ADVANCE DIPLOMA IN CORPORATE TAXATION - NALSAR LAW UNIVERSITY, HYDERABAD

RECENT DEVELOPMENT IN CORPORATE TAXATION-PILLAR TWO APPROACH

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BEPS 1.0 AND BEPS 2.0 – An Overview

- OECD/G20 Base Erosion Profit Shifting (BEPS) Project – 15 Action Plans published in 2013 and Final packaged released in 2015.
- Three fundamentals pillars of Action Plans are:

  - Reinforcing of 'substance' requirements in existing international standards;

  - Alignment of taxation with location of value creation and economic activity;

  - Improving transparency and tax certainty.
- The evolution of OECD/ G20 BEPS Project – from securing political commitment to take action in 2013 to the finalization of detailed actions to counter BEPS has ended the first phase – referred to as BEPS 1.0

Inclusive Framework (IF)

- BEPS means tax planning strategies used by MNCs which exploits gaps and mismatches in tax rules to avoid paying taxes.
- Developing countries suffer more from BEPS
- Inclusive Framework on BEPS was developed in 2016 – to reform international tax rules – to make it coherent and transparent.
- In July 2023, 138 member countries out of 143 agreed to outcome statement on the Two Pillar Solution to address the tax challenges arising from digitalization of economy.
- IF finalizes the work on Pillar one and Subject to Tax Rules (STTR) and its implementation framework.

Two Pillar Approach- Background

- October 2020 – First Blueprint was released which provides the intention and some key provisions. Just a consultation paper.
- July and Oct 2021 – Political agreements in OECD Statements – Outlined the broad operation of Pillar One and Two.
- Dec 2021- OECD released Model GloBE Rules for Pillar Two. GloBE is the basis of Pillar Two rules and enables domestics jurisdictions to align with Pillar Two.
- March 2022 – OECD released its commentary to the Pillar Two Model GloBE rules- on how OECD shall see the implementation. The GloBE rules were to apply from Jan 1, 2023 initially however now postponed to Jan 1, 2024.

Two Pillar Approach- Background

- Dec 2022- OECD issued Safe Harbour and Penalty Relief – Global Anti Base Erosion and Profit Shifting Rules.
- Feb 2023- OECD issued the Agreed Administrative Guidance
- July 2023 - OECD issued its second set of Administrative Guidance on the application of the Pillar Two GloBE Rules
- Oct 2023- OECD released the Minimum Tax Implementation Handbook.

The Implementation Handbook is divided into two chapters:

- The first chapter provides an overview of the global minimum tax.

- The second chapter sets out the considerations to be taken into account in assessing implementation options.

What is Pillar 2 ?

Pillar Two consists of two main rules that seek to ensure that multinationals pay a minimum level of tax on their profits. The rules are:

- the Global Anti-Base Erosion (GloBE) Rules - The GloBE Rules are the main Pillar Two Rules. They apply a 15% minimum rate of tax on in-scope multinationals on their foreign profits., and
- the Subject to Tax Rule (STTR) - The STTR is a taxing right to developing countries on defined intra-group payments that have corporate income tax below 9% on such payments in resident country. The STTR allows that source jurisdiction to tax it at a rate up to the difference between 9% and the nominal corporate income tax rate of the residence jurisdiction.

Elements of Two Pillar Solution:

Multilateral Convention on Amount A of Pillar One:

- Amount A – taxing right for market jurisdictions with respect to a defined portion of the residual profits of the largest and most profitable MNEs operating in their market.
- The countries shall exercise a domestic taxing right with respect to the defined portion of the residual profits of MNE that meet certain revenue and profitability thresholds and have defined nexus to the markets of these parties.
- MLC outlines the substantive features including particular circumstances of devemlopeing countries.
- MLC published in October, 2023 and with objective of enabling MLI to enter into force from 2025.

Elements of Two Pillar Solution:

Amount B of Pillar Two:

- Amount B – Framework for the simplified arm's length principle for baseline marketing and distribution activities which are most often litigative due to unavailability of appropriate local market comparable. The July 2023 statement indicates has reached on various aspects of Amount B framework.
- However, further work will be undertaken on specific aspects:

- An appropriate balance between a quantitative and qualitative approach to identify baseline distribution activities.

- The appropriateness of the pricing framework, the application of same to wholesale distribution of digital goods, country uplifts within geographic markets, and the criteria for using a local database in certain jurisdictions.

