Office of Anticorruption and Integrity

Brown Bag Workshop

Base Erosion and Profit Shifting (BEPS): Pillar 2

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Agenda

BEPS Pillar 2 (45 mins)

1. Status Update
2. Pillar 2 GLoBE Model Rules and STTR
3. Application of GLoBE Rules and STTR
4. Where is the BEPS 2.0 Project Heading?

Question & Answer (15 mins)

01

Status Update

BEPS 2.0 — the Two Pillar Timeline

Pillar One Timeline

Revenue Sourcing/Nexus Public Consultation OECD Secretariat Paper	04/02/2022
Tax Base Public Consultation OECD Secretariat Paper	21/02/2022
Scope Public Consultation OECD Secretariat Paper	04/04/2022
Remaining Pillar One "Element" papers to be released for Public Consultation	Early/Mid 2022
Pillar One Multilateral Convention signing	Mid 2022
Amount B Public Consultation	Mid 2022
Amount B – release of Final Paper	End of 2022

Pillar Two Timeline

Pillar Two Model Rules released	22/12/2021
Pillar Two Model Commentary released	14/03/2022
Pillar Two Implementation Framework Public Consultation process started	14/03/2022
STTR Public Consultation Paper to be released	Early/Mid 2022
Pillar Two Implementation Framework Guidance Paper to be released	Early/Mid 2022

www.oecd.org/tax/beps/statement-on-a-two-pillar-solution-to-address-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-october-2021.htm

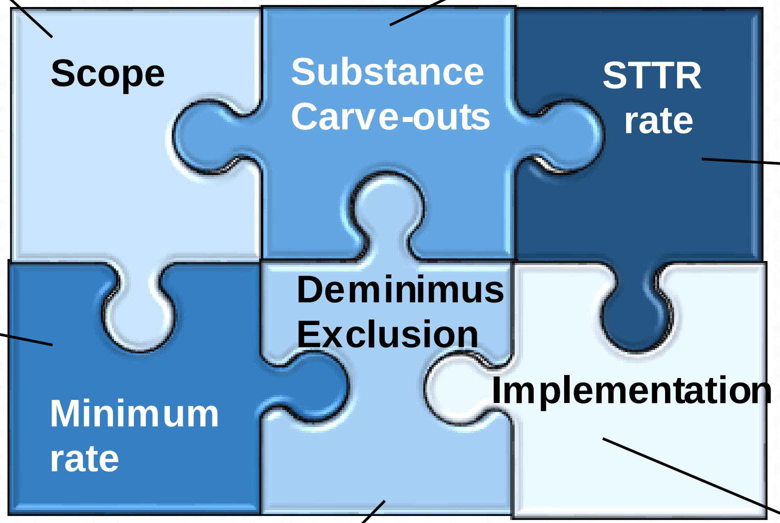
02

Pillar 2 GloBE Model Rules and STTR

Pillar Two in a Nutshell

SCOPE:
MNCs with global revenue of at least €750 million (but a jurisdiction can opt to impose an IIR on its headquartered MNEs regardless of the threshold)

SUBSTANCE BASED CARVE-OUTS:
8% of carrying value of tangible assets and 10% of payroll costs, both phasing down to 5% over 10 years



SUBJECT TO TAX RULE RATE:
9%, applied based on nominal tax rate in each jurisdiction

MINIMUM RATE:
15% for income inclusion rule (IIR) and undertaxed payments rule (UTPR), applied based on effective tax rate in each jurisdiction

IMPLEMENTATION:
Optional for countries, through changes to domestic law (and treaty provision for STTR)

- Effective date of UTPR delayed to 2024

DEMINIMUS EXCLUSION:
Jurisdictions where MNC has global revenues below €10 million and profits below €1 million

