What Could NDA 3.0 Consider in order to Embrace BEPS 2.0?

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Manoj Rathi

Partner, Ernst & Young LLP

Anuja Digrajkar

Manager, Ernst & Young LLP

The global tax landscape is undergoing a significant transformation with the introduction of the Base Erosion and Profit Shifting (BEPS) 2.0 Inclusive Framework (IF), developed by the Organisation for Economic Co-operation and Development (OECD) and agreement of over 140 countries to implement the same.

In this article, we navigate the evolving global framework of BEPS 2.0 implementation, offering a concise overview of Pillar One. Our primary focus, however, will be a detailed exploration of Pillar Two, where we will meticulously lay out the landscape and examine the intricate elements that shape this pivotal tax directive. We will also assess the potential impact on India Inc especially should the NDA 3.0 Government choose to adopt Pillar 2 measures in the upcoming Union Budget.

Pillar 1:

<u>Global landscape:</u>

- Pillar 1 of the BEPS 2.0 framework aims to address the tax challenges arising from the digitalization of the economy and to ensure a fairer distribution of taxing rights among countries in a way that reflects where value is created i.e. market countries. This aspect of the framework holds significant implications for major markets like India, as it promises to shift or augment tax revenues in favour of countries where business activities generate economic value.
- On October 11, 2023, the OECD published the Multilateral Convention (MLC) to implement Amount A of Pillar One accompanied by an Explanatory Statement and Understanding on the Application of Certainty. Amount A aims to reallocate a portion of the profits of the largest and very profitable multinational enterprises (MNEs) to the jurisdictions they operate in. However, as there is still no consensus between Inclusive Framework members on certain aspects, the MLC is not yet open for signature.
- The report on Amount B was published in February 2024, providing a simplified approach to the arm’s length principle for baseline marketing and distribution activities. The OECD/G20 Inclusive Framework on BEPS has completed design aspects, allowing jurisdictions to begin with implementation potentially from 1 January 2025. However, additional work on Amount B is ongoing.
- In the meantime, about 18 countries have unilaterally implemented Digital Service Tax (DST)

and is anticipated to be repealed on implementation of Pillar 1. Recently, Canada's Digital Services Tax Act came into force as on 28 June 2024 whereby 3% DST would be levied on companies that provide digital services to Canadian users or sell Canadian user data. The tax is retroactive on sales dating back to January 2022.

India considerations:

Considering that the Pillar 1 Model rules are yet to see the light of the day, India is likely to continue with previously adopted "interim" measures in the form of Equalization Levy as well as the Significant Economic Presence (SEP) provisions.

Pillar 2:

Global landscape:

Pillar 2 of this framework aims to introduce a global minimum tax rate to address the aggressive tax planning strategies employed by large corporations. Till date, the OECD has released detailed model rules, commentaries, administrative guidance notes to provide a framework for countries to implement the GloBE rules effectively. These model rules cover various aspects, including the calculation of the effective tax rate, the blending of taxes across a jurisdiction, carve-outs, and safe harbors.

Various countries have introduced the legislation albeit with partial rules in some cases. An illustrative status summary covering some of India's prominent trade partners is as follows:

Jurisdictions where final legislation is in place	Jurisdictions where draft legislations has been introduced	Jurisdictions which have indicated intention to implement Pillar 2
Most of the European Union nations including Germany, Switzerland, Netherlands, France, Sweden	Australia, Cyprus, Spain, South Africa, Singapore	Hong Kong, Indonesia, Thailand
Japan, United Kingdom, Canada, South Korea, Malaysia, Vietnam		
Mauritius, United Arab Emirates & Qatar (initial provisions introduced)		

As it can be noted from above, global heavyweights viz USA and China are particularly silent on implementation of Pillar 2. It is pertinent to note that the US believes that it already has some measures in place that align with the objectives of Pillar 2, such as the Global Intangible Low-Taxed Income (GILTI) regime. Moreover, with the upcoming elections, the US may be simply waiting to see how other countries implement the rules and to take the guard thereafter to ensure it aligns with US interests.

