

Tax Update on Inclusive Framework on BEPS Action Plan 2 as released by OECD

OECD has released details on BEPS Action Plan 2 on 8 October 2021 which refines the erstwhile statement of 1 July 2021. 136 of the 140 Inclusive Framework countries have agreed to the said release. It is titled *Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy* and is 8 pages in length.

The OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting (IF) has agreed a two-pillar solution to address the tax challenges arising from the digitalisation of the economy.

Consistent with the statement of 1 July 2021, two Pillars are covered, out of which, **Pillar 1 deals with the reallocation of certain profits from very large Multinational Enterprises (MNEs)** to market jurisdictions and **Pillar 2 deals with a Global Minimum Tax**.

Proposed Timelines:

- Early 2022: Conclude the text of MLC and explanatory statement (Allocation Amount);
- Mid 2022: Development of MLI and MLC signing ceremony;
- End of 2022: Finalise work on ALP for Marketing and Distribution Activities
- November 2022: Model Rules (including model treaty provisions) for GloBE
- 2023: Ratification (entering into force) of MLC;

Pillar 1

- I. **Coverage**- Multinational Enterprises ('MNEs') fulfilling following criteria:
- a. global turnover exceeding Eur 20 Billion (subsequent reduction to Eur 10 Billion); **and**
 - b. global profitability (PBT/Revenue) exceeding 10%

The Multilateral Convention ('MLC') through which allocation is implemented will be developed and opened for signature in 2022, with the same coming into effect in 2023.

- II. **Exclusion**- Extractive Industries and Regulated Financial Services Sector

- III. **Nexus**- Allocation of specified amount when specified MNE derives Eur 1 Mn from a market jurisdiction (for jurisdictions with GDP lower than Eur 40 bn, threshold set at Eur 250 000)

- IV. Quantum and Revenue Sourcing- 25% of the residual profit exceeding 10% revenue (sourced to end user jurisdiction) be allocated to market jurisdiction
- V. Tax Base- Financial accounting income with small number of adjustments will be the measure for profit/loss
- VI. Safe Harbour and Tax Credit- In case the profits are already taxed in market jurisdiction, allocation mechanism would be capped. Double taxation would be eliminated by way of credit or exemption method.
- VII. Dispute Resolution- Eligible MNEs shall be eligible to avail benefit of dispute prevention and resolution mechanism to avoid litigation/ disputes in a mandatory and binding manner.
- VIII. ALP for Marketing and Distribution Activities- The application of the arm's length principle to in-country baseline marketing and distribution activities will be simplified and streamlined, with a particular focus on the needs of low capacity countries (to be completed by the end of 2022).
- IX. Administration- Single entity reporting and tax compliance management to be implemented.
- X. Unilateral measures- The Multilateral Convention (MLC) will require all parties to remove all Digital Services Taxes and other relevant similar measures with respect to all companies, and to commit not to introduce such measures in the future. No newly enacted Digital Services Taxes or other relevant similar measures will be imposed on any company from 8 October 2021 and until the earlier of 31 December 2023 or the coming into force of the MLC. The modality for the removal of existing Digital Services Taxes and other relevant similar measures will be appropriately coordinated.

Pillar 2

- I. Mechanism
 - a. Two interlocking domestic rules [together the Global anti-Base Erosion Rules (GloBE) rules]: (i) an Income Inclusion Rule (IIR), which imposes top-up tax on a parent entity in respect of the low taxed income of a constituent entity; and (ii) an Undertaxed Payment Rule

(UTPR), which denies deductions or requires an equivalent adjustment to the extent the low tax income of a constituent entity is not subject to tax under an IIR; and

- b. a treaty-based rule (the Subject to Tax Rule (STTR)) that allows source jurisdictions to impose limited source taxation on certain related party payments subject to tax below a minimum rate. The STTR will be creditable as a covered tax under the GloBE rules.
- II. Rule Status- GloBE rules shall be considered basis common approach, i.e the IF members: (i) are not required to adopt the GloBE rules, but, if they choose to do so, they will implement and administer the rules in a way that is consistent with the outcomes provided for under Pillar Two, including in light of model rules and guidance agreed to by the IF; (ii) accept the application of the GloBE rules applied by other IF members including agreement as to rule order and the application of any agreed safe harbours.
 - III. Coverage- GloBE rules apply to MNEs meeting the Eur 750 million threshold prescribed under BEPS Action 13 (country by country reporting). Countries are free to apply the IIR to MNEs headquartered in their country even if they do not meet the threshold.

