All about Two-Pillar Solution!! -Part-2

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➢ **All About Two Pillar Solution!! Part-2**

In the previous series, we have gone through the basics of the Pillar One comprising under Two Pillar Solution. Pillar One mainly focuses on the allocation of the residual profits to market jurisdiction/countries based on the newly defined nexus and attribution rule. Whereas on other side, this Pillar Two focuses on the introduction of global minimum corporate tax. It also contains several proposals that have direct nexus on the tax policies of the individual countries that are part of the OECD BEPS Inclusive framework. With this, now, let us grab an idea about what exactly this Pillar Two talks about.

❖ **Pillar Two**

Pillar two is specifically designed to ensure that the multinational organisations pay a certain minimum amount of tax in countries/jurisdiction in which they operate. Currently, many countries / jurisdictions offer low tax/nil tax to attract foreign direct investment in their respective countries / jurisdictions. Pillar Two puts a floor on tax competition on corporate income tax through the introduction of a global minimum corporate tax at a rate of 15%, that countries can use to protect their tax bases. Pillar two mainly consists of the:

i. Global Anti-Base Erosion Rules (GloBE) rules: -

ii. Subject to Tax Rule (STTR): -

Now, let us understand individually that, what these above two rules speak about.

➢ **Global Anti-Base Erosion Rules (GloBE) rules: -**

The GloBE rules, a set of Interlocking rules i.e. (a) an Income Inclusion Rule (IIR) (b) an Undertaxed Payment Rule (UTPR). An IIR is mainly focuses on the imposition of the top-up tax on a parent entity in respect of the low taxed income of the constituent entity, on other hand UTPR 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. IIR is basically main mechanism to achieve targets of GloBE rules with UTPR acting as a backstop. IIR operations are, in some respects, based on traditional Controlled Foreign Company (CFC) principles and trigger inclusion at the shareholder level, UPE or intermediate parent entity. The UTPR is a secondary rule and only applies where a Constituent Entity is not already subject to an IIR.

- **Scope:** GloBE rule will apply to MNEs that meet EUR 750 million threshold. The concepts and threshold are adopted from the country-by-country reporting mechanism prescribed under BEPS Action 13. Here, it may be noted that in case of IIR, jurisdiction/countries are allowed flexibility to adopt lower revenue threshold.

  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.

- **ETR Calculation:** The top-up tax will be imposed using effective tax rate (ETR) test, ETR will be calculated by dividing total amount of covered tax by an amount of an income as determined according to the GloBE rules (i.e., mainly after providing certain adjustments). ETR will be calculated at jurisdictional level. Top-up tax is determined as the excess of the agreed minimum tax over the ETR.

  Moreover, in respect of existing distribution tax systems, there will be no top-up tax liability if earnings are distributed within 4 years and taxed at or above the minimum level.

- **Minimum Rate:** The minimum tax rate used for the purpose of IIR and UTPR is proposed at 15%. Thereby, suppose if ETR works out to be 10%, then in such case top-up tax will 5% (i.e., Minimum tax rate minus ETR).

- **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. Moreover, it has also been proposed to provide exclusion from the UTPR for such MNEs in the initial phase of their international activity, (i.e., basically defined as MNEs that have a maximum of EUR 50 million tangible assets abroad and that operate in no more than 5 other judications). However, this exclusion is limited to a period of 5 years after MNEs comes into the scope of the GloBE rules for first time.

- **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, declining annually by 0.2 percentage points for the first five years, and by 0.4 percentage points for tangible assets and by 0.8 percentage points for payroll for the last five years.

  The GloBE rules will also provide for a de minimis exclusion for those jurisdictions where the MNE has revenues of less than EUR 10 million and profits of less than EUR 1 million.

➢ **Subject to Tax rule (STTR): -**

It is basically treaty-based rule, that allows source jurisdictions to impose limited source taxation on certain related party payments that are subject to tax below the minimum tax rate. It mainly focuses on such cross-border structures which involve intra group payments specifically designed to grab an advantage of treaty and ultimately shifting profit from high tax jurisdiction to low tax jurisdiction. It applies to payments like royalties, interest, and other set of payment as may be defined.

STTR provides for an increased rate of withholding under the tax treaties on certain payments, which are not appropriately taxed in the recipient jurisdiction. The trigger rate is finalised at 9%. Here the taxing right will be limited to difference between the minimum rate for STTR and the applicable tax rate on the covered payment. It may be noted that the STTR paid will be creditable as a covered tax under the GloBE rule. Therefore, unlike IIR or UTPR, the STTR is not concerned with effective tax rate (ETR); instead, it looks to the nominal tax rate that applies to certain covered payments between connected persons.

❖ **Implementation Plan-Pillar Two: -**

Pillar Two is expected to be brought into law in 2022, to be effective in 2023, with UTPR coming into effect in 2024. Apropos this Pillar Two, the global minimum tax, with rate of 15%, is expected to generate around USD 150 billion as additional global tax revenues per year.

❖ **Conclusion: -**

Under the current international tax regime, there are heaps of differences in the tax rates charged by various countries. Certain types of the payment are exempt altogether in certain countries whereas others are subject to double taxation. This Two Pillar solution represents historic development and seeks to re-write the existing tax laws and will mostly affect the large entities. In supplement to benefit in terms of overall tax revenue, additional benefits will also be expected to arise in form of stabilisation of the international tax system and the increased tax certainty for taxpayers and tax administrations mainly due to implementation of this Two Pillar Solution.