BEPS Pillar 2: India impact

December 2021

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KPMG India

BEPS 2.0: Journey so far

- **2012** – OECD BEPS Programme launched
- **2015 (Oct)** – Action 1 – Report on Challenges from taxing the digital
- **2017 (Mar)** – G20 Mandate to extend OECD work agreed in Germany
- **2018 (Mar)** – EU Proposal Directives Digital Services & OECD Interim Report
- **2018 (Dec)** – No Agreement on an EU wide DST Directive
- **2019 (Jan)** – OECD Policy Note on proceeding with a Two Pillar Approach
- **2019 (Feb)** – OECD Consultation Paper – Digital Economy
- **2019 (Mar)** – OECD Public Consultation
- **2020 (Oct)** – OECD Pillar 1 & Pillar 2 blueprint released
- **2021 (July)** – G20/IF Statement approving BEPS Pillar 1 & Pillar 2
- **2021 (Oct)** – G20 Leaders meeting has approved Pillar 1 and Pillar 2
- Legislative and treaty update steps from 2022 onwards

Targeted to have core rules in effect from 2023

The G20 is made up of 19 countries and the European Union. The 19 countries are Argentina, Australia, Brazil, Canada, China, Germany, France, India, Indonesia, Italy, Japan, Mexico, the Russian Federation, Saudi Arabia, South Africa, South Korea, Turkey, the UK, and the US.

Pillar 2 - Broad objectives

Objective

- Disincentivising tax-driven cross-border structures
- Addressing tax competition
- Specify a set of rules that would afford jurisdictions a right to 'tax back'
- **Global minimum Tax** to subject thousands of multinational groups around the world to a minimum tax of 15 per cent
- Additionally, specified intra-group payments made to related parties which are taxed below 9 per cent be subject to new withholding taxes.

Applicability

General Threshold

- MNE groups with consolidated group revenue exceeding **EUR 750 million**

Income Inclusion Rule

- Countries **can adopt** a threshold lower than EUR 750 million.

Subject To Tax Rule

- No threshold prescribed yet for STTR

Indirectly can impact structures below thresholds if countries start removing incentives in domestic law

Pillar 2 - The Rules

Treaty based changes

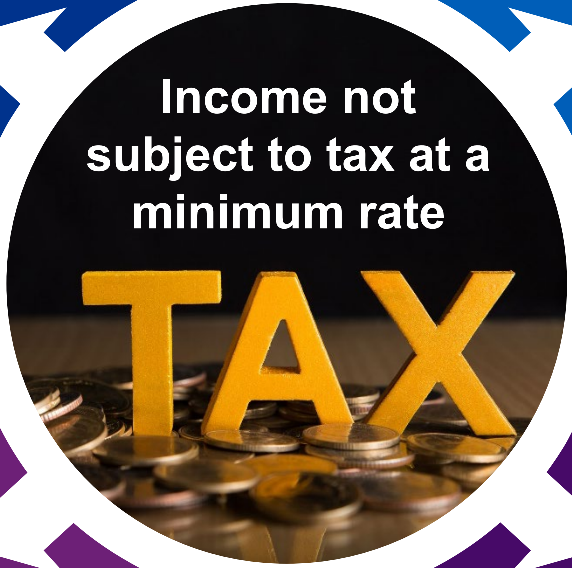
Subject to tax rule ('STTR')

Payer collects top up withholding tax if recipient is not adequately taxed

Switch-over rule?

Switching from exemption to credit method if branches are not adequately taxed

Income not subject to tax at a minimum rate



Income inclusion rule ('IIR')

Country of ultimate parent entity collects top up tax if overseas group companies are not adequately taxed

Undertaxed payments rule ('UTPR')

Deduction for related party payments denied if country of ultimate parent entity does not collect top up tax under IIR

GloBE rules

Domestic law changes

Pillar 2: India Impact

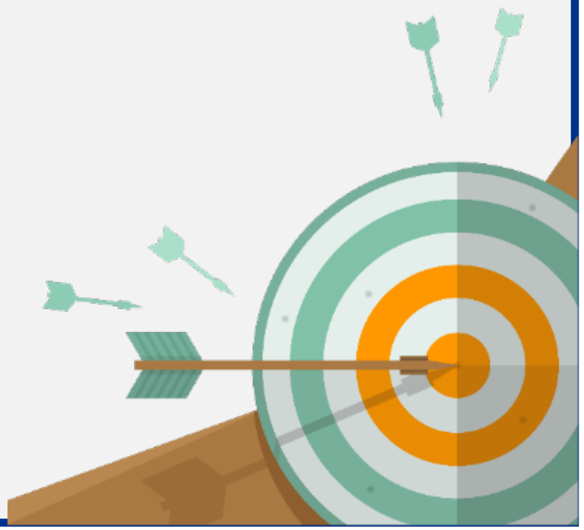
Impact of Pillar 2

01 **On Related party payments by Indian Entities** → **The Subject to Tax Rule (STTR)**

