means for ASEAN+3 – An Update¹

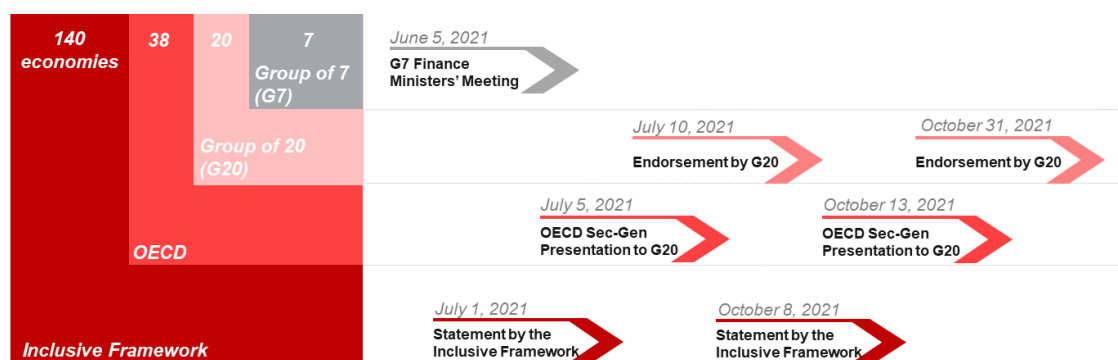
November 1, 2021

I. Introduction

1. On October 8, 2021, 136 economies agreed to the new framework for international tax and its accompanying detailed implementation plan (Figure 1). The landmark agreement saw the participation from previous hold-outs such as Estonia, Hungary and Ireland. With the inclusion of these economies, the agreement is now supported by all Organisation for Economic Cooperation (OECD) and Group of Twenty (G20) countries. Four countries within the 140-member OECD/G20 Inclusive Framework (IF), namely Kenya, Nigeria, Pakistan and Sri Lanka, have not joined the agreement. In the joint statement that announced this landmark deal, the IF also clarified some key parameters pertaining to the implementation of these reforms.

2. This note seeks to highlight the key changes in the [October 8, 2021 IF Statement](#) compared to the [July 1, 2021 IF statement](#), which formed the basis of [the previous AMRO Analytical Note](#) published on September 28, 2021. It will also provide a brief overview of the significance of these changes, particularly to the ASEAN+3 economies.

Figure 1. Key Players and Recent Developments



Source: AMRO illustration; adapted from OECD.

Note: Among the G20 economies, Argentina, Brazil, China, India, Indonesia, Saudi Arabia and South Africa are not members of the OECD.

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II. Pillar One

3. For Amount A under Pillar One (new taxing right for economies where the revenue is generated), the reallocation percentage and removal of digital services taxes were agreed upon.

- The reallocation percentage is defined as the percentage of profit before tax above the 10 percent threshold that will be reallocated to economies where the revenue is generated. This percentage was previously ambiguously proposed at between 20-30 percent. It has now been agreed at 25 percent. Accordingly, the amount of profits that could be reallocated to countries where economic activities take place is now estimated to be USD125 billion, an increase from the previous estimate of USD100 billion (Table 1).
- The most significant agreement under Pillar One is that no new digital service taxes (DST) may be introduced with immediate effect until the end of 2023. The impact of this removal of DST will likely be significant, with developing economies including Nigeria and Kenya, citing it as a contributory factor for the expected reduction in the countries' potential tax revenues ([Giles and others 2021](#)).

4. Amount A will be implemented through a multilateral agreement with a view for it to come into effect in 2023. The agreement, more formally known as the Multilateral Convention (MLC), will provide a framework and define all the necessary rules to determine and allocate Amount A. It will also address the inconsistencies that may arise between the MLC with existing tax treaties and its interaction with future tax treaties. The MLC is envisioned to be completed and opened for signatures by early 2022. Following a high-level signing ceremony that is currently scheduled for mid-2022, all countries are expected to ratify the MLC as soon as possible, with the aim for it to take effect by 2023.

