

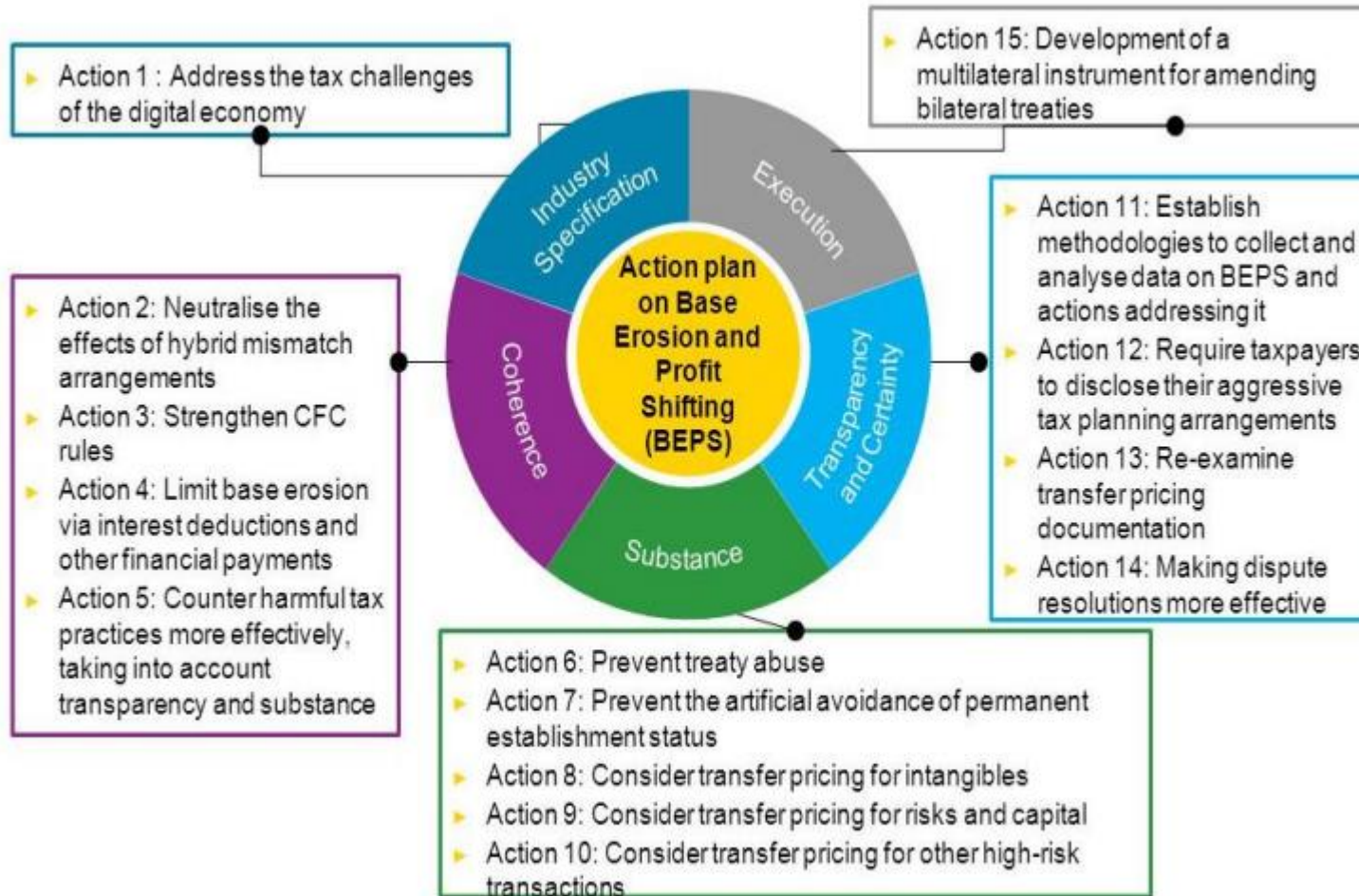
BEPS 2.0

TWO PILLAR INCLUSIVE FRAMEWORK

BEPS 1.0

ACTION PLANS AND HISTORY

# BEPS -Background

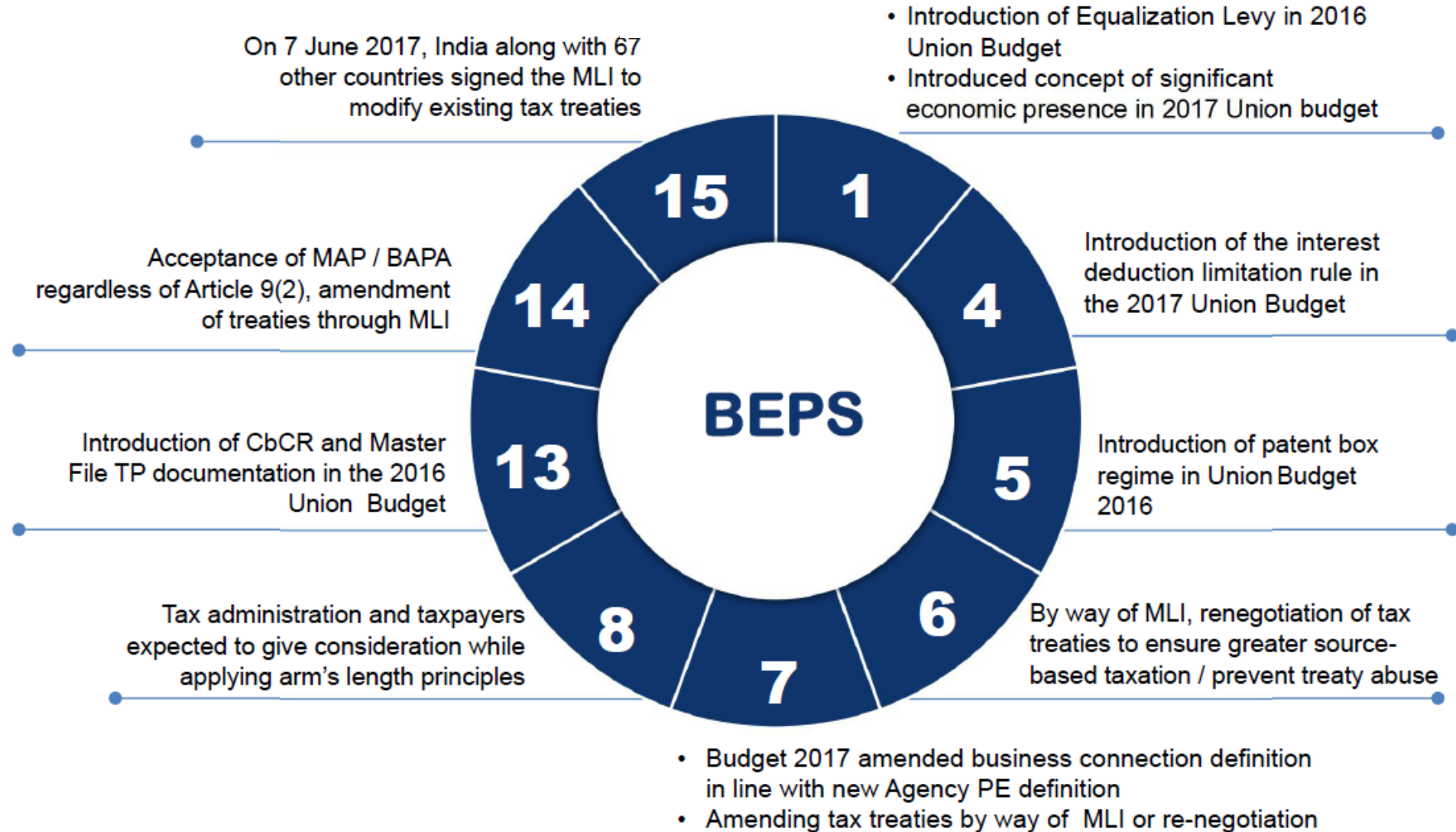


- Work started in 2012
- Final reports published in October 2015
- Aimed at reforming the legacy tax rules and plugging gaps in tax laws
- New concepts like MLI and CbC reporting to enhance tax cooperation
- New approaches to traditional concepts like PE and Transfer Pricing
- Pillar 1 & 2 aimed at curtailing tax planning in the digital economy

### What did India do

- AP 1 – Equalisation levy and Significant economic presence
- AP 4 – New section 94B – Limiting of interest deductions
- AP 5- 115BBF – Patent regime at concessional tax
- AP 6 – GAAR – Principal purpose test
- AP 8-10 – Acknowledgement of DEMPE model
- AP 13 – Introduction of Master File and CbCR into local tax regulation
- AP 15 – Signatory to MLI and CTA list submitted
- India is also a signatory to the Inclusive Framework (IF) for Pillar 1 and Pillar 2.

