G20/OECD Inclusive Framework on BEPS: Report on P1 and P2 Blueprint

LOCAL CONNECT. GLOBAL OUTLOOK.

SBC Proposition :

- We can help entities in evaluation, understanding, & communicate appropriate responses to **BEPS 2.0.**
- We can recommend and implement desired changes to group, capital, and/or intangible structures, using our joint tax and legal capability.
- Using a coordinated approach with accounting advisory services, we can help the organizations to address data related issues.
- We can assist with restructuring, if value chain & group structure are no longer appropriate.
- Our both legal advisory and taxation teams are experienced at working together to help groups restructure.
- We can exhibit the expected impacts of BEPS 2.0 using model outputs prepared by our team.
- We can also provide legal and tax support through:
  - Transfer pricing & international tax issues.
  - Withholding tax and other taxes.
  - R&D and Intangible property considerations.

BEPS - Base Erosion and Profit Shifting

Digital Economy (1)

Coherence

- Hybrid mismatch arrangements (2)
- CFC Rules (3)
- Interest Deductions (4)
- Harmful tax practices (5)*

Substance

- Preventing tax treaty abuse (6)*
- Avoidance of PE status (7)
- Transfer pricing aspects of intangibles (8)
- Transfer pricing risk and capital (9)
- Transfer pricing high risk transactions (10)

Transparency

- Measuring and monitoring BEPS (11)
- Disclosure rules (12)
- Transfer pricing documentation (13)*
- Dispute Resolution (14)*

Multilateral instrument (15)

Minimum standards*

Outline of Pillar One:

Scope	Nexus	Quantum	Allocation Keys	Calculation	Key resources
Global turnover >€20 billion (potentially reducing to €10 billion over seven years)	>€1 million of revenue from jurisdiction	25% of residual profits (i.e., profit above 10% of revenue)	Sourcing to jurisdiction where goods or services are 'used or consumed'	Loss carry forward	Consolidated F/S
Extractive industry and regulated financial services exclusions	>€250,000 of revenue from jurisdictions with GDP <€40 billion		Intermediary tracing rules	Marketing and distribution profits safe harbor	Sales revenues from each jurisdiction and GDP data on smaller jurisdictions
Profit before tax >10% of revenue				Double taxation elimination – exemption or credit method	Tax returns; tax payments & tax losses
				Amount B application to marketing and distribution activities	Real time location of the User: Geolocation or IP address of user (his), his billing address, his residency, Place of final delivery

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Outline of Pillar Two:

Scope

- Consolidated group
- >€750M threshold (with discretion for income inclusion rule (IIR) below threshold)
- Investment funds that are ultimate parent companies, holding vehicles, and pension funds excluded
- Government, international and nonprofits excluded
- Tax transparent entities
- Shipping income exclusion

ETR Calculation

- Covered taxes
- Financial accounting income

Adjustments & Carve-outs

- Carry forward losses?
- Timing differences?
- De minimis exclusion carve out
- Carve out for mark-up on tangible assets (8%) and payroll (10%) initially and 5% after 10 years
- Distribution tax systems

Computation

- ETR ≥15% minimum rate
- Allocation of top-up tax
- Simplification measures
- Undertaxed payment rule (UTPR) - allocation of top-up tax
- Apply STTR minimum rate >9%

Scope

- Consolidated financial statements
- Financial statements of subsidiaries in group GAAP
- Tax returns; tax losses; tax payments; tax rates from jurisdictions where revenue is earned
- Revenue line items and mark-ups – tangible assets; payroll; related- party payments; interest; royalties
- Amounts not taxed

Background:

- OECD and G20 countries are adopted a 15-point Action Plan to address BEPS in September 2013. The Action Plan identified 15 actions along with three key pillars:

    - Introduce Coherence in domestic rules that affect cross-border activities
    - Reinforce substance requirements in existing International Standards
    - Improve transparency as well as certainty

- The 137 members of the Framework have worked on a global solution based on a **Two-Pillar Approach.** Pillar One is focused on new nexus and profit allocation rules and ensure that the allocation of taxing rights with respect to business profits is no longer exclusively circumscribed by reference to physical presence.

- Pillar Two addresses remaining BEPS challenges and it does so via a number of interlocking rules that seek to
    - ensure minimum taxation while avoiding double taxation or taxation where there is no economic profit,
    - Cope with different tax system designs by jurisdictions as well as different operating models by businesses,
    - Ensure transparency and minimize administrative & compliance costs.