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BEPS 2.0 –Pillar Two

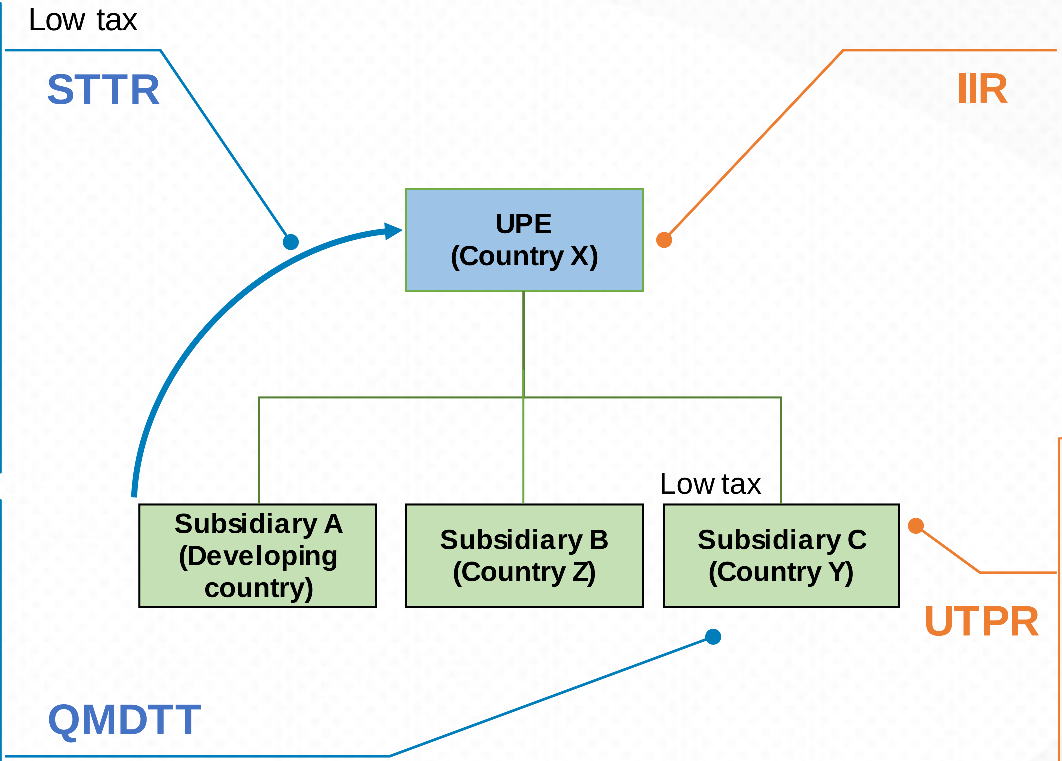
Basic design

1. Subject to Tax Rule (STTR)

- **Applies before GloBE** rules
- A treaty-based rule that allows countries to impose limited source taxation on covered related-party payments that are subject to tax below agreed minimum nominal rate
- Applies to interest, royalties and a defined set of other payments
- **Minimum nominal tax rate: 9%**

2. GloBE Qualified Domestic Minimum Top-up Tax

- **Applies before IIR and UTPR**
- Top-up tax is assessed by the low-tax jurisdiction itself under a computation consistent with Pillar Two top up tax computation on IIR
- **Minimum ETR: 15%**



3. GloBE Income Inclusion Rule (IIR)

- **Primary rule**: a top-up tax is imposed at the level of the ultimate parent entity (UPE) or intermediate parent entity for low-taxed constituent entities
- **Minimum ETR: 15%**

4. GloBE Under Taxed Payment Rule (UTPR)

- **Backstop to IIR — applies if no IIR imposed**
- Top-up tax is allocated to countries with constituent entities based on tangible assets/employees. Imposed by limiting or denying deductions or requiring an equivalent adjustment
- **Minimum ETR: 15%**

