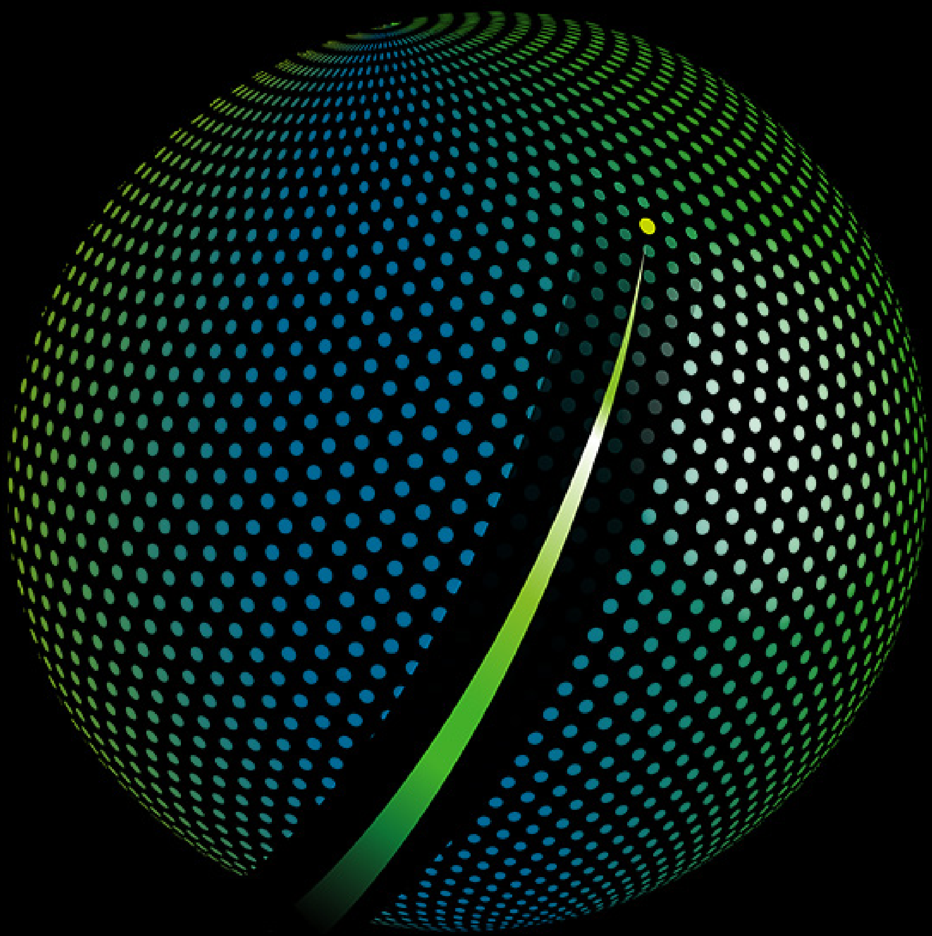
Deloitte.



Pillar Two: GloBE Rules

Overview of Rules, India impact and way forward

April 2024

Table of content

1. Backdrop

The Pillar Two initiative has its roots in the G20/OECD-led Base Erosion and Profit Shifting (BEPS) project a decade ago. The BEPS Action 1 report, entitled 'Addressing the Tax Challenges of the Digital Economy', was released in November 2015. The report highlights that the digital economy is increasingly becoming the economy itself, and it would be difficult, if not impossible, to ring-fence the digital economy from the rest of the economy for tax purposes.

In 2016, the OECD established the Inclusive Framework on BEPS (IF), which has been working on the two-pillar approach. As an outcome of the ongoing work of the Inclusive Framework, on 12th October 2020, the OECD Secretariat released a package consisting of the report on the Pillar One Blueprint and the Report on the Pillar Two Blueprint. Pillar One provides taxing rights to market jurisdictions on part of the residual profits earned by large multinational enterprises (MNE) groups.

Pillar Two is focused on the 'remaining BEPS challenges,' and proposes a systematic solution designed to ensure that MNEs, with annual revenue of EUR 750 million or more, pay a minimum level of tax (agreed at 15%) in each jurisdiction they operate in. The minimum tax is calculated primarily based on the financial statements and relies on two main components: profits and taxes paid. It is calculated on a jurisdictional basis by comparing the Effective Tax Rate (ETR) of each jurisdiction calculated under the Global Anti-Base Erosion Rules (GloBE Rules) with the agreed minimum tax rate of 15%. Any shortfall is collected by way of top-up taxes. Pillar Two also encompasses the Subject to Tax Rule (STTR), which deals with the source state taxation of certain payments.