# BEPS 1.0 – India – Domestic Tax Changes



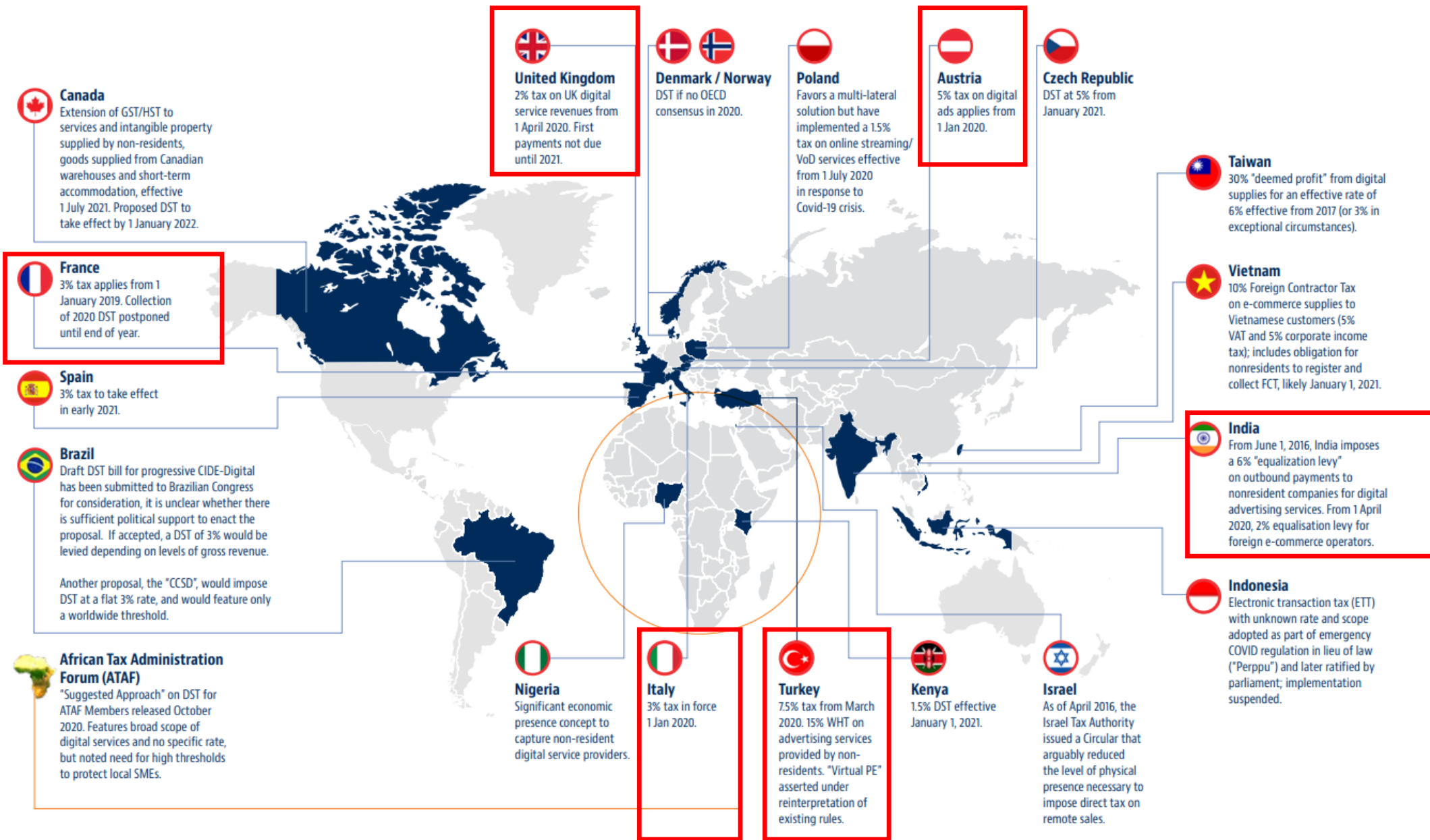
Pillar 1

Nexus Based Tax

### Need for new framework

- Existing tax laws too old to deal with digital businesses.
- Globalisation of business environment and capital flows.
- Erosion of tax base due to tax planning based on the current treaty frameworks
- Taxation rights through Permanent Establishment (PE) concept increasingly outdated.
- Significant importance of market jurisdictions in the value chain and tax base.
- Adoption of unilateral measures by countries on digital services, like India, France, Austria, Poland, UK etc.
- Acceleration of fiscal deficits due to the COVID pandemic spending.
- First time 140 nations worked on the matter and 137 signed for the framework

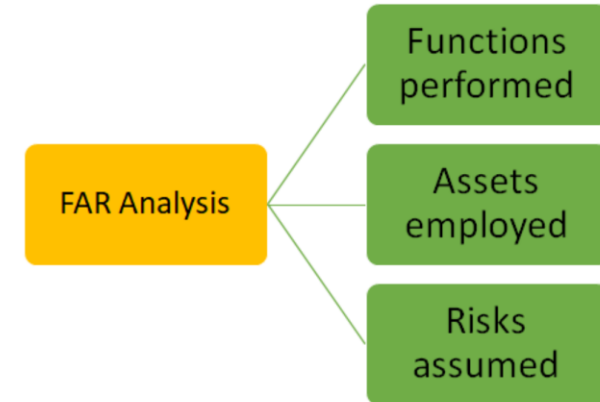
# Unilateral Measures





## Principles

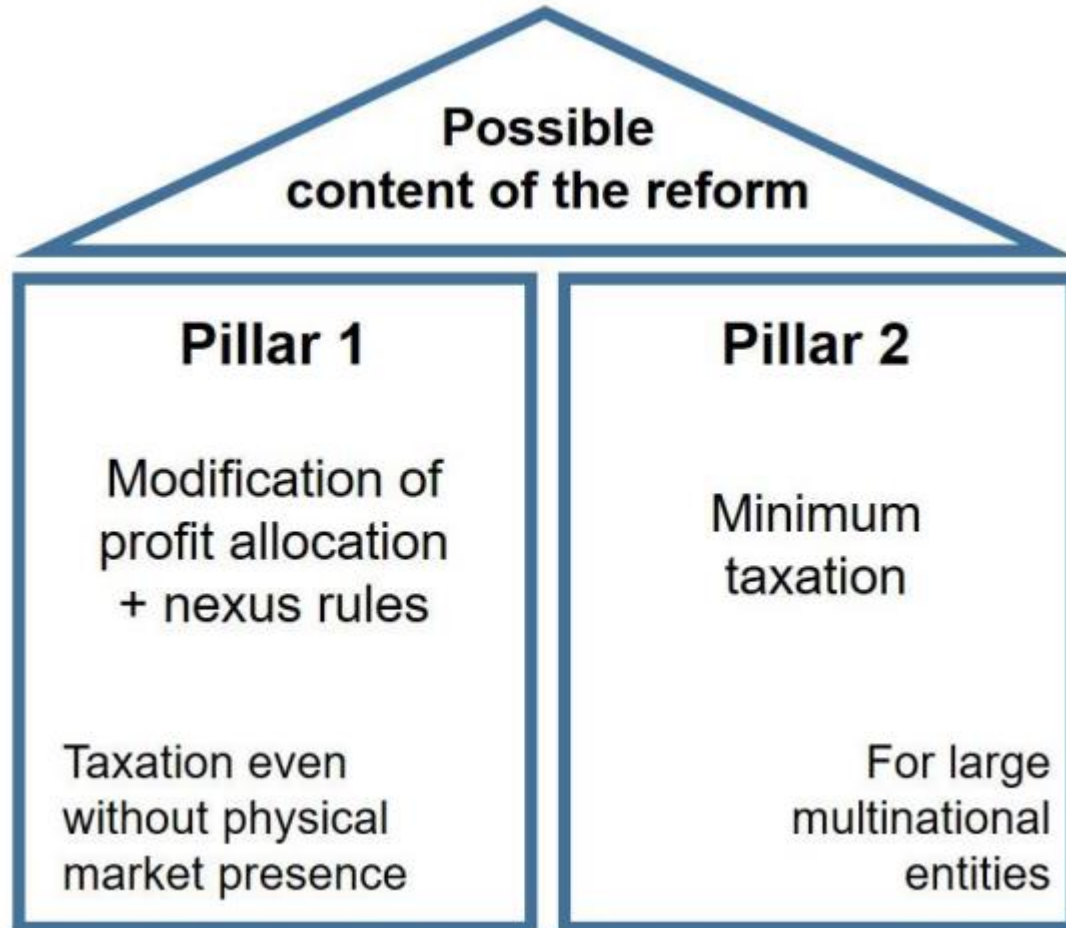
- Recognition of marketing intangibles, against the usual FAR model
- User participation approach for tax
- Significant economic presence concept
- Rejection of separate entity / PE based approaches
- Elimination of both double taxation and double non taxation cases
- Rule based / formulary approach for determination of tax base
- Discourage use of low / no tax jurisdictions
- Information exchange and collaboration



### Wholly owned or almost exclusively owned, directly / indirectly.

- Government entities - Eg – Temasek, GIC
- Sovereign wealth funds - Eq – Abu Dhabi investment authority,
- International Organisations – Subsidiaries of IMF, WB etc
- Non profit organisations
- Pension funds
- Investment funds
- Real estate investment vehicles
- Entities owned by a combination of the above entities

## Two Pillars



- Pillar 1 – Nexus based taxation
- Pillar 2 – Global Minimum Taxation
- Aim to operationalise from 2023 and 2024
- 7 year review period
- 140 countries including OECD nations
- Paradigm shift in international taxation
- Changes in domestic tax laws
- Removal of all unilateral levies

## Pillar 1 - Highlights

- Nexus Rule
- Profit Allocation
- Taxing Rights
- Taxing rights further based on the below
  - User participation – Users contribute value to firms, and value creation gives rise to taxing rights
  - Marketing Intangibles – Allocation of income to market countries
    - This allocation is in excess of DEMPE.
  - Significant Economic Presence
    - Based on user base
    - Digital content
    - Billings
    - Marketing & Sales promotion activities.