As many of the world's major economies advance in rolling out the provisions, it becomes crucial for India to follow suit. The rationale is straightforward: without timely implementation, India risks losing its rightful share of tax revenue to other countries through the Under Tax Payment Rule (UTPR). This rule serves as a safeguard, ensuring that if income is taxed below a certain threshold and does not incur a supplementary tax under the Income Inclusion Rule (IIR) in the jurisdiction of the Ultimate Parent Entity (UPE), then other jurisdictions where the Multi-National Enterprise (MNE) operates may invoke the UTPR to levy the necessary tax to satisfy the global minimum rate. This rule acts as a backstop to prevent profit shifting to low-tax jurisdictions and to ensure a global minimum tax rate is effectively paid by MNEs. In a more colloquial sense, India would need to implement it to avoid the pitfalls of FOMO-Fear Of Missing Out- on its tax entitlements.

In the ensuing paragraphs, we have attempted to capture the key impacting provisions that need to be watched out for without deep diving into the myriad of nuances associated with this transformative tax legislation.

Implementation of base rules:

- Subject To Tax Rule (STTR) – the first rule under Pillar 2 is set to be enacted through treaty negotiations and is expected to be adopted via a Multilateral Instrument (MLI) to streamline the process.
- The subsequent rules Qualified Domestic Minimum Top-up Tax (QDMTT), Income Inclusion Rule (IIR) and UTPR (applicable in this very order and cumulatively called as GloBE rules with interlocking nature) are to be incorporated into domestic legislation by individual jurisdictions.
- India as a jurisdiction largely provides for robust rates easily crossing the minimum tax mark of 15% in most cases and hence on a plain reading, it may seem that Indian MNEs exceeding Euros 750 million may need to reassess their engagements in jurisdictions with lower tax rates.
- However, for both Indian MNEs and MNCs having operations in India, the evolving tax landscape presents opportunities to reassess and potentially optimize their tax positions through strategic jurisdictional blending.

What happens to Joint Ventures (JV) or Permanent Establishments?

Under the GloBE rules, separate mechanism/ treatment is provided to determine how to calculate the impact for JVs entities. Further, Permanent Establishment (PE) is treated as a separate Constituent Entity from the Main Entity and any other PE of the Main Entity. This means that if an MNE Group has any PE, each PE is considered an individual entity for GloBE purposes.

Safe Harbour provisions

The OECD's guidance on safe harbour provisions aims to provide certainty and reduce compliance burdens for MNEs which are briefly captured below. The applicability of safe harbour provisions to an Indian MNE will be determinable once the detailed regulations are officially released and notified.

- **Transitional CbCR Safe Harbour (TCSH)** offers temporary relief of non-application of GloBE calculations (and consequential top up tax, if any) at a jurisdictional level during the first three years of the application of GloBE (calendar years 2024, 2025, and 2026) subject to satisfaction of at least one of the three tests de minimis (revenue + profit threshold), simplified Effective Tax Rate (ETR) test or Routine profits test.
- **QDMTT Safe Harbour** offers relief on non-application of GloBE calculation in a jurisdiction by deeming Top-up tax payable under GloBE to be zero. It is pertinent to note that mere introduction of QDMTT by a jurisdiction does not mean that the safe harbour is available to an MNE. QDMTT introduced by a jurisdiction needs to meet prescribed additional conditions in relation to accounting standard, consistency standard and administration standard for it to qualify as a QDMTT safe harbour.
- **Transitional UTPR Safe Harbor** provides a temporary reprieve from UTPR Top-up Tax in the Ultimate Parent Entity (UPE) jurisdiction during the Transition Period if the UPE Jurisdiction has a Corporate Income-tax rate of at least 20%. These provisions come into effect for fiscal years beginning on or before 31 December 2025 and end before 31 December 2026.
- Further, framework for development of **Permanent Simplified Calculation safe harbour** is under progress.

Interplay amongst the above Safe Harbors:

- Depending on the provisions introduced, MNEs may evaluate whether it qualifies for a QDMTT Safe Harbour in a particular jurisdiction or evaluate applicability of Transitional Safe Harbour at a Group level.
- The coexistence of these safe harbours provides MNEs with multiple options to avail reliefs from application of cumbersome GloBE rules in different jurisdictions during the transition period of the Pillar 2 implementation.

