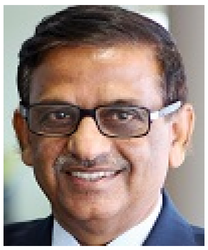
[2021] 128 taxmann.com 136 (Article)

[2021] 128 taxmann.com 136 (Article)

Date of Publishing: July 12, 2021

Global Minimum Tax – Journey so far and impact on India



S.P. SINGH
Ex-IRS Officer

SHARAD GOYAL
CA, Partner, GSAP & Associates LLP

CHANDRA SHEKHAR PANDEY
CA, Partner, GSAP & Associates LLP

1. Background

With globalization and digitization of economies over last decade, historical taxation concepts of cross border transactions which are primarily based upon brick-and-mortar economy have crumbled. Take for example the concept of Permanent Establishment, which is necessarily based upon physical presence in another country, is becoming redundant with the rise of technology as substantial business can be carried out in a country without physical presence. Technological developments have made geographical and chronological difference meaningless. Activities can be carried out simultaneously in several locations through virtual presence. The existing tax laws give a lot of importance to physical presence and time of actions. These developments are being used by Multinational Enterprises (MNEs) to shift their income and fund seamlessly across jurisdictions to minimize their tax burden. Some of these are driven by business reasons, but many a times ridiculously complex tax planning structures are created with sole intention to avoid payment of taxes in the locations from where income are earned.

Consequently, leaderships across the globe are cognizant of the fact that taxation principles of the past are not comprehensive enough to handle the problems of new digital age. Keeping these challenges in mind, OECD and G20 member countries started the ambitious Base erosion and profit shifting ("BEPS") project to device measures and policies in international taxation to plug tax avoidance.They came out with a package consisting of 15 Action Plans to deal with various aspects of profit shifting, measures to plug the loopholes, administrative measure for achieving this and measures to improve dispute resolution mechanism. The latest in the search for ways to make MNEs pay taxes in the locations from which they earn income is the concept of Global Minimum Tax ("GMT") which has been initiated by USA and is finding support from the policy makers across the globe.

In this article we have discussed in detail the Pillar One and Pillar Two approaches proposed by OECD/G20 on July 1st, historical background of GBT of 15% and its impact on India.

2. Recent initiatives by OECD/G20

Recently, considerable work has been done at OECD/G20 level, and a breakthrough came on July 1, 2021, when 131out of 139 members of the Inclusive Framework on BEPS, representing more than 90% of global GDP, released statement suggesting a two-pillar solution to address the tax challenges arising from the digitalisation of the economy. OECD in its recent report[1] termed this agreement a "historic success". This statement proposes a two-pillar approach – Pillar One which is about re-allocation of additional share of profits to the market jurisdictions and Pillar Two is for propagating a minimum global corporate tax of 15%. OECD expects that GMT will generate around US$ 150 billion in additional global tax revenues per year.[2] Additional benefits will also arise from the stabilisation of the international tax system and the increased tax certainty for taxpayers and tax administrations.

India has joined this OECD/G20 Inclusive Framework and issued a Press Release on July 2, 2021[3] stating her position that "*India is in favour of a consensus solution which is simple to implement and simple to comply. At the same time, the solution should result in allocation of meaningful and sustainable revenue to market jurisdictions, particularly for developing and emerging economies. India will continue to be constructively engaged for reaching a consensus based ready to implement solution with Pillar one and Pillar two as a package by October and contribute positively for the advancement of the international tax agenda.*"

It is widely anticipated that once OECD/G20 arrive at conclusive approach and prepares agreement in October this year, it will change the rules of international taxation globally. Not only this, many countries will also be forced to change their domestic tax laws concerning corporate taxation.

Before analysing the development of the concept of GMT and possible implications for India, the basic features of international initiatives on taxation of digital economy are discussed in brief.

3. International initiatives on taxation of digital economy

Among all the action plans of BEPS, Action Plane 1, which addresses Digital Economy is being followed with a lot of interest by all stake holders in digital economy consequent to the changes happening in the way business is being conducted due to ever evolving technology. The Action Plan 1 Report acknowledges that digitalisation, apart from others, raises a series of broader tax challenges, which it identified as "nexus, data and characterisation".[4] In spite of several rounds of discussion no consensus could be build up for taxing Digital Economy.

