PILLAR ONE & PILLAR TWO

STRENGTHENING THE FOUNDATION

K C Mehta & Co LLP
Chartered Accountants

BASICS

Q1 What is BEPS 2.0?

Base Erosion and Profit Shifting (BEPS) relates to avoidance of tax by Multinational Enterprises (MNEs) by use of harmful tax strategies or exploitation of loopholes in tax rules to artificially shift profits to low or no-tax jurisdictions, especially not backed by corresponding economic activity.

BEPS 2.0 is aimed at continuing to address challenges from digitalisation of economies, after successful conclusion of BEPS 1.0 Project.

OECD/ G20 BEPS Project - Addressing challenges from digitalisation of economy

Creation of G20 Inclusive Framework with 147 members till date

G20 countries agreed to work together to ensure a consistent and co-ordinated implementation of the BEPS recommendations

Inception of Two-Pillar Solution in October 2021

Over 135 Inclusive Framework members, representing more than 95% of global GDP, agreed on a ***two-pillar solution*** to reform the international taxation rules to avoid BEPS

Pillar 1 (Amount A and Amount B)

Aims to achieve fairer distribution of profits and taxing rights among countries.
Contains ***new nexus rules*** for allocation of profits and re-allocation of taxing rights to market jurisdictions, irrespective of physical presence or Traditional PE.

Pillar Two - Global Anti base erosion (Global Minimum Corporate Tax)

Prescribes a global minimum tax rate of 15% on jurisdiction basis.
Imposes a Top-up Tax on profits arising in a jurisdiction where effective tax rate is lower than 15%

Q2 What is Pillar One?

The taxing rights of a 'market' jurisdiction are being discussed with increasing urgency in recent times. Countries with large customer base have already unilaterally begun levy of taxes in the form of *digital services tax* in order to gain taxing right on the profits earned by large MNEs from making sale in their jurisdictions. Pillar One determines *where* companies should pay taxes (as against Pillar Two which is focussed on *how much* that tax should be).

Pillar One primarily results in large MNE groups being subject to tax in jurisdictions where its end customers or digital users are located, even if it does not have a presence of permanent nature in that jurisdiction.

Pillar One comprises of two sections (i) Amount A and (ii) Amount B, which are discussed hereunder.

Pillar One determines *where* companies should pay taxes (as against Pillar Two which is focussed on *how much* that tax should be).

Q3 What is Amount A of Pillar One?

Amount A updates the international taxation framework for large and very profitable MNEs. It applies to MNEs with global revenue over EUR 20 billion and total profits greater than 10% of their global revenue.

- Amount A seeks to reallocate taxing rights over a portion of the excess profit (i.e., profit in excess of 10% of revenue) from residence country to selected market jurisdictions that satisfy the quantitative nexus test.
- This reallocation will be based on revenue sourcing rules with a corresponding obligation to relieve double taxation and is proposed to be implemented through Multilateral Convention to implement Amount A of Pillar One ***(the MLC)***, which has been released by the OECD in October 2023.

Q4 What is Amount B of Pillar One?

Amount B simplifies the existing transfer pricing rules for baseline marketing & distribution activities. It applies without a revenue / profitability threshold and jurisdictions can choose to apply the Amount B approach to qualifying transactions of eligible baseline distributors resident in their jurisdictions for fiscal years starting on or after January 2025.

- The primary focus of Amount B is on baseline wholesale distributors (including commissionaires and sales agents) of tangible goods i.e., services (including digital services) or commodities are specifically excluded.
- The term baseline means that in order to qualify as in-scope distributor, there should be no assumption of economically significant risk or ownership of unique / valuable intangibles.
- The arm's length range of margin for in-scope distributors would depend on a number of factors, such as (i) industry grouping, (ii) operating asset intensity i.e., operating assets as a % of net sales, (iii) operating expense intensity i.e., operating expenses as a % of net sales, (iv) risk adjustment for certain qualifying jurisdictions, etc.

On a *principle* basis, India has flagged multiple reservations for computation mechanisms provided within guidance for Amount B, as well as for absence of qualifying criteria for being covered within 'low capacity jurisdictions' and 'qualifying jurisdictions'. It appears unlikely that unless these primary concerns are addressed, India would, as a jurisdiction, subscribe to this approach where profits of in-scope distributors are capped at 1.5% - 5% (margin over sale) as prescribed within this guidance.

Q5 What is Pillar Two?

Pillar Two comprises of two sections (i) Global Anti-Base Erosion (GloBE) Rules, and (ii) the Subject to Tax Rule (STTR) that are designed to ensure that large MNEs pay a minimum level of tax on the income arising in each jurisdiction where they operate.

The GloBE rules are the core Pillar Two rules, which seek to apply a minimum of 15% tax on a jurisdiction-basis to in-scope multinationals.

STTR is, in effect, a treaty-override provision which permits the source country to tax gross amounts of royalties, interest and other defined payments received by connected company at the rate of 9%, even where the treaty provides for a lower tax rate or even where the treaty provides exclusive taxing right to the country of residence.

Q6 What are GloBE rules under Pillar Two? Which entities are impacted by GloBE rules?

As mentioned above GloBE rules are intended to end the *"race to the bottom"* in context of tax rates and ensure that MNEs are subject to a minimum of 15% effective tax in any jurisdiction.

GloBE rules are intended to end the *"race to the bottom"* in context of tax rates and ensure that MNEs are subject to a minimum of 15% effective tax in any jurisdiction.

- GloBE rules are applicable to Constituent Entities (CEs) of MNE groups having a total consolidated group revenue of EUR 750 million or more as per Consolidated Financial Statements (CFS) of the Ultimate Parent Entity (UPE) i.e., the thresholds are same as are applicable for the purpose of preparation of Country-by-Country Reports (CbCR) by MNE groups.
- Important to note that where a group does not have any international presence i.e., no legal entity or Permanent Establishment (PE) in more than 1 country, GloBE rules will not be applicable.
- A key element of GloBE rules is that it permits for jurisdictional blending i.e., Effective Tax Rate (ETR) of all constituent entities in a country taken together is considered to evaluate whether 15% tax is paid by the entities on a collective basis.

Q7 What is Subject to Tax Rule (STTR)?

STTR is a treaty-based rule (to be incorporated in tax treaties through Multilateral Instrument) that has priority over GloBE rules. STTR will allow countries to retain their taxing right, which they may have otherwise ceded under a tax treaty, on certain payments made to related parties abroad which often pose BEPS risks, such as interest, royalties, service fees, guarantee or financing fees, etc.