This paper gives the readers an overview of the Pillar Two project and its journey to date.

2. Pillar Two framework

The Pillar Two solutions can be divided into two sets of rules:

- GloBE Rules

  The GloBE Rules comprise the following:

  - Income Inclusion Rule (IIR), which is the main rule
  - Undertaxed Payments Rule (UPTR), which is the backstop rule; and
  - Qualified Domestic Minimum Top-up Tax (QDMTT), which is a domestic top-up tax.

  The GloBE Rules apply to large MNE groups with a minimum annual consolidated group revenue of EUR 750 million to ensure they are subject to a minimum ETR of 15% in each jurisdiction where they operate. To achieve this, any top-up tax (i.e., the 'top-up' amount needed to bring the overall tax on the profits in each jurisdiction up to the minimum ETR of 15%) will be collected through the IIR, UTPR, or QDMTT.

- STTR: This is a treaty-based rule that has priority over the GloBE Rules and restores taxing rights to the source state, in cases where the source state's taxing rights on certain outbound intra-group payments have been ceded under tax treaties and the income in question is taxed in the residence state at a rate below 9%.

Some of the salient features of the Pillar Two framework are as follows:

- The GloBE Rules do not compel any jurisdiction to adopt a minimum rate of tax. If the jurisdiction does not levy tax at the agreed minimum rate (i.e., if the ETR in the jurisdiction is below the agreed minimum rate of 15%), the taxing rights are given to another jurisdiction(s).
- Top-up tax is determined at a jurisdiction level (i.e., jurisdictional blending) and not at the level of each entity.
- While IIR, UPTR, QDMTT are to be incorporated in the domestic law of each jurisdiction, STTR is to be included in the tax treaty.
- Significant reliance is placed on the existing Country-by-Country Reporting (CbCR) mechanism and concepts.
- The GloBE Rules mechanism ensures that the MNE group does not have to pay additional taxes due to timing differences.
- The Pillar Two framework generally apply to all sectors, other than certain specified exclusions.

3. Pillar Two journey

2013 – Report on addressing BEPS

2015 – Reports issued on the BEPS Action Plans

2016 – Establishment of an Inclusive Framework

October 2020 – Pillar Two Blueprint

October 2021 – OECD Inclusive Statement (IF), consensus after political agreement reached by 139 member countries

December 2021 – Pillar Two Model GloBE Rules

March 2022 – Pillar Two Model GloBE Rules commentary

2023 – Agreed administrative guidance on GloBE Rules

2024 – Implementation of IIR and QDMTT laws in 26+ countries for fiscal years beginning on or after 1st January 2024

2025 – UTPR to be implemented for fiscal years beginning on or after 1st January 2025

4. GloBE Rules

The GloBE Rules are a new set of international tax principles that have been agreed to be implemented by Inclusive Framework member jurisdictions. The rules are fairly complex and have to be read along with the commentary and examples that have been issued.

Key steps that an MNE group must perform in order to determine its liability under the GloBE Rules are as follows:

- **Step 1** Evaluation of the applicability and scope of GloBE Rules
- **Step 2** Evaluate the application of transitional CbCR safe harbours
- **Step 3** Computation of GloBE income for each CE
- **Step 4** Computation of adjusted covered taxes for each CE
- **Step 5** Computation of jurisdictional ETR and top-up tax
- **Step 6** Allocation or payment of the top-up tax

The above steps have been explained below in the context of the model GloBE Rules.

Step 1 Evaluation of the applicability and scope of GloBE Rules

MNE groups having a total consolidated group revenue of EUR 750 million or above in the immediately preceding two out of four fiscal years are subject to the GloBE Rules. For this purpose, an MNE group is a group that consists of entities located in more than one jurisdiction. A group is a collection of entities (i.e., legal persons or arrangements that prepare separate financial accounts) that are related through ownership or control and that either are:

- Included in the consolidated financial statements of the UPE; or
- Excluded from such statements solely on size or materiality or because the entity is held for sale.

The UPE is the entity that is at the top of the ownership control chain and that is not owned by another entity. A Constituent Entity (CE) is an entity included in a group, or a permanent establishment of an entity. A standalone entity is considered an MNE group if it has at least one permanent establishment located in another jurisdiction. The consolidated group revenue threshold is applied to all CEs that are owned and controlled by the same UPE.

It may be noted that investment funds and real estate funds that are UPEs, government entities, international organisations, non-profit organisations, and pension funds are treated as 'excluded entities' for the purposes of the GloBE Rules.

