ITRAF - Latest Developments in OECD's Pillar One and Pillar Two Tax Proposals

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Pillar One - Concept and Framework

Concept

- Revisit tax allocation rules to benefit **market jurisdictions**
- **New nexus rules - created based on sales** rather than physical presence
- Two-tier profit allocation mechanism:
  - ***Amount A:*** Portion of **non-routine profits** allocated to market jurisdictions
  - ***Amount B***: Fixed return for baseline marketing and distribution activities

Framework

- Blueprint reflects extensive technical work done, but key details yet to be agreed
- Rules consider MNE group as a whole rather than entity-by-entity
- Significant focus on development of dispute prevention and resolution mechanisms
- Implementation details under development – may require changes to domestic law and a new multilateral convention

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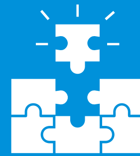
Pillar One Blueprint - Scope and Coverage

What businesses are included?



- **Automated Digital Services ('ADS'):** Digital services requiring minimal human intervention. Includes online advertising, search engines; social media, digital content, online gaming etc.
- **Consumer Facing Businesses ('CFB"):** generating revenue from sale of goods or services of a type commonly sold to consumers
- **Proposed exclusions**: Natural resources, financial services, construction, airline and shipping
- **Global Revenue Threshold: €750 million** on a consolidated basis

When does the market jurisdiction get taxing rights?

- **Nexus rule for ADS:** to be solely based on revenues in the market jurisdiction - expected to be set below €5 million
- **Higher nexus standard for CFBs**: Market Revenue (as above) + '***Plus Factors***' (subsidiary, PE, higher revenue etc.)
- **Detailed revenue sourcing rules:** to determine where revenue is deemed to arise for scope and nexus,

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Pillar One Blueprint - Calculation of Amount A

What does the market jurisdiction get to tax?

Step 1: Identify residual profits
Routine profits based on fixed PBT to Revenue threshold % age - yet to be determined (10% threshold floated)

Step 2: Allocate residual profits to market jurisdictions
Apply a reallocation % age to identify the share of residual profits to allocate to market jurisdictions (20% of residual profit floated)

Step 3: Allocate Amount A among market jurisdictions
Pro-rata allocation based on Revenue earned in each market jurisdictions

Worldwide Revenue	(A)	25,000

Total profits	(B)	6,500

Step 1: Identify Residual Profits		
Identify routine profits assuming a 10% threshold	(C) = (A) x 10%	2,500
Identify residual profits	(D) = (B)-(C)	4,000

Step 2: Allocate Residual Profit to Market Jurisdictions		
Residual profits allocable to market jurisdictions - assuming a 20% reallocation %	(D) X 20%	800

Step 3: Allocate Amount A to each market jurisdiction				
	Country X	Country Y	Country Z	Total
Revenue from each country	2,000	18,000	5,000	**25,000**
Share of residual profits	64	576	160	**800**

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Pillar Two - Global Anti-Base Erosion (GloBE) & Subject to tax rule

Pillar Two – Towards Global Minimum Taxation!

Who is under the lens?

Not restricted to businesses covered by Pillar One

Excluded entities:

- Investment entities
- Pension funds
- Non-profit organizations, etc.

What is the global minimum tax rate?

Complexities for timing differences and losses

Tax base: Parent consolidated FS, with adjustments

Treaty based changes

STEP 1 – Subject to tax rule: *Payer:* Top up tax withheld for undertaxed covered payments

STEP 2b – Switch-over rule: *Head office of branch:* Switch from exemption to credit where branch income is below minimum rate

Income not subject to tax at a minimum rate

STEP 2a – Income inclusion rule: *Ultimate Parent Co:* Top up tax applied where controlled entity tax is below minimum rate

STEP 3 – Undertaxed payments rule: *Payer:* Deny a deduction for payments to entity taxed below minimum rate

Domestic law changes

Jurisdictional blending for IIR/UTPR

Covered taxes: taxes on profits, WHT, CFC

Ordering rules

Shortfall to be recovered through a 'Top-up Tax'

