Deloitte.

Unified Approach: Pillar One of the OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting

IFA WRC
July 30, 2021

Developments in taxation of Digital Economy

1. 2015 BEPS Action Plan 1: Final Report

- Approach to tax digital economy: (i) Significant Economic Presence ('SEP') (ii) withholding tax (iii) equalisation levy ('EL')

2. 2016 Introduction of EL in India

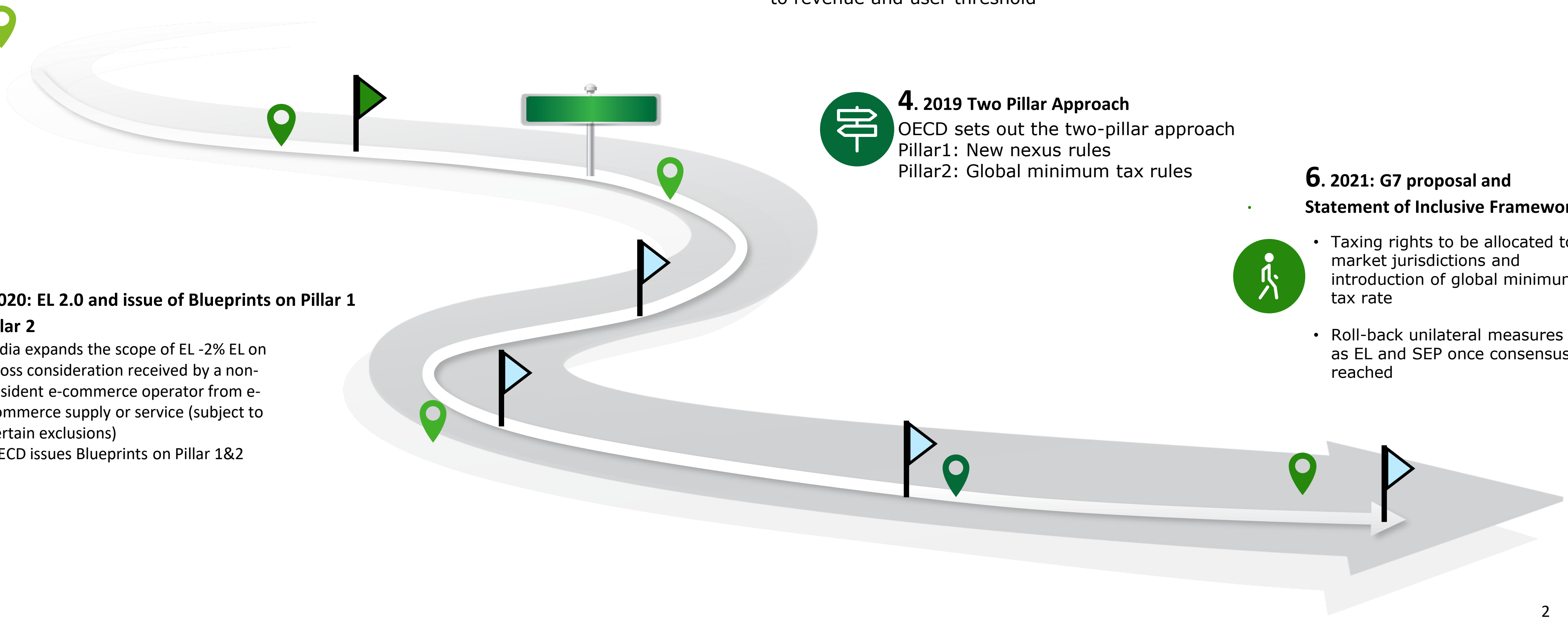
India introduced EL on online advertisement and related activities

3. 2018 Interim Report and SEP

- Issue of Interim report by OECD for addressing tax challenges on digital economy;
- India introduces SEP provisions in its domestic tax law subject to revenue and user threshold

4. 2019 Two Pillar Approach

OECD sets out the two-pillar approach
Pillar1: New nexus rules
Pillar2: Global minimum tax rules



5. 2020: EL 2.0 and issue of Blueprints on Pillar 1 & Pillar 2

- India expands the scope of EL -2% EL on gross consideration received by a non-resident e-commerce operator from e-commerce supply or service (subject to certain exclusions)
- OECD issues Blueprints on Pillar 1&2