It allows developing countries to “tax back” where certain intra-group payments are subject to nominal corporate income tax rates below 9% in recipient’s jurisdiction and withholding tax at a rate less than 9% in payer’s jurisdiction. There are certain applicability thresholds in context of volume of transactions for STTR to be applicable. STTR may be applicable even if MNEs are not subject to GloBE rules based on the applicability thresholds.

STTR may be applicable even if MNEs are not subject to GloBE rules based on the applicability thresholds.

It is important to note that taxes imposed under the STTR are to be levied after the end of the fiscal year in which they arise and not as a withholding tax.

The Multilateral Convention to Facilitate the Implementation of the Pillar Two Subject to Tax Rule (STTR-MLI) was adopted by the OECD/G20 Inclusive Framework on BEPS on September 15, 2023 and has been opened for signatures since October 2, 2023. The current number of signatories to STTR MLI or status of discussion with countries is unknown. Based on publicly available information, a signing ceremony of MLI for STTR is planned in September 2024 in Paris and hence more information may be available closer to September 2024.

GLOBE RULES
AN INTERNATIONAL TAX ON GLOBAL INCOME

Q8 What is a constituent entity?

Any entity, including a PE, would be considered a CE if its financial statements are consolidated on a line-by-line basis in CFS of UPE. Excluded entities are not considered CEs. Consequently, any branch office, project office or liaison office which qualifies as a PE would also be considered as a CE for the purpose of GloBE rules.

Q9 What are Excluded Entities?

There are certain entities that are defined as *Excluded Entities* in the GloBE rules i.e., governmental entities, international organisations, non-profit organisations and pension funds. Investment funds or real estate investment vehicles are also considered as Excluded Entities if they are UPE of an MNE group.

In certain cases, entities that are owned by an Excluded Entity are also considered Excluded Entities, if they meet the specific thresholds of % of holding, activity carried out, nature of income, etc.

While these entities are to be considered for the purpose of computing total consolidated revenue of the MNE group, these entities are excluded from Top-up Tax and related compliance requirements.

Q10 How do GloBE rules implement global minimum tax?

As discussed in the *Basics* section, GloBE rules are intended to implement a global minimum tax on a jurisdictional basis at an Effective Tax Rate (ETR) of 15%. ETR is the ratio of the adjusted Covered Taxes for all CEs in the jurisdiction to the Net GloBE income for all CEs in the said jurisdiction.

Where ETR in a particular jurisdiction is lower than 15%, an additional tax will be levied to bring the total tax up to the minimum rate, called the *Top-up Tax.*

Provisions are also in place to provide a deduction for *Substance Based Income Exclusion (SBIE)* while computing Top-up Tax. SBIE is a reduction from GloBE profits which is based on tangible assets and employee costs in a jurisdiction.

The Top-up Tax payable is reduced by any *Qualified Domestic Minimum Top-up Tax (QDMTT),* which is domestic minimum tax that a jurisdiction can opt to levy in order to retain taxing right over low-taxed profits in that jurisdiction.

Q11 What is SBIE or the Substance Carve-out?

SBIE is primarily aimed at providing some relief to entities with genuine economic activities from the application of Top-up Tax under GloBE rules. Since SBIE / substance carve outs are based on employee costs and tangible assets, it allows jurisdictions to continue to provide tax incentives to entities on the basis of investments / expenditure without triggering GloBE rules. SBIE benefits jurisdictions which provide investment-based tax incentives as against income-based tax incentives and will particularly benefit companies that are part of capital-intensive industries.

SBIE / substance carve outs are based on employee costs and tangible assets, it allows jurisdictions to continue to provide tax incentives to entities on the basis of investments / expenditure without triggering GloBE rules.

SBIE, at its core, is a formulaic mechanism to reduce the tax base on which global minimum tax would be computed. It provides for carving out of two critical components, considered to be less mobile and hence, less likely to be taken undue advantage of for tax avoidance purposes –

- Eligible payroll costs – 10% of average payroll costs of eligible employees (gradually would be reduced to 5% over next 10 years)
- Eligible tangible assets – 8% of average eligible tangible assets (gradually would also be reduced to 5% over next 10 years)

Q12 Who is liable to pay the Top-up Tax and where?

While the computation of Top-up Tax is on the basis of jurisdictional blending, the levy of Top-up Tax is on an entity level. GloBE rules provide for multiple ways in which Top-up Tax may be levied. The order in which application of various rules provide for this Top-up Tax to be levied is as under –

- QDMTT applies first in the rule order. Where ETR in a particular jurisdiction is less than 15%, this provision allows the jurisdiction to collect Top-up Tax in respect of any low-taxed profits of a group in that jurisdiction. Hence it allows a jurisdiction to collect Top-up Tax within its borders, rather than letting other jurisdictions collect those taxes

If a jurisdiction does not opt to apply QDMTT, the right to tax Top-up Tax passes on to the UPE under *Income Inclusion Rule (IIR).*

Also, under QDMTT, not entirety of Top-up Tax may be levied in the jurisdiction where the differential arises. The balance of such original Top-up Tax as reduced by QDMTT would also pass on the basis of IIR.

QDMTT will be governed by local tax regulations and hence, entity subject to QDMTT, mechanism, etc. would have to be incorporated into local tax regulations. Model rules are available under GloBE which jurisdictions can refer to while drafting the local regulations.

- The IIR applies on a top-down basis and hence UPE is primarily liable for Top-up Tax of all low taxed constituent entities (LTCE). IIR is payable in the jurisdiction of the UPE. Where the UPE jurisdiction has not adopted IIR, the Top-up Tax is imposed on the next Intermediate Parent Entity (IPE).

An exception to the top-down approach applies in split-ownership situations. A *Partially Owned Parent Entity (POPE)* applies the IIR in priority over the UPE / IPE based on its Allocable Share of the Top-up Tax. (POPE is a CE that has more than 20% of its Ownership Interests held by non-group members.)

This ensures that the income of a LTCE is subject to the IIR without making UPE / IPE liable to Top-up Tax for income that it does not entirely own. Furthermore, an IIR offset mechanism is available, whereby UPE / IPE that applies the IIR is given a credit for the Top-up Tax levied at POPE's level through a credit mechanism.

- The *Under-Taxed Payments Rule (UTPR)* operates as a last resort to levy the Top-up Tax. Where not all Top-up Tax is collected under the QDMTT or IIR, the liability of the Top-up Tax falls on the other CEs of the MNE group in a ratio comprised of number of employees and tangible assets in their jurisdictions.