[Exclusion- Government entities, international organisations, non-profit organisations, pension funds or investment funds that are Ultimate Parent Entities (UPE) of an MNE Group or any holding vehicles used by such entities, organisations or funds are not covered under GloBE rules].
 - IV. Rule Design- The IIR allocates top-up tax based on a top-down approach subject to a split-ownership rule for shareholdings below 80%. The UTPR allocates top-up tax from low-tax constituent entities including those located in the UPE jurisdiction. The GloBE rules will provide for an exclusion from the UTPR for MNEs in the initial phase of their international activity, defined as those MNEs that have a maximum of EUR 50 million tangible assets abroad and that operate in no more than 5 other jurisdictions. This exclusion is limited to a period of 5 years after the MNE comes into the scope of the GloBE rules for the first time. For MNEs that are in scope of the GloBE rules when they come into effect the period of 5 years will start at the time the UTPR rules come into effect.
 - V. ETR calculation- The GloBE rules will operate to impose a top-up tax using an effective tax rate test that is calculated on a jurisdictional basis and that uses a common definition of covered taxes and a tax base determined by reference to financial accounting income (with agreed adjustments consistent with the tax policy objectives of Pillar Two and mechanisms to address timing

differences). In respect of existing distribution tax systems, there will be no top-up tax liability if earnings are distributed within 4 years and taxed at or above the minimum level.

- VI. Minimum rate and Carve Outs- The minimum tax rate used for purposes of the IIR and UTPR will be 15%. The GloBE rules will provide for a formulaic substance carve-out that will exclude an amount of income that is 5% of the carrying value of tangible assets and payroll. In a transition period of 10 years, the amount of income excluded will be 8% of the carrying value of tangible assets and 10% of payroll, declining annually by 0.2 percentage points for the first five years, and by 0.4 percentage points for tangible assets and by 0.8 percentage points for payroll for the last five years. The GloBE rules will also provide for a de minimis exclusion for those jurisdictions where the MNE has revenues of less than EUR 10 million and profits of less than EUR 1 million. An MNE is considered to operate in a jurisdiction if that MNE has a Constituent Entity in that jurisdiction as defined for purposes of the GloBE rules.
- VII. Other exclusions- The GloBE rules also provide for an exclusion for international shipping income using the definition of such income under the OECD Model Tax Convention.
- VIII. Simplifications- To ensure that the administration of the GloBE rules are as targeted as possible and to avoid compliance and administrative costs that are disproportionate to the policy objectives, the implementation framework will include safe harbours and/or other mechanisms.
- IX. GILTI co-existence- It is agreed that Pillar Two will apply a minimum rate on a jurisdictional basis. In that context, consideration will be given to the conditions under which the US GILTI regime will co-exist with the GloBE rules, to ensure a level playing field.
- X. Subject to tax rule (STTR)- IF members recognise that the STTR is an integral part of achieving a consensus on Pillar Two for developing countries. If members that apply nominal corporate income tax rates below the STTR minimum rate to interest, royalties and a defined set of other payments would implement the STTR into their bilateral treaties with developing IF members when requested to do so. The taxing right will be limited to the difference between the minimum rate and the tax rate on the payment. The minimum rate for the STTR will be 9%.
- XI. Implementation- Pillar Two should be brought into law in 2022, to be effective in 2023, with the UTPR coming into effect in 2024.