India’s tax policy choices: Implementing a global minimum corporate tax

A potential, imminent change in the international tax regime (the proposed “global minimum corporate tax” regime) will now require India to evaluate the need for new corporate tax capture rules under its domestic tax law for implementing them. More than 130 countries working together under the OECD/G20 Inclusive Framework have broadly agreed (in July 2021) on a two-pillar approach to address current challenges in international taxation:

**Under Pillar - 1**

Under Pillar 1, between 20 and 30 percent residual profit (profit in excess of 10 percent of revenue) of multinational enterprises (MNEs) with a global turnover above €20 billion and profitability above 10 percent to be allocated to market jurisdictions (with nexus to that MNE), using a revenue-based allocation key.

**Under Pillar - 2**

Under Pillar 2 (also referred to as the Global Anti-Base Erosion- GloBE proposal), a minimum corporate tax rate (of at least 15 percent) is to be implemented by all countries. This global minimum corporate tax rate is to counter a “race to the bottom” by countries on tax rates.

---

1 In 2016, the OECD/G20 BEPS Project established an Inclusive Framework on BEPS to allow other interested countries and jurisdictions to work with OECD and G20 members to develop standards on BEPS related issues and to review and monitor the implementation of the agreed anti-Base Erosion and Profit Shifting (BEPS) actions.

2 OECD/G20 Base Erosion and Profit Shifting Project Statement on a Two-Pillar Solution to Address the Tax Challenges Arising From the Digitalisation of the Economy
The countries in the Inclusive Framework on BEPS are now attempting to finalise the agreement and plan of implementation by October 2021.\(^3\)

The global minimum corporate tax rate under the Pillar 2 GloBE proposal is currently agreed to be at least 15 percent and proposed to be implemented through two interlocking domestic tax rules, other than a separate treaty-based rule.\(^4\) The domestic tax rules under the GloBE proposal include:

1. An Income Inclusion Rule (IIR), which imposes top-up tax on the parent entity of an MNE group by the country where the MNE group is headquartered. This top-up tax is the difference between the minimum corporate tax rate and effective tax rate and is imposed on the income earned by the MNE groups constituent entity (located in a low-tax jurisdiction), which has been taxed at an effective rate in that jurisdiction, which is lower than the minimum corporate tax rate.

2. An Undertaxed Payment Rule (UTPR)\(^5\) as a top-up tax, if the parent entity in an MNE is not taxed (through an IIR) by its country of tax residence. Under the current consensus, the IIR and UTPR will apply to MNEs that meet the €750 million turnover threshold.\(^6\) Countries are free to apply the IIR, standalone, at a lower threshold to MNEs headquartered there.

The structure of an IIR incorporates several design elements of existing Controlled Foreign Company (CFC) rules in the tax legislations of many countries. The Inclusive Framework on BEPS blueprint document of the OECD/G20 Base Erosion and Profit Shifting (BEPS) Project states that the IIR leverages on CFC rules:

\[\text{The principal mechanism to achieve this outcome is the income inclusion rule (IIR) together with the undertaxed payments rule (UTPR) acting as a backstop. The operation of the IIR is, in some respects, based on traditional Controlled Foreign Company (CFC) rule principles and triggers an inclusion at the level of the shareholder, where the income of a controlled foreign entity is taxed at below the effective minimum tax rate. It is complemented by a Switch-Over Rule (SOR) that removes treaty obstacles from its application to certain branch structures and applies where an income tax treaty otherwise obligates a contracting state to use the exemption method.}\]

Historically, CFC rules in income-tax legislations have been used by countries to tax the accumulated passive income (from interest, capital gains, dividends, royalties, etc.,) of the foreign subsidiary companies (located in low-tax jurisdictions) of their MNE groups. The CFC provisions in the domestic income-tax law allow tax authorities to tax these passive incomes by attributing them to the controlling shareholder (parent company) in the MNE. In such countries, the implementation of the Pillar 2 GloBE proposals will require the adaption and reconciliation with existing CFC provisions. The design of the IIR will need supplementary and separate provisions to address new issues (such as determination of the MNE’s consolidated tax base, the portion of which has not been taxed at the minimum corporate tax rate, etc.,) which are not part of a CFC rule.

India, unlike most member countries of the OECD, does not have CFC provisions in its domestic income-tax legislation. These were proposed in the Direct Taxes Code Bill 2010 (a new legislation to replace the current Income Tax Act, 1961) which was presented in the Parliament in August 2010 but lapsed without being passed. The implementation of the Pillar 2 GloBE proposals will focus policy choices in India that consider the prevailing framework for Indian-headquartered MNEs.

Statistics show that average annual outward Foreign Direct Investments (FDI) from India were more than US$9 billion over the last two decades\(^8\) and these were largely regulated through foreign exchange regulations.\(^9\) This FDI in foreign subsidiaries would be generating and accumulating income abroad, year on year, net of repatriated dividends.