Step 2 Evaluate the application of transitional CbCR safe harbours

The transitional safe harbours are a short-term measure to exclude a group's operations in low-risk jurisdictions from the compliance obligation of preparing full Pillar Two calculations. It applies for years beginning on or before 31 December 2026. The transitional CbCR safe harbour is available only if the taxpayer prepares a 'Qualified CbCR'.

The transitional safe harbour uses information taken from an MNE's CbCR and/or financial statements to determine whether its operations in a jurisdiction meet any of three tests:

- **De minimis test:** This test is met for a jurisdiction if the total revenue for all the entities in that jurisdiction is less than EUR 10 million and profit before income tax is less than EUR 1 million, based on CbCR.
- **Effective tax rate test:** This test is met if the MNE has a 'simplified ETR' for a jurisdiction that is equal to or greater than the 'transition rate' for the year. The transition rate is 15% for years beginning in 2023 and 2024, increasing to 16% and then 17% for years beginning in 2025 and 2026, respectively. The simplified ETR for the purposes of the test is calculated by dividing the jurisdiction's 'simplified covered taxes' by its profit before income tax as reported in the CbCR. Simplified covered taxes are based on financial statement data, not CbCR data. They comprise a jurisdiction's income tax and deferred tax expense as reported on the standalone financial statements (subject to adjustments).
- **Routine profits test:** This test is met if the MNE's profit before income tax in a jurisdiction is equal to or less than the 'substance-based income exclusion amount' (as calculated under the GloBE rules).

Where any of these tests are satisfied and the transitional safe harbour applies, the top-up tax for that jurisdiction will be zero. Detailed calculations need to be done for jurisdictions that do not qualify for any of the above-mentioned safe harbours, as explained in the subsequent steps.

Step 3 Computation of GloBE income for each CE

The GloBE income is the denominator for the calculation of the jurisdictional ETR.

The rules rely on the Financial Accounting Net Income or Loss (FANIL) as a starting point. Financial statements are required to be prepared in accordance with an acceptable financial accounting standard such as the International Financial Reporting Standards (IFRS). In case the financial statements are not prepared in accordance thereto, then such financial statements would be required to be adjusted for any 'Material Competitive Distortions'. It may be noted that the elimination of income and expenses from intra-group transactions that occur in the accounting consolidation process is not considered in the CE's FANIL. Additionally, the net income or loss of the CE has to be determined using the accounting standard that is used in preparing the consolidated financial statements.

Having started with the FANIL of CEs, the next step is to undertake adjustments to arrive at the GloBE income (or loss). These adjustments, inter alia, include net tax expenses, excluded dividends, excluded capital gains, asymmetric foreign currency gains and losses, policy disallowed expenses, prior period errors and changes in accounting principle, pension expenses, stock-based compensation, international shipping income, etc. Each of these adjustments has been discussed in detail in the model commentaries to the GloBE Rules.

To sum up, the amount of GloBE income (or loss) of a CE is determined by taking the FANIL for the CE for the fiscal year and then adjusting this amount with the prescribed adjustments to arrive at the CE's GloBE income (or loss).

Step 4 Computation of adjusted covered taxes for each CE

The adjusted covered taxes are the numerator for the calculation of the jurisdictional ETR.

Just as the starting point for calculating the GloBE income (or loss) is the FANIL, the starting point for calculating the adjusted covered taxes is the current tax expenses with respect to the covered taxes as reported in the financial statements used for the purposes of the FANIL. This is followed by a series of adjustments provided in the GloBE Rules to arrive at the adjusted covered taxes.

Covered taxes include taxes on distributed profits, taxes imposed in lieu of a generally applicable corporate income tax, taxes levied on retained earnings and corporate equity, etc. They exclude any amount pertaining to top-up taxes accrued under IIR, top-up taxes accrued under QDMTT, taxes attributable as a result of the UTPR, taxes paid by an insurance company in respect of returns to policy holders, etc.

Adjustments to covered taxes include any amount of covered taxes that are accrued as an expense in the profit before taxation of the financial accounts, amounts that reduce the effects of temporary differences on volatility, e.g., deferred taxes, taxes paid in relation to an uncertain tax position, any amount of current taxes that is not expected to be paid within three years from the last day of the fiscal year, taxes on excluded dividends or excluded capital gains, etc.

A specific mechanism has been put in place to address the temporary differences that arise when income or loss is recognised in a different year for financial accounting and tax. This principle is built on deferred tax accounting and provides a shelter for the GloBE income at a rate capped at the minimum rate of 15%. The rules also require a recapture of certain amounts claimed as deferred tax liabilities that are not paid within five years. Further, exceptions are also provided for the most common book to tax differences that relate to substance in a jurisdiction or are not prone to taxpayer manipulation. Accordingly, these exceptions do not require monitoring for recapture.

