New international taxation rules– Two-Pillar Solution

Issues

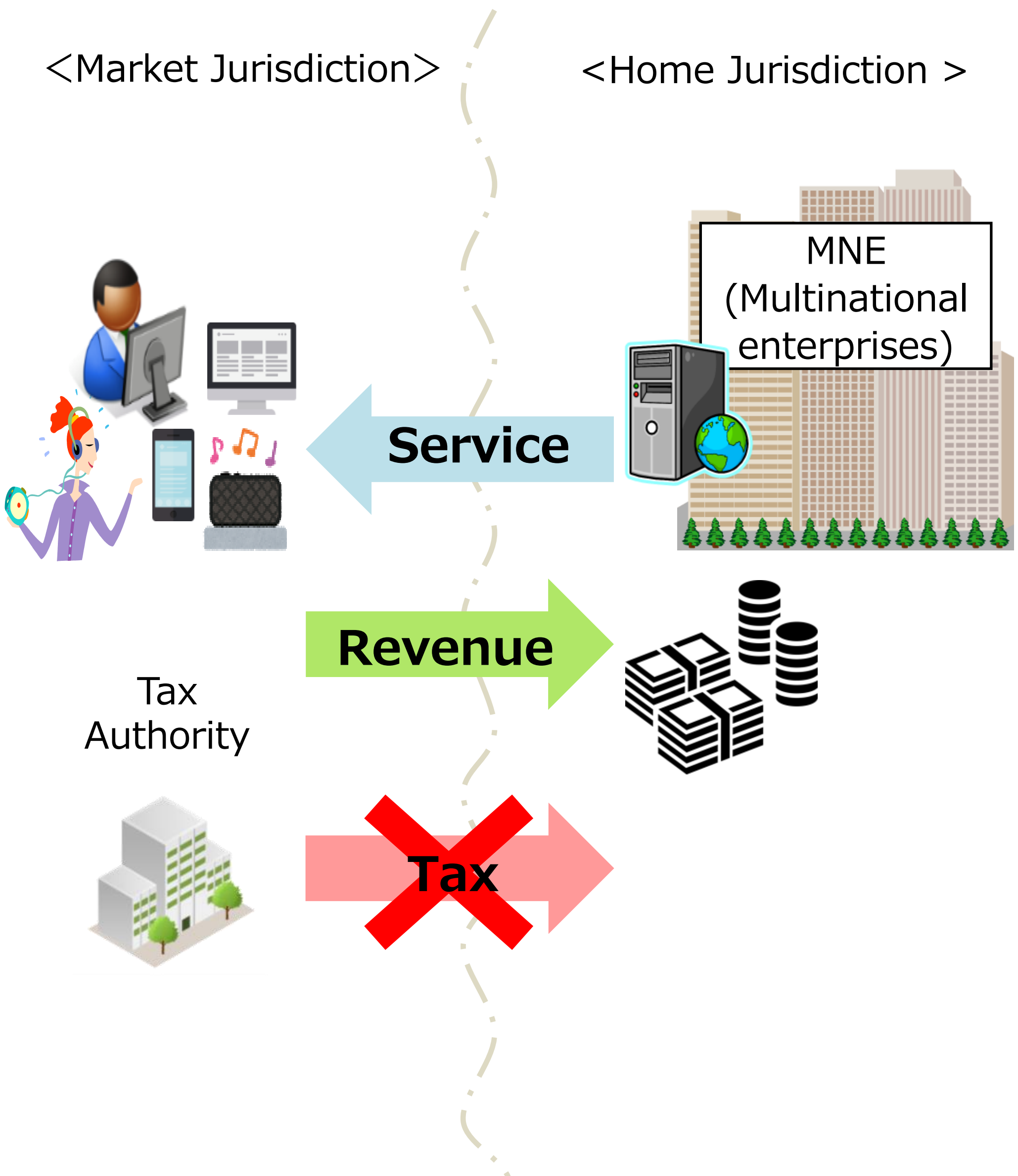
- Increase in the number of companies doing business without permanent establishment (PE) in the market country
  - Under the current principles of international taxation, only if there is a PE such as a branch office of a foreign company taxation on the income generated from the business at the PE is possible and the problem that taxation is not possible in the market country has become evident.
- A trend to attract foreign companies with low corporate tax rate and preferential tax system
  - Continued corporate tax cuts have weakened the corporate tax revenue base of each country.
  - In terms of the tax system, fair competition conditions among companies have been impaired.

- The discussions were held at the "OECD/G20 Inclusive Framework on BEPS" (currently about 140 countries/regions participate in) and an agreement on a two-pillar solution was reached on October 8, 2021.
- The Outcome Statement was released on July 12, 2023, following intense technical negotiations by delegates (approved by 138 Inclusive Framework members).

