The impact of the Global Minimum Tax under Pillar Two on Common Tax Incentives Adopted in Asia-Pacific

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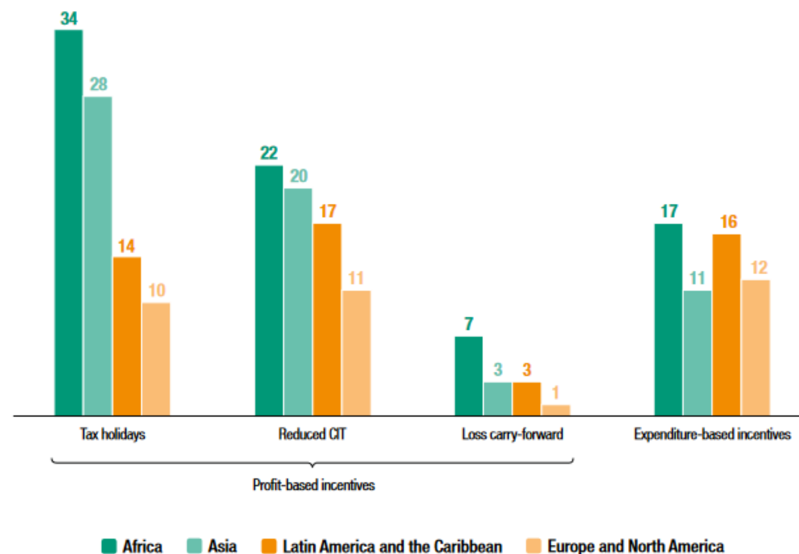
Status Quo

- ASPAC has long been known for its generous incentives

- Incentives programs and schemes to:
  - Nurture specific sectors
  - Promote specific activities
  - Develop specific regions

- Mostly **profit-based** incentives
- Expenditure-based incentives granted, but to a lesser extent

- Pillar Two?



How to assess the impact of Pillar Two on tax incentives?

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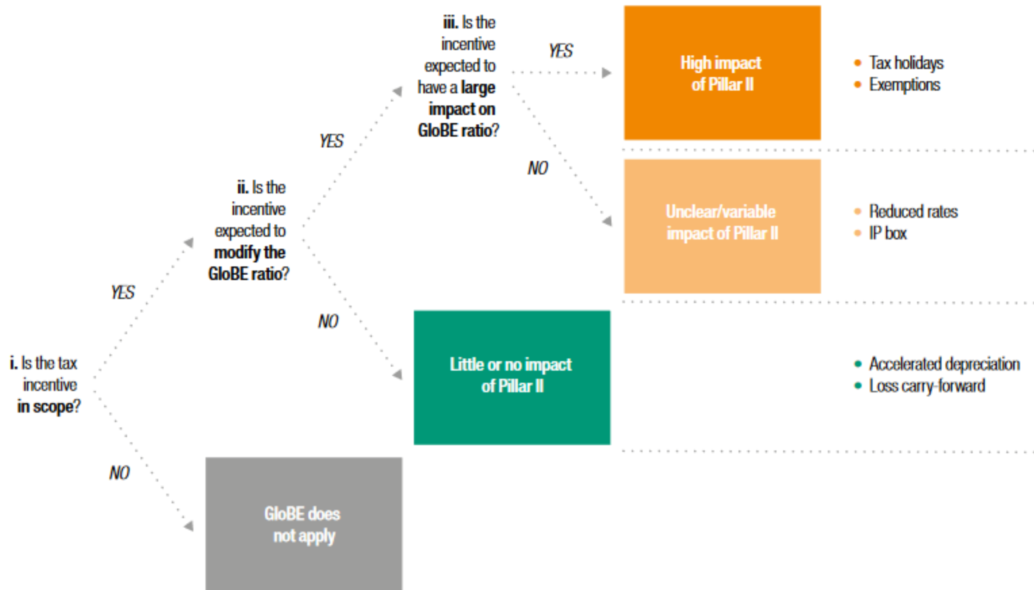
Figure III.17. | Framework to assess the impact of Pillar II on (income-related) tax incentives



Source: UNCTAD.

GloBE ratio (ETR) = $\frac{\text{Adjusted Covered Taxes}}{\text{Net GloBE Income}}$

- ETR below 15%:

  Top-up Tax on "excess profits"

  = GloBE Income - **"substance-based income exclusion" (SBIE) carve-out**

  - SBIE: allows the exclusion of a fixed return on **payroll and tangible assets costs** from the minimum level of taxation
  - i.e. countries may maintain incentives to routine profits

Degree of impact on different areas

Manufacturing

SBIE likely to have a positive impact on labor and tangible asset-intensive activities

