CHAPTER 28

LATEST DEVELOPMENTS IN INTERNATIONAL TAXATION

LEARNING OUTCOMES

After studying this chapter, you would be aware of the -

- latest developments in OECD/G20 BEPS Project
- two Pillar approach to address tax challenges out of digitalization
- key highlights of Pillar One and Pillar Two of BEPS 2.0

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28.1 BRIEF BACKGROUND OF BEPS

What is BEPS?

Base erosion and profit shifting (BEPS) refers to tax planning strategies used by multinational enterprises that exploit gaps and mismatches in tax rules to avoid paying tax. Developing countries' higher reliance on corporate income tax means they suffer from BEPS disproportionately.

The report Addressing Base Erosion and Profit Shifting (OECD[1], 2013) concluded that no single tax rule on its own enables BEPS, it is rather the interplay among different issues that makes it possible. Domestic laws and rules that are not coordinated across borders, international tax standards that have not always kept pace with the changing global business environment and a pervasive lack of relevant information at the level of tax administrations and policymakers combine to provide opportunities for taxpayers to undertake BEPS strategies. The availability of harmful tax practices was also identified as a key pressure area.

Out of a shared desire to address BEPS concerns, there is agreement on a comprehensive package of measures which are designed to be implemented domestically and through treaty provisions in a coordinated manner, supported by targeted monitoring and strengthened transparency. The goal is to tackle BEPS structures by comprehensively addressing their root causes rather than merely the symptoms.

Thus, in 2015, under the OECD/G20 BEPS Project, 15 Actions Plans were delivered to tackle tax avoidance, improve the coherence of international tax rules, and ensure a more transparent tax environment (BEPS package).

ACTION-1 Addressing the tax challenges of the digital economy	**ACTION-2** Neutralise the effects of hybrid mismatch arrangements	**ACTION-3** Strengthen CFC Rules	**ACTION-4** Interest deductions and other financial payments	**ACTION-5** Counter harmful tax practices
ACTION-6 Preventing treaty abuse	**ACTION-7** Prevent the artificial avoidance of PE status	**ACTION-8** Transfer pricing	**ACTION-9** Transfer pricing	**ACTION-10** Transfer pricing
ACTION-11 Measuring and monitoring BEPS	**ACTION-12** Disclosure of aggressive tax planning arrangements	**ACTION-13** Re-examine transfer pricing documentation	**ACTION-14** Making dispute resolution more effective	**ACTION-15** Developing a multilateral instrument

[1] Organisation for Economic Co-operation and Development (OECD)

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Recognising all the progress made, including establishing a new OECD-G20 framework for more inclusive deliberations, it appears necessary to further deepen cooperation and focus on monitoring the implementation and effectiveness of the measures adopted in the context of the BEPS Project as well as the impact on both compliance by taxpayers and proper implementation by tax administrations.

OECD and G20 countries agree to keep working on an equal footing to monitor the implementation of the BEPS measures. The monitoring will consist of an assessment of compliance in particular with the minimum standards in the form of reports on what countries have done to implement the BEPS recommendations.

28.2 ESTABLISHMENT OF INCLUSIVE FRAMEWORK (IF)

Globalisation requires that global solutions and a global dialogue be established which go beyond OECD and G20 countries. The strong interest expressed by developing countries through their participation in the BEPS Project should be sustained by the establishment of an even more inclusive framework, which will continue to include other international organisations and regional tax organisations.

Drawing on the successful experience of the Global Forum on Transparency and Exchange of Information for Tax Purposes, in early 2016 OECD and G20 countries decided to work together to design and propose a more inclusive framework to support and monitor the implementation of the BEPS package, with countries and jurisdictions participating on an equal footing.