02 **On outbound structures and arrangements** → **The Income Inclusion Rule (IIR) coupled with the Undertaxed Payment Rule (UTPR)**

Impact Area # 1 - Related party payments

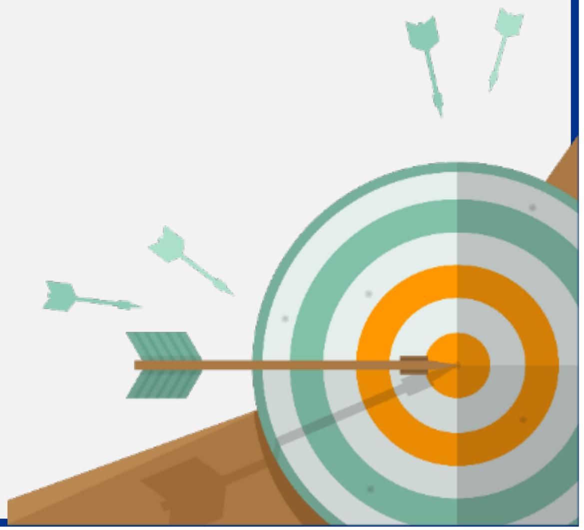
- STTR can apply to levy or increase WHT on the following covered payments[1] to connected persons
  - Interest
  - Royalties
  - Franchise fee or other payment for use of or right to use intangibles in combination with services
  - Insurance or reinsurance premiums
  - Guarantee, brokerage or financing fee
  - Rent or other payment for the use of or right to use moveable property:
  - Consideration for supply of marketing, procurement, agency or other intermediary services
  - Others?



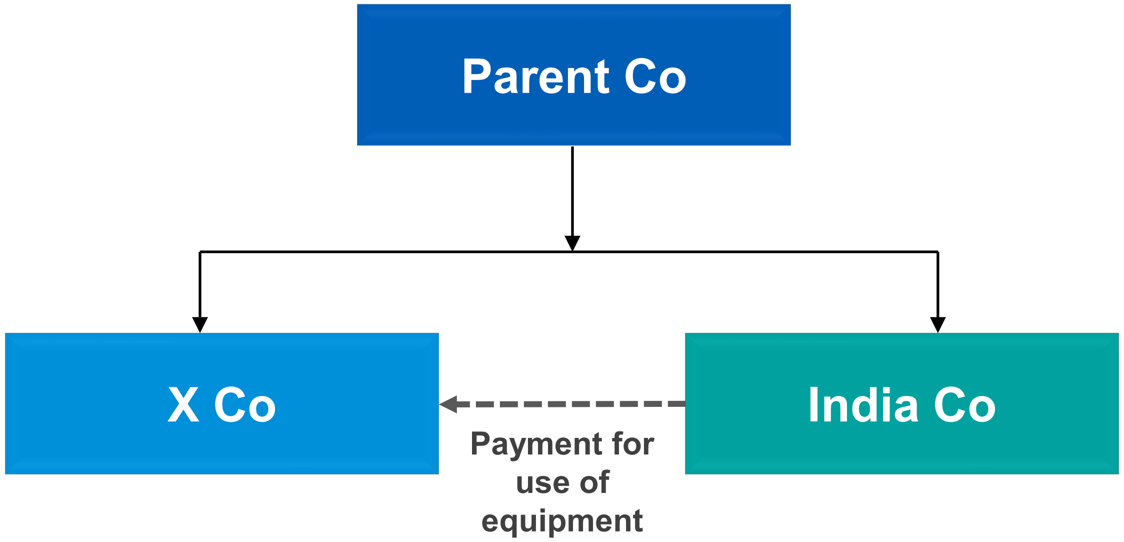
1. Tax challenges arising from digitalisation-Report on the Pillar Two Blueprint, OECD, October 2020

Impact Area # 1 - Related party payments

- Applies when (adjusted) nominal tax rate applicable to the payment in the recipient’s jurisdiction is below 9 per cent
- Exclusions for government entities, investment funds, SWFs etc. and possibly also to certain low return payments
- Treaty based implementation – akin to a minimum standard
- Multilateral Instrument in mid-2022 – implementation from 2023 onwards.