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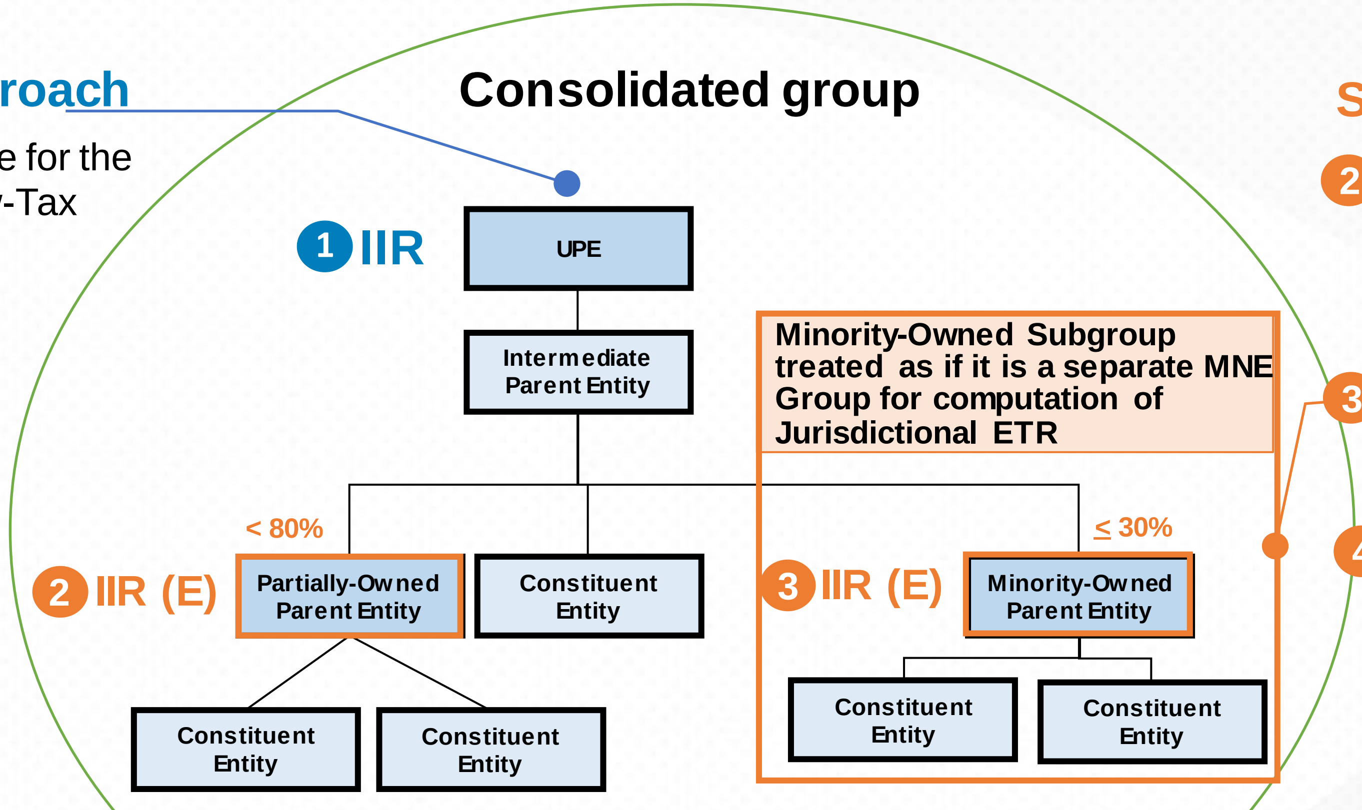
Pillar Two Model Rules: Mechanics of IIR

Alternative build chart

1 Top–down Approach

UPE is primarily liable for the Top-up Tax of all Low-Tax Constituent Entities



(E) - Exception

Note: The assets, liabilities, income, expenses and cash flows of the above entities are included in the Consolidated Financial Statements of the UPE.