Step 5

Computation of jurisdictional ETR and top-up tax

The next step is to compute the ETR using the jurisdictional blending mechanism. This is done by aggregating the GloBE income (or loss) determined in step 3 above (the denominator) and the adjusted covered taxes in step 4 above (the numerator) for all CEs located in the same jurisdiction. The aggregate jurisdictional adjusted covered taxes, divided by the aggregate jurisdictional GloBE income, results in the jurisdictional ETR. If the jurisdictional ETR is lower than the minimum rate of 15%, then it is regarded as a low- tax jurisdiction for the MNE group.

$$\text{Effective Tax Rate (ETR) (for a jurisdiction)} = \frac{\text{Adjusted covered taxes for all constituent entities in the jurisdiction (covered taxes)}}{\text{Net GloBE income for all constituent entities in the jurisdiction (GloBE income)}}$$

The top-up tax is determined as follows:

Jurisdictional excess profit X Jurisdictional top-up tax percentage

Jurisdictional excess profit: The jurisdictional excess profit is arrived at after reducing the substance-based income exclusion (SBIE) from the GloBE income. The SBIE is calculated as the sum of the payroll carve-out and the tangible asset carve-out for each CE. The payroll carve-out for a CE is generally equal to 5% (a higher percentage for initial years) of the eligible payroll costs of eligible employees that perform activities for the MNE group in such jurisdiction, subject to certain exceptions. Similarly, the tangible asset carve-out for a CE is equal to 5% (a higher percentage for initial years) of the carrying value of eligible tangible assets located in such jurisdiction. The rationale for a formulaic substance-based carve-out based on payroll and tangible assets is to exclude a fixed return for substantive activities within a jurisdiction from the application of the GloBE Rules. Excluding a fixed return from substantive activities focuses on 'excess income', such as intangible-related income, which is most susceptible to BEPS risk.

Jurisdictional top-up tax percentage: The jurisdictional top-up tax percentage is the difference between the minimum rate of 15% and the jurisdictional ETR as calculated above.

Top-up taxes would be computed for jurisdictions that have an ETR of less than 15% (i.e., low tax jurisdiction)

Top-up tax *(for a low tax jurisdiction)* = [Top-up tax percentage X Excess profits] + Additional current top-up tax - Domestic top-up tax

- Top-up tax percentage: 15% (minimum rate) - ETR
- Excess profits: Net GloBE income – Substance-based income exclusion +
- Additional current top-up tax: Additional top-up tax in respect of a prior period
- Domestic top-up tax: Amount payable domestically

Substance-based income exclusion of a fixed return on

Payroll	**Payroll: 10% (to be reduced to 5% over 10 years).** Includes salaries, health insurance, pension contributions, employment taxes, and employer social security contributions. Eligible employees include independent contractors
*Net book value of tangible assets	**Tangible assets: 8% (to be reduced to 5% over 10 years).** Includes property, plant and equipment, and natural resources

* Net book value of tangible assets means the average of the beginning and end values of tangible assets after considering accumulated depreciation, depletion, and impairment, as recorded in the financial statements.

Step 6 Allocation/payment of the top-up tax

The final step under the GloBE Rules is to allocate or pay these top-up taxes under QDMTT, IIR, or UTPR under an 'agreed rule order'.

- IIR: IIR applies on a top-down basis such that, in most cases, tax due is computed and paid by the ultimate parent entity (UPE) of the group to the revenue authority of the UPE jurisdiction.
- UTPR: UTPR applies as a secondary or backstop rule in cases where the ETR in a jurisdiction is below the minimum rate of 15% and the IIR has not been fully applied. The top-up tax will be allocated to jurisdictions that have adopted the UTPR based on a formula. The UTPR is to be implemented either by denial of deduction for payments or by making an equivalent adjustment.
- QDMTT: The GloBE Rules also permit jurisdictions to enact a QDMTT that is aligned with the GloBE Rules. Under QDMTT, top-up tax in respect of any low-taxed profits of a group in a jurisdiction is payable in that jurisdiction itself rather than to other jurisdictions under the IIR or UTPR.

The overall objective of applying the GloBE Rules is to achieve a minimum tax of 15% globally, irrespective of where the top-up tax is paid.