Impact Area # 1 - Related party payments - simplified example



Impact

- Headline rate in Country X is 25 per cent but leasing income taxable at concessional regime of 5 per cent
- No withholding under existing provisions of India's treaty with Country X (No PE, no Tax)
- Payment is a covered payment, nominal rate in recipient jurisdiction is below 9 per cent - India gets to levy top-up withholding tax of 4 per cent (i.e., 9 per cent -5 per cent)

Impact Area # 1 - Related party payments

Open Areas

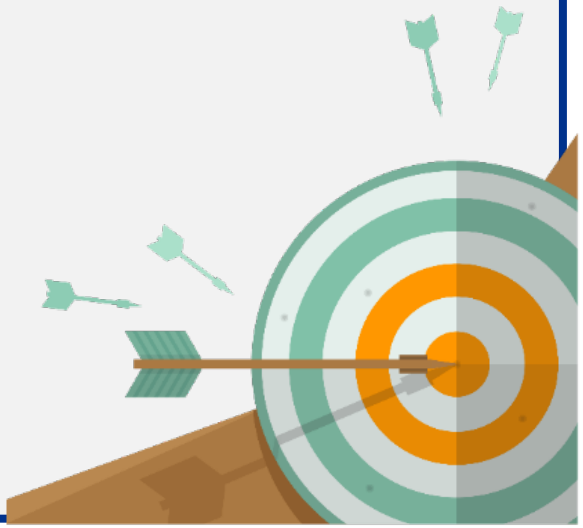
- Materiality threshold
- Scope of covered payments - other services, capital gains?
- Exclusions for low return payments

Practical Considerations

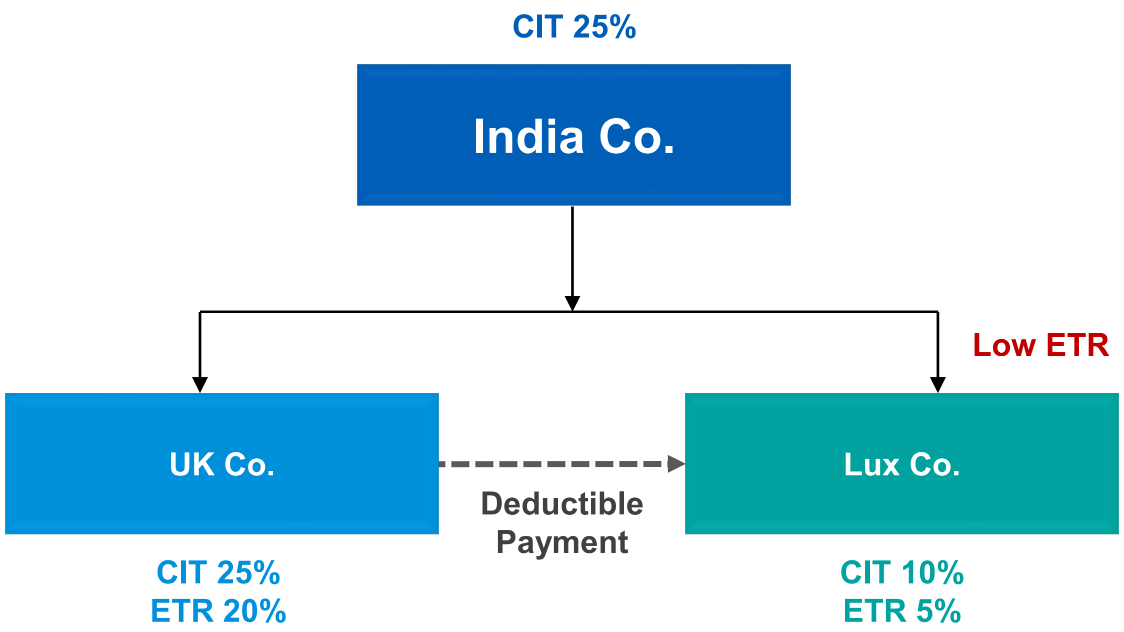
Can increase complexity in the compliance process for foreign remittance by Indian subsidiaries of MNC Groups

Impact Area # 2 -Outbound structures

- GloBE rules apply when income of overseas subsidiaries is subject to an ETR below 15 per cent - complex rules envisaged for computing ETR
- Rules neutralise the effect of the low ETR in a country by enabling other countries to collect a top-up tax on the low taxed income
- Top-up tax collected at the parent country level (IIR) or through disallowance for intra-group payments by other group entities (UTPR)
- Exclusions for investment and pension funds, SWF and International Shipping
- Domestic law based implementation – status of common approach.



Impact Area # 2 -Outbound structures- simplified example



Key assumptions

- Global minimum tax rate 15 per cent
- Lux Co ETR below 15 per cent
- **Scenario 1:** IIR incorporated in the domestic law in India
- **Scenario 2:** If IIR not incorporated in the domestic law in India and UK adopts UTPR

Implications

- Scenario 1: India has the first right to levy top-up tax under IIR
- Scenario 2: UK gets the right to collect top up tax by denying deduction on payment made to Lux Co.

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Impact Area # 2 - Outbound structures

Open Areas

- Indian threshold for IIR
- Elements relating to ETR calculation
- UTPR fine print
- Impact of simplification options.

Practical Considerations

IIR impact analysis: Complex modeling of ETR calculations to identify impacted jurisdictions and assess financial consequences.

Thank you

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