IMPLICATIONS OF THE PILLAR TWO GLOBAL MINIMUM TAX FOR INDONESIA

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OUTLINE OF PRESENTATION

- Background: Where are we now?
- Brief description of the operation of the global minimum tax, the undertaxed payments rule (UTPR) and the subject-to-tax rule (STTR)
- Discussion of the implications for Indonesia
- Concluding remarks

BACKGROUND

- 2015 BEPS Action 1 Report on the digital economy
- January 2019 two-pillar approach launched
- October 2020 Blueprints for Pillar One and Two issued
- October 2021 Statement of political agreement of G7, G20 and 137 countries of Inclusive Framework on Pillars One and Two
  – To be implemented by 2023

BACKGROUND

- Model Rules for Pillar Two (60 pages) issued on December 20, 2021
- Commentary on Model Rules expected soon
- Public consultation on administrative issues in February 2022
- Model STTR and Commentary plus multilateral instrument to be issued in March 2022 for public consultation

Basic Operation of the Global Minimum Tax

- Minimum tax on profits of an MNE group earned through PEs or subsidiaries (CEs) in a country that taxes at an effective tax rate (ETR) of less than 15%
- Applies only to MNEs with consolidated revenue in excess of EUR 750 million for 2 of previous 4 years
  - n/a to pension and investment funds, REITs, government entities, etc. (excluded entities)
- Members of an MNE group are related through ownership or control and included in consolidated financial statements of ultimate parent entity (UPE)

Basic Operation of the Global Minimum Tax

- Minimum tax does not apply if average revenue of CEs in a country (for current and 2 preceding years) is less than EUR 10 million and average net income is less than EUR 1 million
- Top-up tax (15% in excess of ETR on profits of CEs in country) paid by ultimate parent entity (UPE)
- Top-up tax paid by lower-tier intermediate parent entity (IPE) where UPE country does not apply minimum tax – top down approach

Basic Operation of the Global Minimum Tax

- Computation of a country's ETR requires determination of the adjusted accounting income and covered taxes of each CE
- Covered taxes are limited to income taxes
- Taxes paid with respect to PEs, CFCs and hybrid entities pushed down
- Withholding taxes on dividends are allocated to payer

Basic Operation of the Global Minimum Tax

- Top-up tax is 15% less ETR times net income of CEs less substance-based exclusion (5% of tangible assets and payroll)
- Exclusion is a rough proxy for active business income
- Top-up tax is reduced by qualified domestic top-up tax (domestic minimum tax equivalent to Pillar Two)
- Top-up tax allocated to CEs in a country based on their relative net accounting income

Basic Operation of the Global Minimum Tax

- Many, many special rules, which might not apply to Indonesian CEs, but could apply to CEs in other countries
- Rules for partially (20% or more) owned parent entity
- Rules for minority owned CE (30% or less)
- Rules for hybrids, flow throughs, and stateless entities

BASIC OPERATION OF THE UTPR

- UTPR supplements the minimum tax; applies only to top-up tax not captured by the minimum tax
- Unpaid top-up tax allocated to countries based on the number of employees and net book value of tangible assets (equally weighted)
- Does not apply to payments
- Countries to which UTPR top-up tax is allocated may deny deductions or make equivalent adjustment to CEs in order to impose the tax

BASIC OPERATION OF THE STTR

- Developing countries can request developed countries to modify tax treaties with respect to interest, royalties and high value services to allow 9% withholding tax where developed country has nominal corporate tax rate of less than 9%
- High value services may include franchise fees, fees for the use of intangibles combined with services, insurance and reinsurance premiums, guarantee and financing fees, rent for movable property, and payments for marketing, procurement and other intermediary services

IMPLICATIONS FOR INDONESIA – GENERAL

- Assumes that Indonesia agrees to implement Pillar Two
- Comments are speculative because it is unclear how MNEs and countries will respond to the new minimum tax
- Important considerations:
  - Revenue
  - Competitiveness
  - Base erosion
  - Tax administration – complexity, enforcement
  - Incorporation into Indonesian domestic law

IMPLICATIONS OF THE MINIMUM TAX

- Outbound aspects: UPE in Indonesia
- Incentive remains for Indonesian MNEs to shift profits to countries that impose tax at ETR of only 15%
  - Consider ways to get Indonesian MNEs to shift profits (operations) back to Indonesia
- Little revenue to be gained by Indonesia if all or most low-tax countries increase their ETRs to 15%, which seems likely

IMPLICATIONS OF THE MINIMUM TAX

- Inbound aspects: foreign MNEs with CEs in Indonesia
- CEs in Indonesia should be subject to an ETR of at least 15% otherwise Indonesian tax is effectively shifted to other governments
- Same strategy applies for purposes of the UTPR

Implications of the Minimum Tax

- Possible strategies:
  - Increase nominal corporate tax rate
  - Convert non-tax payments to government (e.g. royalties) to income taxes and gross-based taxes to net-based income taxes
  - Eliminate or reduce corporate tax incentives (asset and payroll based incentives?)
  - Convert tax incentives into direct grants
  - Adopt qualified domestic minimum tax

IMPLICATIONS OF THE UTPR

- Outbound: where Indonesia applies UTPR top-up tax, it must decide whether to deny deductions or impose tax
- Little revenue if other countries impose minimum tax or if countries increase ETR to 15%
- Inbound: Indonesia should ensure parent entity and any CEs located in Indonesia are subject to ETR of at least 15% (possible strategies on previous slide)

IMPLICATIONS OF THE STTR

- Details for the STTR have not yet been settled
- Review of Indonesian tax treaties shows that opportunities to impose STTR are limited
  - Treaties usually provide for rates in excess of 9% except for services
  - Most developed countries impose corporate tax at rates in excess of 9% and other countries may increase their rates to at least 9%
- Indonesia must amend its domestic law to impose withholding of 9% on all payments covered by the STTR

CONCLUSIONS

- If successfully implemented, global minimum tax will be an unprecedented achievement for the OECD
  - Limits the race to the bottom with respect to tax rates
- Ironic that primary beneficiaries may be tax havens
- Competition for foreign investment will shift from tax rates and incentives to ?
- Responses of countries and MNEs remain to be seen
- Significant benefits for Indonesia are not obvious

CONCLUSIONS

- Complexity of the new rules is enormous: all the issues have not yet even been identified let alone solved
- What is the rush?
- Best overall approach for Indonesia may be “wait and see;” but be prepared to act quickly in response to international developments