Special rules

The GloBE rules contain separate rules for various aspects, some of which are as follows:

- Joint ventures, multi-parented MNE groups, minority-owned CEs, investment entities, flow-through entities that are UPEs, etc.
- Calculating the consolidated revenue threshold in the case of mergers and demergers
- Application of the GloBE Rules when assets and liabilities are transferred and when a CE enters or leaves an MNE group during the fiscal year
- Transition rules
- Exclusion from the UTPR for MNE groups in the initial phase of international activity
- Elections (annual, five-year, or perpetual until revoked)

Safe harbours

QDMTT safe harbour

The administrative guidance issued in 2023 covers the provisions relating to QDMTT safe harbour and outlines when a switch-off rule would apply to jurisdictions adopting the QDMTT safe harbour provisions. The provisions exclude the application of the GloBE Rules in jurisdictions where QDMTT applies by deeming the top-up tax payable under the GloBE Rules to be zero. To qualify for QDMTT safe harbour, additional standards must be met:

- The QDMTT accounting standard, requiring the QDMTT to be computed based on UPE's financial accounting standard or a local financial accounting standard
- The consistency standard requiring the QDMTT computations to be same as the computations required under GloBE Rules, except for the mandatory variations explicitly outlined in the guidance
- The administration standard, which requires QDMTT jurisdiction to meet the requirements of an on-going monitoring process like the one applicable to jurisdictions implementing the GloBE Rules.

Finally, a peer review process will determine whether a minimum tax can be considered a QDMTT. Once this criterion is met, the next step in the peer review process would be to determine whether such QDMTT meets the standards of the QDMTT safe harbour discussed above.

Transitional UTPR safe harbour

A transitional UTPR safe harbour has been designed to provide transitional relief in the UPE jurisdiction, where implementation of the IIR or the QDMTT is pending. These provisions come into effect for fiscal years beginning on or before 31 December 2025 and end before 31 December 2026. The UTPR top-up tax for a UPE jurisdiction shall be deemed to be zero if the nominal corporate tax rate of the UPE jurisdiction is equal to or more than 20%.

GloBE Information Return

The Inclusive Framework has developed the standardised information return to be filed by MNEs within the scope of the GloBE Rules. The information return will include a comprehensive set of data points required for a tax authority to evaluate the correctness of an MNE's calculation of its top-up tax liability in each jurisdiction. The information return includes sections on: the business in general, including a summary table with a high-level overview of the application of the rules in each jurisdiction (e.g., stating the range in which the effective tax rate and amount of top-up tax payable fall); the corporate structure; the application of jurisdictional safe harbours and exclusions; detailed calculations of amounts of Pillar Two income and losses, adjusted covered taxes, and effective tax rates; and the allocation of top-up tax liabilities. In addition, the members of the Inclusive Framework will also come up with a separate template for capturing data points where QDMTT provisions are adopted.

A CE subject to GloBE Rules must file a Globe Information Return (GIR) with the local tax administration within the prescribed timelines. The return can be filed directly by the CE or by a designated local entity located in that same jurisdiction on its behalf. Further, a CE is discharged from its filing obligation when the UPE or a designated filing entity files the GIR with another jurisdiction that has a qualifying Competent Authority Agreement to exchange the GIR with the tax administration of the CE's jurisdiction. In those cases, a CE or a designated local entity shall notify the tax administration where it is located of the identity of the entity that is filing the GIR and the jurisdiction in which it is located. This mechanism would allow the filing of a single GIR covering all CEs in the MNE group.

Implementation and administration

The GloBE Rules, along with the model commentaries and the administrative guidance, serve as a template that can be used as a basis for interpretation as well as implementation of the Pillar Two framework by various jurisdictions in their domestic laws. If jurisdictions decide to adopt all or a part of the GloBE Rules, they are required to do so under a common approach, i.e., consistent with the model rules agreed upon by the members of the Inclusive Framework.

5. Subject to Tax Rule

The members of the Inclusive Framework have designed the STTR as the priority rule, and it is an integral part of the consensus solution on Pillar Two. The STTR is a tax treaty-based rule that applies to intra-group payments from a source state that are subject to low nominal taxes of below 9% in the state of the payee. The model rules around STTR were codified in October 2023 and have been developed to restore the partial taxing rights to the source state.

The STTR applies to 'covered income' such as interest, royalties, insurance and reinsurance premiums, fees to provide a financial guarantee, or other financing fees, rent, etc. made between connected persons. The STTR excludes from its scope items of covered income that result in a mark-up on costs of 8.5% or less, in the hands of the person deriving the income; this mark-up threshold aims to exclude from the application of the STTR any transactions that present minimal BEPS risk.

The term 'connected persons' has been defined based on control relationships with a deeming rule providing that a connection exists where there is direct or indirect participation of more than 50%. There is also an anti-abuse rule set in place to target cases where unconnected persons are inter-positioned in a series of transactions between two connected persons.