After the BEPS package was released, implementation of its recommendations became the focus of the work. In June 2016, the OECD established the Inclusive Framework on BEPS. Within **OECD/G20 Inclusive Framework on BEPS**, 139 countries (of developed, developing and under-developed world) are collaborating on the implementation of 15 measures/Actions to tackle tax avoidance, improve the coherence of international tax rules and ensure a more transparent tax environment. So, the thrust of the OECD/G20 Inclusive Framework on BEPS is to plug harmful tax practices followed by MNEs.

4. About Two-Pillar Approach of OECD/G20

Efforts to find an acceptable solution on taxation of Digital Economy continued at the OECD level. In January 2019 the Inclusive Framework agreed a Policy Note that grouped the proposals into two pillars – one of nexus and profit allocation and another on ensuring a minimum level of taxation – and contained an agreement to examine them as a possible basis for consensus.[5] The two-pillar approach is two-pronged strategy (i) to ensure large MNEs pay their fair share in all countries where they operate, and (ii) brings certainty and stability to the international tax system. Pillar One which is about reallocation of additional share of profit to the market jurisdictions and Pillar Two is related to consisting of minimum tax and subject to tax rules. Some countries have suggested to improve further the policy design of Pillar Two to ensure its focus on remaining BEPS issues and take the view that a systematic solution designed to ensure that all internationally operating businesses pay a minimum level of tax would go beyond the policy objective of Pillar Two.[6]

One important point regarding two-pillar approach is that it will apply to all companies, not just digital companies, subject to thresholds.

Pillar One

Pillar One is aimed at ensuring fairer distribution of profits and taxing rights among countries with respect to the largest MNEs, including digital companies. It would re-allocate some taxing rights over MNEs from their home countries to the markets where they have business activities and earn profits, regardless of whether firms have a physical presence there or not.

It is proposed that a MNE group can nominate one entity of the group to carry out all compliances under Pillar One. Once accepted, member countries will have to do away with unilateral measures they have already taken like imposing Equalisation Levy or Digital Service Tax on MNEs.

Key features of Pillar One are as follows:

Pillar One proposals	
Scope	MNEs which fall under the scope are enterprises with global turnover above 20 billion euros and profitability above 10% (i.e., profit before tax/revenue) with the turnover threshold to be reduced to 10 billion euros going forward. Extractives and Regulated Financial Services are excluded.
Nexus	Nexus will be said to be established when the in-scope MNE derives at least 1 million euros in revenue from that jurisdiction. For smaller jurisdictions with GDP lower than 40 billion euros, the nexus will be set at 250,000 euros.
Quantum	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. Detailed source rules for specific categories of transactions will be developed.
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.
Elimination of double taxation	Double taxation of profit allocated to market jurisdictions will be relieved using either the exemption or credit method.
Tax certainty	Disputes relating to all issues concerning Amount A will be resolved in a mandatory and binding manner. An elective mechanism will be provided to developing countries based on

	certain agreed criteria.
Timelines	A multilateral instrument will be finalised for Pillar One and will be opened for signature in 2022 and will come into effect in 2023.

Pillar Two

Pillar Two seeks to put a floor on competition over corporate income tax, through the introduction of a global minimum corporate tax rate that countries can use to protect their tax bases.

Pillar Two consists of:

- two interlocking domestic rules together called as Global anti-Base Erosion Rules ("GloBE rules"):
  - (*i*) 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
  - (*ii*) an Under taxed 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 called 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.