Special Provisions Apply For:

2. Partially-Owned Parent Entity (i.e., more than 20% of the ownership interests held by non-group members)
3. Minority-Owned Parent Entity (i.e., less than 30% held directly or indirectly by the UPE)
4. Joint Venture (i.e., at least 50% held directly or indirectly by the UPE and equity accounted in consolidated accounts of the MNE Group)

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Pillar Two Model Rules: Operation of IIR and UTPR

Top-up tax calculation under the GloBE rules

1. **GloBE income** calculated on jurisdictional basis
2. **Adjusted Covered Taxes** calculated on a jurisdictional basis (including a WHT under an STTR)
3. **Jurisdictional ETR** = Adjusted Covered Taxes/GloBE Income
4. **Top-up Tax%** = 15% Minimum Tax Rate - Jurisdictional ETR
5. **Excess Profit** = GloBE Income – Substance-based Income Exclusion
6. **Jurisdictional Top-up Tax** = (Top-up Tax% x Excess Profit) – Domestic Minimum Top-up Tax

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Pillar Two Model Rules: Effective Tax Rate Calculation

GloBE Income or Loss

- Start with net income or loss for consolidation purposes before elimination of intra group items
- Adjust financial accounting net income or loss
- Intercompany transactions adjusted to arm's length price
  - Non-portfolio dividends and certain gains or losses
  - Policy disallowed expenses
  - Elections: stock-based compensation and fair value accounting
  - Asymmetric foreign exchange gains and losses
  - Exclude international shipping income
- Allocate GloBE Income to permanent establishment (PE) and owners of flow-through entities

Adjusted Covered Taxes

- Start with current tax expense in financial accounts
- Adjust Covered Taxes for temporary differences
- Recast deferred taxes at minimum tax rate
  - Recapture certain deferred tax liabilities (DTL) not paid within 5 years
- Exclude uncertain tax positions
- Allocate Covered Taxes to other entities
  - e.g., controlled foreign corporations (CFC) taxes, withholding taxes (WHT)
- Post filing adjustments
  - Recalculate prior year ETR for material reductions
  - Do not amend prior year ETR for increases in tax

OECD/G20 Base Erosion and Profit Shifting Tax Challenges Arising from the Digitalisation of the Economy – Global Anti-Base Erosion Model Rules (Pillar Two) Inclusive Framework on BEPS (OECD, Paris, 20 December 2021) OECD/G20 Base Erosion and Profit Shifting Tax Challenges Arising from the Digitalisation of the Economy – Commentary to the Global Anti-Base Erosion Model Rules (Pillar Two) Inclusive Framework on BEPS (OECD, Paris, 2022)

Pillar Two Model Rules: Operation of UTPR

Back-stop mechanism, allocating the residual Top-up Tax to UTPR jurisdictions where the group has employees or tangible assets:

- Allocation key for dividing UTPR Top-up Tax among UTPR jurisdictions:

$$50\% \times \frac{\text{Number of Employees in jurisdiction}}{\text{Number of Employees in all UTPR jurisdictions}} + 50\% \times \frac{\text{Total value of the tangible assets in jurisdiction}}{\text{Total value of the tangible assets in all UTPR jurisdictions}}$$

- Allocation of residual Top-up Tax to a UTPR jurisdiction does not depend on payments from group member in that jurisdiction to low-taxed group member

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Pillar Two Model Rules: Operation of UTPR

UTPR Top-up Tax collected through denial of deduction (or equivalent adjustment) resulting in additional cash tax expense equal to the UTPR top-up tax allocated to that jurisdiction

- If the deduction denial or adjustment is insufficient to create a cash tax expense equal to the allocated UTPR Top-up Tax, the difference is carried forward to succeeding years
- No further allocation of UTPR Top-up Tax to a jurisdiction if prior year's allocated UTPR Top-up Tax has not been fully brought to tax