Administrative rules prescribed under the STTR Model Commentaries suggest that the resident of a state will be required to submit a tax return in the other state following the end of a fiscal year, only where it has a liability to pay self-assessment tax under the STTR. As the STTR is tax treaty-based, jurisdictions wishing to implement the STTR will have to incorporate the STTR into bilateral treaties; this can be done through a multilateral instrument (MLI) for swift and consistent implementation. The MLI is open for signatures and ratification by the countries.

Recent update: On 3rd October 2023, OCED Inclusive Framework members adopted a multilateral instrument (MLI) to facilitate the implementation of STTR. It is now open for signatures and ratification.

6. Implementation status around the world[1]

Europe

- In December 2021, the European Commission (EC) published its proposal for a draft Minimum Tax Directive to implement the GloBE Rules in a coherent and consistent way across EU Member States.
- It closely followed the GloBE Rules and in order to be adopted, the draft directive was required to be unanimously approved and adopted by all 27 member states.
- On 15th December 2022, the Council of the EU unanimously adopted the EU Minimum Tax Directive. The final text of the Directive was published in the Official Journal on 22nd December 2022 and entered into force the following day.
- The agreed-upon Directive required member states to transpose the rules into domestic law by 31st December 2023, and to start applying the IIR for fiscal years beginning on or after this date. The UTPR will be applied for fiscal years beginning on or after 31st December 2024.
- In addition, the agreed text provides the option for member states to implement a domestic minimum top-up tax and to defer the application of the IIR and the UTPR up to 31st December 2029, where a maximum number of 12 UPEs are based in that EU Member State.
- Out of the 27 countries, 18 countries have passed legislation to implement GloBE Rules and 5 countries (Estonia, Latvia, Lithuania, Malta and Slovenia) have deferred application of IIR and UTPR till 2029.
- UK has enacted the legislation on IIR and QDMTT with effect from 1st January 2024
- Switzerland enacted the ordinance to implement the QDMTT from 2024; the implementation of IIR and UTPR is uncertain
- Norway has enacted the legislation on IIR and QDMTT with effect from 1st January 2024

[1] https://taxcms.deloitte.com/pillartwo

Rest of the World

- Japan has enacted IIR from 1st April 2024
- Australia has announced implementation of IIR and QDMTT from 1st January 2024 and UTPR from 2025
- Canada has proposed enacting a Canadian Global Minimum Tax Act
- South Korea has enacted IIR from 1st January 2024 and UTPR from 1st January 2025
- Vietnam has enacted IIR and QDMTT with effect from 1st January 2024.

Jurisdictions that have implemented Pillar Two law for fiscal years beginning on or after 1st January 2024

Austria	Germany	Norway
Belgium	Greece	Romania
Bermuda	Hungary	Slovakia
Bulgaria	Ireland	Slovenia
Croatia	Italy	South Korea
Czechia	Japan	Sweden
Denmark	Liechtenstein	Switzerland
Finland	Luxembourg	United Kingdom
France	Netherlands	Vietnam

7. India and Pillar Two impact

India being a member of the Inclusive Framework, is expected to incorporate the GloBE Rules into its domestic law. In the interim budget, announced on 1st February 2024, there were no policy announcements on the implementation of the GloBE Rules in India. The announcement may take place in the 'full budget' to be released later this year.

It is however pertinent to note that since the GloBE Rules may have come into effect (say, from 1st January 2024) in other jurisdictions where Indian headquartered MNE groups have presence, such MNE groups will be required to comply with the GloBE Rules even if India has not implemented the rules for that period. Given this background, some of the immediate key areas of consideration for Indian MNE groups would be as follows:

Application of GloBE Rules for overseas jurisdictions

- As stated above, an MNE group is subject to the GloBE Rules once any jurisdiction in which the group operates has incorporated the GloBE Rules in its domestic law. Given that the IIR and QDMTT are effective from 1st January 2024 in various implementing jurisdictions, an Indian MNE group may be subject to a top-up tax, if applicable. Moreover, the implementing jurisdictions may also require compliance under the GloBE Rules as of 1st January 2024.
- Provision for tax: Indian MNE groups will have to provide for top-up tax in the books of account, if applicable, in their financial statements for the year ended 31st March 2024.
- Mandatory accounting disclosures:
  - On 23rd May 2023, the International Accounting Standards Board (IASB) issued amendments to International Accounting Standard (IAS) 12, Income Taxes, arising from Pillar Two. The amendments: (1) introduce a mandatory temporary exception from accounting for deferred income taxes arising from Pillar Two income taxes; and (2) require an entity to disclose that it has applied the temporary exception. In addition, effective for annual periods beginning on or after 1st January 2023, in periods in which Pillar Two legislation is enacted or substantively enacted, but not yet in effect, an entity is required to disclose known or reasonably estimable information that helps users of financial statements understand the entity's exposure to Pillar Two income taxes. Similar amendments have been carried out in major accounting standards across the world.
  - In line with the above, on 25th July 2023, the Accounting Standards Board of the Institute of Chartered Accountants of India (ICAI), issued an Exposure Draft of International Tax Reform—Pillar Two Model Rules—Amendments to Ind AS 12 corresponding to Amendments to IAS 12 issued by the IASB.