UTPR is a measure introduced to prevent jurisdictions from providing an advantage to the MNEs located in their jurisdictions from liability of Top-up Tax. It is noteworthy that UTPR is not applicable only to tax LTCE that are co-subsidiaries / affiliates. It would also be applicable if the UPE is located in a low-taxed jurisdiction and has an ETR lower than 15%. In such a scenario, the Top-up Tax in respect of low-taxed income of the UPE would be taxed in jurisdictions of its subsidiaries.

QDMTT – Source country i.e., the country where the differential arises may opt to introduce QDMTT, whereby it can tax a portion of low-taxed profits of its jurisdiction, rather than passing the taxing rights on to UPE / IPE.

IIR - POPE – In case of split ownerships, the first liability for Top-up Tax lies with the POPE

IIR - UPE / IPE – UPE / IPE have the next liability for Top-up Tax to the extent of their allocable share of the Top-up Tax

UTPR – Where complete IIR is not collected through QDMTT / IIR, the liability falls on other CEs of the MNE group in a specified ratio

Q13 What is the treatment of Joint Ventures for the purpose of GloBE rules?

GloBE rules differ from Action 13 (CbCR & Master File) on the treatment of a Joint Venture (JV) to some extent.

For being considered as a CE for Action 13, a JV was considered if it was consolidated on a line-by-line basis for CFS of UPE. That continues to be the case for GloBE rules as well. Any JV that is consolidated on a line-by-line basis shall be considered as a part of the MNE group (in the proportion of ownership of the JV) in the same way as any other CE.

However, where all JVs accounted under *Equity Method* were excluded for Action 13, they would be considered for limited application of GloBE rules based on the following criteria –

- Where the UPE holds, directly or indirectly, at least 50% of ownership interests (equity interests that carries the right to profits, capital or reserves of an entity) in the JV, the ETR of the JV group (JV together with its subsidiaries) is computed separately from the rest of MNE group.
- Top-up Tax is calculated at the level of JV group and is levied from the UPE / IPE / other MNEs under IIR / UTPR in the proportion of ownership percentage in the JV group.
- Where the JV is an UPE of an in-scope MNE for Pillar Two on the basis of its total consolidated revenue, the above does not apply.

Q14 Are there any exclusions or exemptions for small entities?

Under *De Minimis Exclusion,* where (i) average GloBE Revenue in a jurisdiction is less than EUR 10 million and (ii) average GloBE Income or Loss of such jurisdiction is either a loss or less than EUR 1 million computed on a three-year average basis, Top-up Tax can be deemed as zero for CEs located in such jurisdiction.

Under De Minimis Exclusion, where (i) average GloBE Revenue in a jurisdiction is less than EUR 10 million and (ii) average GloBE Income or Loss of such jurisdiction is either a loss or less than EUR 1 million,
Top-up Tax can be deemed as zero for CEs located in such jurisdiction.

Q15 What is a Covered Tax? Would the payment of MAT and STTR be included as a Covered Tax?

Covered Taxes include taxes recorded in the financial accounts of a CE, taxes on distributed profits, taxes imposed in lieu of a generally applicable corporate income tax, taxes levied on retained earnings and corporate equity, etc.

Covered Tax is required to be adjusted for timing differences, allocations to other jurisdictions in case of CFC taxes, allocations of dividend taxes to jurisdiction of MNE distributing certain dividends, etc. for computing jurisdictional ETR.

- **Minimum Alternate Taxes (MAT):** Covered Taxes include taxes paid "in lieu of" normal taxes and this concept also covers taxes that are imposed on an alternative basis, and which are used as substitutes for a generally applicable income tax under the laws of the jurisdiction. Accordingly, MAT paid would be a Covered Tax for GloBE rules.
- **STTR:** Covered Tax also includes tax paid under STTR which effectively reduces Top-up Tax liability under GloBE rules. Covered Taxes however exclude any amount pertaining to Top-up Taxes accrued under QDMTT, IIR, UTPR, etc

Q16 Are intra-group incomes and taxes thereon included in calculation of GloBE Income?

Financial statements are to be considered before any consolidation adjustments eliminating intra-group transactions. However, certain adjustments are required to be made to the Financial Accounting Net Income or Loss (FANIL) for arriving at GloBE Income. Such adjustments include net tax expense, excluded dividends, excluded equity gain or loss, asymmetric foreign currency gains or losses, included revaluation gain / loss, etc. Hence, intra-group incomes and taxes thereon are included in calculation of GloBE Income.

Q17 What are the mechanisms for addressing timing differences and how would this impact Deferred Tax Assets (DTA) / Deferred Tax Liabilities (DTL) of a CE?

As GloBE tax is calculated based on accounting profits, GloBE rules leverage the deferred tax accounting mechanisms to adjust for differences in timing of recognition of incomes and expenses for accounting vis-a-vis tax purposes. When an income is recognised in financial statements but the same is yet to be offered for local corporate income tax purposes, a credit is allowed under GloBE rules from Top-up Tax for DTL on such income calculated a rate capped at 15%.

- As an anti-avoidance measure, GloBE deferred tax accounting mechanism provides for a number of adjustments to and limitations on the use of DTL. The rules also provide a safeguard that DTL that does not reverse in five years should be recaptured and that the MNE Group shall be required to recompute its ETR excluding such DTL and pay any additional Top-up Tax where DTL is not reversed within 5 years.
- On May 23, 2023, the International Accounting Standards Board (IASB) issued amendments to IAS 12 Income Taxes, clarifying its application to income taxes arising from laws implementing the OECD/G20 Inclusive Framework on BEPS Pillar Two model rules. The amendments introduce a mandatory temporary exception for accounting for deferred taxes due to these rules and require disclosures to help users understand an entity's exposure to Pillar Two income taxes.
- The Accounting Standards Board of Institute of Chartered Accountants of India on July 25, 2023 has issued Exposure Draft of International Tax Reform—Pillar Two Model Rules - Amendments to IND-AS 12 and AS 22 corresponding to amendments to IAS 12 issued by IASB.