- The final agreement is intended to be incorporated into the OECD Transfer Pricing Guidelines by Jan 2024

Elements of Two Pillar Solution:

Subject to Tax Rule (STTR) of Pillar Two:

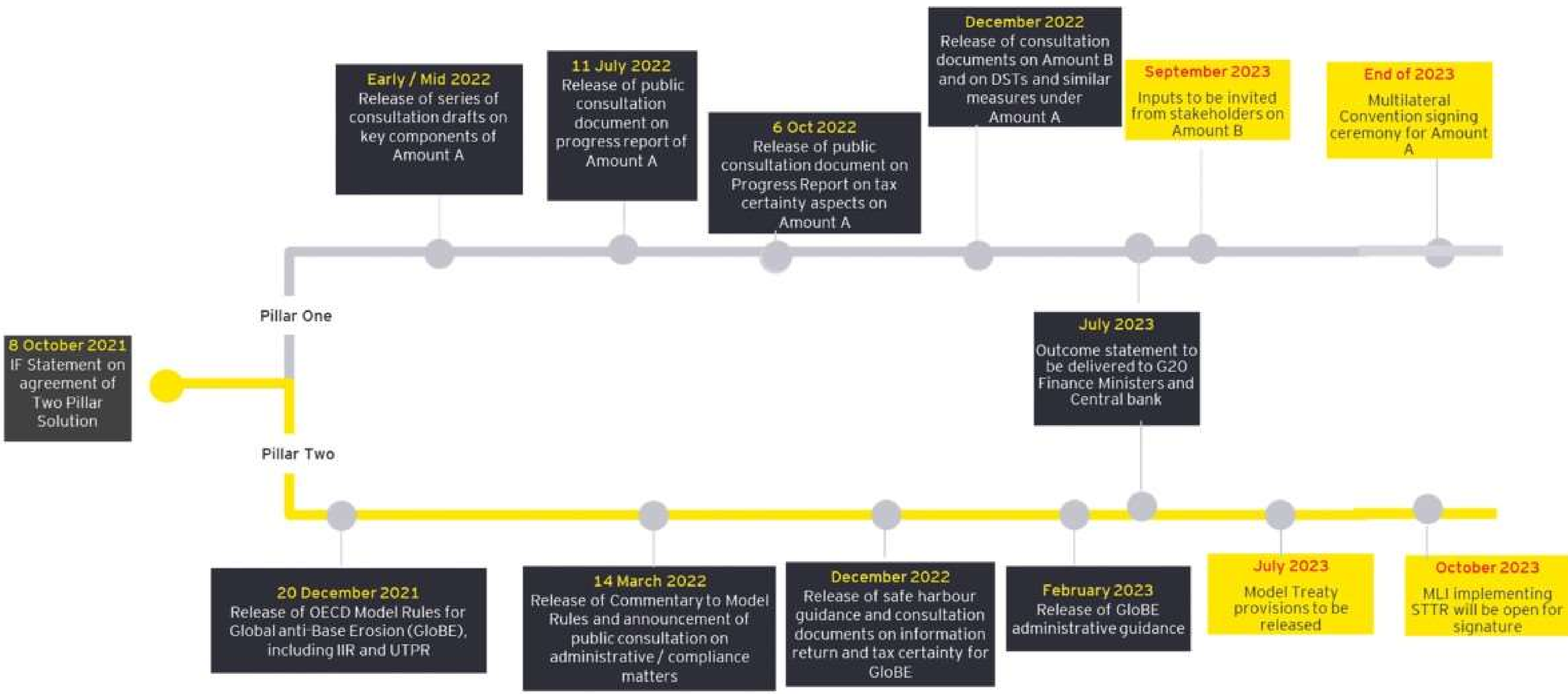
- The STTR model provision and commentary have been completed and delivered. The statement also suggests that work has been completed on a Multilateral Instrument (MLI) together with an Explanatory Statement to enable implementation of the STTR, which opened for signature from 2 October 2023.
- In essence, the STTR is effectively a treaty-override provision. It allows a source state to tax the gross amount of interest, royalties and a defined list of other payments received by a connected company, up to a globally agreed 9% minimum rate, even if a relevant tax treaty only permits the source country to impose withholding tax on the payment at a rate below 9% or allocates exclusive taxing rights over the payment to the recipient’s country of residence.
- Where a jurisdiction applies a tax rate on the receipt of relevant payments that is less than the globally agreed 9% minimum rate, the payer jurisdiction has the right to “top up” the tax payable with a withholding tax.

Elements of Two Pillar Solution:

Implementation Support:

- The IF has called upon the OECD Secretariat to prepare an action plan to support the coordinated implementation of Pillars One and Two.
- In particular, the plan should provide additional support and technical assistance to enhance the capacity necessary for the implementation of the Two Pillar solution by developing countries in coordination with relevant regional and international organizations.

Time lines to implement Two Pillar Approach



GloBE Rules

- The Pillar Two GloBE Rules operate by calculating the effective tax rate (ETR) of the MNE in the jurisdictions it operates in, and then comparing this with the 15% minimum rate.
- If the ETR is less than the 15% minimum rate, additional tax (referred to as top-up tax) may be payable. If the ETR is 15% or above, there is no additional taxation.
- The OECD had two main approaches to calculating the ETR, a global blending approach, or a jurisdictional blending approach. They chose the latter.
- A global blending approach would have blended all the profits and losses of an MNE internationally.
- The jurisdictional blending approach just blends the profits and losses on a jurisdictional basis. Global blending would have significantly narrowed the scope of the GloBE rules.