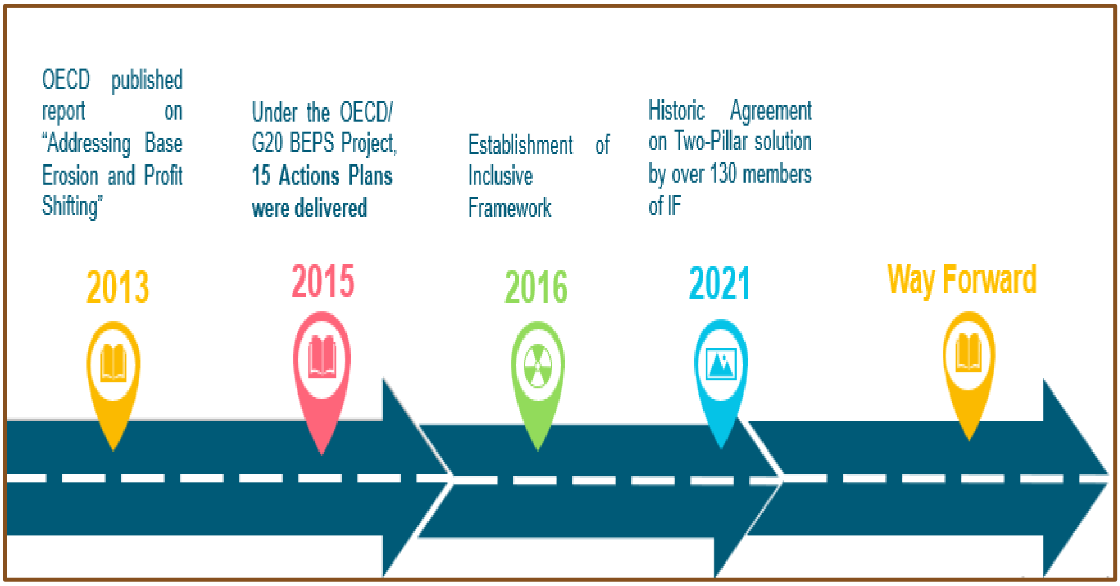
The idea was to include consideration of the manner in which non-OECD non-G20 countries and jurisdictions can commit to the agreed standards and their implementation. Thus, it was proposed to call on the OECD to prepare a framework by early 2016 with the involvement of interested non-G20 countries and jurisdictions, particularly developing economies, on an equal footing.

Resultantly, in June 2016, at the request of the G20, **the OECD/G20 Inclusive Framework on BEPS (Inclusive Framework)** was established in Kyoto, Japan with an initial membership of 89 countries and jurisdictions.

As of 28th May 2024, the Inclusive Framework includes 147 members, who, on an equal footing, monitor the implementation and contribute to the development of measures to combat BEPS, while reviewing and monitoring the implementation of the OECD/G20 BEPS Project.

28.3 INTRODUCTION OF TWO-PILLAR SOLUTION (BEPS 2.0)

In July 2021, 134 members of the Inclusive Framework, representing more than 90% of worldwide GDP, reached a historic agreement on a two-pillar solution to address the tax challenges of digitalisation and introduce a global minimum tax on the profits of large multinational enterprises (MNEs).



The agreement provides for fundamental tax reforms updating key elements of the century-old international tax system and will help countries protect their tax bases.

139 countries and jurisdictions have joined the landmark agreement reached on the 8th of October 2021 Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy (Two-Pillar Solution or 2021 October Statement).

It represented a major step forward in the reform of the international tax system and the outcome of intensive work carried out under BEPS Action 1 "Addressing the tax challenges arising from the digital economy," which has been the top priority of the OECD/G20 Inclusive Framework.

Since the agreement on the 2021 October Statement, the OECD/G20 Inclusive Framework has moved to its implementation, with significant progress achieved.

There are two parts to Pillar One: Amount A, the international framework for reallocation of taxing rights over profits of large and highly profitable MNEs; and Amount B, the simplified transfer pricing approach for baseline distribution activity.

Pillar Two is similarly structured around two complementary components: the Global Anti-Base Erosion (GloBE) Rules, which establish a minimum tax framework in each jurisdiction where large MNEs operate, and Subject-To-Tax-Rule (STTR), which allows a source jurisdiction to "tax back" where taxing rights have been ceded under a tax treaty and a payment is subject to a low nominal rate in the residence jurisdiction.

The following discussions provide an overview of Pillar One and Pillar Two.

28.3.1 Overview

Digital transformation spurs innovation, generates efficiencies, and improves services while boosting more inclusive and sustainable growth and enhancing well-being. At the same time, the breadth and speed of this change introduce challenges in many policy areas, including taxation.

Reforming the international tax system to address the tax challenges arising from the digitalisation of the economy, restore stability to the international tax framework and prevent further uncoordinated unilateral tax measures has therefore been a priority of the international community for several years, with commitments to deliver a consensus-based solution.

These tax challenges were first identified as one of the main areas of focus of the OECD/G20 BEPS Project, leading to the 2015 BEPS Action 1 Report (the Action 1 Report) (OECD, 2015). The Action 1 Report found that the whole economy was digitalising and, as a result, it would be difficult, if not impossible, to ring-fence the digital economy.