As the rules are now in effect in many jurisdictions as of 1st January 2024, the above disclosure requirements have kicked in for 2024 financial reporting, including the requirement to disclose the amount of current tax expense for any top-up tax.

Tax incentives given to International Financial Services Centre (IFSC)

- With the intent of attracting MNE groups and establishing a finance hub in India, the Indian government had set up IFSC in Gujarat – The Gujarat International Finance Tec-City (The GIFT City) in 2015. Conglomerates from the financial services industry who have set-up base in the GIFT City are inter-alia incentivized with tax holiday benefits for a period of 10 out of 15 years and a lower rate of alternate minimum taxes to be paid for units set-up therein at 9% (plus applicable surcharge and cess). While the domestic corporate tax rates in India are higher than 15%, having units in the GIFT City may bring down the ETR. The Pillar Two Law aims to discourage tax incentives-based investments. However, considerations have been given to cases where there is substance in the form of payroll and tangible assets. The SBIE, as described earlier, reduces the top-up tax liability by a certain percentage of eligible payroll costs and eligible tangible assets, and hence labour and capital-intensive industries could benefit from it. The units in IFSC may not have enough employees and assets to benefit from SBIE and hence, could end up having a top-up tax liability due to ETR less than 15%.
- Given the above, in-scope MNE groups having operations in the GIFT City, will need to evaluate the overall tax impact in India, pursuant to the Pillar Two Globe Rules. A group having non IFSC presence along with a unit in IFSC, may be able to benefit from the jurisdictional blending at India level.

Other Tax/Non-tax incentives

- The governments may grant incentives to the businesses, in the form of a tax credit, which could be adjusted against its covered tax liability, with the excess being refundable in cash or cash equivalent. These incentives are given to encourage certain activities, such as research and development, whereby the government allows the company to offset its taxes or refunds the amount of the unused credit in absence of any tax liability. This is also an easier way to monitor and grant incentives. The tax credit if refundable within 4 years from when the conditions under the laws of the jurisdiction granting the credit are met, is known as Qualified Refundable Tax Credit (QRTC) under the GloBE Rules. This is treated as income in the computation of GloBE Income or Loss of a Constituent Entity. Non-Qualified Refundable Tax Credit (NQRTC) is a tax credit that is not a Qualified Refundable Tax Credit, but that is refundable in whole or in part. This shall not be treated as income in the computation of GloBE Income or Loss of a Constituent Entity but shall be reduced from the amount of covered taxes. The treatment of these tax credits under the GloBE Rules is mandatory, irrespective of how the tax credits are accounted for by the MNE Group. Government grants are also accorded similar treatment as QRTC.
- At times the governments may also grant non-tax incentives, for e.g. PLI scheme in India. The treatment of this for GloBE purposes would depend on whether it qualifies as QRTC or NQRTC.
- To summarize, any kind of incentive provided to business may have an impact in the computation of its ETR under the GloBE Rules. Thus, it is imperative to analyse its impact while evaluating the Pillar Two impact of the MNE group.

Other impacts

The applicability of Pillar Two Rules is bound to meet with teething challenges. There are open issues which may become impediments for the success of Pillar Two Law. The interplay between calculation of GloBE income and top-up taxes, if any, with the USA corporate tax rules is also an important aspect to be considered by taxpayers having presence in the USA. Countries may continue giving favourable incentives in some other form to the businesses and may formulate ways to circumvent increase of tax outgo under Pillar Two. India is adopting a wait and watch approach for adoption of the Pillar Two Law in the Income-tax Act. Indian MNEs will however have to analyse the impact of Pillar Two and other related developments around the world on its business and taxes and be implementation ready.

8. Practical challenges, complexities and solution

The GloBE Rules are fairly complex, and the related calculations would depend upon the availability of numerous data points from varied data sources within an MNE group. On average, at least 60% of the data points are outside of the ERP.