6. 2021: G7 proposal and Statement of Inclusive Framework

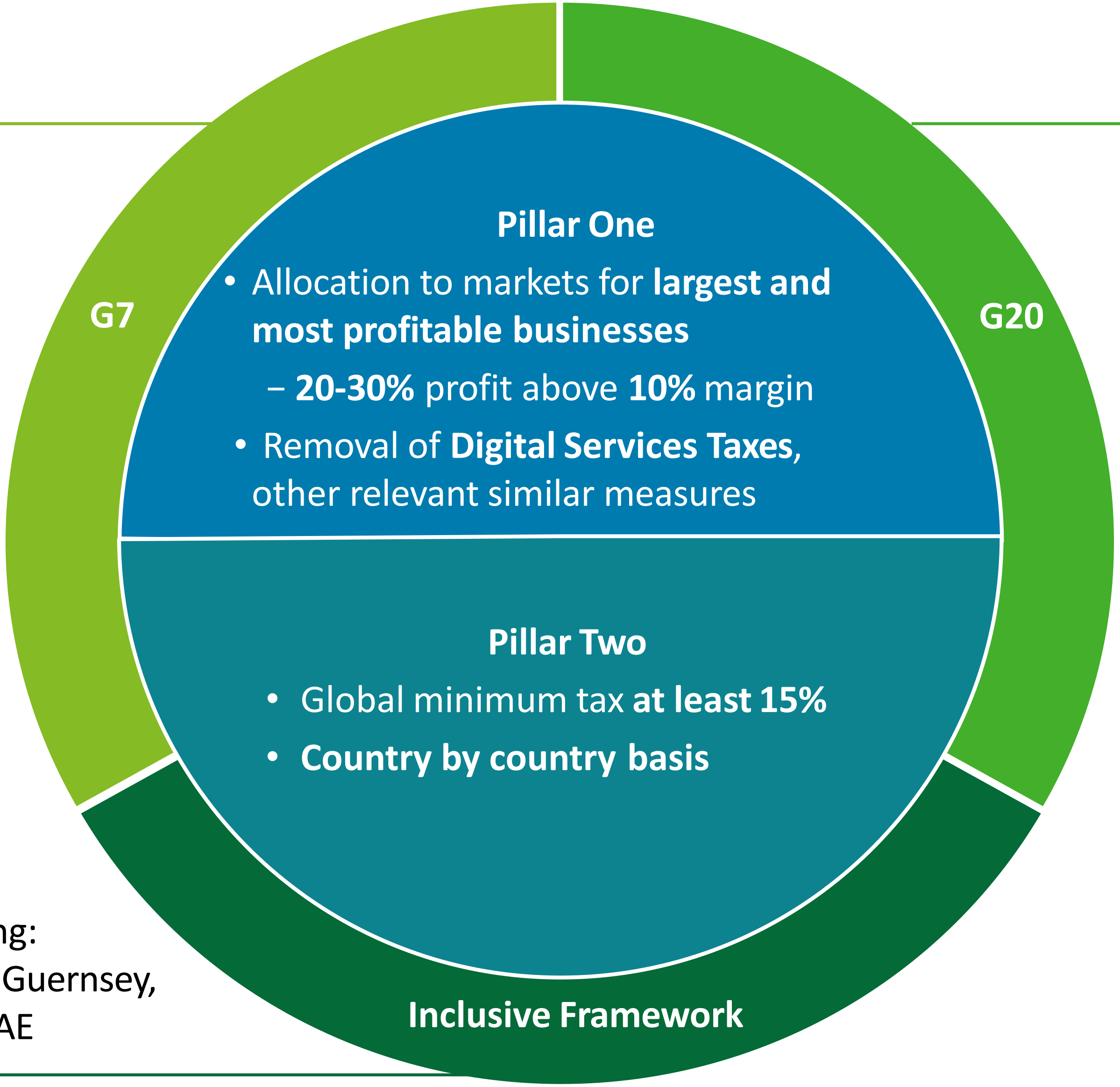
- Taxing rights to be allocated to market jurisdictions and introduction of global minimum tax rate
- Roll-back unilateral measures such as EL and SEP once consensus is reached

Latest developments on Pillar one and Pillar two

Pillar One and Two – G7, G20, and OECD Inclusive Framework

G7 political agreement
5 July 2021

G20 endorsement
10 July 2021



OECD Inclusive Framework statement
1 July 2021
Agreed by 132 countries including:
G7, G20, Switzerland, Bermuda, Guernsey, Isle of Man, Jersey, Singapore, UAE

Seven OECD Inclusive Framework countries not yet signed up:

- Ireland
- Hungary
- Estonia
- Barbados
- Kenya
- Nigeria
- Sri Lanka

Pillar One

Key elements

Pillar One

Key elements

Amount A	**New taxing right** A share of residual profit allocated to market countries using a formulaic approach	**Largest and most profitable businesses**
Amount B	**Fixed 'baseline' return** For marketing and distribution functions based on the arm's length principle	**All businesses**
Tax certainty	**Tax certainty** Through effective dispute prevention and resolution mechanisms	**All businesses**