### Two new concepts proposed

- Amount A – Profits to be allocated to market jurisdictions.
- Amount B – Remuneration for baseline marketing and distribution activities.

(Amount B expected to be mostly in line with the current international TP regulations.)

### Other significant steps

- Dispute resolution mechanism – In built mechanism to solve disputes among member nations.
- Complete removal of all unilateral taxing measures like – equalisation levy or other digital taxes.

## Pillar 1 – Outline

### Amount A

#### Scope

Business activity test

Revenue thresholds

Domestic business /  
foreign revenue test

#### Nexus

Jurisdiction specific revenue threshold

Plus factors for CFB

#### Tax base

Financial accounts  
and determine PBT

Use of segmentation and  
allocation of income and costs

Accounting  
for losses

#### Allocation

Profitability threshold

Reallocation  
percentage

Allocation key

#### Elimination of double taxation

Identify the paying  
entities

Method to relieve  
double taxation

Simplified admin.  
system

- Scope restricted to
  - Automated Digital Services ( ADS)
  - Customer Facing Businesses ( CFB)
- New nexus rules developed for certainty
- Tax base determined as percentage of profits.
- Allocation to market jurisdiction based on some parameters. Mostly revenue.

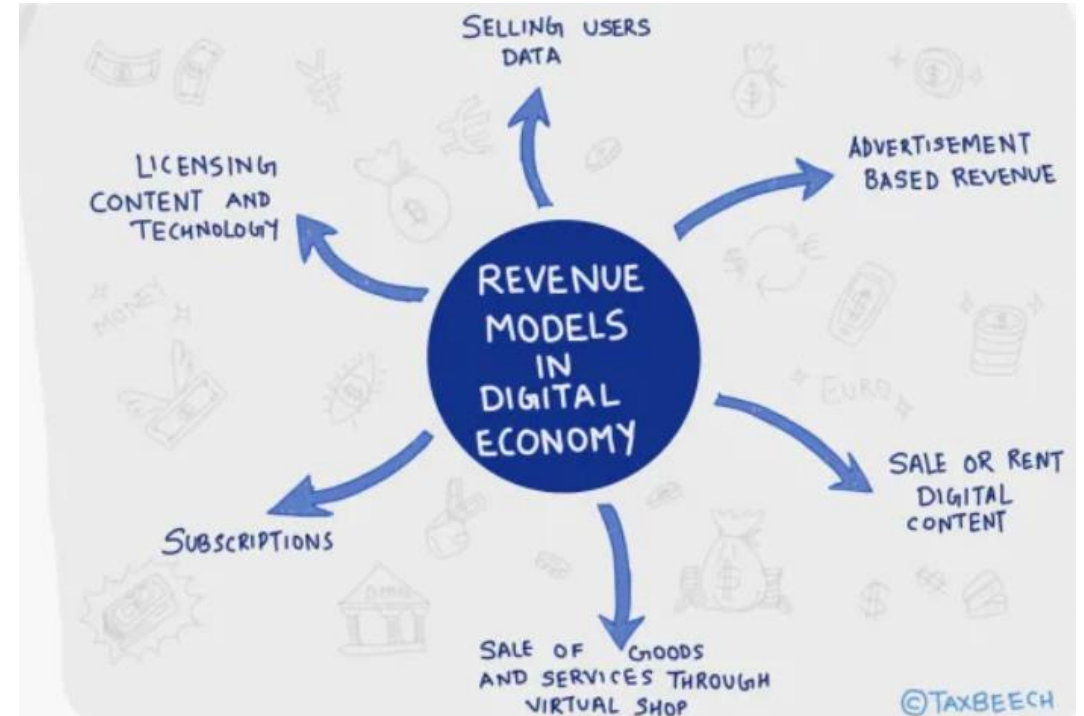
# Pillar 1 – Automated Digital Services

## Essential conditions

- Automated – Minimal human involvement.
- Digital – Provided over the internet or other digital network.

## Examples

- Online advertising services – Google, Facebook, Twitter etc
- Search engine services.
- Online gaming platforms.
- Online teaching services, and educational content.
- Online intermediation of tangible goods / services – Amazon, Uber etc
- Digital services – OTT Platforms like Netflix, Hotstar.
- Licensing of data, online content provision.
- Cloud computing – Google, Microsoft, Amazon etc.



### Determination

- Revenue from sale of goods and services
- Goods or services of the type commonly sold to customers
- Covers a broader group than ADS category.
- Includes both online and offline modes.
- Not considered for Amount A, for tax base determination
- Examples – Pharmaceuticals, Franchising, Licensing
- Carveouts – Financial services, natural resources, construction
- CFB is not completely defined and the scope is currently being arrived at by the working group.
- Changes can be expected in the final outcome.



### Determination

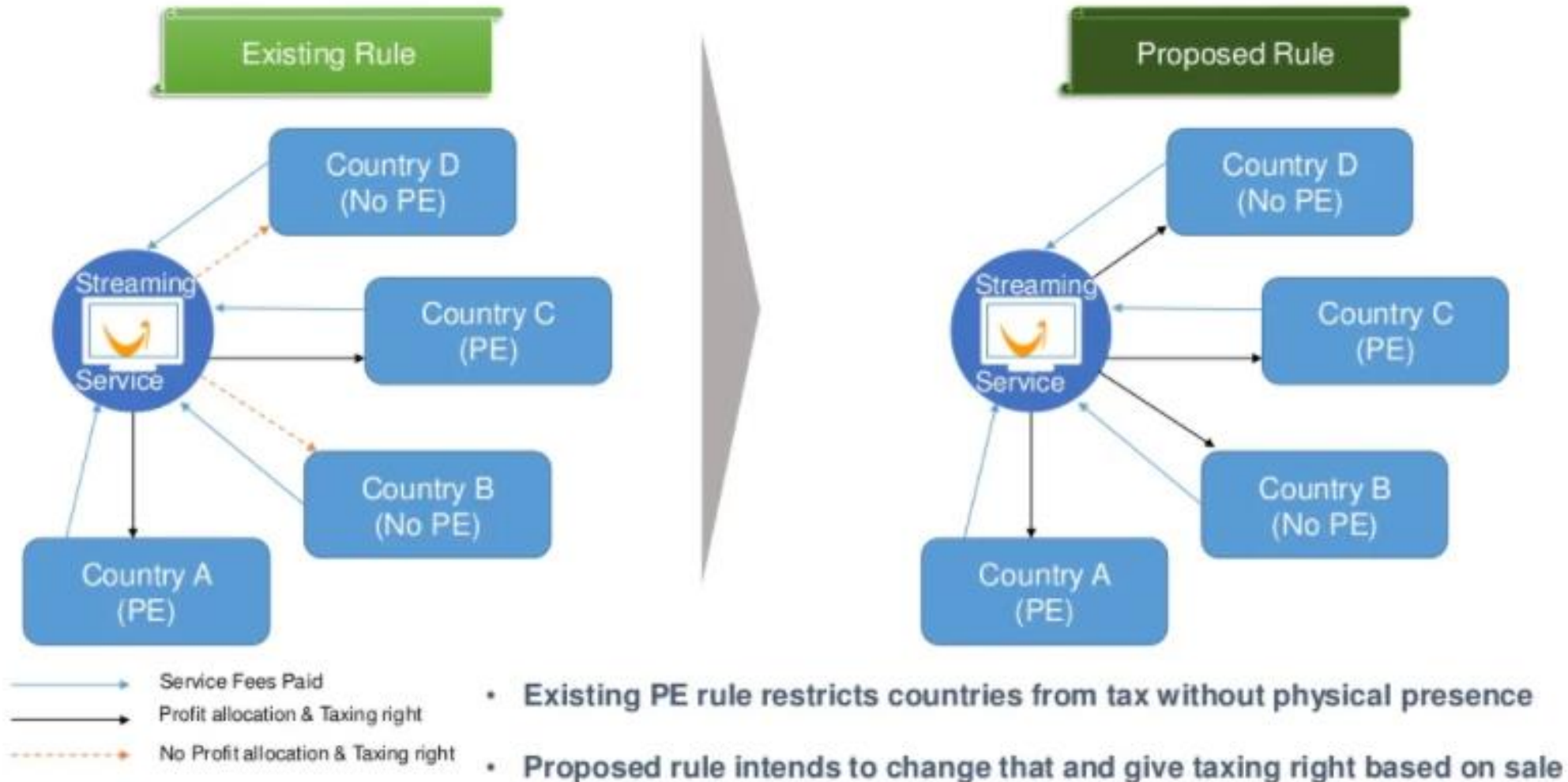
- Global Revenue Test
  - Aligned with the CbC threshold of Eur 750Mn
  - Revenue based on GAAP used for preparation of financial statements.
  - Expected to cover around 2,300 multinational groups
- De minimis foreign in-scope revenue test
  - Minimum level of foreign revenue for cost – benefit