Table 1. Key Changes in Pillar One

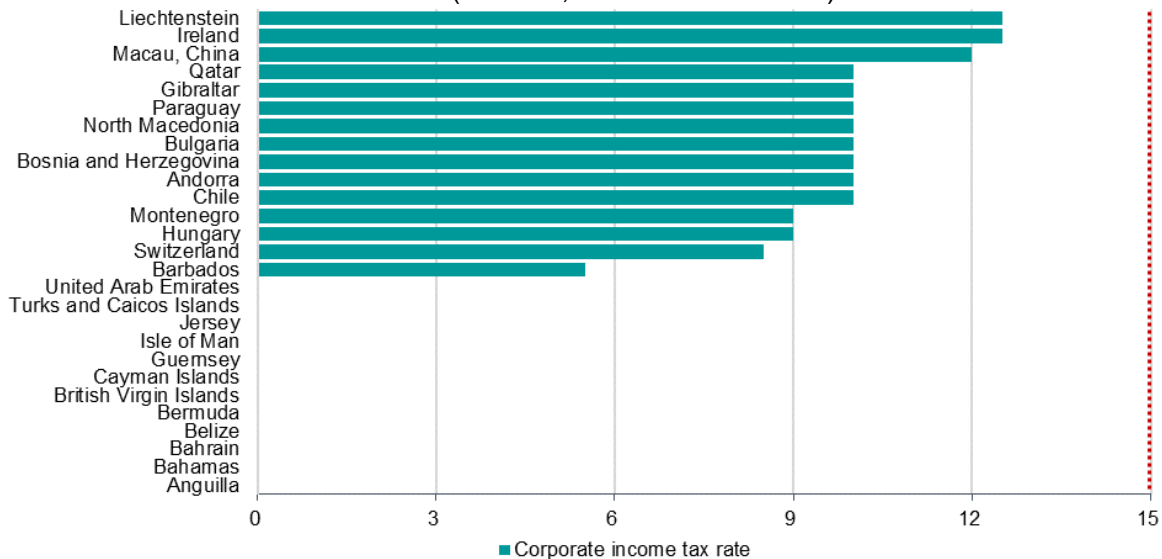
	Information as of August 31, 2021	Update on October 8, 2021
Profit reallocation	USD100 billion (100 largest and most profitable MNEs)	USD125 billion (100 largest and most profitable MNEs)
Reallocation percentage	20 – 30 percent on residual profit	25 percent of residual profit
Digital Services Taxes (DST)	There will be appropriate coordination between new tax rules and the removal of DST. No additional details were provided.	<ul style="list-style-type: none">• To remove all DST and other similar measures. Similar new measures cannot be introduced in the future.• No newly enacted DST or similar measures will be imposed from October 8, 2021, until December 31, 2023 (or the implementation of the Multilateral Convention, whichever earlier)

III. Pillar Two

5. The minimum global corporate tax rate has been set at 15 percent, and some key parameters have been refined.

- The concession for a fixed rate of 15 percent rate rather than “at least 15 percent” previously was crucial in determining Ireland’s participation (Figure 2). It is now agreed that there will be no top-up tax liability² if earnings are distributed within four years³ and taxed at or above the minimum level (Table 2).
- The expenditure incurred from business activities, such as payroll payments and the purchase of equipment needed to carry out the activities, will be exempted, or carved out, from taxable income. The amount of this expenditure has been agreed upon. In order to facilitate ease of implementation, a formula-based carve-out will be used. Under this approach, five percent of the carrying value of payroll and tangible assets can be excluded from income calculation. As championed by Hungary, a ten-year transition was agreed upon to achieve this target. In the first year, the deductible will be set at 8 percent of the carrying value for tangible assets and 10 percent for payroll. The rates will be gradually reduced on an annual basis until it reaches the target of five percent for both components.
- Where there was previously no distinction, the *de minimis* exclusion⁴ is now confined to economies where the multinational enterprise (MNE) has revenue of less than EUR10 million and profit of less than EUR1 million.

Figure 2. Statutory Corporate Income Tax Rate of IF Economies with Corporate Income Tax Rate Below 15 Percent
(Percent, as of October 2021)



Source: OECD Tax Statistics and Tax Foundation.

² If a company is taxed below the agreed effective tax rate (ETR) in a different country, its home country can collect a top-up tax amounting to the difference between the ETR and the tax that was paid in the host country.

³ In some countries, corporate tax is only payable when profits are distributed, instead of earned. In these instances, a company’s earnings must be distributed to its foreign entities within four years and taxed at a minimum of 15 percent in the host country, to ensure that the parent company will not be subject to any top-up tax in the home country.

⁴ *de minimis* exclusion is the exemption of a small amount or minor breach of agreement, particularly in the context of under-assessed or underpaid tax.

6. The rules that serve as backstop to support the implementation of Pillar Two were also refined. The Undertaxed Payment Rule (UTPR)⁵ now provides a five-year exemption for in-scope MNEs⁶ that are in initial expansion phase into the global market. This clause, as advocated by China, is applicable to MNEs with at least EUR50 million tangible assets abroad and operate in no more than five other countries. If a country does not exercise its taxing right under the UTPR, the Subject to Tax Rule (STTR) that serves to protect tax base, ensure tax certainty, and avoid double taxation can be applied. The application of this rule would enable the host country to impose a top-up tax with a minimum rate of 9 percent.