\(^4\) The Pillar 2 treaty-based rule is 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. Refer https://www.oecd-ilibrary.org/sites/1a789510-en/index.html?itemId=/content/component/1a789510-en
\(^5\) The UTPR would deny deductions or require an equivalent adjustment to the extent the low tax income of a constituent entity of an in-scope MNE is not subject to tax under an IIR.
\(^6\) https://www.oecd.org/tax/beps/tax-challenges-arising-from-digitalisation-report-on-pillar-two-blueprint.pdf. 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 e Ultimate Parent Entities (UPE) jurisdiction under a methodology to be agreed.
\(^7\) https://www.oecd-ilibrary.org/sites/1a789510-en/index.html?itemId=/content/component/1a789510-en#endnotea1z2
\(^8\) Source: UNCTAD: https://unctad.org/search?operator=and&keys=FDI+outflows&sort_by=search_api_relevance&sort_order=DESC
\(^9\) https://m.rbi.org.in/Scripts/BS_ViewMasDirections.aspx?id=10637
The income-tax law does have specific provisions, stated below, for taxing the income of foreign companies that are subsidiaries of Indian companies or controlled by persons located in India:

There is an incentive provision for Indian parent companies to receive dividends from their foreign subsidiaries by taxing such dividend incomes at a rate lower than the normal tax rate applicable to dividends received as shareholders of domestic companies.\(^{10}\)

The income-tax law also has Place of Effective Management (POEM) rule, which treats a company incorporated abroad as a domestic company as a result of which, its global income becomes taxable in India, if it is established that the effective control and management of such a foreign company is from India.\(^{11}\) The POEM rule is a fact-specific exercise meant to cover a specific sub-set of cases to tax the annual corporate profits of a foreign company on the grounds that as its decisions are made by persons located in India, its tax residence would be in India even though it is incorporated abroad. A CFC, on the other hand, treats the passive income of a controlled foreign subsidiary as an income in the hands of the controlling domestic parent company (of the MNE group) and taxes it accordingly.

The Indian regulations, hence, have both a positive incentive for remittances back to India and anti-avoidance rules through a POEM, in addition to foreign exchange management regulations and reporting, possibly limiting the need for a CFC rule as a separate anti-avoidance provision.

India - Implementing GloBE Rules under Pillar 2

As India is not encumbered with an existing CFC regime, it will have the advantage of being able to start out on a clean slate while incorporating Pillar 2-based GloBE Rules in its domestic income-tax legislation, once they are implemented through international consensus under the inclusive framework.

Under the current Pillar 2 consensus, the GloBE rules would necessarily apply to MNEs that meet a turnover threshold of €750 million. The immediate choice for every country would be to apply the GloBE top-up tax rate to the parent company of its headquartered MNE group using a different turnover threshold.\(^{12}\)

Therefore, in India, the policy design could possibly follow the following pattern:

- The implementation of GloBE rules (IIR and UTPR) to levy a top-up tax rate (up till the global minimum corporate tax) on MNE groups with a turnover threshold more than €750 million
- Determination if there should be a lower turnover threshold prescribed in the scope of a standalone IIR
- Harmonise the GloBE rules to ensure that there is no double-taxation risk, given the prevailing framework in India, while continuing the incentive to repatriate dividends.

Tax authorities in India, after a global consensus under Pillar 2 on implementing a global corporate minimum tax rate is arrived at, could issue a discussion paper to get stakeholder inputs on the potential GloBE provisions in the domestic law to help arrive at a set of rules that are simple and predictable in their design and application.

---

10 Section 115BBD of the Income-tax Act
11 Section 6(3) of the Income-tax Act read with CBDT Circular No. 6 of 2017 dated 24 January 2017
Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee ("DTTL"), its network of member firms, and their related entities. DTTL and each of its member firms are legally separate and independent entities. DTTL (also referred to as "Deloitte Global") does not provide services to clients. Please see www.deloitte.com/about for a more detailed description of DTTL and its member firms.

This material is prepared by Deloitte Touche Tohmatsu India LLP (DTTILLP). This material (including any information contained in it) is intended to provide general information on a particular subject(s) and is not an exhaustive treatment of such subject(s) or a substitute to obtaining professional services or advice. This material may contain information sourced from publicly available information or other third party sources. DTTILLP does not independently verify any such sources and is not responsible for any loss whatsoever caused due to reliance placed on information sourced from such sources. None of DTTILLP, Deloitte Touche Tohmatsu Limited, its member firms, or their related entities (collectively, the "Deloitte Network") is, by means of this material, rendering any kind of investment, legal or other professional advice or services. You should seek specific advice of the relevant professional(s) for these kind of services. This material or information is not intended to be relied upon as the sole basis for any decision which may affect you or your business. Before making any decision or taking any action that might affect your personal finances or business, you should consult a qualified professional adviser.

No entity in the Deloitte Network shall be responsible for any loss whatsoever sustained by any person or entity by reason of access to, use of or reliance on, this material. By using this material or any information contained in it, the user accepts this entire notice and terms of use.

© 2021 Deloitte Touche Tohmatsu India LLP. Member of Deloitte Touche Tohmatsu Limited