### Determination

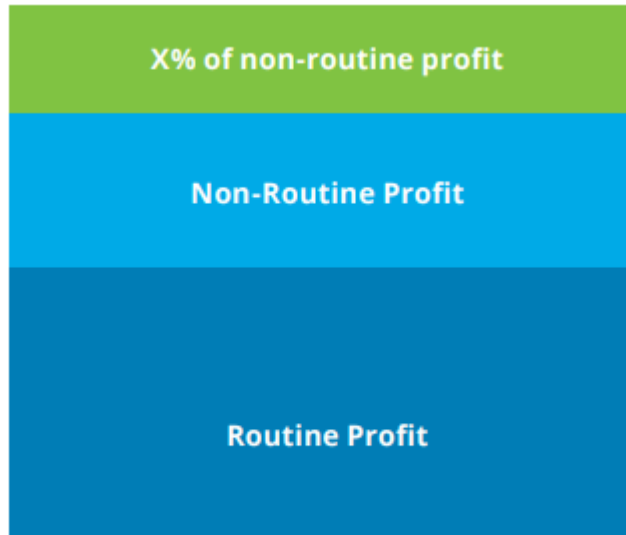
- Multinational corporations with below conditions
  - Consolidated revenue more than Euro 20 Bn ( USD 22 Bn)
  - Profitability above 10%
- The numbers will be evaluated again after 7 years from the date of implementation.
- **Source jurisdictions – Nexus rule**
  - Cut off kept at Eur 1Mn for GDP more than EUR 40Bn
  - Eur 250k for GDP less than EUR 40Bn
  - Nexus rule applied to eliminate one off instances and check sustained participation in the economy

# Pillar 1 – Proposed changes

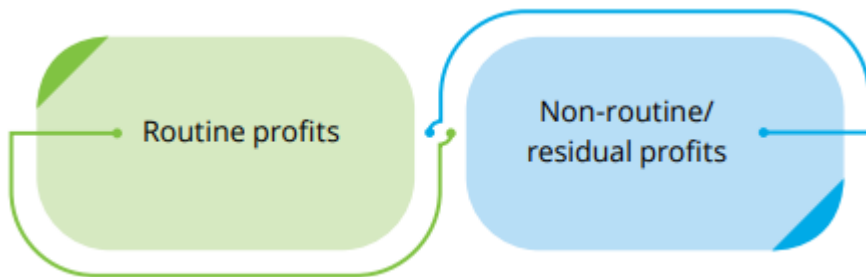
## Pillar 1 - Need of new Nexus Rule



## Pillar 1 – Tax base determination – Amount A



Total profit of the MNE Group



- New taxing rights for market jurisdictions
- New concepts of routine and non-routine profits introduced
- Routine profits belong to the parent jurisdiction
- Part of non-routine / residual profits are allocated to market jurisdictions
- 25% of the non-routine profits are agreed to be allocated
- Allocable amount is the tax base and shared by market jurisdictions
- Nexus based approach for allocation
- Nexus is primarily based on revenue, but other considerations can be taken

## Pillar 1 – Example – Amount A

### Example - Facebook

Particulars	USD Bn – FY 2021
Revenue	117.9
PBT	47.3
Profitability %	40.1%

Particulars	%	Tax base	Remarks
Routine Profit	10	11.8	For USA
Non routine profit	30.1	35.5	To be apportioned
Amount A		8.9	25% of non routine
Total for US		38.4	Routine+ NRP

Geography	Revenue	%	Tax Base share
Canada	3.1	4	0.4
UK	2.4	3	0.3
Europe	26.6	38	3.4
Asia Pacific	26.7	38	3.4
Rest of World	10.6	15	1.4
Total	69.5	100	8.9

- Facebook falls in the purview of pillar 1 as both revenue and profitability are above thresholds
- Allocation of Amount A applicable for all countries where there is no PE
- Amount B takes care of cases where there is a PE and traditional TP rules apply based on FAR

## Pillar 1 – Key challenges – Amount A

### Step 1: Identify residual profits

Routine profits based on fixed PBT to Revenue threshold % age - yet to be determined (10% threshold)

### Step 2: Allocate residual profits to market jurisdictions

Apply a reallocation % age to identify the share of residual profits to allocate to market jurisdictions (25% of residual profit)

### Step 3: Allocate Amount A among market jurisdictions

Pro-rata allocation based on Revenue earned in each market jurisdictions

- Based on accounting profits at group level
- Adjustments to be made to the accounting numbers yet to be worked on
- Plan to put in place the IF architecture by 2023
- Respective changes to be made in the domestic laws
- Exchange of information
- Collection mechanism
- Dispute resolution
- Addressing the loss to exchequer

## Pillar 1 – Amount A – Dispute resolution

- Mandatory dispute resolution mechanism to be inbuilt
- Mechanisms include revenue sourcing, identification of receiving jurisdictions
- Limited opt out provisions for certain developing countries
- Provision for advance rulings at the request of the MNE
- Formation of dispute resolution panel in case of need with other jurisdictions
- Second determination panel if the results of the first panel are disputed
- If still not agreed proceed to MAP

### Issues :

- No time bound measures proposed
- No central authority to monitor disputes and provide guidelines
- Collection of disputed taxes, interest, penalties ?

### Considerations

- Equalisation levy currently generates Rs 4,000 cr in annual taxes
- This amount will have to be foregone after implementation of Pillar 1.
- Based on OECD data only 78 companies meet the thresholds, and may not work in Indian interests
- “Amount A” – Calculation at 25% of residual profits may be very low to be revenue positive for India.
- Lot of companies which currently pay EL will be out of tax base.
  - Netflix has PBT ratio of 17% - so Amount A will be 1.75% - Imagine India share and tax there on
  - Amazon PBT ratio 8.1% - Doesn't qualify for based on threshold
- 7 year initial period to re look at the thresholds is too long and has to be revisited
- Neighbours like Sri Lanka and Pakistan did not sign the agreement,
- Estimates put in the total additional taxes to developing countries may be less than USD 1 Bn



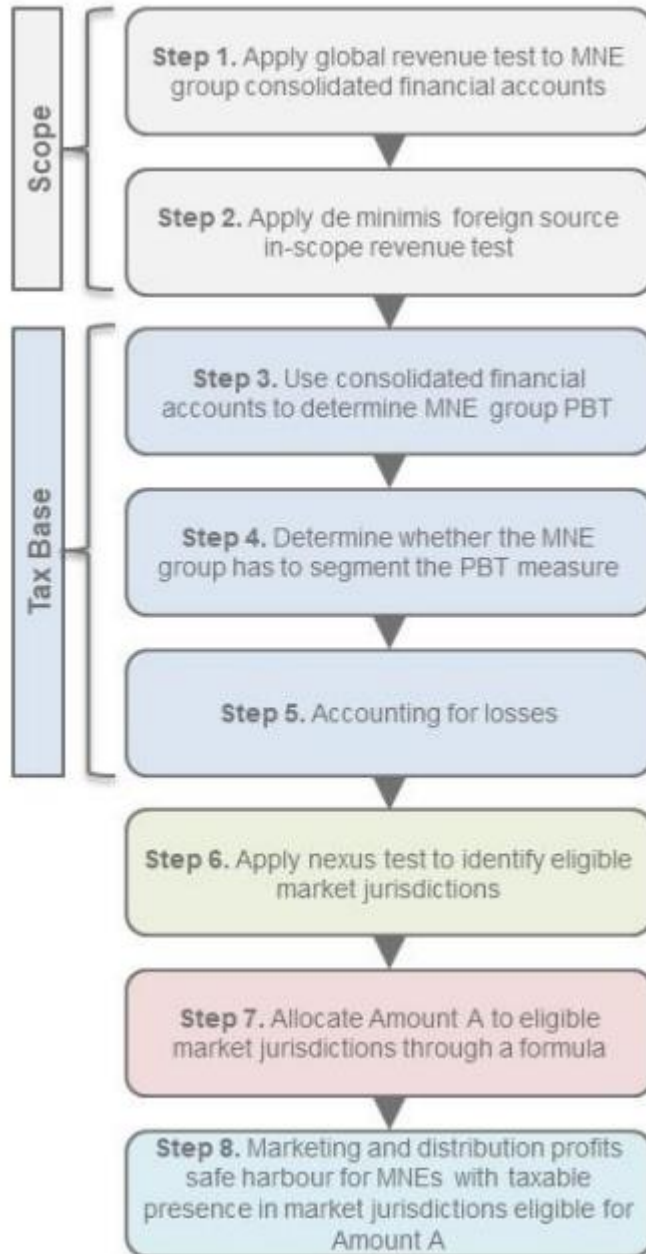
## UN Model Convention – Article 12B

- Alternate set of rules to the Pillar 1 project of OECD
- New article will be a part of the revised Model Tax Convention (MTC)
- Applicable only when two countries have treaties and amend the treaty
- Source state will also have the right to tax ADS activities
  - No De Minimis threshold – All companies fall in ambit unlike OECD exclusions
  - Tax applicable on all revenues on gross basis
  - Not applicable where the income falls under royalties / FTS
- Tax base to be calculated at a certain percentage of gross revenues
- Percentage to be mutually decided on tax treaties, and can include gross or net basis
- Indicative rate of 3-4% on gross basis provided, thresholds may also be applied by countries
- Developing countries may choose to work on this if they are not satisfied with Amount A

## Pillar 1 – Tax base determination – Amount B

- Standardise remuneration to related party distributors
- Baseline marketing and distribution activities covered
- Helps in reduction of TP disputes and reduction of compliance costs
- Aids fixation of remuneration in jurisdictions where TP legislation / administration machinery is yet to evolve
- Arrive at fixed percentages for the activities to enhance certainty of taxation
- Activities categorised into two lists
  - Positive list – Importing for local resale, CRM, negotiating, processing of contracts, logistics, G&A and marketing
  - Negative list – DEMPE activities for intangibles, strategic sales, entrepreneurial risk related activities.
- Domestic TP laws may need to be modified once implemented to accommodate ALP
- Work on this project is expected to be complete by end of 2022 – As per OECD report of Oct 2021