The 2015 Action 1 report provided the options to safeguard against BEPS on account of digitalisation, however, it did not provide any recommendations and left it to the discretion of the countries to resort to these measures as part of their domestic law. The report also indicated that it was agreed between the members to continue to monitor developments in respect of the digital economy.

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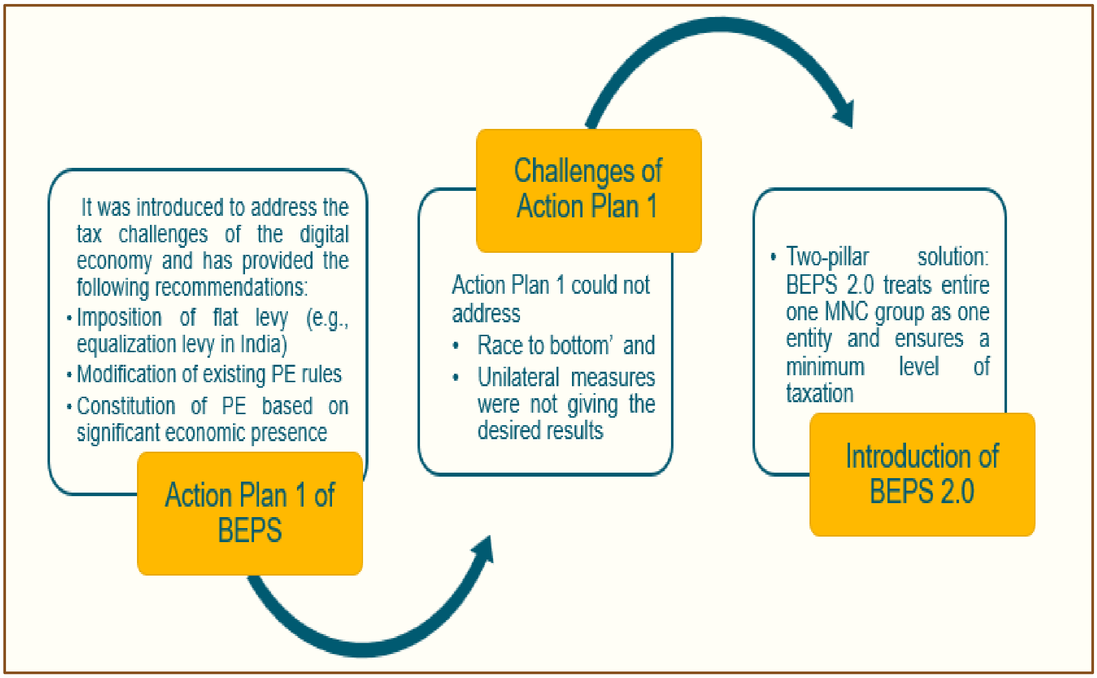
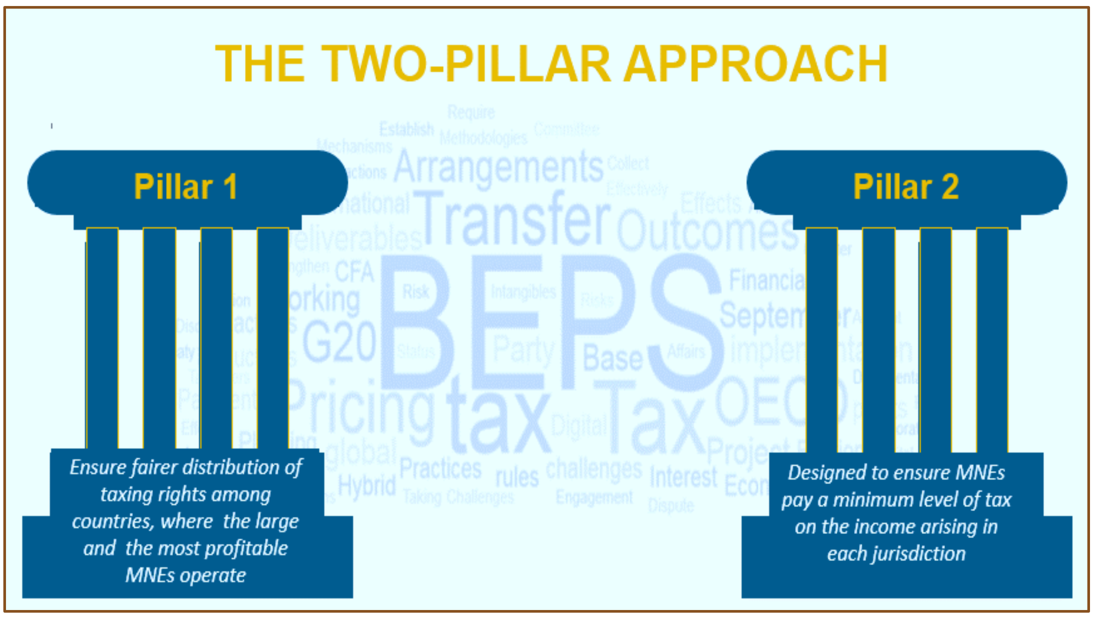