Reporting in financial statements and CbCR:

- For groups reporting under International Financial Reporting Standards (IFRS), the IASB has issued a narrow scope amendment to IAS 12 'Income Taxes' that provides temporary relief from accounting for deferred taxes that arise from the implementation of Pillar Two, while also introducing targeted disclosure requirements.
- Similar updates could also be expected in Ind-AS 12: Income taxes which are likely to suggest disclosure such as known/ reasonably estimable information that helps users of financial statements understand the entity's exposure to Pillar Two income taxes arising from the legislation in line with IAS 12. Furthermore, auditors are likely to be tasked with providing insights into the Indian MNEs' adherence to the Pillar 2 regulatory framework.

Accurate reporting has never been so crucial before!

For overseas subsidiaries of Indian MNEs and for Indian subsidiaries of multinational corporations (MNCs), maintaining consistency between the consolidated financial statements of the Ultimate Parent Entity (UPE) and the Country-by-Country (CbC) reporting is of paramount importance. These documents must accurately represent the financial position and activities of the constituent entities within each jurisdiction. Such alignment is essential not only for adhering to global tax reporting standards but also because tax authorities will scrutinize these reports in comparison with local filings and publicly available information. Discrepancies could lead to regulatory challenges and reputational risks, underscoring the need for meticulous financial reporting and transparency.

GloBE Information Return (GIR):

- MNEs will likely be required to file a GloBE information return that includes the calculation of the effective tax rate (ETR) for each jurisdiction, the application of the IIR and UTPR. This return would detail the income, taxes paid, and any top-up tax owed under the GloBE rules.
- Similar to CbCR, it is expected that the GloBE Information Return would be filed by the Ultimate Parent Entity with the countries entering into Information Exchange Agreement to share the relevant information and thereby discharging Constituent Entities discharged from this requirement. However, where such agreements are not entered into, there could be GIR filings in multiple jurisdictions.
- Additionally, it is anticipated that domestic legislation will mandate separate Pillar 2 filings, potentially amplifying the compliance burden not only for Indian companies with international headquarters but also for local subsidiaries of foreign MNCs.

Key insights on some of the countries which have already introduced additional filing requirements are as follows:

Belgium: On 2 July 2024, the Belgian Tax Authorities published on their website that in-scope groups that will not make (Belgian) advance payments for purposes of the 2024 QDMTT and/or 2024 IIR may submit their Pillar 2 Notification Form by 16 September 2024.

Sweden: The Swedish Procedural Act states that a registration is due 15 months after the end of the fiscal year in which the registration requirement arose. i.e. 15 months after end of 31 December 2024 the earliest i.e. 31 March 2026. This also aligns (partly) with what the Swedish Tax Agency writes on their website where they state that no information is due to them before 28 February 2026. The Swedish Tax Agency is also clear on saying that they will publish more information around the registration requirements in due time before any deadline and that corporations do not need to take any actions as of now.

UK: In scope multinational and domestic groups with at least one entity in the UK must register with HMRC within 6 months of the end of the first accounting period that started on or after 31 December 2023 which makes them subject to the IIR and QDMTT rules.

Vietnam: MNE group is required to determine a CE that is responsible to declare and pay top-up tax for a MNE as provided under the guidance.

Call to action for MNEs with global footprint to embark on the BEPS Pillar 2 journey:

- Assess tax impact which includes understanding the Pillar 2 requirement, determining data readiness, collating data, undertaking modelling to determine country by country impact, improving tax strategies.
- Evaluate Safe Harbours which includes ensuring that CbCR reflects contemporaneous view of the group profile.
- Develop a compliance roadmap which includes preparing the systems for interim compliances as well as eventual Pillar 2 GloBE returns.
- Continuous monitoring and analysing impact of regulations across jurisdictions

Conclusion:

As India gears up for its budget, the anticipation around the incorporation of BEPS 2.0 Pillar 2 regulations is palpable. The move is expected to be a significant step in curbing tax avoidance and ensuring tax equity. However, it is imperative for India to carefully design these regulations to balance the need for tax revenue with the competitiveness of its economy. The forthcoming changes will significantly affect companies headquartered in India, as well as the Indian subsidiaries of multinational corporations. It is essential for these organizations to keep up to date with the latest developments and to prepare adequately for the changes that lie ahead. India's approach will also be closely watched by other developing countries as they formulate their own responses to the global minimum tax initiative.