7. The IF will develop a general set of rules to enable the implementation of Pillar Two by the end of November 2021. The general rules, formally known as model rules, will cover the scope and mechanics of the rules under Pillar Two, the rules for determining the effective tax rate (ETR), and MNEs' filing obligations, among others. The IF will also develop a multilateral instrument by mid-2022 to facilitate the implementation of the STTR. Pillar Two is expected to be brought into law in 2022 and to be effective in 2023. UTPR is anticipated to come into effect in 2024.

Table 2. Key Changes in Pillar Two

	Information as of August 31, 2021	Update on Oct 8, 2021
Minimum corporate income tax rate	"at least" 15 percent	At 15 percent
No top-up tax liability if earnings are distributed...	...within 3 to 4 years (and taxed at or above the minimum level)	...within 4 years (and taxed at or above the minimum level)
Carve-outs	A formulaic substance carve-outs of at least 5% (in the five-year transition period, at least 7.5%) of carrying value of tangible assets and payroll	<ul style="list-style-type: none"> • 5 percent of carrying value of tangible assets and payroll • A transition period of 10 years: 8 percent of carrying value of tangible assets, and 10 percent of payroll: <ul style="list-style-type: none"> ➤ First five years: -0.2 percentage points (ppt) per annum for both components ➤ Second five years: -0.4ppt per annum for tangible assets and -0.8ppt per annum for payroll
<i>De minimis</i> exclusion	No distinction	Only for economies where the MNE has revenues of ≤EUR10 million and profit of ≤EUR1 million
Undertaxed payment rule (UTPR)	N/A	In-scope MNEs in the initial expansion phase will be exempted for five years (i.e., MNEs ≤EUR50 million tangible assets abroad and operate in ≤5 other economies).
A minimum rate for Subject to Tax Rule (STTR)	7.5 percent to 9 percent	9 percent
OECD to develop model rules to give effect to Global anti-Base Erosion (GloBE), and a Multilateral Instrument	In 2022 (Effective implementation: 2023)	<ul style="list-style-type: none"> • Model rules: By end-Nov 2021 • Multilateral Instrument: By mid-2022 (Effective implementation: 2023)

⁵ The UTPR allows a home country of a parent company to claim some tax liabilities if a top-up tax is not imposed.

⁶ Refers to MNEs that meet the criteria, such as generate at least EUR750 million in annual revenue, to be subject to Pillar Two.

IV. Significance of the October 8 Changes

8. The participation of major advanced and developing economies is a key enabler to implementing the global tax reform. The inclusion of Hungary and Ireland paves the way for a smoother adoption of eventual multilateral arrangements across the European Union, which operates on a consensus-based approach. The participation of a significant number of emerging and developing economies, including China and India, also augur well for the implementation of these reforms globally. Some ASEAN+3 economies, such as Indonesia, have made early preparations in anticipation of the upcoming reforms. Indonesia approved the enactment of the Harmonized Tax Law in early-October with the aim to optimize tax revenue collection. The domestic tax reform include higher value-added tax rate, a new carbon tax and the cancellation of previous plans to reduce corporate income tax.

9. However, obtaining parliamentary approval and incorporating these reforms into domestic law in each of the 136 economies could be challenging. For example, significant political resistance toward the proposed global tax reforms is expected in the United States Congress. In view of impending increases in domestic corporate tax rates, proponents of the global tax reform welcome the introduction of a global minimum tax, which will reduce incentives for companies to shift abroad ([Gottlieb 2021](#)). The two-year ban on the imposition of new DSTs will also reduce the tax burden currently faced by American technology companies abroad. However, opponents of the global tax reform argue that the United States would lose taxing rights of highly profitable American MNEs to foreign countries. Technical complexities over the ratification process of the reform are expected to stall the approval of the tax accord ([Condon 2021](#)). In anticipation of similar legislative challenges in other signatory economies, the two-year timeline set by the IF to implement the majority of these reforms could be optimistic.

10. Within regional economies, home countries of MNEs that have a large global presence could see some reduction in tax collection. Given greater clarity on the implementation of two-pillar reforms, potential effects on some regional MNEs and government revenue have been highlighted in news articles. For example, Samsung Electronics and SK Hynix, which reported revenue of USD198 billion and USD26 billion in 2020, respectively, are likely to be in-scope MNEs. This means that some of their corporate profit taxes to the Korean government will be shifted to foreign governments according to Pillar I. However, the Korean government has thus far assessed that the total impact on its government revenue would likely be a net positive, as higher collectible taxes from companies operating in Korea are expected. The government has also emphasized that it will look into measures to mitigate the impact of the global tax reform on Korean companies ([Lee 2021](#)).

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