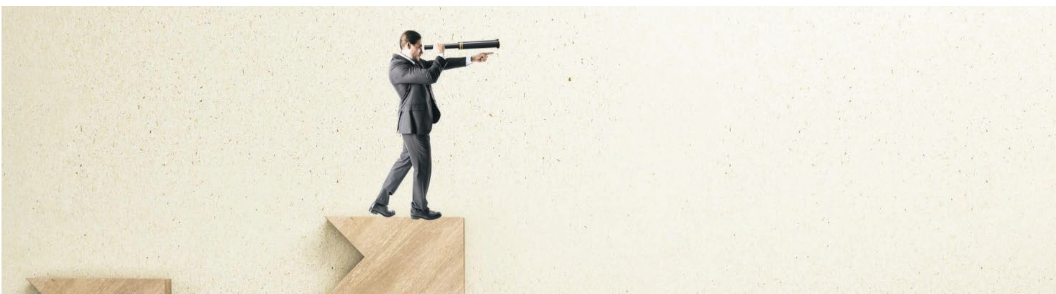
The Accounting Standards Board of Institute of Chartered Accountants of India on July 25, 2023 has issued Exposure Draft of International Tax Reform—Pillar Two Model Rules - Amendments to IND-AS 12 and AS 22 corresponding to amendments to IAS 12 issued by IASB.

Q18 Do GloBE rules apply to loss making CEs? Do the GloBE rules include provisions for the carry forward of losses?

- Unless de-minimis exclusions apply, loss making CEs may also have Top-up Tax liabilities due to jurisdictional blending with other profitable CEs.
- MNEs that incur losses in low taxed jurisdictions may elect to be allowed carry forward of losses in form of deemed GloBE Loss Deferred Tax Asset determined by multiplying jurisdictional GloBE Loss by the 15% minimum rate to be offset against tax GloBE income in future years. The GloBE also rules provide a transition rule to take into account losses that have been incurred prior to the effective date of the rules.

Q19 Will the POPE / UPE / IPE / other group entities be given credit if their ETR is higher than 15% while discharging Top-up Tax for a LTCE?

- The GloBE rules are not mandatory but have been agreed as a "common approach". This means that jurisdictions are not required to adopt the GloBE rules, but if they choose to do so, they agree to implement and administer them in a way that is consistent with the agreed outcomes set out under the GloBE rules. An MNE group is subject to the GloBE rules once any jurisdiction in which the group operates has incorporated the GloBE rules in its domestic law.
- In case the jurisdiction of LTCE does not adopt QDMTT, the Top-up Tax calculated for that jurisdiction ought to be borne by the POPE / UPE / IPE / other group entities located in other jurisdictions which have adopted IIR / UTPR under GloBE rules. Hence if a POPE / UPE / IPE / CE of a MNE Group is a high-tax paying entity, it may still be required to discharge its allocable portion of top up tax calculated in respect of other CEs of the group which are Low Taxed CEs.



Q20 How will the introduction of the GloBE rules affect tax incentive schemes, particularly for IFSC gift entities that currently enjoy a tax holiday?

- In general, Pillar Two aims to discourage the "race to the bottom" where jurisdictions incentivise companies in form of favourable tax regime to attract investments in their jurisdictions.
- However, GloBE rules recognize tax incentives focused on substance creation in their jurisdictions. SBIE provides relief to LTCE that are part of labour / capital intensive industries or are creating a substance in the jurisdictions in which they exist in form of employees / tangible assets. Jurisdictions thus providing tax incentives on the basis of expenditure / tangible investments will fare better than jurisdictions providing tax incentives on the basis of income / profits.
- IFSC units are provided tax incentives on the basis of income. Hence, units in IFSC that have setup an office without corresponding investment in tangible assets / employees will not be able to claim continuous tax incentives if GloBE rules are introduced. MNEs with both IFSC and non-IFSC operations may be able to benefit from jurisdictional blending at India-level.
- Noteworthy that while the IFSC tax incentives are provided on income, the government does intend units in IFSC to have substance rather than just establish an office space which is why regulatory provisions are in place which require commensurate investment in assets and employees to obtain an approval for setup in IFSC. Hence, the intention of incentivising IFSC is not far off from what is envisaged in GloBE rules.
- Currently, there are no Tax Sparing provisions under the GloBE rules. [Tax sparing provisions are a feature in some tax treaties where one country agrees to give credit for the tax that would have been paid in the other country but for a tax incentive, such as a tax holiday or exemption, provided by that other country.]

Q21 Are there specific deadlines set by the OECD for the payment of Top-up Tax? How would this affect withholding tax obligations for Indian payers if India adopts the GloBE rules?

The existing withholding tax obligations would continue to apply even if India adopts GloBE rules.

- The existing withholding tax obligations would continue to apply even if India adopts GloBE rules.
- The due date for payment of any Top-up Tax liability is dependent on the country implementing the GloBE rules. The GloBE rules should be implemented and administered in such a way that any Top-up Tax liabilities incurred are due and paid within a reasonable period and in line with the intended outcomes under the GloBE rules.
- The Top-up Tax under GloBE rules is to be paid basis the consolidated financial statements and hence the payment cannot be made by way of withholding tax. Furthermore, even taxes imposed under the STTR are levied after the end of the fiscal year in which they arise and are not liable to withholding tax.

The Top-up Tax under GloBE rules is to be paid basis the consolidated financial statements and hence the payment cannot be made by way of withholding tax.

Q22 Will Equalisation Levy (EL) continue after implementation of BEPS 2.0? Will the same be creditable or includible in calculation of ETR?

- EL was introduced by the Indian government as a measure to address the challenges of taxation arising from digitalisation of economies where they have significant user bases and generate revenue from India without constituting a physical presence or a traditional PE.

- The Covered Taxes for calculating ETR under GloBE rules include taxes on income or profits of a CE. The commentary on the GloBE rules provides that digital services taxes are generally designed to apply to the gross revenues from the provision of certain digital services and so would not be considered an income tax. Further it also provides that digital services taxes are generally designed to apply in addition to, and not as substitutes for, a generally applicable income tax under the laws of a jurisdiction, and so would not fall under the "in lieu of" test for Covered Taxes either.

- Mere implementation of GloBE rules in domestic laws would not affect charge of EL and the provisions would co-exist until EL is officially withdrawn. However, it may be relevant to note that OECD Inclusive Framework members have agreed for removal and standstill of digital services taxes as part of MLC for implementation of Amount A of Pillar One. Accordingly, if India becomes a party to the MLC for implementation measures relating to Amount A, provisions relating to EL will have to be withdrawn. It may be relevant to note that 2% Equalisation Levy 2.0 levied on ecommerce operators has been removed *vide* Finance (No. 2) Act 2024. However, no announcement has been made for removal of Equalisation Levy 1.0 on online advertisement services.

GLOBE INFORMATION RETURN

Q23 What is a GloBE Information Return (GIR)?