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03

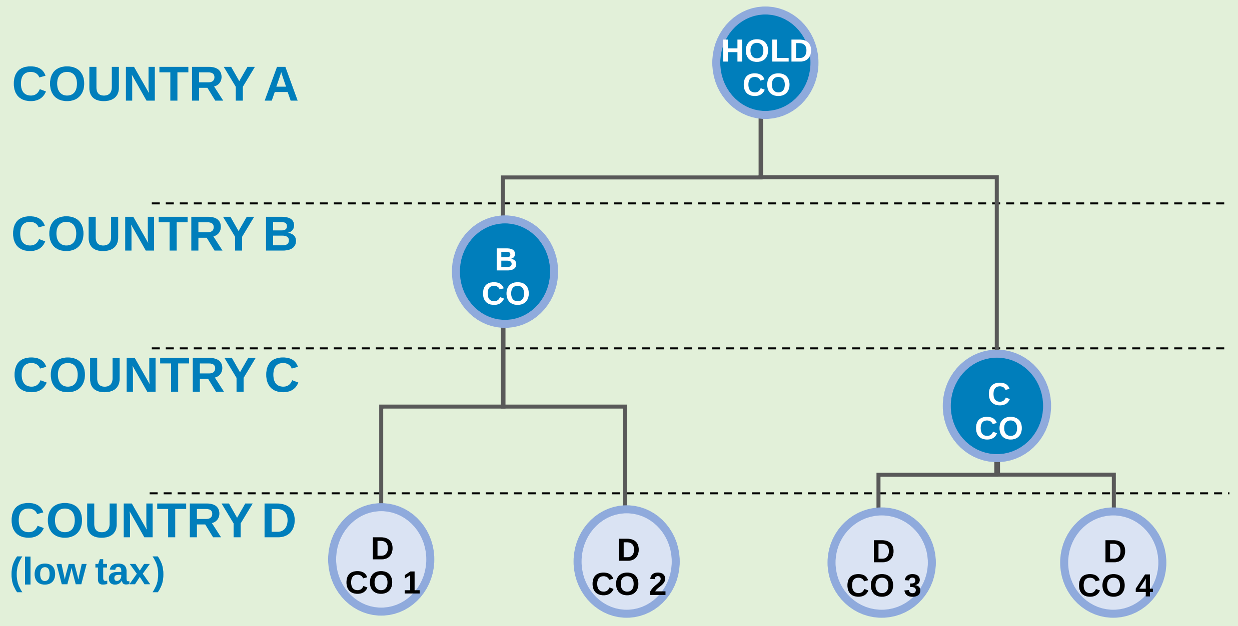
Application of GloBE Rules and STTR

Calculating the Effective Tax Rate

- **The GloBE rules calculate the ETR** by dividing the Adjusted Covered Taxes in a jurisdiction by the Net GloBE Income in a jurisdiction:
  - Net GloBE Income is GloBE Income of all CEs minus GloBE Losses of all CEs
  - Adjusted Covered Taxes of a CE includes current tax expense accrued in its Financial Accounting Net Income or Loss with significant adjustments and allocation rules

In our example:

- **Key issue**: how to deal with timing differences?
- **Adjusted Covered Taxes**: **500**
- **Net GloBE Income**: **4000**
- **ETR for Country D**: 500 / 4000 = **12.5%**



