THE POWER OF BEING UNDERSTOOD

RSM Tax Advisory (Hong Kong) Limited
羅 申 美 稅 務 諮 詢 有 限 公 司

Welcome to Tax Flash – RSM Tax Advisory (Hong Kong) Limited's Newsletter Covering Technical Development in Taxation

RECENT DEVELOPMENTS ON PILLAR ONE AND PILLAR TWO

On 1 July 2021, the Organization for Economic Co-operation and Development ("OECD") announced that 130 countries and jurisdictions[1] joined the new two-pillar plan to reform international taxation rules. Taxing rights on more than US$100 billion of profit are expected to be reallocated to market jurisdictions each year (Pillar One), and the global minimum corporate income tax (with a minimum rate of at least 15%) is estimated to generate around US$150 billion in additional global tax revenues annually (Pillar Two).

The technical work on the two pillars will be finalized in October 2021, with a plan for effective implementation in 2023.

1. BACKGROUND AND DEVELOPMENT

The two-pillar plan aims to ensure multinational enterprises ("MNEs") pay a fair share of tax wherever they operate. A chronology of the recent significant developments is set out below: -

Date	Development
October 2020	The OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting ("BEPS") released the Blueprints of "Pillar One" and "Pillar Two": - • "Pillar One" will ensure a fairer distribution of profits and taxing rights among countries with respect to the largest MNEs, including digital companies. It would reallocate some taxing rights over MNEs from their home countries to the markets where they have business activities and earn profits, regardless of whether firms have a physical presence. • "Pillar Two" seeks to put a floor on competition over corporate income tax through the introduction of a global minimum corporate tax rate that countries can use to protect their tax bases.

[1] *A small group of the Inclusive Framework's 139 members have not yet joined at this time.*

18 May 2021	The European Commission ("EC") released a "Communication on Business Taxation for the 21st Century", setting out the EU's short-term and long-term tax policy announcements. Their views on the two pillars are: - • Pillar One will be mandatory for participating countries; and • Pillar Two will reflect the BEPS Inclusive Framework rules with necessary adjustments. It will become one of the criteria for its notorious list of non-cooperative jurisdictions.
20 May 2021	During an OECD tax steering group meeting, the US Treasury expressed that the global minimum tax rate should at least be 15%, i.e. businesses should pay a global minimum corporate tax of at least 15% on their overseas profits.
4-5 June 2021	After the meeting in London, the G7[2] Finance Ministers issued a communiqué announced that its member countries had reached an agreement on the two-pillar approach:- • a new profit allocation mechanism where market countries awarded taxing rights on at least 20% of the profit of a multinational group exceeding a 10% margin; and • a global minimum tax of at least 15% on a country by country basis. The G7 agreed to provide for appropriate coordination between the application of the new international tax rules and the removal of all Digital Services Taxes ("DST") and other relevant similar measures.
1 July 2021	The OECD announced that 130 countries and jurisdictions had joined the new two-pillar plan to reform international taxation rules.

2. THE POTENTIAL IMPACT

➢ The two-pillar approach will lead to a huge shift in global tax policy. Pillar One was initially aimed solely at tech giants, but the scope is now expanded to include the world's top 100 companies, both digital and non-digital, with global annual revenue of more than EUR20 billion. It will affect more internationally active companies than just the top MNEs in the world. Permanent establishment rules will likely change even further to accompany the Pillar One changes.

➢ If MNEs operations in each country cannot meet the minimum tax rate, a 'Top-Up' tax will be applied. That will have a great impact on countries with low corporate tax rates or offer generous tax incentives. Whether all the 139 Inclusive Framework members accept the minimum tax rate of 15% will be one of the major concerns under Pillar Two.

➢ Other than that, there are still many significant challenges to meeting the demands of other Inclusive Framework members, such as the rollback of all unilateral tax measures designed to target particular industries and legislative changes affecting local taxpayers.