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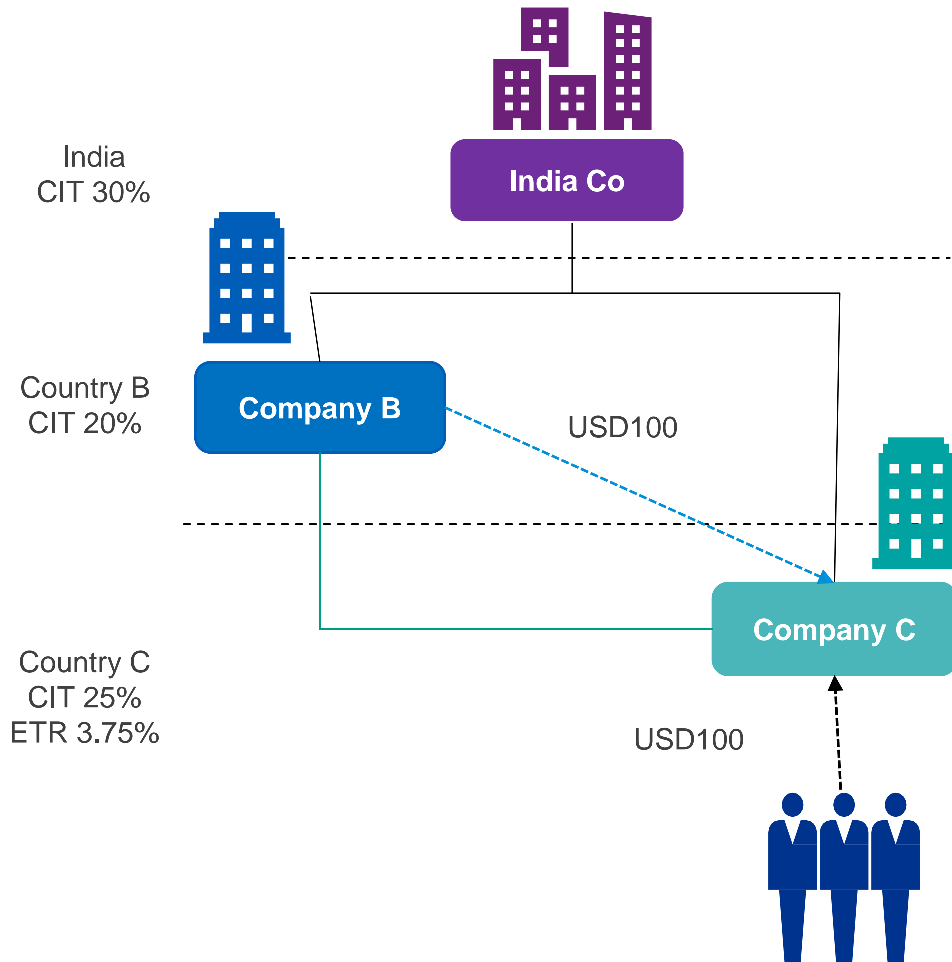
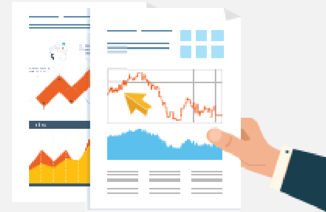
Example - Indian HQ



Assumptions:

- STTR trigger rate 7.5%; Global min tax rate 12%
- Company C local statutory rate 25%, but special regime reduces tax to 20% of normal rate (i.e. 5%). All third-party income tax exempt.
- Company B ETR 20%



Rules application:

		Tax paid in:
Step 1: Apply STTR		
Company C special regime tax rate	5%<7.5%	
WHT under STTR	2.5%*100=**2.5**	Country B
Step 2: Apply IIR (assuming India introduces IIR)		
Company B ETR	20%>12%, No need to include in IIR	
Company C ETR	(5+2.5) / (100+100) =3.75%<12%	
Company C top-up tax	200* (12%-3.75%) =**16.5**	India
Step 3: Apply UTPR (assuming India does not apply IIR and Country B introduces UTPR)		
Company C top-up tax	16.5	
Company B denied deduction under UTPR	16.5/20%=**82.5**	Country B

Incremental tax of 19 imposed on undertaxed income of Company C - ETR increases to 12%

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Example - Indian HQ

UN Proposition under Article 12B:

Impact on IF Consensus?

Activity test :

Distinguishing between what is a covered by activity test and what is not - potential for classification disputes?

Plus factors for CFB:

Could add subjectivity to otherwise objective criteria - increased ambiguity and litigation?

Pillar 1

STTR:

Inclusion of capital gains under consideration for STTR – Impact on grandfathering under India's treaties

Interaction with other tax enforcement measures:

For e.g., Use Indian residency rules (POEM) vis-à-vis foreign subs

Pillar 2

Implementation:

- Legislating model provisions, direct use of IF guidance by tax authorities
- Administrative challenges
- Ensure that compliance burden does not increase disproportionately in relation to the overall tax benefit

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Thank you

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