The GIR is a return in a standardised template that provides tax administration with the information it needs to evaluate the correctness of a CE's tax liability under the GloBE rules. Each CE is obliged to file a GIR with the local tax administration. This return can be filed by each CE directly with its local tax administration or through a Designated Local Entity on behalf of one or more CEs located in the same jurisdiction.

Each CE is obliged to file a GIR with the local tax administration.

Q24 Is GIR a component of transfer pricing compliance or an additional reporting obligation? Will it substitute or complement the existing CbCR obligation?

GIR is an additional reporting requirement and is in addition to current transfer pricing compliances. It offers a detailed view of a MNE's worldwide activities and tax contributions, assisting tax authorities in ensuring accurate tax compliance beyond what traditional transfer pricing documents cover. Further, GIR is designed to complement, and not replace, the existing CbCR. While CbCR delivers a snapshot of financial data across various jurisdictions, the GIR provides a more detailed and comprehensive overview of a MNE's global operations and tax payments.

GIR is designed to complement, and not replace, the existing CbCR.

Q25 What is a GloBE Information Return (GIR)?

GIR to be filed no later than 15 months after the last day of the Reporting Fiscal Year. The said due date has been extended to 18 months for the transition year. The commentary also provides that the due date for filing and notification obligations for any Fiscal Year shall not be before 30 June 2026.

Q26 Are there any exceptions for filing GIR?

Similar to automatic exchange of CbCR information within jurisdictions by way of a Multi Competent Authority Agreement (MCAA), the GloBE rules also provide for automatic exchange of GIR information by way of a Qualified Competent Authority Agreement (QCAA).

A CE is discharged from its filing obligation when the UPE or a designated filing entity files the GIR with another jurisdiction that has a QCAA to exchange the GIR with the tax administration of the CE's jurisdiction. In those cases, a CE or a designated local entity shall file a notification with its tax administration of the entity that is filing the GIR and the jurisdiction in which it is located.

Hence, UPE or a designated filing entity of the MNE Group can file a single GIR covering all CEs in the MNE Group, which can be provided to all tax administrations with CEs located in their jurisdiction through appropriate international exchange mechanisms.

Q27 What information would be required under the GIR?

The GIR includes a comprehensive set of data points, a few of which are highlighted below:

- Identification of the CEs, including their tax identification numbers, the jurisdiction in which they are located and their status under the GloBE rules (e.g. a POPE, JV, JV subsidiary, Investment Entity, Flow-through Entity, PE etc.)
- Information on the overall corporate structure of the MNE Group including the Controlling Interests in the CEs held by other CEs
- Information necessary to compute ETR for each jurisdiction and Top-up Tax for each CE
- Information necessary to compute the allocation of Top-up Tax under the IIR, and the UTPR Top-up Tax amount to each jurisdiction
- Information regarding application of jurisdictional safe harbours
- Other information agreed and required as a part of GIR

Q28 What essential data points must an MNE group consider if GloBE rules are implemented in any of the jurisdictions in which the group operates?

- **Evaluate impact:** Assess the current group structure and the status of CEs in each jurisdiction to understand the implications of GloBE rules.
- **Assess technological infrastructure:** The GloBE rules are intricate, requiring data from various sources within a MNE group. Assess whether existing accounting systems / ERPs can capture the necessary data for compliance and calculations.
- **Liaise internally:** Ensure close collaboration between tax and accounting teams to gather and report accurate data.
- **Data management and integration:** Ensure that data management practices are robust and that data from different sources can be integrated effectively for accurate reporting and compliance.
- **Training and capacity building:** Provide training for relevant staff to ensure they understand the new regulations and how to comply with them. Build capacity within the organization to handle the complexities of the GloBE rules.
- **Detailed assessment:** Perform detailed calculations of Top-up Tax and analyse applicable exemptions, such as the election of safe harbours for eligible jurisdictions. Ensure all calculations are traceable and auditable.
- **Informed stakeholders:** Update executives and management on the financial and administrative impacts of the new GloBE rules to ensure they are well-informed.
- **Tax control framework:** Establish strong internal controls to ensure compliance with the new rules and to mitigate risks. Implement a robust tax control framework to manage and monitor compliance.
- **Monitor country reactions:** Stay informed about how different countries are implementing and applying the new GloBE rules. This includes monitoring legislative changes and administrative guidance.
- **Future disclosures:** Consider how upcoming tax reporting requirements will align with the GloBE rules. Plan for future disclosures and ensure that they are consistent with the new regulations.

- **Engage with external advisors:** Consult with external tax advisors, legal experts, and industry bodies to gain insights and best practices for implementing GloBE rules. This can help in navigating complex regulatory landscapes.

This comprehensive approach will help multinational corporations navigate the complexities of implementation of GloBE rules ensuring compliance and minimizing risks.

TRANSFER PRICING ASPECTS

Q29 Will transfer pricing fade out with advent of GloBE rules and a global minimum tax?

Transfer Pricing has always been about identifying the value created by an entity in a supply chain and ensuring that commensurate profit is booked and tax is paid in the jurisdiction where the value is created.

Over the years, intra-group agreements shifting profits from high-tax to low-tax jurisdictions by way of agreements or shifting legal ownership of intangibles, etc. was observed. BEPS Action Plan 10 which amended the OECD Transfer Pricing Guidelines focussed on 'substance over form' by accentuating the importance of economic ownership vs. legal ownership, actual conduct vs. agreement, etc.

GloBE rules further emphasize on the creation of substance by implementing a global minimum tax, thereby removing the (tax) incentive to establish entities in low-tax jurisdictions. With the advent of GloBE rules, the focus on transfer pricing will increase, in particular on correctness of functional analysis, entity characterisation and selection of tested parties. Standard 'ready-to-insert' benchmarks' that had become the norm for meeting the compliance requirements will now have to shift to diligent qualitative reviews for comparable companies.

Tax administration, hitherto armed with the existing 3-tier documentation i.e., Master File, Local File and CbCR, will further be supported by GIR to enable a 360º evaluation of the taxpayer entity in context of MNE group's overall activities and performance.

Tax administration, hitherto armed with the existing 3-tier documentation i.e., Master File, Local File and CbCR, will further be supported by GIR to enable a 360º evaluation of the taxpayer entity in context of MNE group's overall activities and performance.

Q30 How will the GloBE rules impact transfer pricing compliance?

The computation of GloBE income presupposes cross-border transactions having been undertaken between members of an MNE at arm's length. That is the primary underlying assumption and hence, transfer pricing will have to be diligently undertaken by all entities to ensure their financial results are compliant with the arm's length principle.