Pursuant to this, the OECD Inclusive Framework on BEPS came up with a consensus-based solution for tax challenges arising out of digitalisation (commonly known as BEPS 2.0), framed within two complementary pillars, namely, **Pillar One and Pillar Two**.



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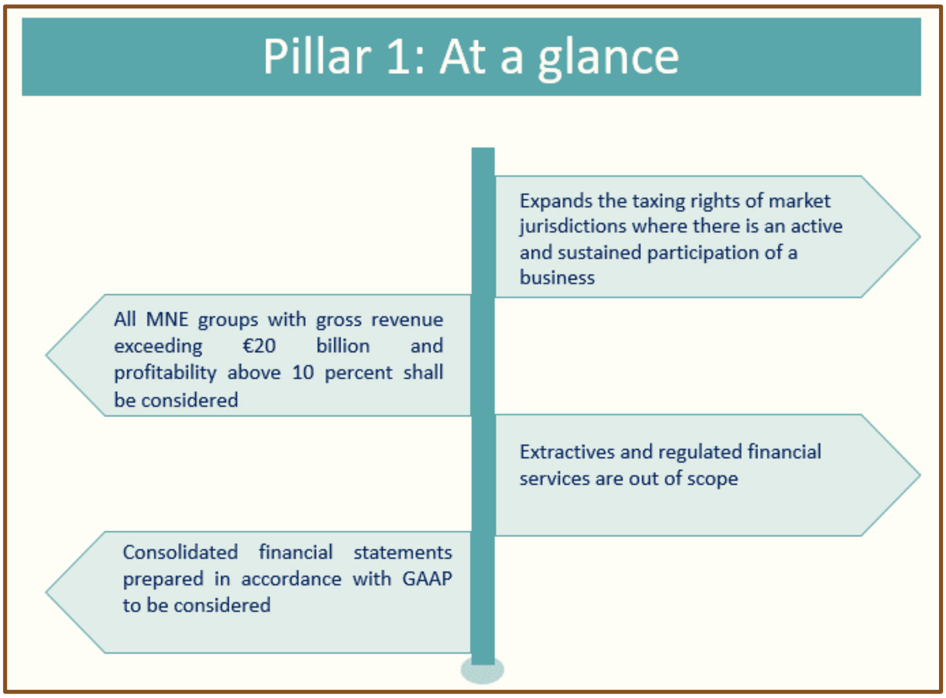
As already discussed above, 2021 October Statement has been agreed upon and joined by 139 countries and jurisdictions. The agreement demonstrates that developing countries can indeed play an active and influential role in international standard setting through their participation in the Inclusive Framework. This is not to say that the agreement reflects developing country preferences in all respects since all participants have recognised the need for compromise.

28.3.2 Pillar One

(1) Introduction

Pillar One is designed to deliver a sustainable taxation framework reflective of today's digitalising economy, with the potential to achieve a fairer and more efficient allocation of taxing rights.

It aims to ensure a fairer distribution of taxing rights among countries with respect to the largest and most profitable MNEs. It will reallocate taxing rights over a portion of the residual profits of MNEs to the market countries and jurisdictions where they have business activities, regardless of whether they have a physical presence there.



(2) Scope

In-scope companies are the MNEs with global turnover above 20 billion euros and profitability above 10% (i.e., profit before tax/revenue).