Pillar 1 - Amount A:

- **Amount A** is a new taxing right over a share of the residual profit of MNE groups that fall within its defined scope. The tax base is therefore determined on the basis of the profits of a group (rather than on a separate entity basis), and it is necessary to start with consolidated group financial accounts.

- A new taxing right for market jurisdictions over a share of residual profit calculated at an MNE group (or segment) level **(Amount A)**

- A fixed return for certain baseline marketing and distribution activities taking place physically in a market jurisdiction, in line with the ALP **(Amount B)**

- Processes to improve **tax certainty** through effective dispute prevention and resolution mechanisms.

Scope of Amount A:

Global Threshold Limit:
MNE Groups with Global Turnover above **€20 B**
&
Profitability above **10% (PBT/ Revenue)**

NEXUS: Local Revenue
1) € 1M for > €40 B GDP countries.
2) € 2.5 M for < €40 B GDP countries.

Automated Digital Services:
1. Advertisement Services
2. Sale/other Alination of user data
3. Online Intermediation Platforms
4. Digital Content Services
5. Online Gaming

Real-Time location of User – Based on Indicators below:
- Geolocation
- IP Address
- Other Location Information

Consumer Facing Businesses:
1. Consumer Facing goods
2. Consumer Facing Services
3. License or Franchise

Place of Final Delivery of the Product or use of service

Report by Licensee or Franchisee

Exclusions: Extractives (non-renewable resources) and regulated financial Services

Revenue Sourcing rules –
Note: 1) **Hierarchy of Indicators** should be followed. If not, MNE should justify the reason for not availing.
2) MNE must retain the **Documentation** of
- Internal Control Framework related revenue sourcing.
- Indicators used for Present category.

Scope of Amount A (Contd.):

i. **Profitability Test:** Pre-Tax Profit Margin of the Group must be **greater than 10 %** in all the following cases:

- **Period Test**: Pre-Tax Profit Margin of the Group must be greater than **10 %** in the Period;
- **Prior Period Test**: Pre-Tax Profit Margin of the Group must be greater than **10 %** in two or more of the four Periods immediately preceding the Period; and
- **Average Test:** Pre-Tax Profit Margin of the Group must be greater than **10 %** on Average across the Period and the four Periods immediately preceding the Period

❖ **Merger & Demergers :**

In cases of Group merger in the Period or any of the 3 Periods immediately preceding the Period, the calculation of the Pre-Tax Profit Margin for the Period(s) prior to the Merger Period should be made by replacing "Group" in that definition with "Acquiring Group" & "Demerging Group" for mergers & Demergers respectively. Where there is no "Acquiring Group", "Group" is replaced with "Existing Group".

New Taxing right:

Profit Allocation:

1) Isolate the Routine profits & Residual profits. Threshold Limit = 10% of Revenue.
2) 25% fixed reallocation is used to allot appropriate share of residual profits to market jurisdictions.
3) Finally, Amount A is distributed based on the rules on Scope, Nexus & Revenue Sourcing.

Double Taxation Elimination:

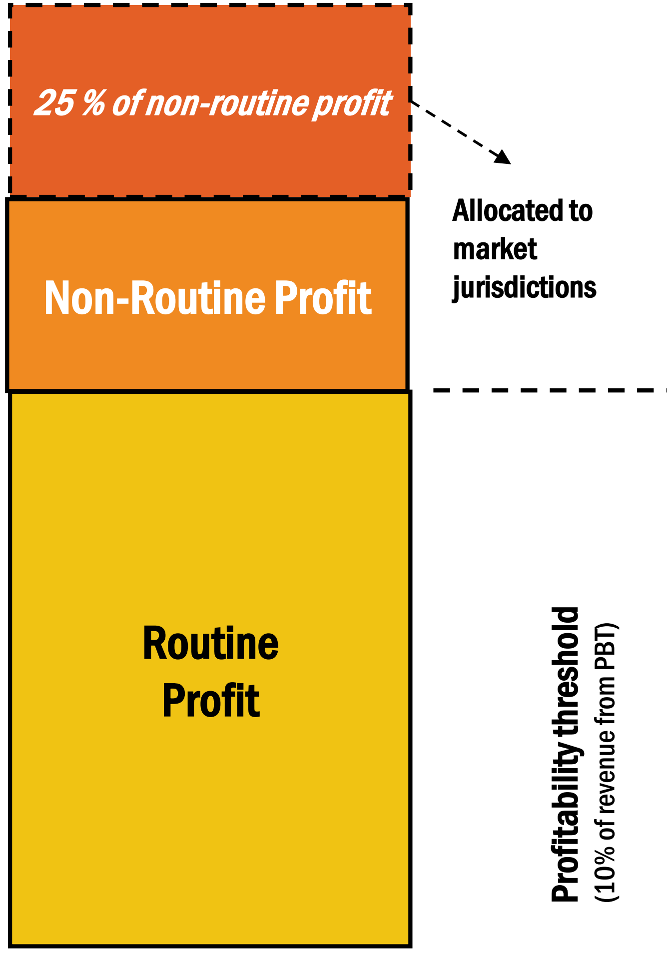
1. Identify the paying entity

I Activities Test
II Profitability Test
III Market connection priority test
IV Pro-rata allocation

2. Exemption or Credit Methods are used to eliminate double taxation.

Tax Base determination:

1. Use PBT derived from Consolidated Financial Statements.
2. Segmentation framework Threshold is yet to decide.
3. In-regime Losses can be carry forward.
4. No cross segment blending of Profits & losses are allowed



Total profit of the MNE Group

Case Study (modified as per Guidelines released by OECD in October 2021)

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Facts

Group A is a large MNE group providing exclusively in-scope ADS via an online platform. It is assumed that Group A is treated as one segment for Amount A purposes and that it has the following simplified income statement:

	in million EUR
Revenue (R)	25,000
Profit before tax (P)	6,500
PBT margin (P/R)	26%

in million EUR	Local revenue (S)	
Market 1	2,000	local subsidiary
Market 2	18,000	remote activity
Market 3	5,000	remote activity
Total	25,000	

Applying Amount A formula	
Step 1: Profitability Threshold	Step 2: Reallocation percentage
Determine Group A's ***residual profit*** (W) by subtracting 10% from the PBT margin (P/R).	Determine Group A's ***allocable tax base (A)*** by multiplying residual profit (W) by 25%.
W = P – (R*10%)	A = 25% * W
W = 6,500 – (25,000 * 10%)	A = 25% * 4,000
W = 4,000	**A = 1000**

10% is a threshold agreed by the IF members

25% is a threshold agreed by the IF members

Case Study (Contd)

Step 3: Allocation key

Allocation key based on the ratio of locally sourced revenue (S) to total revenue (R). This last step provides for the quantum of Amount A taxable in each eligible market jurisdiction (M), as described in the below table.

in million EUR	Local revenue (**S**)	Allocation Key (**S/R**)	Amount A (**M**)
Market 1	2,000	8%	A * S/R = **80**
Market 2	18,000	72%	A * S/R = **720**
Market 3	5,000	20%	A * S/R = **200**
Total	**25,000**	**100%**	**1000**

Amount B – Introduced to simplify the TP Rules for tax administrations & Taxpayers -
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.

Tax Certainty and Implementation:

Tax Certainty

Dispute Prevention & Resolution:

1. New mechanism Using panels.
2. Amount A allocation to be improved by panels.
3. Encourages Multilateralism in tax matters.

Dispute Resolution:

1. Mandatory binding dispute resolution mechanisms.
2. Foe countries with few MAP cases deferred from MAP peer review.

Implementation & Administration:

Implementation of Pillar 1 require action across –

1. Domestic law
2. Public International law
3. Guidance on Scope , Nexus & Revenue sourcing rules to Taxpayers & Tax Administrations.
4. Guidance could be revised & reviewed periodically

Pillar 2 - Global Minimum Tax Rule

Applicability of Global Anti-Base Erosion (GloBE):

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

Pillar 2:

Two interlocking domestic rules of GloBE –

(i) Income Inclusion Rule (IIR): Which imposes **top-up tax** on a parent entity in respect of the **low taxed income** of a constituent entity; if that income was subject to tax at an Effective Tax Rate (ETR) that is below a minimum rate

(ii) Undertaxed Payment Rule (UTPR): **Denies deductions** <u>or</u> requires an equivalent adjustment to the extent the low tax income of a constituent entity is not subject to tax under an IIR i.e., **withholding tax for a payment to a related party** if that payment was not subject to tax at or above a minimum rate.