There are certain nuances in the operation of GloBE rule which impact transfer pricing.

- **Amount confirmations and truing-up exercise**

  The GloBE rules require that transactions between members of MNE group are recorded at the same price for GloBE purpose for all CEs that are party to the transaction.

  Continuous intra-group transactions, emanating from intra-group agreements providing a pricing mechanism like cost-plus or resale-minus, generally require true-ups at periodic intervals to ensure that financial results at the end of a financial period tie with the pricing mechanism provided in intra-group agreement.

  MNE groups having such pricing mechanisms will have to diligently carry out true-ups / downs at financial close for CFS purposes, ensuring that same amount is recorded by all entities to the intra-group transactions.

- **Interaction of true-ups with ETR**

  Where truing up exercise is carried out at financial close of UPE for CFS purposes, it is unclear whether corresponding tax adjustment would be made for computing Covered Taxes. If an 'unbilled revenue' is booked for truing up without corresponding impact on tax computation, it would impact the ETR in that jurisdiction negatively. The guidance is currently unclear on this treatment.

If an 'unbilled revenue' is booked for truing up without corresponding impact on tax computation, it would impact the ETR in that jurisdiction negatively.

- **Transfer Pricing adjustments**

  GloBE rules respect transfer pricing adjustments made by any jurisdiction and provide for corresponding adjustment to the income/expense of other entity to the transaction, except where it would lead to double taxation / no taxation.

  Unilateral adjustments, either by way of audit / assessment by tax office, or by way of complying with unilateral APAs are respected. Only where the unilateral adjustment is to the profit of undertaxed jurisdiction, the corresponding impact is not given in order to avoid double taxation.

  The Top-up Tax paid on behalf of LTCE that has now also been paid in the low-taxed jurisdiction by way of a unilateral adjustment will be given credit for to the entity who paid the original Top-up Tax in the year in which such unilateral adjustment was made and tax was paid.

- **Transfer Pricing on intra-group transactions within same jurisdiction**

  Given that GloBE rules work on a jurisdictional blending basis, compliance with the arm's length principle does not impact the working of GloBE rules where both entities to the transaction are included for GloBE computation purposes.

  One exception is where one of the parties to the transaction is an excluded entity, or who is subject to GloBE separately from the rest of the MNE group. In that case, transactions between two entities within the same jurisdiction need to comply with the arm's length mechanism.

  Other exception is where the transaction pertains to transfer of assets within the same jurisdiction. GloBE rules provide that in case where asset transfer leads to a loss, the transaction should be at arm's length in order to avoid manufactured losses by intra-group transfer of assets.

Q31 How do transfer pricing adjustments interact with the GloBE rules under Pillar Two?

Transfer pricing adjustments interact with the GloBE rules under Pillar Two by:

- Affecting the calculation of the ETR in each jurisdiction. Any transfer pricing adjustments that increase taxable income in a high-tax jurisdiction will increase the ETR, while adjustments that reduce taxable income will decrease the ETR.
- Potentially leading to Top-up Taxes if the adjusted ETR in a jurisdiction falls below the minimum tax rate set by the GloBE rules.
- Requiring MNEs to carefully consider the impact of transfer pricing adjustments on their overall tax position to avoid unintended consequences, such as double taxation or increased compliance burdens.

Q32 How do unilateral adjustments impact compliance with Pillar Two?

Unilateral adjustments impact compliance with Pillar Two by:

- Altering the ETR in the jurisdiction where the adjustment is made, potentially leading to Top-up Taxes if the ETR falls below the global minimum standard.
- Creating mismatches and double taxation if not coordinated with corresponding adjustments in other jurisdictions.
- Requiring MNEs to ensure that any unilateral adjustments are well-documented and justified to mitigate the risk of disputes and penalties.

Q33 What are bilateral adjustments in the context of transfer pricing under Pillar Two and how do bilateral adjustments impact compliance with Pillar Two?

Bilateral adjustments in the context of transfer pricing under Pillar Two refer to coordinated adjustments between two tax authorities to ensure consistent and fair allocation of profits. These adjustments impact compliance with Pillar Two by:

- Providing greater certainty and reducing the risk of double taxation, as both jurisdictions agree on the adjustments.
- Ensuring that the ETR calculations in both jurisdictions reflect the agreed-upon profit allocations, aligning with the objectives of Pillar Two.
- Requiring robust documentation and cooperation between tax authorities and MNEs to implement bilateral adjustments effectively.

Q34 How should MNEs address potential transfer pricing disputes arising from Pillar Two implementation?

MNEs should address potential transfer pricing disputes arising from Pillar Two implementation by:

- Strengthening their transfer pricing documentation to provide clear evidence of the arm's length nature of their transactions and the economic substance behind their operations.
- Engaging in proactive dialogue with tax authorities to resolve disputes amicably and avoid lengthy litigation.
- Considering advance pricing agreements (APAs) or mutual agreement procedures (MAPs) to provide certainty and prevent disputes.
- Monitoring changes in local and international tax regulations to stay compliant and minimize the risk of disputes.

Q35 What is the significance of the substance requirements under Pillar Two for transfer pricing?

The substance requirements under Pillar Two are significant for transfer pricing because:

- They ensure that profits are allocated to jurisdictions where actual economic activities and value creation occur.
- MNEs must demonstrate that their operational structures and transfer pricing policies reflect real economic substance to avoid challenges from tax authorities.
- Substance requirements help prevent profit shifting to low-tax jurisdictions without corresponding economic activities, aligning with the broader objectives of Pillar Two.

Q36 How does Pillar Two affect the treatment of losses in transfer pricing?

Pillar Two affects the treatment of losses in transfer pricing by:

- Requiring MNEs to consider how losses impact the calculation of the ETR in each jurisdiction. Losses in one jurisdiction could reduce the overall ETR, potentially triggering Top-up Taxes.
- Encouraging MNEs to carefully document and substantiate the reasons for losses, ensuring they are aligned with economic activities and not a result of profit shifting.
- Mandating a detailed analysis of loss carry forwards and their impact on the minimum tax calculations under Pillar Two.

Q37 How does Pillar Two impact the need for secondary adjustments and what strategies can MNEs use to manage secondary adjustments effectively under Pillar Two?

Pillar Two impacts the need for secondary adjustments by:

- Increasing the likelihood of secondary adjustments if initial transfer pricing adjustments result in mismatches or double taxation.
- Requiring MNEs to carefully document and justify their transfer pricing policies to avoid secondary adjustments and potential disputes.