ASPAC: most of tax incentives are granted to manufacturing

ICT, IP, R&D

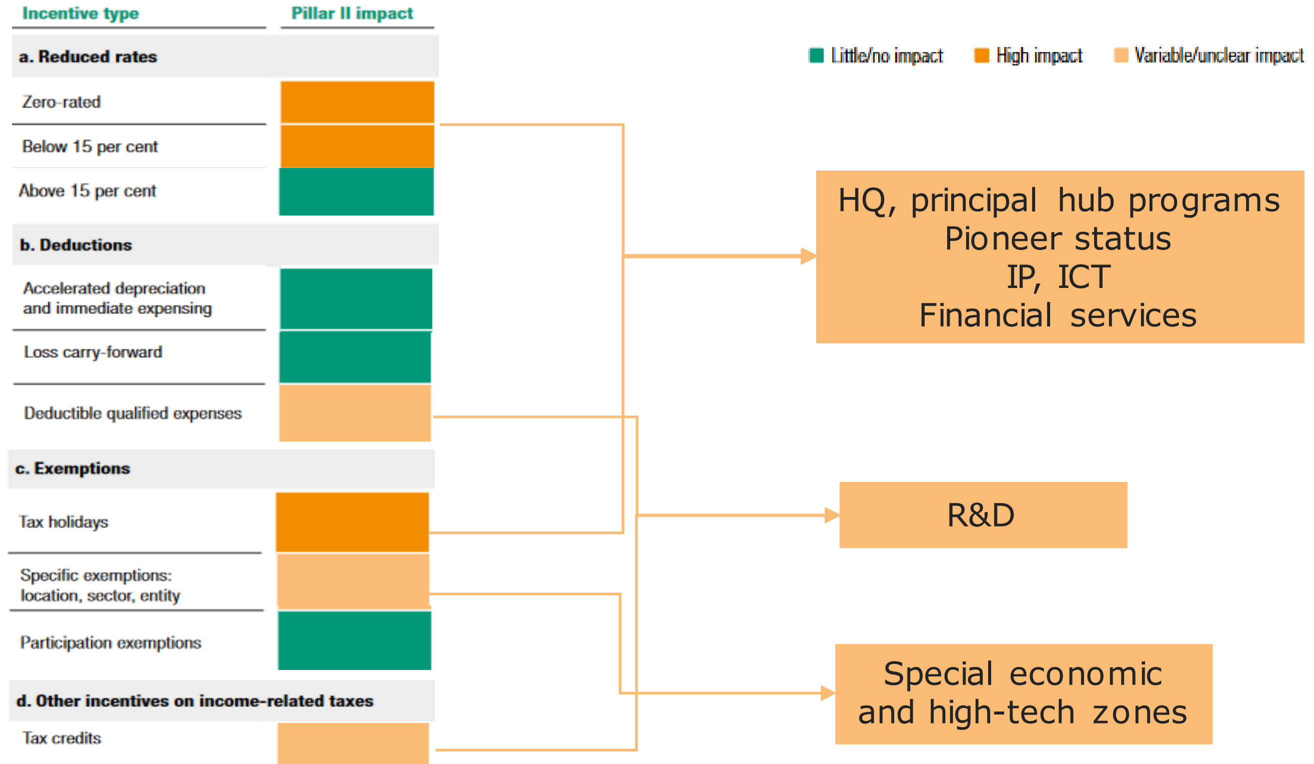
SBIE likely less effective: not a tangible asset-intensive activity

Financial Services

SBIE likely less effective: financial services sector leverages capital and risk

Degree of impact on different incentives

1. Size of the fiscal benefit
2. Weight of the incentive's tax base on the GloBE Income



Policy responses (1)

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- Two-tier evaluation:

1. Is the area of the incentive substantially affected?

- Does it mainly generate routine or excess profits? (the TP method applicable might in some instances be indicative) – e.g. manufacturing vs R&D/HQ/financing role
- Does it cover in-scope MNEs? – dependent on the structure of the domestic market

2. Is the type of incentive substantially affected?

- Refundable tax credit/grant vs tax holiday/sector specific exemption

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Policy responses (2)

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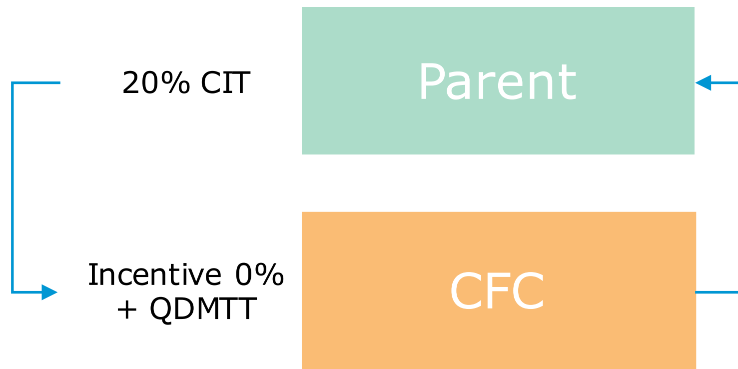
- QDMTT vs corporate tax reform

- Even if a **low risk** of falling under Pillar Two **->** the QDMTT is sensible for the marginal cases that might fall.

- If **high risk** of falling under Pillar Two and the incentive being impacted:
    i. QDMTT **but** splitting the taxpayers' base depending on the arbitrary Pillar Two scope criteria.
    ii. Withdrawing the incentive altogether up to 15% effective ETR **but** then also affecting instances that would not have been within the scope.
    iii. Switching to other types of incentives such as refundable tax credits for some activities (e.g. R&D) **but** then higher budgetary impact due to cash payments.

Policy responses (3)

- Interaction between CFC rules and the QDMTT
  - **CFC rules take priority** in the sense that residence CFC taxation is attributed at the level of the subsidiary for calculating the ETR in the CFC jurisdiction.



But there might be a benefit for the group from using a CFC

Before Pillar Two: Some profits (e.g. 10%) in low tax jurisdiction without triggering CFC
After Pillar Two: the 10% would be subject to IIR unless further income that triggers the CFC is pushed down to increase the ETR

CFC jurisdiction has incentive to amend its CIT regime instead of relying on QDMTT

Thank you!

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