Present Status

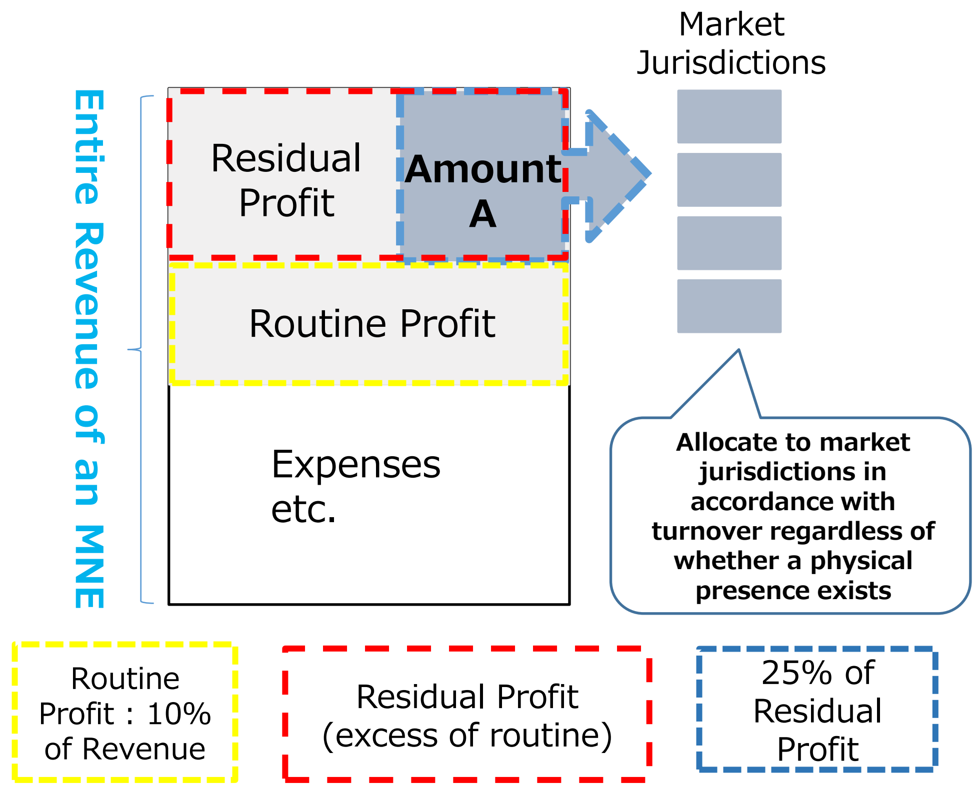
- Pillar 1 (Allocation of new taxing rights to market countries): The text of the Multilateral Convention (MLC) has been published.
- Pillar 2 (Global Minimum Tax): Japan has already completed the legislative process on the Income Inclusionn Rule (IIR) in the 2023 FY tax reform. The legislation of remaining parts will be completed in or after 2024 FY tax reform.

OECD BEPS Project Pillar One : Rules on Allocation of New Taxing Rights to Market Jurisdictions



- In-scope companies are large and highly-profitable MNEs (Multinational enterprises) with **<u>global turnover above 20 billion euros and profitability (profit margin) above 10%</u>** (approx. 100 companies across the world could be in scope.).

- Amount A, equivalent to 25% of an MNE's profit in excess of 10% of the MNE's revenue, is allocated to market jurisdictions.



OECD BEPS Project Pillar One :
Rules on Allocation of New Taxing Rights to Market Jurisdictions