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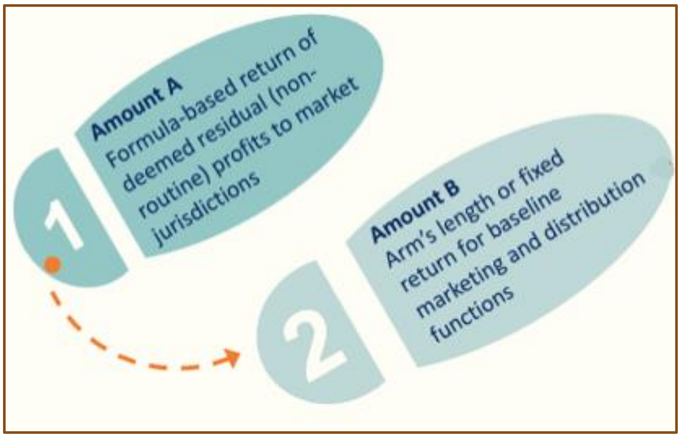
Extractives and regulated financial services are out of the scope of Pillar 1.

Under Pillar 1, an MNE is treated as a consolidated entity, and taxing rights are allocated on some predetermined formulas and assumptions which are briefly discussed in this chapter. These are primarily classified into two parts, Amount A and Amount B.



(3) Amount 'A' and Amount 'B'

Overview

Pillar 1 modifies nexus and profit allocation rules, redistributing super-profits to market jurisdictions of the MNE Groups. This allocated profit is termed as 'Amount A'. Market jurisdictions must fulfil the nexus test to be eligible for 'Amount A' allocation.

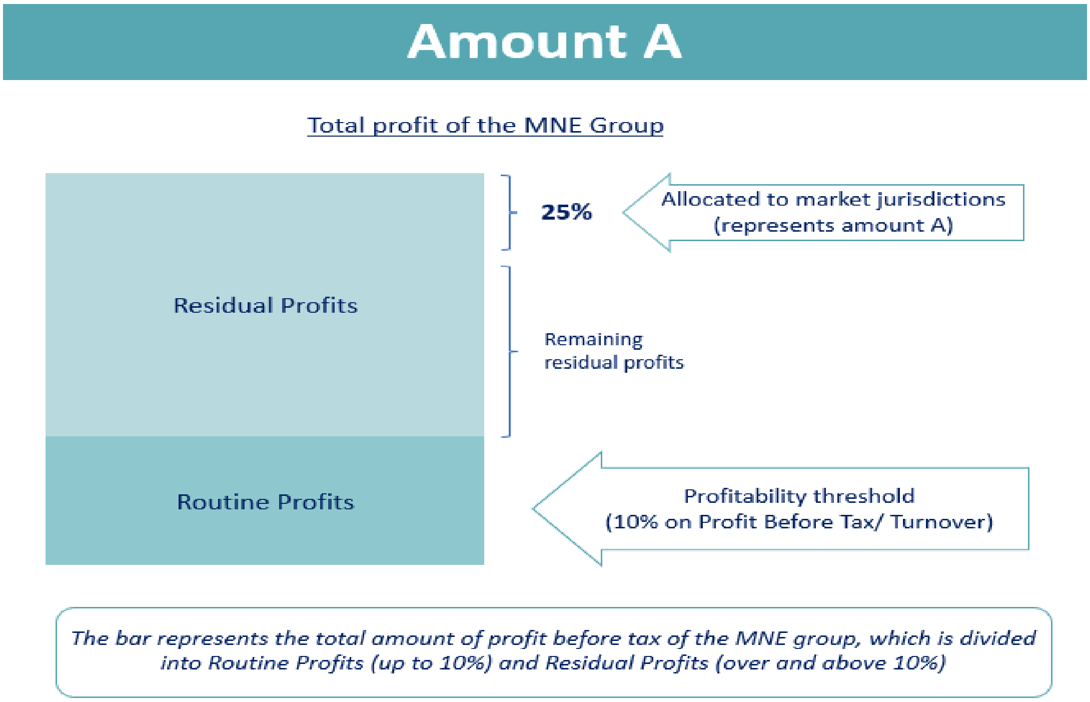
Amount B is a critical component of Pillar One. While the work on Amount A updates the international taxation framework with respect to large and very profitable multinational enterprises (MNE), Amount B simplifies the existing transfer pricing rules for all taxpayers. It is focused on the application of transfer pricing rules to so called baseline marketing and distribution activities, likely the most frequent fact pattern that MNEs encounter in the jurisdictions where they operate. Amount B is intended to increase tax certainty, reduce compliance and administrative costs and in particular assist low-capacity jurisdictions that often suffer from the absence of local market comparables.