Amount A – new taxing right

Amount A – new taxing right

Scope

Superseded OECD Blueprint proposal:

Automated digital services

Consumer-facing businesses

Inclusive Framework proposal:

Groups with **global turnover above €20 billion** and **profitability above 10% (PBT/revenue)**

Reduced turnover threshold of €10 billion potentially in 2031

Extractives and Regulated Financial Services excluded

Amount A – new taxing right

Nexus - A market country will only be entitled to an allocation of Amount A if there is a nexus

	Countries with GDP over €40 billion	Countries with GDP less than €40 billion
Local sales threshold to create nexus	€1,000,000	€250,000

The Amount A nexus cannot be used for any other tax purpose (including VAT and customs duties)

Amount A – new taxing right

Tax Certainty

Mandatory and binding dispute prevention and resolution

For **businesses in scope of Amount A**

Includes **all issues related to Amount A**
e.g. transfer pricing and business profits disputes

Disputes on **whether issues relate to Amount A** will be solved in a **mandatory and binding manner**

Under consideration:
Elective binding dispute resolution mechanism

For **countries** with **few MAP cases** deferred from **MAP peer review** (e.g. Nigeria, Pakistan, Jamaica, Kenya, Malaysia, Botswana, Albania)

For issues related to Amount A

Amount B – baseline marketing and distribution activities

Amount B

Baseline marketing and distribution activities

Simplify transfer pricing of **in-country baseline marketing and distribution** activities

Focus on needs of **low-capacity countries**

Technical work completed **by end of 2022**

Per Blueprint:

Applies to **all business sectors**

Fixed return **based on comparable company benchmarking analyses**, under the Transactional Net Margin Method (TNMM), potentially varying by industry and/or region

- Rebuttable if another transfer pricing method would be the most appropriate (e.g. a strong Comparable Uncontrolled Price)

Does not supersede existing **advance pricing agreements / mutual agreement procedure settlements**

Narrow scope – may be buy/sell distributors that take legal title to goods

Pillar Two

Key elements

Pillar Two – global minimum tax

Key elements

All rules operate as a "top up" to a minimum rate

Priority rule

Subject to tax rule

Source country taxation of specific types of **intra-group payments**

Gross level taxation (not a tax on net profits)

Threshold?

Main rule

Income inclusion rule

Large multinational groups pay a **minimum level of tax in each country** in which they operate

Includes the **switch-over rule** to bring overseas permanent establishments within scope of IIR

Backstop rule

Undertaxed payments rule

(backstop)

Group revenues of €750 million+

Income inclusion rule and undertaxed payments rule

Calculation of **effective tax rate**

- **Jurisdictional-blending basis:**
  - Effective tax rate calculated annually **for each country** where the group has entities
  - The **covered taxes** and the **tax base** need to be calculated for each country

- **Covered taxes** are taxes on a group company's **income or profit:**
  - Domestic and foreign taxes on income are included
  - Taxes such as sales taxes, VAT, digital services taxes, are **not** covered taxes

Taxes paid under **controlled foreign company (CFC)** rules are attributed to the country with the underlying income

Income inclusion rule and undertaxed payments rule

Calculation of effective tax rate – **tax base**

Group accounting **entity-level profit (or loss) before tax**

- **Starting point:** entity-level data used in preparation of parent company's consolidated financial accounts
- **Subject to some adjustments** (e.g., transfer pricing)
- **Profits attributable to a permanent establishment** determined in accordance with **local tax rules**

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Limited number of **book-to-tax adjustments**

- Limited number of adjustment for common **permanent items**, including:
  - **Dividends**
  - **Gains/loss on disposal** of shares
  - **Share-based compensation expenses**
- Additional rules to:
  - Mirror local tax deferrals arising from **intragroup transfers of assets**/reorganizations
  - Account for **immediate expensing** and accelerated depreciation of **business assets**
  - Classify **government grants** and **tax credits**

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Tax base

Next steps

Next steps

Key dates

- G7 Finance Ministers meeting
- Inclusive Framework meeting
- G20 Finance Ministers meeting

2021

June / July 2021

October 2021

Jan 2022

Jan 2023

Jan 2024

Inclusive Framework meeting
G20 Finance Ministers meeting

- Implementation plan
- Remaining political issues

P1

Ongoing technical work

Multilateral instrument

Domestic legislation

Amount B technical work: end of 2022

Pillar One: in effect in 2023

P2

Ongoing technical work & Model Rules

Co-ordinating multilateral instrument?

STTR multilateral instrument

Domestic legislation

Pillar Two: effective in 2023

Possible deferral of UTPR

Panel Discussion