International Tax Updates

1. The OECD released consultation documents on the BEPS 2.0 proposals

The OECD released the following two consultation documents on the BEPS 2.0 proposals in October and November 2019 respectively:

- Secretariat Proposal for a “Unified Approach” under Pillar One; and

Pillar One proposes a new nexus rule and revised profit allocation rules with the effect of allocating more profits to the market or user jurisdictions. The rules do not only apply to highly digitalised businesses but also large “consumer-facing” businesses, with potential carve-outs for certain sectors (e.g. extractive industries, commodities and financial services) and businesses with annual revenue of less than EUR 750 million.

Under the OECD Secretariat’s Unified Approach, the following rules are proposed:

- Under the proposed new nexus rule, a business will create a taxable presence in a jurisdiction if it has a sustained and significant involvement in the economy of a market jurisdiction even if it does not have any presence in that jurisdiction. The consultation document proposes that the primary indicator for such sustained and significant involvement be based on a revenue threshold in the market (which could be adapted to the market size) and also take into account certain activities, such as online advertising services.

- Under the proposed revised profit allocation rules, the following three-tier mechanism is proposed:
  
  i. Amount A – allocate a portion of deemed residual profit of a group to the market jurisdictions using a formulaic approach;
  
  ii. Amount B – set a fixed return for “baseline” or routine marketing and distribution functions performed in the market jurisdictions; and
iii. Amount C – additional profits in the market jurisdictions where in-country functions exceed the baseline activities compensation by Amount B above, with legally binding and effective dispute prevention and resolution mechanisms to avoid double taxation.

Pillar Two proposes the following rules that would provide parent or source jurisdiction with a right to tax back untaxed or undertaxed income up to an agreed top-up rate where the income is not taxed at an effective minimum tax rate: (1) income inclusion rule, (2) switch-over rule (to complement the income inclusion rule), (3) undertaxed payments rule and (4) subject to tax rule (to complement the undertaxed payments rule).

In the consultation document, inputs are sought on the following three aspects of the design of the rule:

- **Tax base determination** - whether financial accounts should be used as a starting point for determining the income base for computing the effective tax rate of a taxpayer and whether adjustments should be made to take into account certain permanent and temporary differences between the income computed under financial accounting standards and the income tax rules.

- **Blending** - whether blending of high-taxed and low-taxed income should be allowed in computing the effective tax rate of the profits and if yes, whether the blending should be at the entity level, jurisdictional level or global level.

- **Carve-outs** – whether there should be carve-outs for (1) preferential tax regimes that are compliant with the standards of BEPS Action 5 on harmful tax practices, and other substance-based carve-outs, (2) a return on tangible assets and (3) controlled corporations with related-party transactions below a certain threshold.
2. The OECD guidance on spontaneous exchange of information by no or nominal tax jurisdictions under the new economic substance regime

On 31 October 2019, the OECD published guidance on spontaneous exchange of information by no or nominal tax jurisdictions under the new economic substance regime.

Under the new substantial activities standard for no or nominal tax jurisdictions introduced by the OECD in November 2018, these jurisdictions are required to spontaneously exchange information with the competent authorities of the relevant overseas jurisdictions in certain circumstances.

The guidance set out (1) the applicable timelines for conducting the exchanges, (2) the legal mechanism to operationalize the exchange process, (3) the details to be exchanged and (4) the standard format for the exchanges in the following scenarios:

- All jurisdictions – cases of non-compliance with the economic substance requirements;
- Jurisdictions with standard monitoring mechanism – high risk Intellectual Property (IP) cases;
- Jurisdictions with fully equipped monitoring mechanism – high risk IP cases; and
- Jurisdictions with standard monitoring mechanism – all other cases.

It is expected that exchanges pursuant to the standard will commence in 2020.

For more details and a copy of the guidance, please refer to this <link> to the OECD’s website.
3. The EU review on foreign source income exemption regimes


The report identifies 24 new preferential tax regimes that will be subject to the review by the European Union (EU) against the criterion of whether it is a harmful preferential regime for the purpose of updating the EU list of non-cooperative jurisdictions for tax purposes. Among the 24 newly identified regimes are 13 foreign source income exemption regimes of various jurisdictions, including the offshore regime of Hong Kong (i.e. non-Hong Kong sourced income is not subject to tax in Hong Kong).

According to the report, the EU assessment of the newly identified offshore foreign source income exemption regimes will initially focus on the nine jurisdictions (including Hong Kong) that are either developed countries or developing countries with a financial centre. The review will assess whether the regimes concerned contain harmful elements. For the remaining four regimes in developing countries without a financial centre, the Group agreed to engage in a dialogue on this matter with those jurisdictions first and assess those regimes in a second stage.

For more details and a copy of the report, please refer to this link to the website of the EU.

The Group also agreed on an approach to assess foreign source income exemption regimes and such approach has been endorsed by the European Council on 10 October 2019. The guidance acknowledges that foreign source income exemption regimes, or regimes that charge corporate tax on a territorial basis are not, in themselves, problematic. However, problems arise when such regimes not only prevent double taxation, but also create situation of double non-taxation. This is particularly the case for regimes that have (1) an overly broad definition of the income
excluded from taxation, notably foreign source passive income without any conditions or safeguards, and/or (2) a nexus definition that is non-compliant with the definition of a permanent establishment in the OECD Model Tax Convention.

For more details and a copy of the guidance, please refer to this [link].