The Inclusive Framework on BEPS is nearing completion of negotiations on a final package on Pillar One. This includes the text of Multilateral Convention (MLC) for Amount A and a framework for Amount B.

Broadly, the material released by OECD till date, explain Amount A and Amount B as under:

Amount 'A'

Amount A is **25% of the residual profit** defined as profit in excess of 10% of revenue that will be allocated to market jurisdictions with nexus using revenue-based allocation keys.



Allocation of Amount A is majorly based on the following two factors:

(i) Nexus Test

(ii) Revenue Sourcing Rules

Nexus test

The new special-purpose nexus rule applies solely to determine whether a jurisdiction qualifies for profit reallocation under Amount A. These rules will not alter the nexus for any other tax or non-tax purpose. Amount A is allocated to the market jurisdiction only if the nexus exists. To determine whether an MNE in-scope of Amount A satisfies the nexus test for Amount A in a jurisdiction, it will have to apply the **revenue sourcing rules** to identify the jurisdiction in which revenue arises for purposes of Amount A.

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To establish nexus, the market revenue thresholds is:

- Greater than or equal to €1 million for jurisdiction with annual GDP ≥ €40 billion
- Greater than or equal to €250,000 for jurisdiction with annual GDP < €40 billion

It transfers taxing rights over residual profits to jurisdictions with business activities regardless of the physical presence.

Revenue sourcing rules

Revenue will be sourced to the end market jurisdictions where goods or services are used or consumed. To facilitate the application of this principle, detailed source rules for specific categories of transactions will be developed. In applying the sourcing rules, an MNE must use a reliable method based on the MNE's specific facts and circumstances.

Revenues must be sourced according to the category of Revenues earned. Revenues that fall under more than one category are sourced according to their predominant character. Revenues derived from Supplementary Transactions may be sourced in accordance with the revenue sourcing rule that applies to the Revenues that they supplement.

Specific revenue sourcing rules provide a common basis for identifying an MNE's market countries that will benefit from Amount A, categorised per type of revenue. For revenues from online advertising, for example, the sourcing principle is based on the "eyeballs" of the viewer, and not on the location of the advertiser. To identify the viewer, the MNE should use data points that reliably indicate the location of the viewer, such as IP address or geolocation, or other reliable commercial information.

In some cases, it will be very challenging for an MNE to locate the end-user. This may be the case, for example, for revenues from cloud computing services, where the MNE may not have information available on where its customer's employees use the service. In order to provide certainty in these more challenging cases, the MNE is allowed to use targeted proxies or allocation keys, which approximate the market country (such as allocation keys based on statistical information on aggregated headcount data or macroeconomic proxies). This is a way to balance the compliance burden while ensuring that Amount A profits are reliably reallocated in all cases.

Once an MNE has determined how much revenue it generates in each of its market countries, Amount A profit will be reallocated only to the market countries where the MNE meets a new quantitative special purpose nexus test.