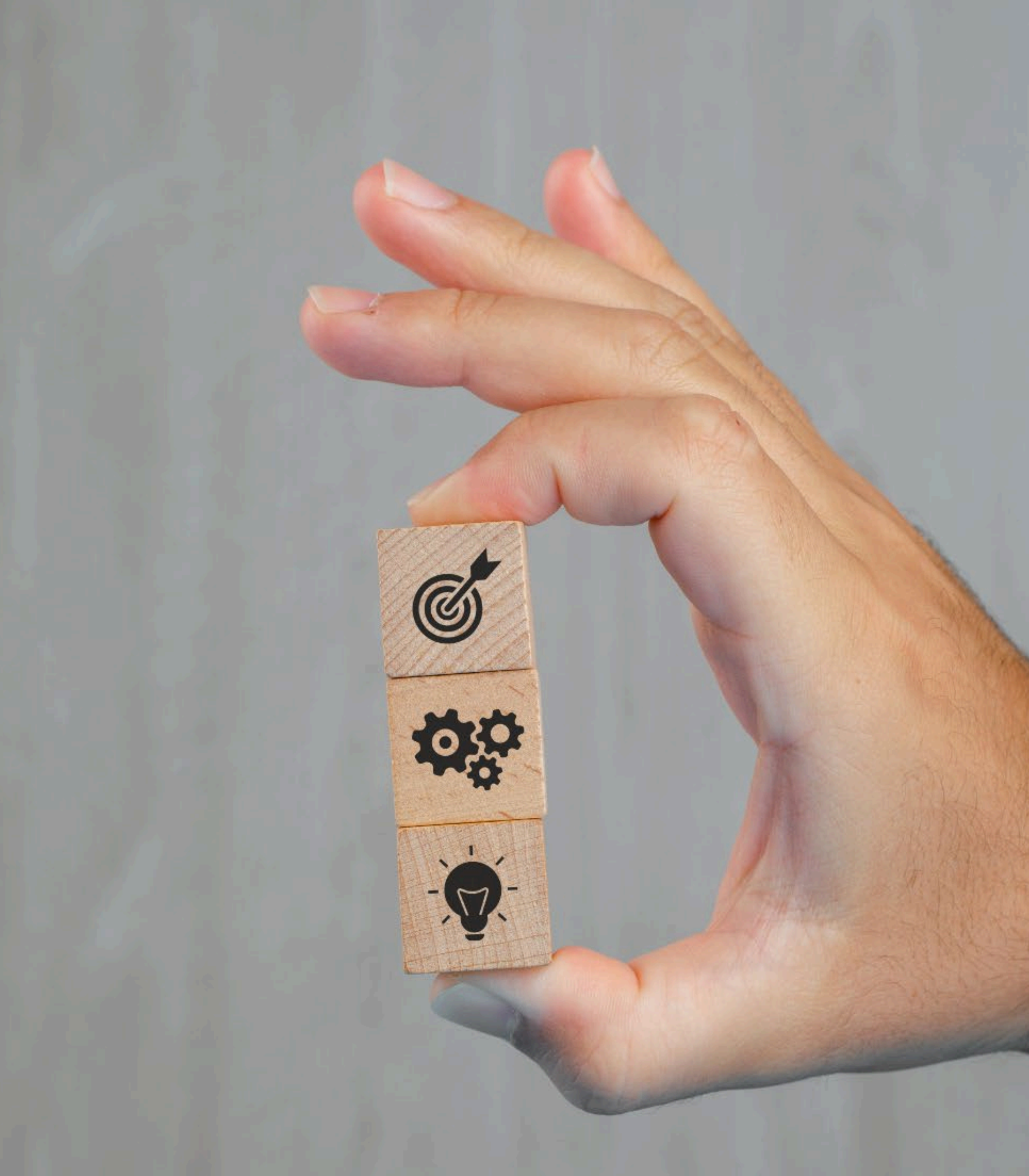
Strategies MNEs can use to manage secondary adjustments effectively under Pillar Two include:

- Engaging in APAs to obtain certainty on transfer pricing arrangements and minimize the risk of secondary adjustments.
- Utilizing mutual agreement procedures (MAPs) to resolve disputes and avoid double taxation.
- Ensuring robust transfer pricing documentation and maintaining clear evidence of the economic substance behind their transactions.

Q38 What can Indian headquarters do to meet the arm's length requirement under BEPS Pillar Two?

Indian headquarters can meet the arm's length requirement under BEPS Pillar Two by:

- Ensuring that all intra-group transactions are priced at arm's length, based on thorough transfer pricing analysis and benchmarking studies.
- Maintaining detailed transfer pricing documentation to support the arm's length nature of their transactions.
- Demonstrating the economic substance and value creation behind their operations to justify the profit allocations to different jurisdictions.
- Staying updated on local and international transfer pricing regulations to ensure compliance with the latest requirements.



IMPLEMENTATION STATUS

Q39 Which major countries have adopted GloBE rules?

A brief overview of adoption of GloBE rules by certain countries is presented in the table below:

Country Name	Whether GloBE rules implemented	Whether draft bill / legislation introduced	Effective from financial years beginning on or after		
			IIR	UTPR	QDMTT
Austria	Yes	NA	Jan 24	Jan 25	Jan 24
Australia	No	Yes	Proposed from Jan 24	Proposed from Jan 25	Proposed from Jan 24
Belgium	Yes	NA	Jan 24	Jan 25	Jan 24
Brazil	No	No	No announcement	No announcement	No announcement
Canada	Yes	NA	Jan 24	Proposed from Jan 25	Jan 24
China	No	No	No announcement	No announcement	No announcement
Denmark	Yes	NA	Jan 24	Jan 25	Jan 24
Finland	Yes	NA	Jan 24	Jan 25	Jan 24
France	Yes	NA	Jan 24	Jan 25	Jan 24
Germany	Yes	NA	Jan 24	Jan 25	Jan 24
Greece	Yes	NA	Jan 24	Jan 25	Jan 24
Hungary	Yes	NA	Jan 24	Jan 25	Jan 24
Ireland	Yes	NA	Jan 24	Jan 25	Jan 24
Italy	Yes	NA	Jan 24	Jan 25	Jan 24
Japan	Yes	NA	Apr 24	May be introduced subject to tax reform proposal	May be introduced subject to tax reform proposal
Luxembourg	Yes	NA	Jan 24	Jan 25	Jan 24
Malaysia	Yes	NA	Jan-25	No announcement	Jan-25
Netherlands	Yes	NA	Jan 24	Jan 25	Jan 24
New Zealand	Yes	NA	Jan-25	Jan-25	Jan-26 (for New Zealand headquartered MNEs)
Norway	Yes	NA	Jan-24	Proposed to be implemented from Jan-25	Jan-24
Philippines	No	No	No announcement	No announcement	No announcement
Poland	No	Yes	Proposed from Jan 25	Proposed from Jan 25	Proposed from Jan 25