## Pillar 1 – Accounting Interface



- Use of consolidated financial statements
- Not impacted by intra group margins
- USGAAP, IFRS as acceptable GAAPS. Ind AS also accepted
- Easier administration of thresholds as most countries use IFRS

## Pillar 1 – Accounting Challenges

- Impairments – Significant for many tech companies
- Write downs on financial assets, fair value adjustments
- Exceptional gains / losses
- Corporate events like mergers, demerges, spinoffs
- Treatment of OCI items
- Treatment of related party expenses outside MNE group
- Loss carry forwards in parent jurisdiction
- Impact due to foreign exchange rates
- Restatement of financial statements

## UN Vs OECD Models

Particulars	Article 12B	OECD Pillar I (Amount A)
Scope	Narrow in scope: Covers only Automated Digital Services	Broader in scope: Covers Automated Digital Services & Consumer Facing Businesses
Thresholds on implementation	There are no thresholds	Thresholds are present
Profit allocation	On gross and net basis	On net basis
Dispute Resolution Provisions	No	Yes
Implementation	Simple to implement	Complexity in implementation

- UN has certain drawbacks in strength of technical team
- Limited set of countries on UN tax committee at 25 vs 139 in OECD IF
- Major economies not represented in UN tax committee, like US, UK, Japan, France
- Renegotiation of treaties without a framework like MLI very time consuming

## Pillar 1 – Open Issues

- Definition of MNE group
- Foreign De Minimis revenue thresholds
- Rules around revenue sourcing
- Agreement on Amount B and rules thereon
- Rules around corporate restructuring, mergers, demergers, loss setoffs.
- Offsets of Amounts A and B local tax jurisdictions for credits as WHT

Pillar 2

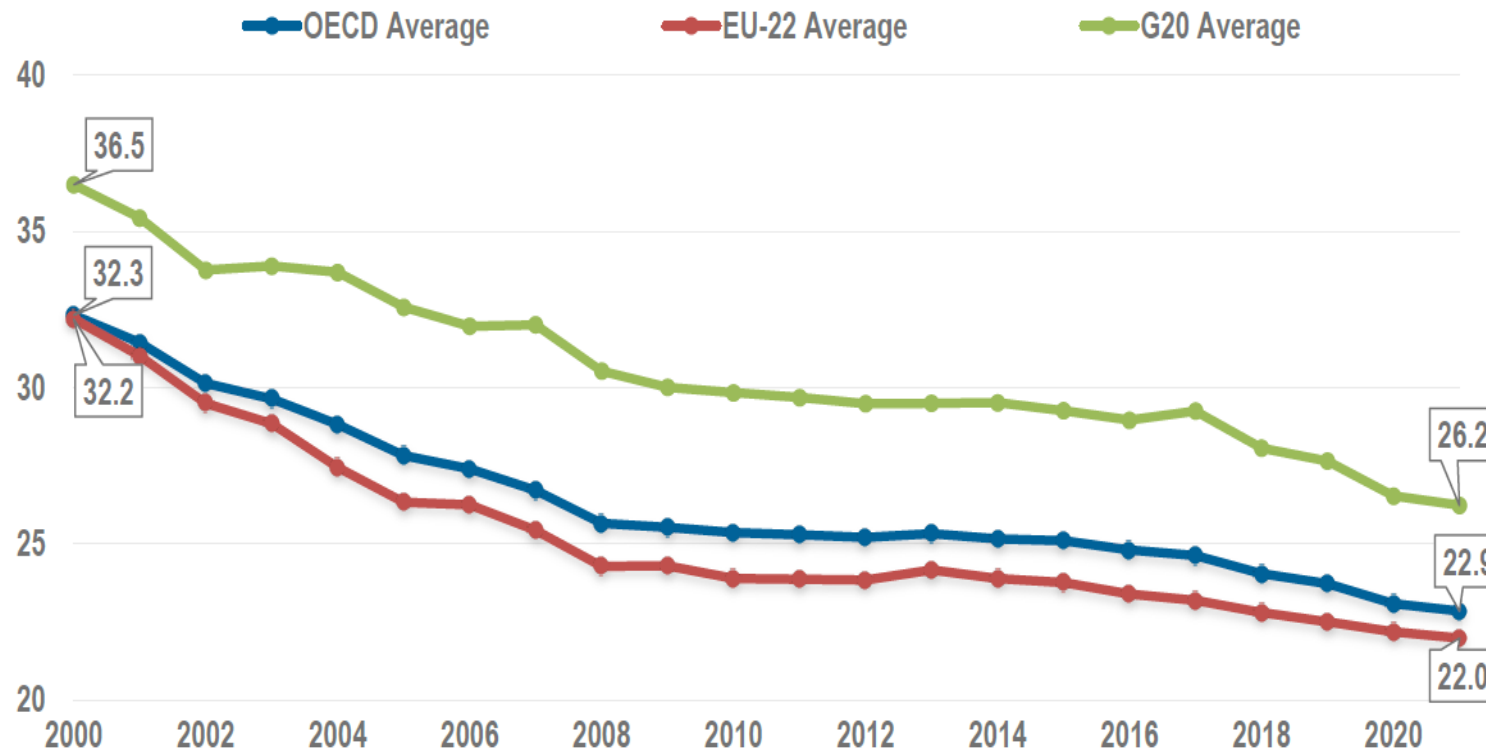
Global Minimum Tax

### Need for GMT

- Tax rate cuts by countries across the globe – “Race to the bottom”
- Average corporate tax rate down from 40% in 1990 to 26.5% in 2020
- Negligible tax payments by companies despite huge profits, Apple, IKEA, Google etc
- Profit shifting to low or no tax jurisdictions- Oracle, Microsoft etc.
- Improper use of tax treaties, treaty shopping, unfair incentives.
- Formation of tax havens like Cayman Islands, Bermuda, UAE, Barbados etc.
- Low tax jurisdictions and complex holding structures
- Fiscal deficits due to Covid 19 pandemic.
- Re allocation of capital formation in home countries.

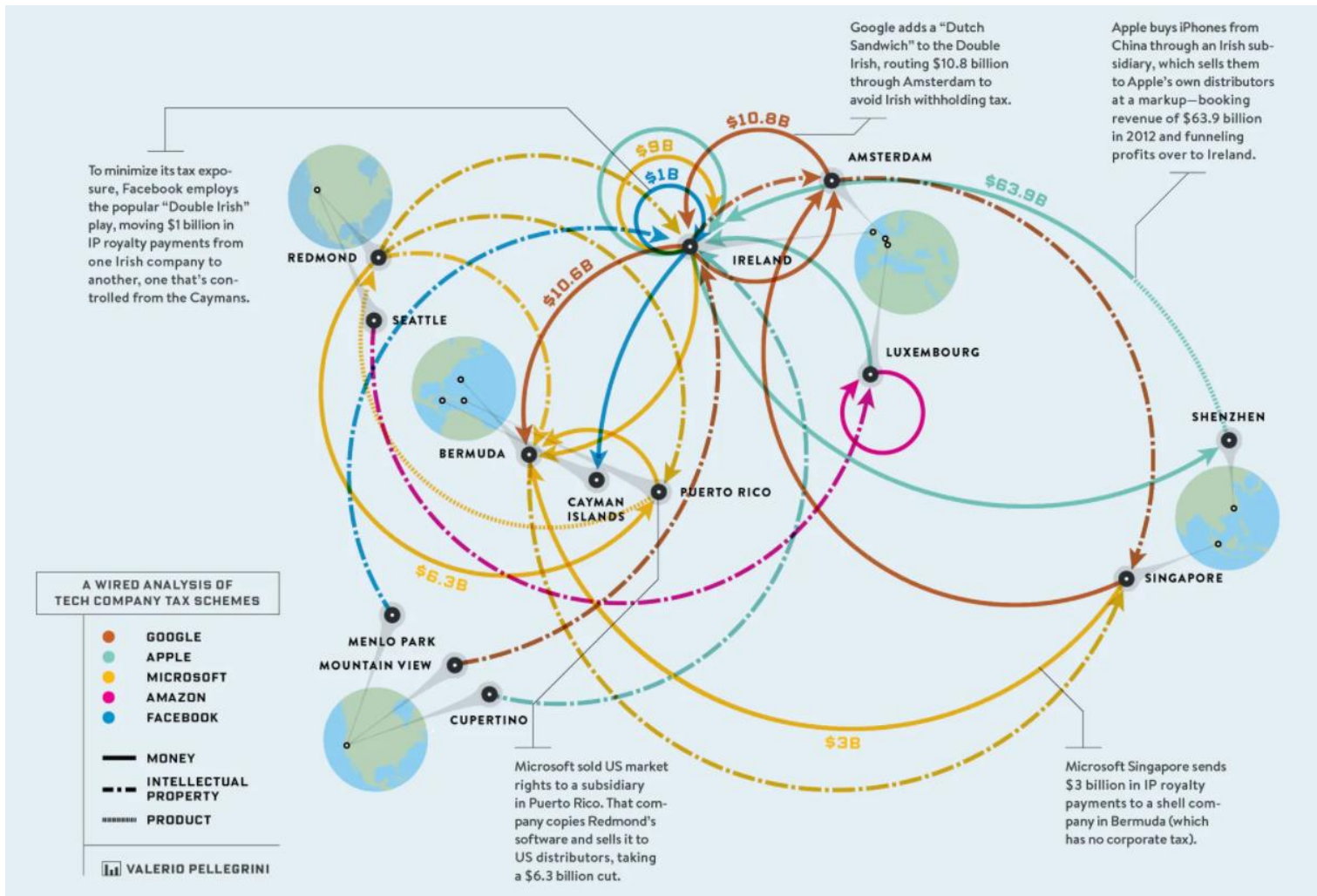


## Pillar 2 – Background



- Significant drop in Tax rates across all groupings
  - Race to cut down on taxes for friendly business atmosphere
  - Loss of tax base, earnings and tax to GDP ratio
  - Higher fiscal deficits and borrowings by governments
  - Lot of un used capital held up outside the eco system
- 
- Aim to bring a level playing field across nations
  - To achieve the goal either through cooperation or multilateral regulation

## Pillar 2 – Case Studies



Apple – Subsidiary in Ireland, part ownership of IP. Contracts manufacturing and books sales to marketing entities.