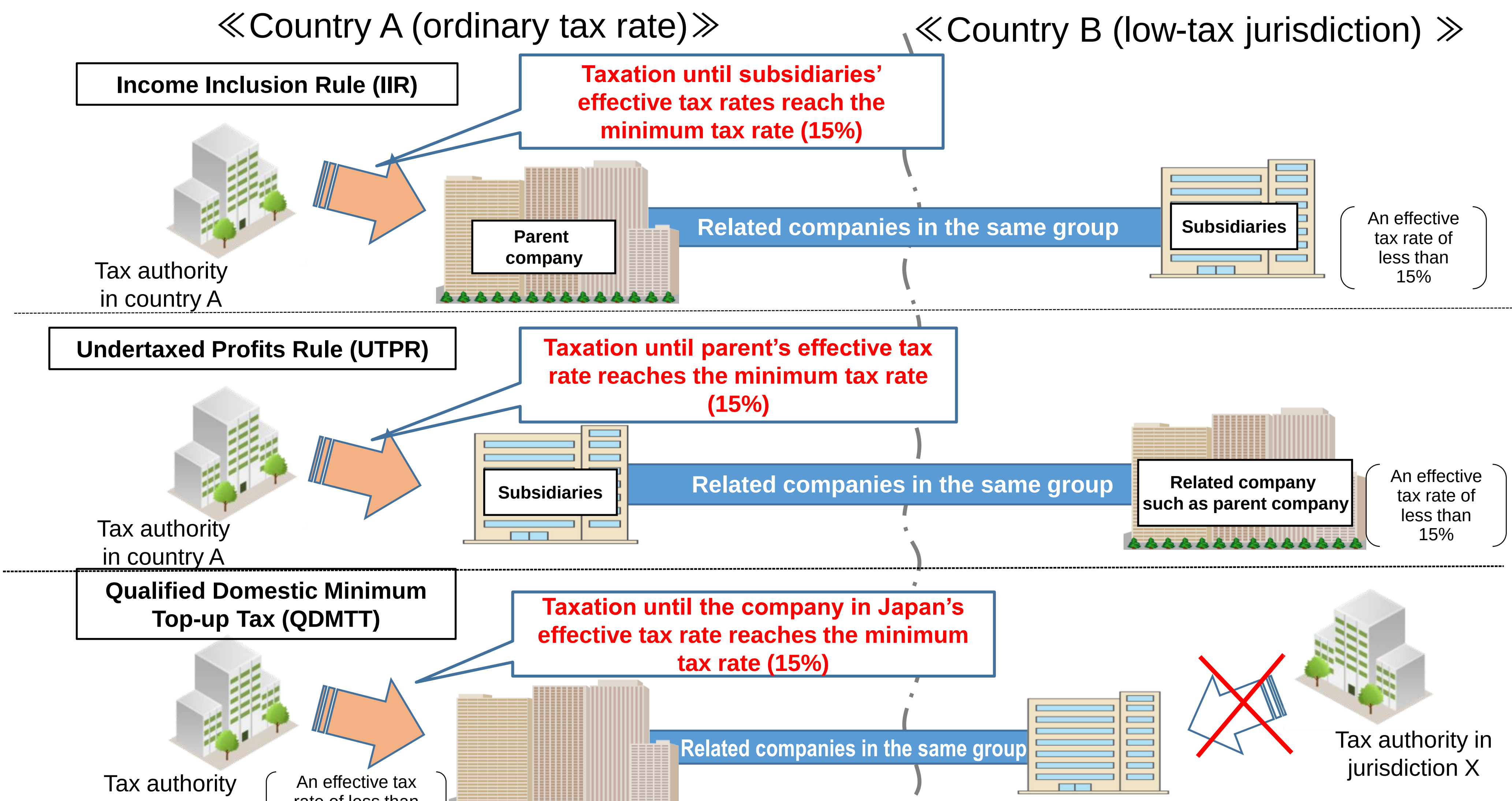
- Enables reallocation of taxing rights to **“market”** jurisdictions:
  - ✓ Tackles the challenges of *“No taxation without Permanent Establishment (PE)”*

➡ **Possibility for emerging economies, with growing markets, to expand their tax base.**

- Removes Digital Services Tax (DST) and its similar measures:
  - ✓ DST is not regarded as corporate income taxation, thus no elimination of double taxation.

➡ **Enhances stability and certainty in the international tax system.**

OECD BEPS Project Pillar Two： Global Minimum Tax



* When QDMTT is implemented in Japan, IIR and UTPR will not be applied.

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- Restricts the effects of tax incentives for large MNEs:
  - ✓ (tax incentives') "fiscal cost can be high, reducing opportunities for much-needed public spending on infrastructure, public services or social support, or requiring higher taxes on other activities" (PCT, 2015).

➡ **Ensure a level playing field and put a floor under tax competition.**

Time to reconsider the costs of tax incentives to attract MNEs.

- Curbs the *"race to the bottom*" in corporate taxation:
  - ✓ Pillar 2 will ensure the effective tax rate (ETR) of 15% worldwide for the in-scope MNEs.

➡ **The revenue base is expected to be more stabilized worldwide.**

- Qualified Domestic Minimum Top-up Tax (QDMTT) as a game-changer:
  - ✓ Enables jurisdictions to protect themselves from the minimum top-up tax of other jurisdictions.

➡ **Optimal strategy for each jurisdiction would be to introduce QDMTT so that it can protect its tax revenues from IIR and UTPR of other jurisdictions.**

Asia Pacific Tax Hub

- Regional Framework to promote domestic resource mobilization and international tax cooperation.
- Launched in May 2021 during the 54th Annual Meeting of the ADB.
- All the ADB members are included.
- Consists of three (3) building blocks:
  - ✓ International Tax Cooperation (ITC): The Global Forum on Transparency, Exchange of Information for Tax Purposes, The Inclusive Framework on BEPS.
  - ✓ Medium-Term Revenue Strategy (MTRS)
  - ✓ Digitalization of tax administration.
- Japan is supporting ADB's projects through the DRMTF (Domestic Resource Mobilization Trust Fund).

Indo-Pacific Economic Framework (IPEF)

- Launched in May 2022 in Tokyo, by issuance of the Leaders' Statement, joined by 14 countries:
  - ✓ Australia, Brunei Darussalam, Fiji, India, Indonesia, Japan, Republic of Korea, Malaysia, New Zealand, Philippines, Singapore, Thailand, the United States, Viet Nam
- Consists of four (4) pillars: i) Trade, ii) Supply Chains, iii) Clean Economy, **iv) Fair Economy**
- Scoping completed in September 2022 by the Ministerial Statement, it includes:
  - ✓ enhance ***transparency and exchange of information for tax purposes*** between tax competent authorities pursuant to existing international agreements and standards
  - ✓ support global and regional efforts ***to improve tax administration and domestic resource mobilization*** through technical assistance, capacity building, and more efficient tax administrative practices
  - ✓ support the ongoing work of the OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting's ***Two Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy***, as applicable
- Aims to implement and accelerate progress on tax initiatives consistent with international agreements and standards