Country Name	Whether GloBE rules implemented	Whether draft bill / legislation introduced	Effective from financial years beginning on or after		
			IIR	UTPR	QDMTT
Romania	Yes	NA	Jan 24	Jan 25	Jan 24
Saudi Arabia	No	No	No announcement	No announcement	No announcement
Singapore	No	Yes	Proposed from Jan 25	No announcement	Proposed from Jan 25
Slovenia	Yes	NA	Jan 24	Jan 25	Jan 24
Sweden	Yes	NA	Jan 24	Jan 25	Jan 24
Taiwan	No	No	No announcement	No announcement	No announcement
USA	No	No	No announcement	No announcement	No announcement
UAE	No	Public consultation released	No announcement	No announcement	No announcement
United Kingdom	Yes	NA	Jan 24	Proposed from Jan 25	Jan 24

Q40 Status of Implementation in India and Impact on MNEs

An MNE group is subject to the GloBE rules once any jurisdiction in which the group operates has incorporated the GloBE rules in its domestic law. No announcement was proposed in Budget 2024 with respect to QDMTT or GloBE rules, however, stakeholders expect some announcement in Budget 2025 proposed to be announced in February 2025. If India adopts GloBE rules, the same need to be in line with the model rules and commentaries as provided by OECD in this regard.

An MNE group is subject to the GloBE rules once any jurisdiction in which the group operates has incorporated the GloBE rules in its domestic law.

If India adopts GloBE rules:

- If India adopts QDMTT, the taxing rights for LTCE in India would be retained by India rather than letting other jurisdictions collect those taxes under IIR or UTPR.
- If the UPE or IPE or POPE is in India and India adopts GloBE rules, the UPE / IPE / POPE shall be liable to pay their allocable share of IIR Top-up Tax in India for LTCE of the MNE group.
- If India adopts UTPR, CEs in India of the MNE group shall be liable to pay the allocable share of UTPR Top-up Tax where parent entities (i.e., UPE or IPE) in other jurisdictions are not required to apply a Qualified IIR or when an IIR has not been fully applied.

If India does not adopt GloBE rules:

- If UPE of the group is a tax resident of a country that has implemented IIR and there is a CE in India and the Indian company is not liable to pay taxes by virtue of tax exemptions / deductions / tax holidays, in such a case, in absence of QDMTT provisions in India and considering that UPE jurisdiction has implemented IIR in its domestic laws, while India has provided tax concessions or incentives, the MNE will end up paying top up taxes on accounting profits of the Indian company in UPE jurisdiction.

GLOSSARY

ALP	Arm's length price
APA	Advance Pricing Agreements
AS	Accounting Standards
BEPS	Base Erosion and Profit Shifting
CbCR	Country-by-Country Reporting
CE	Constituent Entity
CFC	Controlled Foreign Company
CFS	Consolidated Financial Statements
DST	Digital Services Taxes
DTA	Deferred Tax Assets
DTL	Deferred Tax Liabilities
ERP	Enterprise Resource Planning
ETR	Effective Tax Rate
FANIL	Financial Accounting Net Income or Loss
GDP	Gross Domestic Product
GIR	GloBE Information Return
GloBE	Global Anti-Base Erosion
IAS	International Accounting Standards
IASB	International Accounting Standards Board
IFRS	International Financial Reporting Standards
IFSC	International Financial Services Centre
IIR	Income Inclusion Rule
INDAS	Indian Accounting Standards
IPE	Intermediate Parent Entity
JV	Joint Venture
LTCE	Low Taxed Constituent Entities
MAP	Mutual Agreement Procedures
MAT	Minimum Alternate Tax
MLC	Multilateral Convention
MLI	Multilateral Instrument
MNE	Multinational Enterprises
OECD	Organization for Economic Cooperation and Development
PE	Permanent establishment
POPE	Partially Owned Parent Entity
QCAA	Qualified Competent Authority Agreement
QDMTT	Qualified Domestic Minimum Top-up Tax
SBIE	Substance-based Income Exclusion
SEP	Significant Economic Presence
STTR	Subject to Tax rule
UPE	Ultimate Parent Entity
UTPR	Undertaxed Payments Rule

LET'S CONNECT

Stuti Trivedi
Partner, Transfer Pricing
+91 99982 40000
stuti.trivedi@kcmehta.com

Dhwani Shah
Director, International Tax
+91 87587 99776
dhwani.shah@kcmehta.com

Monica Mulchandani
Manager, Transfer Pricing
+91 9998 987161
monica.mulchandani@kcmehta.com

Dhaval Trivedi
Partner, International Tax
+91 99983 24622
dhaval.trivedi@kcmehta.com

Pranjal Borad
Deputy Manager, Knowledge & Solutions
+91 90333 14499
pranjal.borad@kcmehta.com

Om Thakkar
Assistant Manager, International Tax
+91 75671 17272
om.thakkar@kcmehta.com

DISCLAIMER

This booklet is prepared exclusively for the benefit and use of the clients of K C Mehta & Co LLP. This should not be used as a substitute for professional advice. Reasonable care has been taken for ensuring the accuracy and the authenticity of the contents of this booklet. However, we do not take any responsibility for any error or omission contained therein on any account. It is recommended that the readers should take professional advise before acting on the same.

K C Mehta & Co LLP
Chartered Accountants

Independent Member
kcm
NETWORK

Ahmedabad
Level 11, Tower B,
Ratnaakar Nine Square,
Vastrapur,
Ahmedabad - 380 015

Phone: +91 79 4910 2200

Bengaluru
4/1, Rudra Chambers,
First Floor, 4th Main,
B/W 8th & 9th Cross Road,
Malleshwaram,
Bengaluru - 560 003
Phone: +91 80 2356 1880

Mumbai
315, The Summit Business Bay,
Nr. WEH Metro Station,
Gundavali, Andheri East,
Mumbai-400 069

Phone: +91 22 2612 5834

Vadodara
Meghdhanush,
Race Course,
Vadodara - 390 007

Phone: +91 265 2440 400