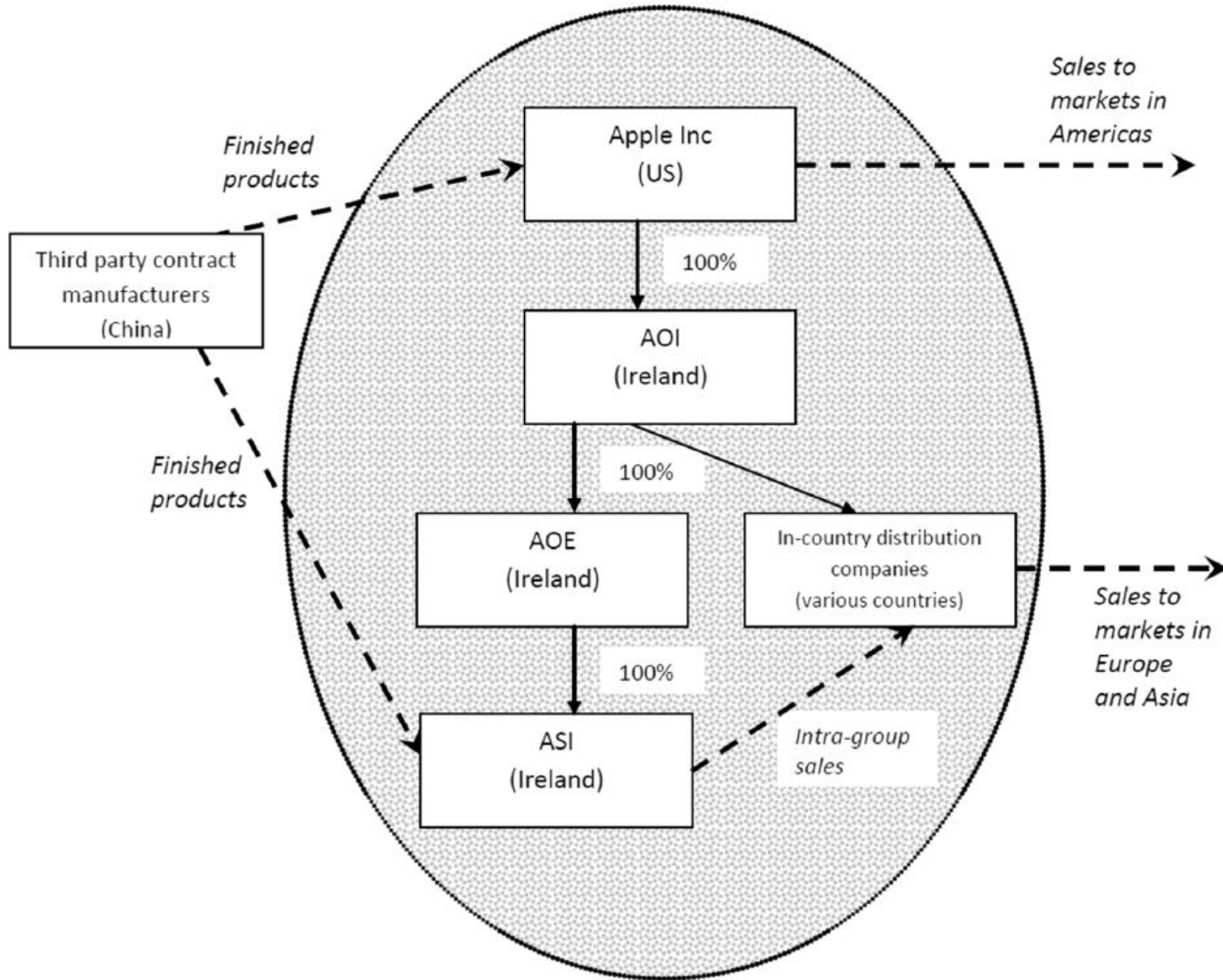
Google – Used two Irish companies and a Dutch company for tax planning and retention of cash in Ireland.

Microsoft – Payments from Singapore to Bermuda as IP royalty.

IKEA – Shifted global profits between Netherlands, Luxembourg, Belgium and Lichtenstein

Other companies – Facebook, Pfizer, Amazon with different structures for planning

## Pillar 2 – Case Study- Apple



AOI – Incorporated in Ireland but managed from US

Not tax resident in Ireland or US

Pays for R&D costs for rights on IP on cost sharing

Holds rights for economic ownership of IP in non US markets

No royalty to Apple US due to cost share in R&D

US IRS rules allow cost sharing for R&D by subsidiary

ASI – Contracts manufacturing to China and sells to distributors in various countries

CFC provisions have manufacturing exception

Check the box regime disabled intra group profits

## Pillar 2 – Proposed Rules

- **Income Inclusion Rule (IIR)**

- Based on foreign source income
- Top up tax for the differential

- **Under Taxed Payments Rule (UTPR)**

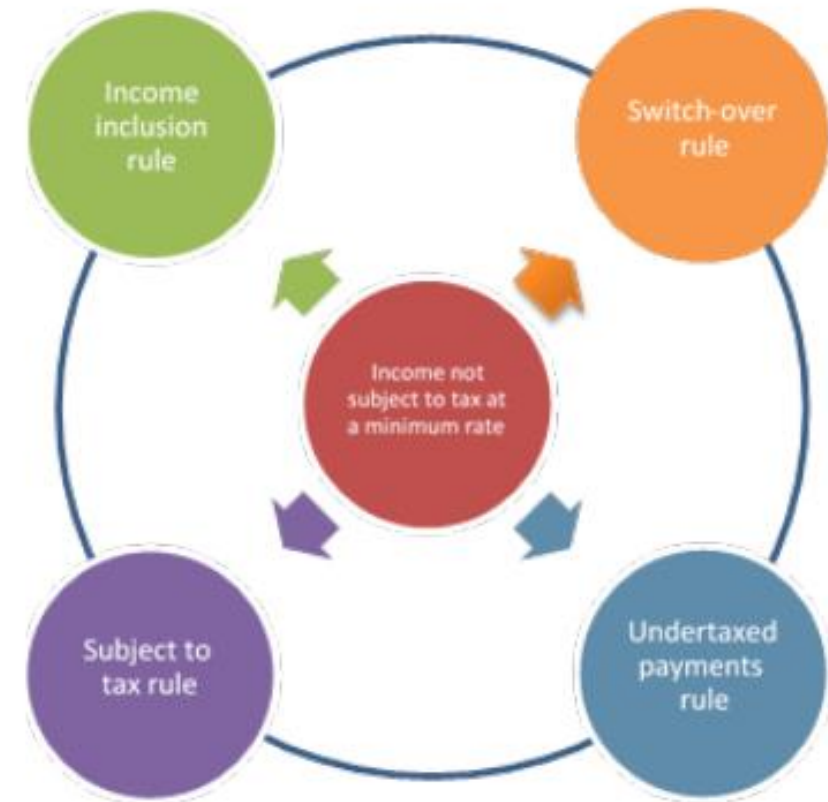
- Denial of deduction for payments to RPs
- Withholding taxes

- **Switch Over Rule (SOR)**

- Modification of tax treaties
- Switch between exemption and credit for top up tax

- **Subject To Tax Rule (STTR)**

- Adjustment of eligibility for treaty benefits if payments are not subject to tax at GMT



- Income Inclusion Rule (IIR)

### Step 1 – Constituent Entities within scope

- Identify Groups within Scope and the location of each Constituent Entity within the Group

### Step 2 – GloBE Income

- Determine Income of each Constituent Entity

### Step 3 – Covered taxes

- Determine taxes attributable to Income of a Constituent Entity

### Step 4 – Effective Tax Rate and Top-up Tax

- Calculate the Effective Tax Rate of all Constituent Entities located in the same jurisdiction and determine resulting Top-up Tax

