

Pillar 2: Global Minimum Tax - Indian Perspective

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With the increase in digitalisation and globalisation, tax regulations needed to be refined to deal with challenges of dynamic world. The Organisation for Economic Co-operation and Development ('OECD') released 15 Action Plans in form of Base Erosion and Profit Shifting ('BEPS') project to address the challenges of profit shifting and tax avoidance by Multinational Entities ('MNE's') as a first step. The BEPS project made good progress in addressing zero and low taxation, increasing tax transparency and ensuring substantive operations in profit-earning countries. However, the BEPS project still needed a concrete solution to address the challenges of digital economy. To address this twin challenge of digitalisation and globalisation, 141 countries have come to consensus to be part of Inclusive Framework Agreement in connection with historic two pillar solution. The focus of Pillar 1 deviates from the concept of physical presence and reallocates taxing rights to market jurisdiction. Pillar 2 proposes to introduce a global minimum tax on in-scope MNE's.

Pillar 2 consists of:

1. a treaty-based, Subject to Tax Rule (STTR) that allows source jurisdictions to impose source taxation on certain payments if subjected to tax below a minimum rate by the jurisdiction where the recipient entity is located;
2. Income Inclusion Rule ('IIR'), which imposes a top-up tax on a parent entity in respect of the low taxed income of its constituent entity; and
3. an Undertaxed Payment Rule ('UTPR') which denies deductions or requires an equivalent adjustment to the extent the low taxed income of a constituent entity is not subject to tax under an IIR

The IIR and UTPR are coordinated set of rules known as the Global Anti-Base Erosion ('GloBE') Rules. The GloBE Rules provides jurisdiction-based taxation in case of an MNE group having consolidated revenue of EUR 750 Mn based on their consolidated financial statements in a particular fiscal year ('FY'). The in-scope MNE's are required to calculate their effective tax rate ('ETR') for each jurisdiction and pay 'top-up tax' for difference between minimum rate of 15% and the ETR. This top-up tax is charged in the jurisdiction of the ultimate parent of the MNE or constituent entity of the MNE (as the case may be).

The initial timelines provided by OECD for implementing IIR was 2023, UTPR was 2024 and STTR in 2023 or 2024. However, since the public consultation on Tax Certainty and GloBE Information Return has been

on released on 20th December 2022 and UTPR is still under development, it is estimated that implementation of GloBE Rules may be deferred to 2024.

Several jurisdictions have initiated the process of implementing GloBE Rules.

- The Australian treasury released a consultation paper in October 2022 seeking views on how it can best engage with the OECD two-pillar solution. The paper comprises 24 questions on Pillar 2.
- On 12 December 2022, the EU members reached the necessary unanimous agreement to implement the Pillar 2 Directive.
- On 16 December 2022, the Swiss parliament approved the constitutional validity to implement the Pillar 2 rules and is expected to implement from 1 January 2024.
- The South Korean parliament has approved the GloBE Rules which will be effective from FY beginning on or after 1 January 2024. Thus, South Korea becomes the first nation that shall levy top-up tax based on GloBE Rules. In addition to South Korean MNE's that needs to comply with the South Korean IIR Rules, non-South Korean MNE's (whose ultimate parent entities are located in countries yet to implement the Pillar 2 rules) may need to pay the top-up tax to the South Korean tax authorities in accordance with South Korean UTPR Rules for FY 2024 onwards. Therefore, it is of paramount importance that MNE's monitor the progress of GloBE Rules around the globe.

Budget 2023 - India's opportunity be a front runner on Pillar 2

Even India is a member of the Inclusive Framework to implement the GloBE Rules. The erstwhile Central Board of Direct Taxes (CBDT) chairman Mr. JB Mohapatra had stated that *"Pillar 2 alone can get USD 500 Bn to India's revenue"*. The Hon'ble Finance Minister at G-20 meeting in Washington DC stated that *"international tax laws should be straightforward, manageable, and produce significant revenue in developing nations"*. She also stated that India is on the verge of finalising the specifications of the two-pillar taxation proposal at the G-20 forum.

The above statements of the Hon'ble Finance Minister clarify the intentions to implement domestic GloBE Rules. The Budget 2023 may introduce provisions enabling IIR and UTPR to levy top-up tax rate either by amending Income Tax Act or introducing a specific legislation (which would need appropriate remedies to avoid double taxation). It may lay down the foundation for implementation of GloBE rules for computing the effecting tax rate, reporting of information and ways to evaluate the substance based carve outs to ensure that entities carrying on substantive economic activities are least impacted by these rules. The CBDT could issue a consultation paper to seek inputs from stakeholders on potential Pillar two provisions in domestic tax law. However, this may delay implementation to a subsequent period (which may also align with other countries).

The headline corporate tax rate in India including tax rate for newly set up manufacturing entities is more than 15% (excluding surcharge and cess). Even with Minimum Alternative Tax, it is anticipated that foreign MNE's having subsidiaries in India may not be much impacted since the permanent disallowances/adjustments can enhance the ETR. Further, with respect to investment-based incentives or past year losses the timing difference may get addressed by way of deferred tax which is duly considered in computing ETR as per GloBE Rules. However, entities having lower ETR due to certain tax incentives, profit linked deductions, exempted incomes like agricultural income may need to evaluate the impact of GloBE rules. Indian MNE's having constituent entities in low tax jurisdiction will need to consider impact of top-up tax as per GloBE rules.

It would be interesting if India announces implementing the GloBE Rules in Budget 2023 since it has always been a front runner in implementing various propositions suggested in BEPS project such as Equalisation levy, significant economic presence etc.