The MNE groups would generally be facing the following challenges:

- Familiarising the relevant stakeholders with the GloBE Rules and being implementation ready
- Complex data requirements:
  - Mapping various master data points such as in-scope entities, jurisdictions, ownership structure, etc.
  - Identifying 100+ data points and mapping them with existing structured and unstructured data sources
- Establishing an efficient and largely automated process for data collation:
  - Required data points exist in multiple sources, such as ERPs, consolidation tools, tax reporting tools, reconciliation tools, Excel/working files, etc.
  - A plethora of data exists outside of ERPs and consolidation platforms
- Carrying out complex calculations as per GloBE Rules:
  - Calculation of jurisdiction-wise ETR and top-up taxes
  - Allocation of top-up tax under IIR and UTPR
  - Agility to adapt to evolving domestic tax rules, including QDMTT
- Compliance relating to GIR

The complexities outlined above would require a long-term and viable solution. Being data-centric, the data fed into the calculation modules would have to be extremely reliable. The calculations undertaken need to be traceable/auditable. The fact that calculations and compliances would have to be undertaken for each entity within the MNE group, relying on simple tools like Excel models, may lead to increased complexities. Technology is accordingly going to play a major role in this regard.

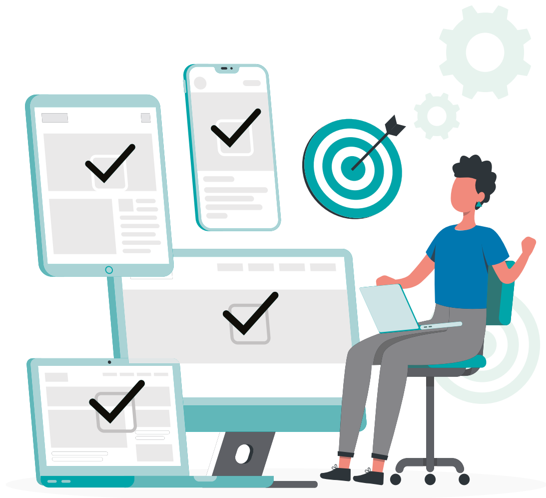
The technology solution has to be an end-to-end solution to address the complex requirements under the Pillar Two Rules and aid with the following aspects:

- Data identification: Mapping current entity structure, technological landscape, and accounting policies, and identifying relevant data points and their sources
- Data extraction: Data availability assessment and source system remediation; defining formats and templates to initiate data collection activities for remaining datasets; data extraction automation
- Data collation, wrangling, and computation: Transition safe harbour checks, perform complex calculations to arrive at ETR and top-up tax via a calculation engine, conduct fully transparent calculations with complete visibility and assurance of data and calculations
- Management dashboards and reports: Provide interactive dashboards, pre-formatted reports for scenario analysis/what-if analysis for management review
- Compliance: Undertake the filing of the GloBE information return and related compliances

9. Conclusion

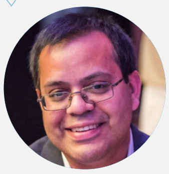
We are on the cusp of a new era in international taxation. From varied domestic laws across the world, we are moving to consistent GloBE Rules to be applied uniformly by all jurisdictions, with a common objective of minimum taxation at the rate of 15% for global MNEs.

The Pillar Two framework, which has been under discussion for some time, is now reality. India has been an important part of the G20 / OECD BEPS project and is expected to bring in the Pillar Two GloBE Rules in its domestic law shortly. Being based on a common understanding and to ensure uniform implementation, the law adopted by each country is expected to be aligned with the OECD Model GloBE Rules and India is also expected to broadly follow the model GloBE Rules. Independent of when and how India implements the GloBE Rules, Indian MNE groups will have to comply with the GloBE Rules in the jurisdictions where they operate. It is imperative that MNE groups understand how to navigate the Pillar Two framework and are implementation ready. Indian groups need to move ahead from analysing the impact of Pillar Two, to being ready to implement the requirements of the GloBE Rules.

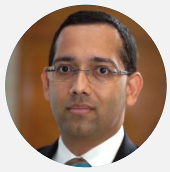


Contact Us

Rohinton Sidhwa
Partner – Business Tax
rsidhwa@deloitte.com



Pritin Kumar
Partner – Business Tax
pkumar@deloitte.com



Utkarsh Trivedi
Partner – Business Tax
utrivedi@deloitte.com

Key contributors

Chandni Baheti
Madhu Agarwal
Manish Shah

Acknowledgments

Arshi Bansal
Niteesh Ginde
Pradeep Thokale
Shital Tribhuvan