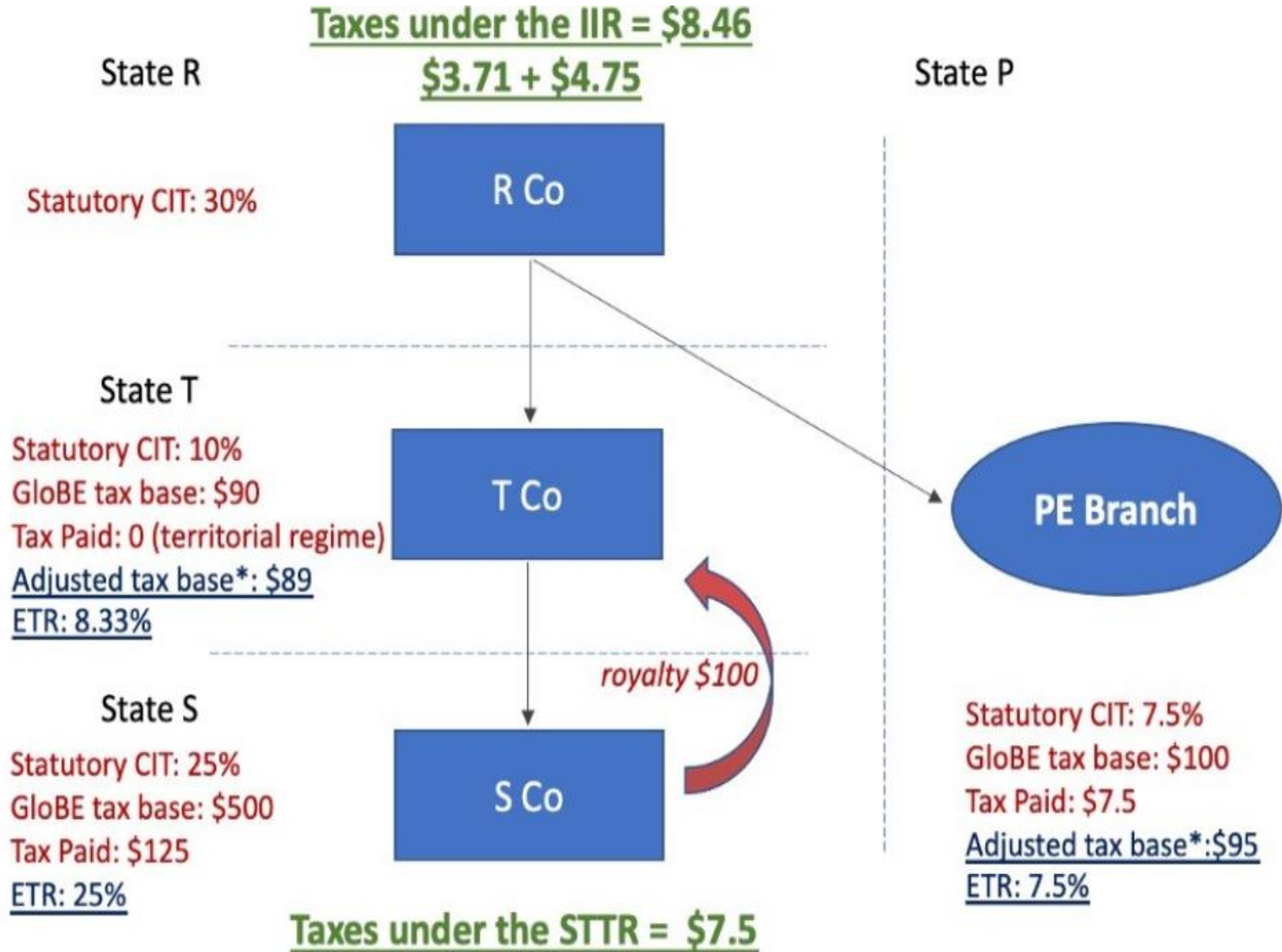
### Step 5 – IIR and UTPR

- Impose Top-up Tax under IIR or UTPR in accordance with agreed rule order

## Pillar 2 – Income Inclusion Rule (IIR)

- Income Inclusion Rule (IIR)
  - Applicable for branches and controlled foreign companies ( in jurisdictions where CFC applicable)
  - Compute the Effective Tax Rate (ETR) of the jurisdiction of the constituent entity
  - Income of the constituent entity taxed in the parent jurisdiction – top down
  - Differential tax topup added in the parent jurisdiction to make up for GMT rate (GMT – ETR)
- Complexities yet to be solved
  - Split ownership – say 60% & 40% or JV etc
  - Intermediate parents through complex structures
  - Top down approach – ultimate parent jurisdiction taxes the differential
  - Coordination between tax authorities

# PILLAR 2 – IIR Example



## Pillar 2 – Untaxed Payments Rule (UTPR)

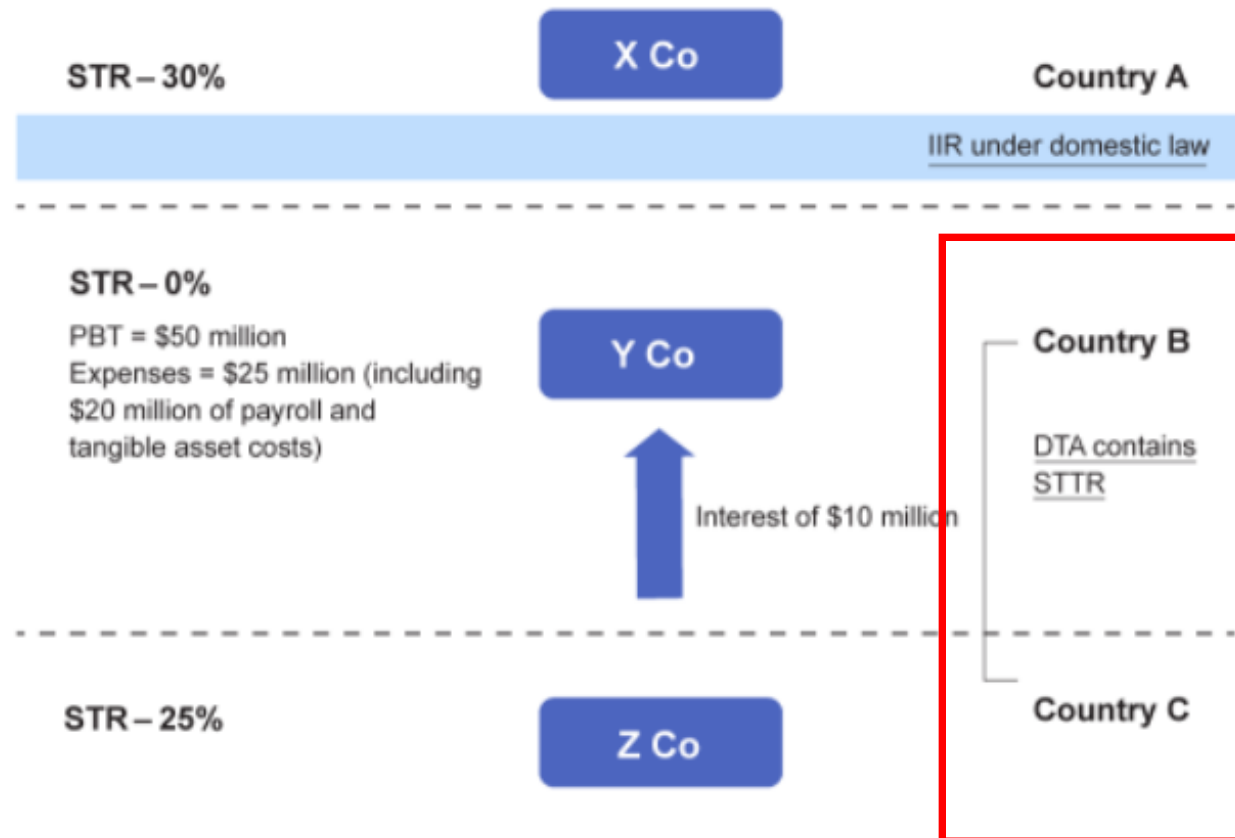
- Main features
  - Applies to MNE groups above Eur 750Mn revenues
  - Applicable in case of payments to countries below GMT rates
  - Adjustment made by denying deduction for the payment
  - Applies in coordination with IIR
  - Can be either a denial of deduction or in form of withholding tax



