

Implications of the Pillar 2 Global Anti-Base Erosion (GloBE) rules on businesses

March 2022

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(7 min read)

Key takeaways:

- *Impact analysis of OECD Pillar 2 model rules is important for multinational enterprises as this can possibly impact their ETR and may necessitate re-alignment of holding structures, pricing policies and strengthening of internal data management.*

Background

Over the past decade or so, there has been a widespread recognition that several international tax rules are not equipped to deal with new business realities, and that a radical overhaul is needed. The Organisation of Economic Cooperation and Development ('OECD') took the lead on this under its Base Erosion and Profit Shifting ('BEPS') project in 2013. This has led to a far-reaching consensus involving over 137¹ countries last year which seeks to address the following specific issues through a package deal, known as BEPS 2.0 or the OECD's 2 Pillar approach:

- Under traditional international tax rules, a foreign entity could not be taxed on profits that it earned from another country unless it had some form of a physical presence there. The ability to tax profits based solely on physical nexus has been increasingly questioned, as technological advancement has made it possible to do significant business in a market country (through websites, apps, etc.) without having any physical presence. This aspect is proposed to be addressed under the **Pillar 1** rules, which allow market countries to tax a portion of the profits of large multinational enterprises (MNEs) even if they do not have a physical presence in countries where such goods are sold/services are availed.
- With growing mobility of capital and investments, countries tend to offer a wide range of tax incentives to attract and retain investments, leading to what many experts call a 'race to the bottom'. A wide disparity in tax costs across countries also leads to MNEs 'shifting profits' to low tax countries through complex intra-group supply chain, financing and intellectual property holding structures. These two aspects are sought to be addressed under the **Pillar 2** rules, which *inter alia*, propose a global minimum tax of 15 per cent for large internationally operating MNEs.

The Pillar 2 rules that impose this global minimum tax are called the Global Anti-Base Erosion rules (GloBE rules). The model GloBE rules are highly detailed and complex and could have significant implications for internationally operating MNEs.

How do the GloBE rules work?

As countries have sovereign powers on tax matters, the GloBE rules do not directly compel countries to levy a minimum 15 per cent income tax. Instead, it provides a series of complex rules that allow other countries to step in

¹ As on 4 November 2021

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and collect additional tax if a country chooses to not levy a 15 per cent tax. This is done through a series of interlocking rules and calculations, which is explained with a simplified example below.

ABC Limited, an MNE, is headquartered in India and operates in several other countries through subsidiaries, including in Country Y. ABC's subsidiary in country Y makes a profit of USD100 but pays only USD5 of income tax there because of incentives, or due to a low tax rate. This translates to an effective tax rate (ETR) of only 5 per cent, which is lower than the 15 per cent global rate fixed under the GloBE rules. The difference of 10 per cent (i.e., USD10) is called the 'top-up' tax, which is proposed to be taxed in one of three ways under the GloBE rules:

- First, Country Y can itself levy a top-up tax of USD10, which will increase the ETR to 15 per cent;
- If it does not, then India (as the country where the parent of the group is headquartered) can levy a USD10 top-up tax on the parent entity of the group (under what is called the *Income Inclusion Rule* or the *IIR*);
Or
- If neither Country Y nor India levy a top-up tax, any other country in which ABC group operates can collect the USD10 of tax (under what is called the *Undertaxed Payments Rule* or the *UTPR*). There are rules that determine how this USD10 will be divided between the various countries where the group operates.

The calculations required to give effect to these rules are very detailed and involve multiple steps/adjustments. Key elements involve jurisdictional blending, use of accounting profits as a base, adjustments for deferred taxes and other items, carve-outs and exclusions, interplay with the U.S. global intangible low-taxed income (GILTI) rules as well as potential safe harbour rules for simplification.

What are the key implications and next steps for businesses?

The GloBE rules are intended to be applied to MNEs with a consolidated global revenue of EUR750 million. However, it is possible that some elements of these rules could apply to or affect smaller groups as well. In such cases, the GloBE rules could entail:

- Potentially increased tax costs that would eliminate or offset the benefit of low rates or incentives enjoyed by the group in various countries
- A need to put systems in place to ensure availability of granular and robust data to undertake various calculations under the rules
- A need for review/realignment of group structure
- Increased compliance burden

The timelines for implementation are ambitious. It is expected that many countries will put in place domestic law changes based on the model rules over the course of 2022 with the final rules coming into force from 2023 onwards. As a result, groups must take several measures during the year to ensure preparedness, which could include - undertaking calculations of how these rules will affect them, impact on group structures, monitoring global developments, including on how individual countries are reacting to the GloBE rules and also consider and communicate its potential impact on customers and investors.

For more information, please read [Inclusive framework BEPS Agreement – policy perspectives](#), KPMG response to the Inclusive Framework BEPS announcement made on 20 December 2021.

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