Country D

Net Globe Income	1,000	1,000	1,000	1,000
Adjusted Covered Tax	0	0	250	250

ETR = 12.5%

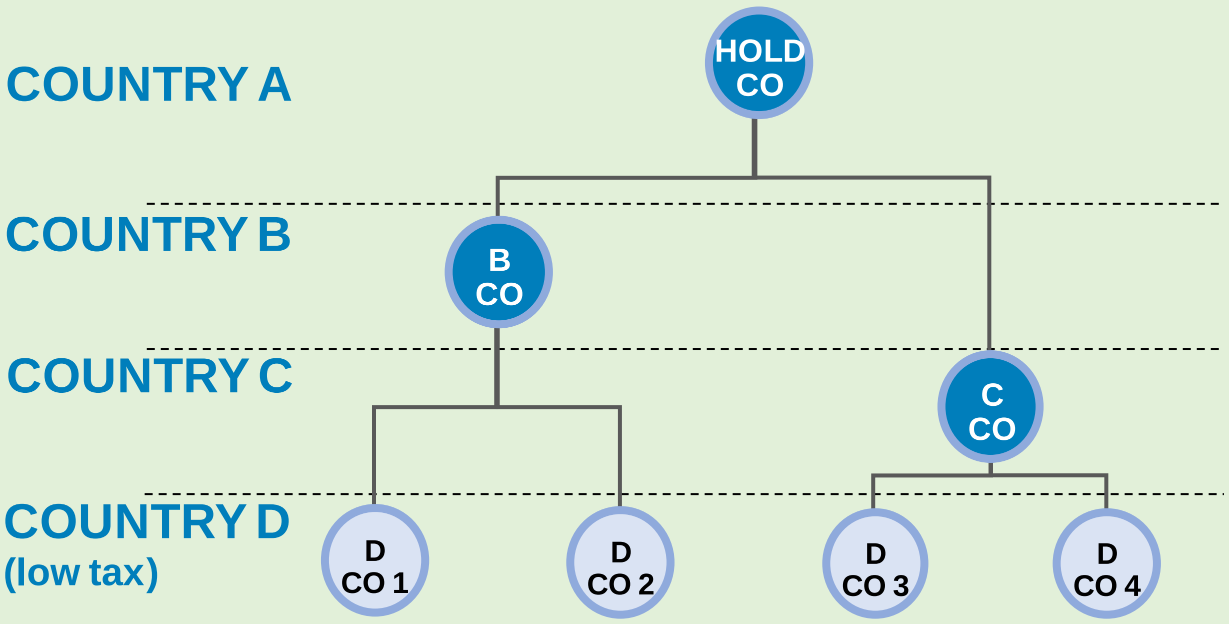
Calculating the Top-up

- **Subtract jurisdictional ETR from minimum tax rate** (15%)
- Calculate the **Substance Based Income Exclusion**:
  - Broadly [5%] of eligible payroll costs, plus
  - [5%] of eligible tangible assets in the relevant jurisdiction
- Calculate **Excess Profits** by subtracting the Substance Based Income Exclusion from the Net GloBE Income
- **Other important deductions** may also be available, including a reduction of Jurisdictional Top-up for Qualified Domestic Minimum Top-up Tax

In our example, Jurisdictional Top-up Tax is 100 (i.e. 4000 x 2.5%), assuming zero Substance Based Income Exclusion:

Top-up Tax Amount per CE:

- **D Co 1: 1,000/4,000 x 100 = 25**
- **D Co 2: 1,000/4,000 x 100 = 25**
- **D Co 3: 1,000/4,000 x 100 = 25**
- **D Co 4: 1,000/4,000 x 100 = 25**



Country D

Net Globe Income	1,000	1,000	1,000	1,000
Adjusted Covered Tax	0	0	250	250
Top-up Tax	25	25	25	25