It is not mandatory for Inclusive Framework member countries to apply GloBE rules. Key features of Pillar Two are as follows:

Pillar Two proposals	
Scope	The GloBE rules will apply to MNEs that meet the 750 million euros 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.
Exclusions	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.
Effective Tax Rate ("ETR") calculation	The GloBE rules will operate to impose a top-up tax using an ETR test that is calculated on: ♦ a jurisdictional basis, ♦ uses a common definition of covered taxes, and ♦ a tax base determined by reference to financial accounting income (with agreed adjustments) ETR = Amount of covered taxes

	Amount of GloBE income
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.
Safe harbour	Safe harbour rules will be implemented to reduce compliance costs.
GILTI co-existence	Consideration will be given to the conditions under which US global intangible low-taxed income ("GILTI") regime will exist with GloBE rules.
Subject to tax rule ("STTR")	Inclusive Framework 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 Inclusive Framework members when requested to do so. The taxing right will be limited to the difference between the minimum rate and the tax rate on such payments. The minimum rate for the STTR will be from 7.5% to 9%.
Timelines	Pillar Two would be brought into law in 2022, to be effective in 2023.

5. Global Minimum Tax - Journey

The current US government played pivotal role in building global consensus towards minimum global corporate tax on large MNEs. The Global Minimum Tax suggested by USA defines Pillar Two approach.

The Made in America Tax Plan ("MATP")

Following the introduction of AJP ("The American Jobs Plan") in March 2021, U.S. government introduced MATP on April 7, 2021. The goal of MATP is to make American companies and workers more competitive by eliminating incentives to offshore investment, substantially reducing profit shifting, countering tax competition on corporate rates, and providing tax preferences for clean energy production. Importantly, this tax plan would generate new funding to pay for a sustained increase in investments in infrastructure, research, and support for manufacturing, fully paying for the investments in the AJP over a 15-year period and continuing to generate revenue on a permanent basis.

MATP is guided by principles like collecting sufficient revenue to fund critical investments, building a fairer tax system that rewards labour, reducing profit shifting and eliminating incentives to offshore investment, **ending the race to the bottom**, requiring all corporations to pay their fair share of tax, building a resilient economy to compete.

This includes raising the corporate tax from 21 percent to 28 percent; **strengthening the global minimum tax**, incentives for new research and development rather than incentives that reward excess profits from intangible assets, incentives for clean energy rather than fossil fuel subsidies, establishing enforcement to address corporate tax avoidance. Apart from this, MATP include several other benefits such as a marked increase in the resources available through the low-income housing tax credit and other housing incentives.

U.S. Treasury floated global corporate tax of at least 15%

The U.S. Treasury Department in a May 20, 2021 meeting[7] between the Office of Tax Policy at the U.S Department of the Treasury and the OECD tax steering group on BEPS offered to accept a global minimum corporate tax of at least 15% during international negotiations. The U.S. Treasury also expressed its belief that the international tax architecture must be stabilized, that the global playing field must be fair, and that an environment may be created in which countries work together to maintain their tax bases and ensure the global tax system is equitable and equipped to meet the needs of the 21st century global economy. The U.S. Treasury also expressed desire to work unitedly to end the pressures of corporate tax competition and corporate tax base erosion.

Press Release dated June 5, 2021of the G7 meeting

Following years of discussions, finance ministers of G7 countries agreed to reforms which will see multinationals pay their fair share of tax in the countries they do business.G7 countries agreed to the principle of a global minimum rate that ensures multinationals pay tax in each country they operate in. The magical number was agreed as 15 percent.

During the meeting, finance ministers of G7 member countries agreed the principles of an ambitious Two-Pillar global solution to tackle the tax challenges arising from an increasingly globalised and digital global economy.

Under Pillar One of this historic agreement, the largest and most profitable multinationals will be required to pay tax in the countries where they operate – and not just where they have their headquarters. The rules would apply to global firms with at least a 10% profit margin – and would see 20% of any profit above the 10% margin reallocated and then subjected to tax in the countries they operate.

Under Pillar Two, the G7 agreed to 15% global minimum corporation tax operated on a country-by-country basis, creating a more level playing field and cracking down on tax avoidance.

This Press Release gave only a broad framework of Two-Pillar approach. Specific details or the text of the agreement were not release to public. So, many questions remained unanswered as how proposed solution will be implemented.

OECD/G20 Statement dated July 2, 2021

Later on, OECD and G20 members countries issued a statement on July 2, 2021 on OECD/G20 Inclusive Framework on BEPS. Members of Inclusive Framework, including India, adopted a high-level statement containing an outline of a consensus Two-Pillar solution to address the tax challenges arising from the digitalisation of the economy.