Carve outs and Carry forward:

Carve-outs:

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.

Carve-out allows countries to continue to **offer tax incentives** to promote business activity with real substance, like building a hotel or investing in a factory.

The GloBE rules will also provide for a de minimis exclusion for those jurisdictions where the MNE's revenue is less than €10 million and profits of less than € 1 million.

Carryforward:

Excess Taxes	Losses
If excess tax paid in previous year, create an **Income Inclusion Rule tax credit (IIR tax credit)** (Or)	Losses in jurisdiction carryforward and allowed as deduction in computation of GloBE tax base is subsequent year from profits arising in same country.
local tax carry- forward is created, 7 year look back/Carry forward period.	Carry-forward allowed Indefinitely.

Implementation of BEPS Actions in India:

Action 1	- Equalization Levy – Finance Act 2016 and 2020 - "Significant economic presence" from FY 18-19
Action 13	Country by Country Reporting (CbCR) and Master File TP documentation from FY 16-17
Action 6	Bilateral re-negotiation of tax treaties to ensure greater source based taxation/ prevent treaty abuse (e.g. India – China DTAA[1])
Action 8-10	Tax administration and taxpayers expected to give consideration while applying ALP
Action 4	Interest deduction limitation rule (S. 94B) from FY 17-18
Action 14	Committed to minimum standards for improving effectiveness on Mutual Agreement Procedures (MAP)
Action 15	On 7 June 2017, India (along with 67 countries) signed the Multilateral Instrument (MLI) to modify existing tax treaties. India submitted ratified copy of MLI with OECD on 25 June 2019

[1] Provisions influenced by MLI/ BEPS- Principal purpose test (PPT), competent authority rule as tie-breaker test for dual resident entities, narrowing the permanent establishment definition

General points:

Entities not subject to GloBE rules:

- Government entities,
- International organizations,
- NPOs,
- pension funds or investment funds that are Ultimate Parent Entities (UPE) of an MNE Group or any holding vehicles used by such entities, organizations or funds.

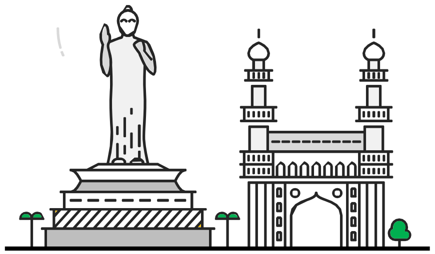
Switch-over rule (SOR):

Introduced into tax treaties that would permit a residence jurisdiction to **switch from an exemption** to a **credit** method where the profits attributable to a permanent establishment (PE) are subject to an effective rate below the minimum rate.

Subject to tax rule (STTR):

Treaty-based rule, that would complement the UTPR by subjecting a payment to withholding or other **taxes at source** and adjusting eligibility for **treaty benefits on certain items of income** where the **payment is not subject to tax at a minimum rate.** The STTR will be creditable as a covered tax under the GloBE rules.

Contact us



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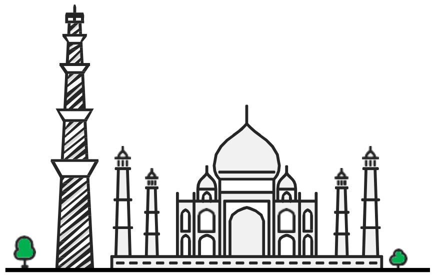

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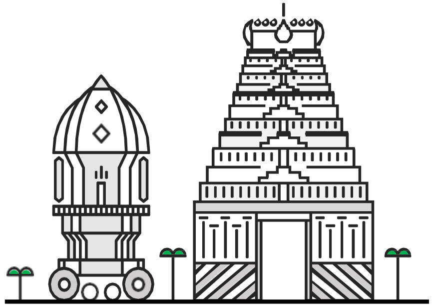

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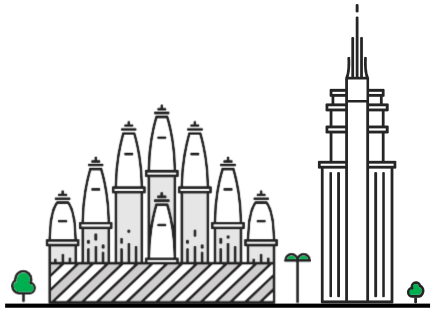

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Thank You

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