## Pillar 2 – Subject To Tax Rule (STTR)

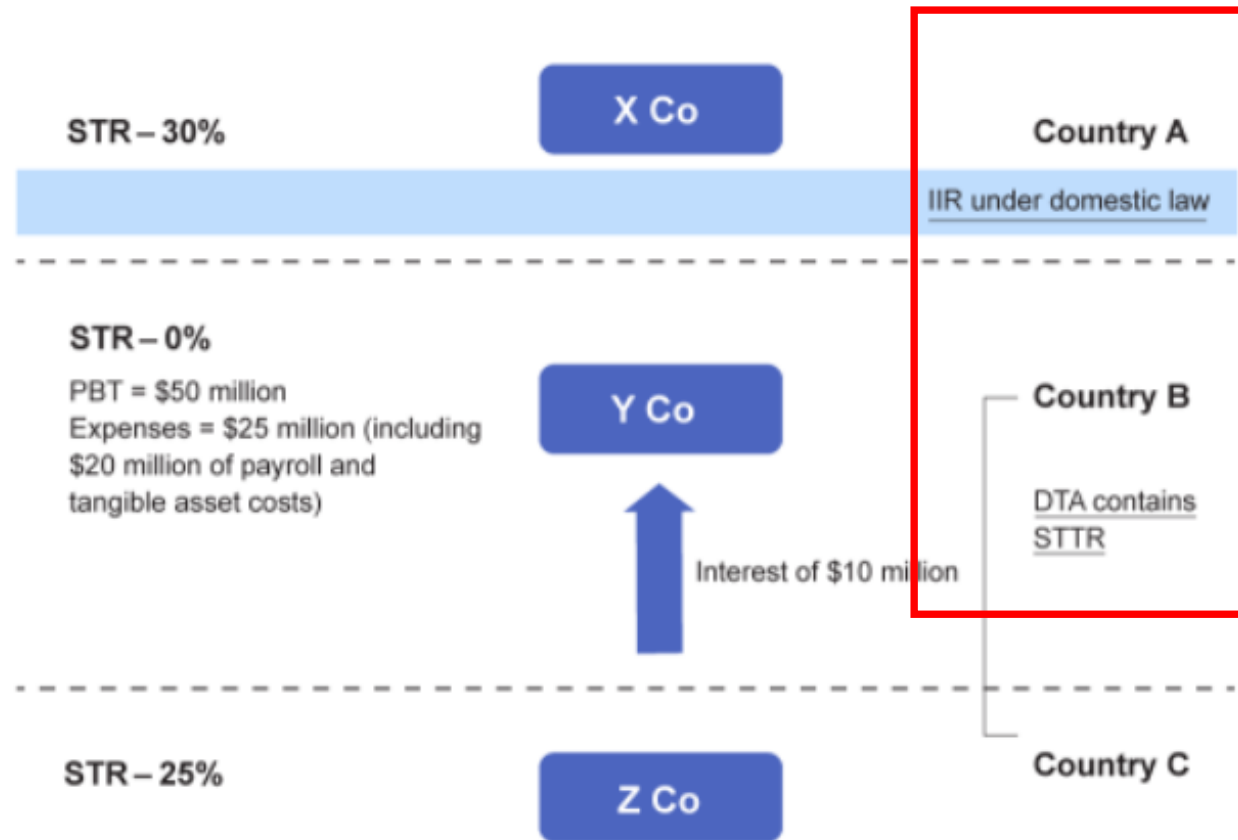
- Treaty based measure, negotiated between countries
- Overriding treaty in respect of certain payments
- Applicable only on payment to related parties
- No minimum threshold like EUR 750Mn like IIR
- Applicable on transaction by transaction basis
- Triggered when the payment is taxed in recipient country below threshold rate
- Threshold rate for applicability set at 7.5% to 9%
- STTR comes higher in the hierarchy over IIR and UTPR

## Pillar 2 – Subject To Tax Rule (STTR)



- X co is UPE of Y co and Z co
- Country B is a tax haven, Say Bermuda / Cayman Islands
- Z Co makes \$10Mn payment to Y Co
- STTR treaty between Country B and C
- Threshold rate of STTR agreed at 7.5%
- Country B tax rate is less than 7.5%, so the full rate comes as top up \$750k
- \$750k will be collected in Country C as top up tax as per STTR

## Pillar 2 – STTR & IIR



- PBT of Y Co – 50Mn – Tax suffered \$750k
- Country A has IIR in domestic tax laws
- ETR of X co from Country B is 1.5%
- GMT ETR rate is 15%
- Additional top up tax 13.5%
- Tax collected in country A as per IIR
- \$750k will be collected in Country C as top up tax as per IIR \$6.75Mn

- Both STTR and IIR ensure to bring the ETR to GMT rate
- UTPR to apply if STTR and IIR application is not possible

### Exclusions

- Dividends
- Equity gains or losses
- Revaluation / notional gains or losses
- Policy disallowed expenses
- Prior period expenses, changes due to accounting principles
- Accrued pension expenses

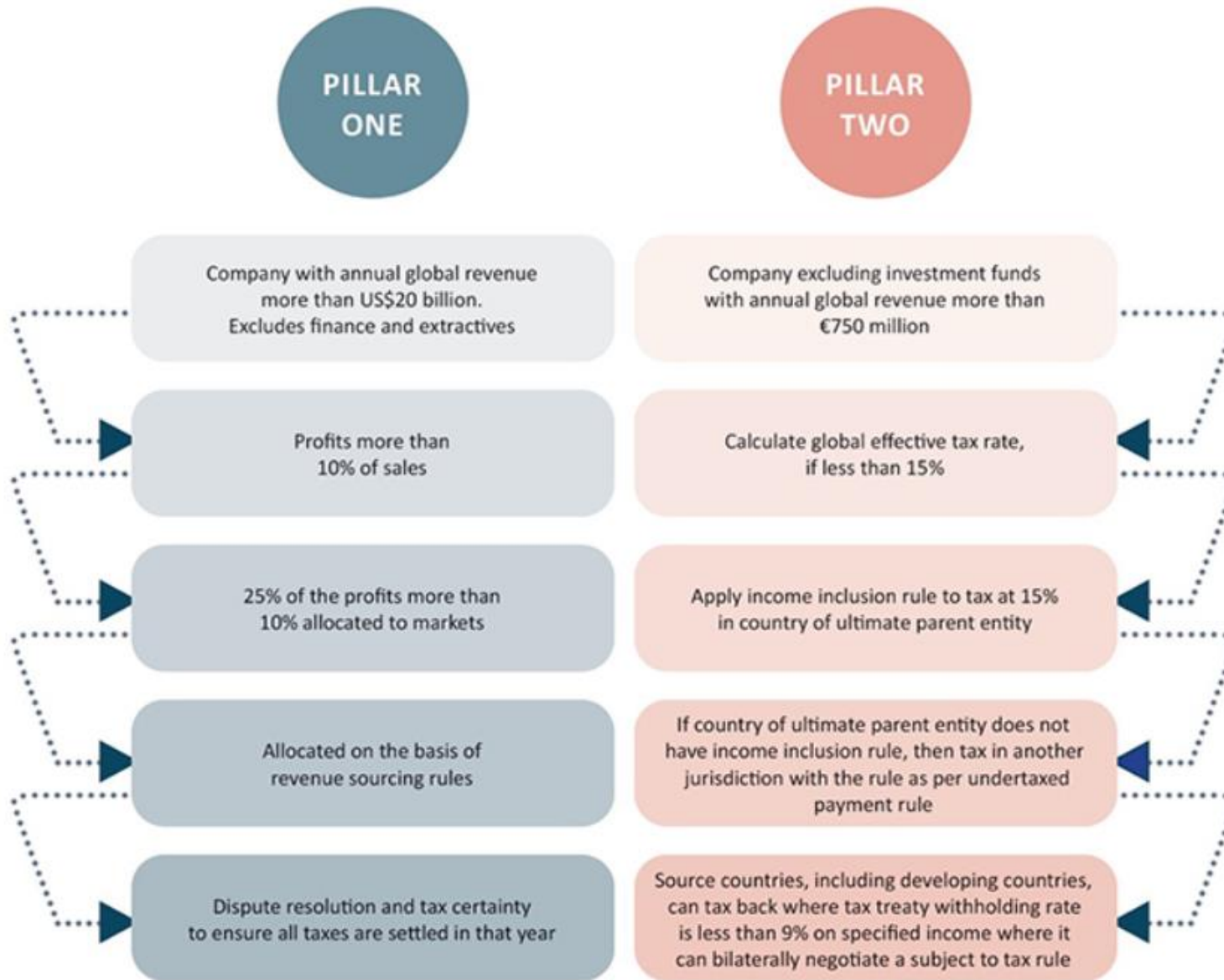
## Pillar 2 – Impact on India

- Inability to provide any economic stimulus
- Concessional rate u/s 115BAB just above the GMT rate
- Units running within SEZs with Sec 10AA exemption will be impacted as ETR below 15%
- Units in IFSC – GIFT city enjoying concessional may be impacted
- Ability to garner additional revenue on IIR / UTPR
- Minimisation of treaty shopping on existing un changed treaties

## Timelines

Agreement	Adoption into Law	Implementation	Review
<p><b>1 July 2021</b> – Agreement by 130 countries in the IF to a new international tax framework</p> <p><b>October 2021</b> – Detailed implementation plan for both pillars and resolution of remaining issues including the detailed mechanics for the operation of both pillars.</p> <p><b>2022</b> – Additional details on Amount B in Pillar One</p>	<p><b>2022</b> – A multilateral instrument (that will have to be ratified domestically) is contemplated for Pillar One and the STTR rule in Pillar Two. Other components might need to be adopted through domestic legislation.</p>	<p><b>2023</b> – Effective date for implementation for both Pillar One and Pillar Two (with a possible deferred implantation of the UTPR)</p>	<p><b>c. 2030</b> – Review of Pillar One including potential reduction of the scope threshold from EUR 20 billion to EUR 10 billion</p>

# Highlights



- Address two different issues
- Group approach vs individual treaties
- 2023 and 2024 as starting years
- Aggressive timelines
- Complex legislations
- Lot of groundwork still pending
- Local laws and implementation issues
- Benefits to developing countries is key for success

### Global Minimum Tax

- International tax system for a fair allocation of taxes
- Historically never there has been consensus due to vested interests
- No final conclusions yet
- Is the threshold for Pillar 1 realistic ?
- Is the GMT at 15% good enough or should it be at 17-18% ?
- Still good for theory – practical application may still be very difficult
- Expected to add generate additional USD 150Bn, will it ?
- Heavy reliance on realtime information and sharing



*“If an idea is not absurd, then there is no hope for it” –*

**Albert Einstein**

**Thank You**