



130 member jurisdictions agree to OECD/G20 Inclusive Framework on BEPS

OECD announced joining of 130 countries and jurisdictions over a new two-pillar plan on July 1 to reform international taxation rules. The multilateral tax deal and detailed implementation plan is expected to be finalized by October 2021 to see effective implementation in 2023. Notable holdouts include Nigeria, Hungary and Ireland.

The OECD/G20 Inclusive Framework on BEPS was established to ensure interested countries and jurisdictions, including developing economies, can participate on an equal footing in the development of standards on BEPS related issues, while reviewing and monitoring the implementation of the OECD/G20 BEPS Project. The agreed key components of each Pillar are as under:

Pillar one

Scope

Companies within scope are multinational enterprises (MNEs) with global turnover above € 20 billion and profitability above 10% (PBT). Turnover threshold to be reduced to € 10 billion contingent on successful implementation including tax certainty on

Amount A, 7 years after the agreement comes into force, along with annual reviews. Further, Extractives and Regulated Financial Services are excluded from the scope.

Nexus

There will be a new special purpose nexus rule permitting allocation of Amount A to a market jurisdiction when in-scope MNE derives at least € 1 million in revenue from that jurisdiction. For smaller jurisdictions with GDP lower than € 40 billion, the nexus will be set at € 250 000.

The special purpose nexus rule applies solely to determine whether a jurisdiction qualifies for the Amount A allocation. Compliance costs (incl. on tracing small amounts of sales) will be limited to a minimum.

Quantum

For in-scope MNEs, between 20-30% of residual profit defined as profit in excess of 10% of revenue will be allocated to market jurisdictions with nexus using a revenue-based allocation key.

Revenue sourcing

Revenue will be sourced to the end market jurisdictions where goods or services are used or

consumed. To facilitate the application of this principle, detailed source rules for specific categories of transactions will be developed. In applying the sourcing rules, an MNE must use a reliable method based on the MNE's specific facts and circumstances.

Tax base determination

The relevant measure of profit or loss of the in-scope MNE will be determined by reference to financial accounting income, with a small number of adjustments. Losses will be carried forward.

Segmentation

Segmentation will occur only in exceptional circumstances where, based on the segments disclosed in the financial accounts, a segment meets the scope rules.

Marketing and distribution profits safe harbour

Where the residual profits of an in-scope MNE are already taxed in a market jurisdiction, a marketing and distribution profits safe harbour will cap the residual profits allocated to the market jurisdiction through Amount A. Further work on the design of the safe harbour will be undertaken, including to take into account the comprehensive scope.

Elimination of double taxation

Double taxation of profit allocated to market jurisdictions will be relieved using either the exemption or credit method. The entity (or entities) that will bear the tax liability will be drawn from those that earn residual profit.

Tax certainty

In-scope MNEs will benefit from dispute prevention and resolution mechanisms, which will avoid double

taxation for Amount A, including all issues related to Amount A (e.g. transfer pricing and business profits disputes), in a mandatory and binding manner. Disputes on whether issues may relate to Amount A will be solved in a mandatory and binding manner, without delaying the substantive dispute prevention and resolution mechanism.

Consideration will be given to an elective binding dispute resolution mechanism for issues related to Amount A for developing economies that are eligible for deferral of their BEPS Action 14 peer review and have no or low levels of MAP disputes.

Amount B

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. This work will be completed by the end of 2022.

Administration

The tax compliance will be streamlined (including filing obligations) and allow MNEs to manage the process through a single entity.

Unilateral measures

This package will provide for appropriate coordination between the application of the new international tax rules and the removal of all Digital Service Taxes and other relevant similar measures on all companies.

Implementation

The multilateral instrument through which Amount A is implemented will be developed and opened for signature in 2022, with Amount A coming into effect in 2023.

Pillar two

Overall design

Pillar Two consists of:

- two interlocking domestic rules (together the Global anti-Base Erosion Rules (GloBE) rules):
 - 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
 - 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
- 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.

Rule status

The GloBE rules will have the status of a common approach. This means that IF members:

- 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;
- 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.

Scope

GloBE rules will apply to MNEs that meet the € 750 million threshold as determined 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.

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 subject to the GloBE rules.

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 under a methodology to be agreed.

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 3 to 4 years and taxed at or above the minimum level.

Minimum rate

The minimum tax rate used for purposes of the IIR and UTPR will be at least 15%.

Carve-outs

The GloBE rules will provide for a formulaic substance carve-out that will exclude an amount of income that is at least 5% (in the transition period of

5 years, at least 7.5%) of the carrying value of tangible assets and payroll. The GloBE rules will also provide for a de minimis exclusion.

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.

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.

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.

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.¹ 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 from 7.5% to 9%.

Implementation

IF members will agree and release an implementation plan. This will contemplate that Pillar Two should be brought into law in 2022, to be effective in 2023. The implementation plan will include:

- GloBE Model rules with proper mechanisms to facilitate over time the coordination of the GloBE rules that have been implemented by IF members, including the possible development of a multilateral instrument for that purpose.
- An STTR model provision together with a multilateral instrument to facilitate its adoption.
- Transitional rules, including the possibility of a deferred implementation of the UTPR.

Next steps

The agreement reached above indicates the ambition of the IF members for a robust global minimum tax with a limited impact on MNEs carrying out real economic activities with substance. It acknowledges that there is a direct link between the global minimum effective tax rate and the carve-outs and includes a commitment to continue discussions in order to take a final decision on these design elements within the agreed framework by October. Excluding MNEs in the initial phase of their international activity from the application of the global minimum tax will also be explored.

Source: IF Statement dt. July 1, 2021

CONTACT DETAILS:

Head Office

75/7 Rajpur Road, Dehradun

T +91.135.2743283, 2747084, 2742026

F +91.135.2740186

E info@vkalra.com

W www.vkalra.com

Branch Office

80/28 Malviya Nagar, New Delhi

E info@vkalra.com

W www.vkalra.com

For any further assistance contact our team at

kmt@vkalra.com

© 2021 Verendra Kalra & Co. All rights reserved.

This publication contains information in summary form and is therefore intended for general guidance only. It is not a substitute for detailed research or the exercise of professional judgment. Neither VKC nor any member can accept any responsibility for loss occasioned to any person acting or refraining from actions as a result of any material in this publication. On any specific matter, reference should be made to the appropriate advisor.