---

[2] *The G7 members are Canada, France, Germany, Italy, Japan, the United Kingdom, and the United States.*

- The OECD has recently indicated that an agreement on the full package on Pillars One and Two may be reached in October 2021. A framework will also be produced by October 2021 for identifying unilateral measures (e.g. DST) to be withdrawn as part of the agreement on Pillar One.

- Although Hong Kong's profits tax rate is 16.5%, the effective tax rate for many MNEs operating here is lower than the 15% minimum global tax rate. This is mainly due to the Hong Kong territorial basis of taxation (only Hong Kong sourced income is subject to profits tax) and incentives offered by the Hong Kong government. Unless there will be specific carve outs for territorial regimes, situations where income is treated as non-Hong Kong sourced and therefore not subject to Hong Kong tax may lead to such income subject to a top-up tax under Pillar Two. In which case, Hong Kong's tax regime will lose its competitive advantage of having low tax rates. Hong Kong government will be under pressure to amend its tax regimes to avoid being placed on the EU's list of non-cooperative jurisdictions again.

- MNEs should start preparing for the upcoming changes, planning and assessing how these changes may impact their overall tax burden and group operating model.

- The next critical events are the coming G20 Finance Ministers meeting on 9-10 July 2021 held in Venice, Italy. Taxpayers should closely monitor the regulatory and practice developments and seek professional assistance where necessary.

For further information on the above subject and discussion on the potential impact on your group, please feel free to contact us.

RSM Tax Advisory (Hong Kong) Limited

RSM Hong Kong's dedicated and experienced tax specialists can:

- Advise on tax efficient holding and operational structures for new cross-border investment, including the formation of Hong Kong and Chinese business entities
- Review existing cross-border investment structures, advise on identified deficiencies, quantify any potential exposure from such deficiencies, and further advise on restructuring approach and procedures
- Assist clients to discuss and clarify matters with tax officials, including transfer pricing and advance rulings
- Act as client representative in tax audits and tax investigations
- Provide transaction support services on mergers and acquisitions, including tax due diligence, deal structure advice, tax health checks, related human resources arrangements and other tax compliance and consultation services
- Provide tax expert witness services at Courts.
- Act as tax advisor on transfer pricing and tax compliance reviews for IPO applications.
- Advise on human resources and structuring employment arrangements in a tax-efficient manner
- Advise on tax equalization schemes
- Provide tax compliance services for individual and corporate clients in Hong Kong and China

The aim of Tax Flash is to alert readers to recent developments. The information is general in nature and it is not to be taken as a substitute for specific advice. RSM Hong Kong accepts no responsibility for any loss that occurs to any party who acts on information contained herein without further consultation with us. If you have any comments or require further information, please contact:

Mr. Eric Chen T +852 2583 1259 E ericchen@rsmhk.com	Mr. Samuel Chan T +852 2583 1242 E samuelchan@rsmhk.com	Ms. Lilian Poon T +852 2583 1241 E lilianpoon@rsmhk.com	Mr. Patrick Ho T +852 2583 1258 E patrickho@rsmhk.com
Mr. Caesar Wong T +852 2508 2851 E caesarwong@rsmhk.com	Ms. Catherine Tsang T +852 2583 1256 E catherinetsang@rsmhk.com	Ms. Joanna Lee T +852 2583 1317 E joannalee@rsmhk.com	Mr. Alan Chow T +852 2583 1378 E alanchow@rsmhk.com
Ms. Catherine Wong T +852 2583 1396 E catherinewong@rsmhk.com	Ms. Shirley Lo T +852 2583 1211 E shirleylo@rsmhk.com		

RSM Tax Advisory (Hong Kong) Limited

29th Floor, Lee Garden Two
28 Yun Ping Road
Causeway Bay, Hong Kong

T +852 2598 5123
F +852 2598 7230
E tax@rsmhk.com

www.rsmhk.com