ETR = 12.5%

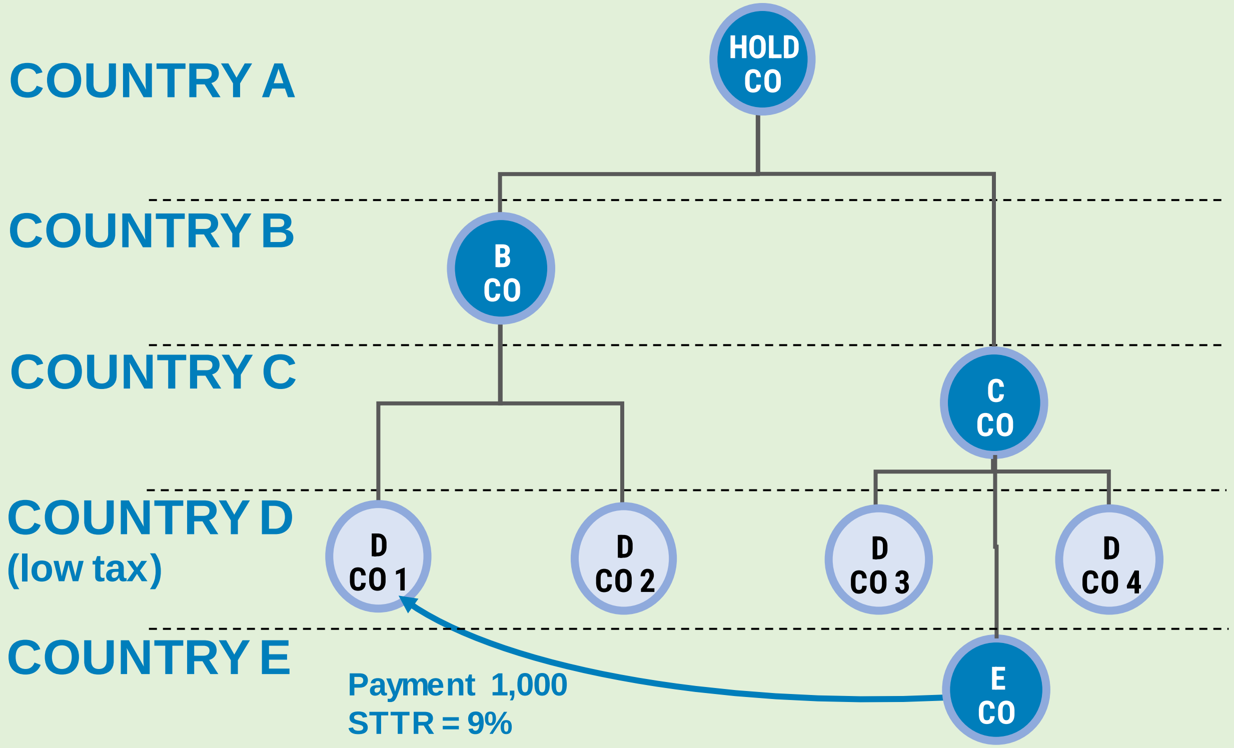
What is the impact of the Subject To Tax Rule (STTR)?

- Country D and Country E have implemented the STTR in their bilateral tax treaty
- E Co makes 1,000 in annual payments to D Co 1
- Determine whether the payment is in scope of the STTR (what in the case of COGS?)
- Determine the *nominal* tax rate applied by Country D to the payment

In our example:

- **0% (in D Co 1) is 9% under the 9% minimum rate**
- **E Co may subject the gross payment to 9% withholding tax**
- **D Co 1's Covered Tax is increased by 90 and as a consequence, the Country D's ETR becomes 14.75%**

The Public Consultation on STTR has not yet occurred



Country D

Net Globe Income	1,000	1,000	1,000	1,000
Adjusted Covered Tax	90	0	250	250
Withholding Tax	90			

ETR = 14.75%

04

Where is the BEPS 2.0 Project Heading?

BEPS 2.0 – Next Steps and Public Consultation Process

UPCOMING REQUESTS FOR INPUT

Following the agreement reached in October 2021 by over 135 members of the OECD/G20 Inclusive Framework on BEPS to address the tax challenges arising from digitalization and globalization of the economy, work on the implementation of the two-pillar plan is underway. As part of this next phase, the Inclusive Framework intends to consult stakeholders as follows:

For **Pillar Two**, a public consultation on the implementation framework will be held in February, focusing on the particular issues to be agreed by the end of 2022 (i.e., administration and compliance).

For the **Subject to Tax Rule (STTR) of Pillar Two**, the draft model provision and its commentary will be released in March 2022 with a defined set of questions set for input. The multilateral instrument to facilitate the implementation of the STTR would also be released for comment at the same time.

www.oecd.org/tax/beps/statement-on-a-two-pillar-solution-to-address-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-october-2021.htm

Question and Answer Session

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