This statement is in line with the June 5th Press Release of the G7 nations, though, much more clarity is provided in G20 statement regarding two-pillar approach.

6. Next steps

As discussed above a broad framework on the two Pillars has already been prepared and agreed upon by 131 Inclusive Framework member countries. Participants in the negotiation have set an ambitious timeline for conclusion of the negotiations. This includes an October 2021 deadline for finalising the remaining technical work on the two-pillar approach, as well as a plan for effective implementation in 2023.

7. Possible impact on India

India seems to have agreed to the Two-Pillar approach, but with riders. As per Press Release dated July 2, 2021bythe Ministry of Finance, India (discussed earlier) and another Press Release dated July 10, 2021 [8] ; Indian Finance Minister suggested that further work needs to be

done to ensure a fairer, sustainable and inclusive tax system which results in meaningful revenue for developing countries.

Pillar One allocates only 20-30% residual profits of large MNEs above 10%. Developing countries like India with large consumer market should have a bigger pie of the cake. Further, the proposed GloBE rules will apply on companies having turnover 750 million euros. India may argue for a lower threshold to bring a larger number of companies under the tax net.

Since India's corporate tax rate is above the proposed GMT rate of 15%, it is expected that India's ETR will also be above this rate. So, it should not impact companies doing business in India. But Indian government may like to estimate the benefit of GMT vis-à-vis Equalisation Levy ("EL") as Pillar One has the condition that member countries will have to withdraw EL or similar unilateral taxes. India introduced EL of six percent on online advertisement services in the year 2016. The scope of EL was increased in the year 2020 to non-resident e-commerce operators at the rate of two percent. As per media report[9] during the FY 2018-19 online advertisement EL brought in more than US$ 126 million revenue to exchequer. With pandemic situation there are tremendous scope for the expansion of digital spends by the Indian companies. In such a scenario, India may not like to lose on EL compared to GMT.

8. Conclusion

It will be interesting to watch how these two-pillar recommendations, if finalised, would be implemented because it is proposed that there will be multilateral instrument signed for Pillar One and some of the recommendation of Pillar Two (like STTR) have to be implemented via bilateral treaties, particularly when there may not be bilateral DTAAs among 131 Inclusive Framework member countries.

Though there is a broad consensus among 131 countries about the framework of Two-Pillar approach, there would be many finer details on which consensus building might take time. Further, computation of covered income is proposed to be based on financial profits (with minimum adjustments), which may be easy to say but difficult to implement as not all countries follow same accounting standards. A question may arise, will accounting standards like IFRS become mandatory for in-scope entities? Solution around this needs to be found.

Further, unless not all countries come onboard OECD/G20 framework, there may still be chances that MNEs would take shelter tax favourable countries and remain untaxed.

■■

---

1. OECD (2021), OECD Secretary-General Tax Report to G20 Finance Ministers and Central Bank Governors – July 2021, OECD, Paris, www.oecd.org/tax /oecd-secretary-general-tax-report - g20-finance - ministers-july-2021.pdf.
2. Ibid
3. India joins OECD/G20 Inclusive Framework tax deal – PIB Press Release dated July 2, 2021https://pib.gov.in/Press Release IframePage.aspx?PRID=1732150
4. OECD (2020), Statement by the OECD/G20 Inclusive Framework on BEPS on the Two-Pillar Approach to Address the Tax Challenges Arising from the Digitalisation of the Economy – January 2020, OECD/G20

Inclusive Framework on BEPS, OECD, Paris. www.oecd.org /tax/beps/ statement - by-the-oecd - g20-inclusive - framework - on-beps-january-2020.pdf

5. Ibid
6. Ibid
7. READOUT: U.S. Department of the Treasury's Office of Tax Policy Meetingshttps://home.treasury.gov / news / press-releases / jy0189
8. Finance Minister Smt. Nirmala Sitharaman attendsThird G20 Finance Ministers and Central BankGovernors Meetingby PIB Delhihttps://www.pib.gov.in/PressReleasePage.aspx?PRID=1734499
9. Tax on online ads on Google, Facebook makes govt richer by Rs 939 croreTax on online ads on Google, Facebook makes govt richer by Rs 939 crore – Business Today