Application of GloBE Rules

Scope:

- MNE group needs to determine whether it is subject to the GloBE Rules. In general, MNE groups with revenue exceeding 750 million euros are within scope. However, not all group entities are subject to the GloBE Rules. There are some Excluded Entities are not subject to the ETR calculation or top-up tax liabilities.
- If a group is in scope it also needs to determine where its subsidiaries are located for the purposes of the GloBE Rules.

Application of GloBE Rules

ETR Calculation:

- The broad operation of the rules is simply calculate the ETR and compare it to the 15% global minimum rate - The Model Rules apply a series of separate rules to adjust the financial results of the MNEs subsidiaries.
- The starting point of the GloBE Rules is the financial accounts. The tax figure used to calculate the ETR for instance is not based on the tax payable in that jurisdiction in its corporate income tax return, but the tax expense in the financial accounts. The GloBE rules then adjust this figure before it can be used in the GloBE ETR calculation
- Similar principles also apply to calculating GloBE income.

Application of GloBE Rules

Top Up Tax Calculation:

- Once the GloBE ETR is calculated, if this is less than the 15% global minimum rate, the amount of top-up tax needs to be calculated. The top-up tax percentage (ie the amount by which the ETR is less than 15%) is multiplied by GloBE income for the jurisdiction after a deduction for the Substance-Based Income Exclusion.
- This is a reduction in the GloBE profits based on the amount of tangible assets and payroll costs in a jurisdiction.
- The amount of top-up tax payable is then reduced by any Qualified Domestic Minimum Top-Up Tax (QDMTT).
- A QDMTT is a domestic minimum tax that operates in a similar way to the GloBE rules. Many jurisdictions are likely to implement a QDMTT to ensure that they retain taxing rights over any low taxed profits of entities in their jurisdiction.

Indian Current Taxation System

- To understand India's perspective on Pillar Two, it is necessary to consider the current corporate tax regime:
- India offers taxation of corporate income at different rates varying from 15% to 30% (plus applicable surcharge and cess), subject to certain deductions and exemptions.
- Separately, an entity is also under an obligation to pay minimum alternate tax at the rate of 15% (plus applicable surcharge and cess), calculated on the basis of book profits of the entity, if under the normal tax provision, the tax payable is less than the minimum alternate tax.
- Moreover, there should be no tangible impact by the GloBE Rules on the income of constituent entities located in India, as the effective tax rate applicable in the case of Indian entities is already more than the agreed minimum rate of 15%.

Indian Current Taxation System

- From a Pillar Two perspective, another area of concern could be the tax incentives provided under domestic tax laws. For example- in certain cases, India grants exemption from payment of tax on incomes such as dividends and interest.
- Indian tax policymakers will also have to align their tax incentive schemes with the STTR.
- It is expected that India would implement qualified domestic minimum top-up tax rules that will ensure that the income of an Indian constituent entity from its economic activities in India would be taxed in India only, and any taxing right wouldn't be surrendered to the resident jurisdiction of the ultimate parent entity.
- India's tax policy approach continues to be optimistic toward GloBE Rules but also cautious to safeguard its interest in terms of tax revenue.

Global Implementation of Pillar Two Approach:

- December 2021- European Commission released a Proposed Directive based on the model GloBE rules.
- March 2022- Commentary published by OECD.
- June 2022- Objections raised by Hungary.
- June 2022- The French Finance Minister announced that Pillar Two will be implemented with or without Hungary.
- September 2022- Germany, France, Italy, Spain, and the Netherlands issued a joint statement stating that if agreement is not reached on Pillar Two in 'the next few weeks' they will push forward domestic implementation of the Pillar Two GloBE rules 'by any possible legal means' in 2023

- September 2022- Belgium announced it is willing to participate in the enhanced cooperation procedure to implement Pillar Two GloBE Rules.
- December 2022- the EU issued a press release stating that ‘the ambassadors of EU member states decided to advise the Council to adopt the Pillar 2 directive, and a written procedure for the formal adoption will be launched.’
- December 2022- the Council of the European Union formally adopted the EU Pillar Two directive.
- December 2022- the EU Global Minimum Tax Directive was published in the EU official journal as Council Directive (EU) 2022/2523 of 14 December 2022.
- February 2023- Agreed Administrative Guidance for Pillar Two GloBE Rules, issued by OECD.
- July 2023- Second set of Administrative Guidance for Pillar Two GloBE Rules, issued by OECD. https://oecdpillars.com/pillar-tab/pillar-two-implementation/


Q&A

Thank You !!!

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