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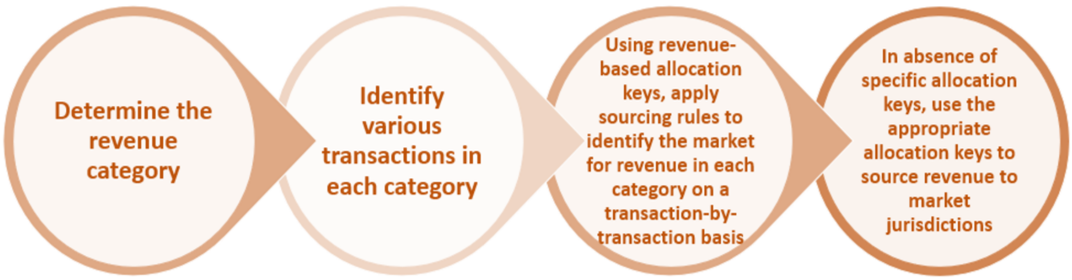
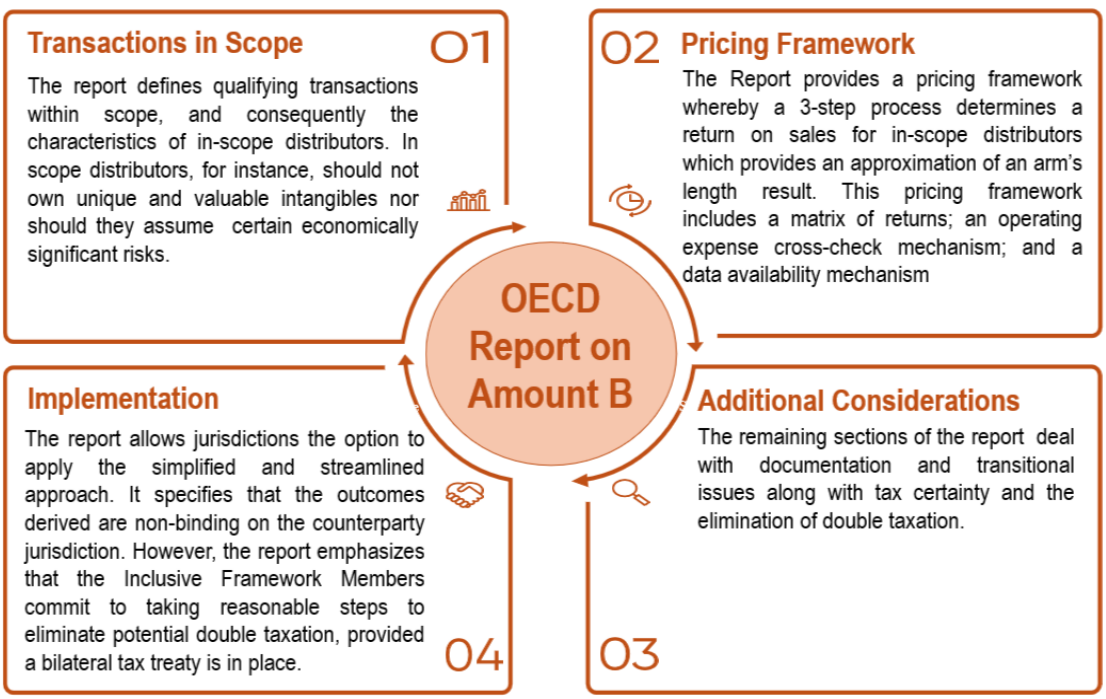
Process to be followed while applying the nexus test and the revenue sourcing rules is summarized as under:



Amount 'B'

The Inclusive Framework on BEPS released a report on Amount B of Pillar One on 19 February 2024, aimed at simplifying and streamlining the application of the arm's length principle to in-country baseline marketing and distribution activities, with a particular focus on the needs of low-capacity jurisdictions. On 17 June 2024, the Inclusive Framework published the pending design aspects of Amount B.

In summary, the framework for Amount B, as outlined in the report, is as follows:



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The Inclusive Framework continues working on an Amount B framework that goes beyond the elective approach and is linked with Amount A.

28.3.3 Pillar Two

(1) Introduction

This pillar explores the design of a system to ensure that MNEs pay a minimum level of tax. This pillar is intended to address the remaining issues identified by the OECD/G20 BEPS initiative by providing countries with new tools to protect their tax base from profit shifting to jurisdictions that tax these profits at below the minimum rate.

Pillar Two consists of the Global Anti-Base Erosion (GloBE) Rules and a treaty-based Subject to Tax Rule (STTR).

The GloBE Model Rules for the minimum tax were released in December 2021, followed by the related Commentary and Administrative Guidance. The GloBE Model Rules consist of an interlocking and coordinated system of rules which are designed to be implemented into the domestic law of each jurisdiction. The GloBE Rules introduced a 15% global minimum tax that applies to MNE groups with consolidated revenues of at least EUR 750 million. They consist of a coordinated system of rules, under a common framework, which ensures in-scope MNE groups pay at least the agreed minimum level of tax on the income arising in each of the jurisdictions in which they operate. The minimum level of tax may also be imposed locally under a qualified domestic minimum top-up tax. The implementation of the GloBE Rules has begun globally.

The STTR takes priority over the GloBE Rules. STTR is a treaty-based rule that allows jurisdictions to impose limited additional taxation on certain cross-border payments between connected companies where the recipient is subject to a nominal corporate income tax rate below 9%. The rule has been developed to cater for the priorities of developing countries and is an important part of achieving consensus on Pillar Two for developing countries. Inclusive Framework members can elect to implement the STTR by signing the MLI, or bilaterally amending their treaties to include the STTR when requested by developing Inclusive Framework members.

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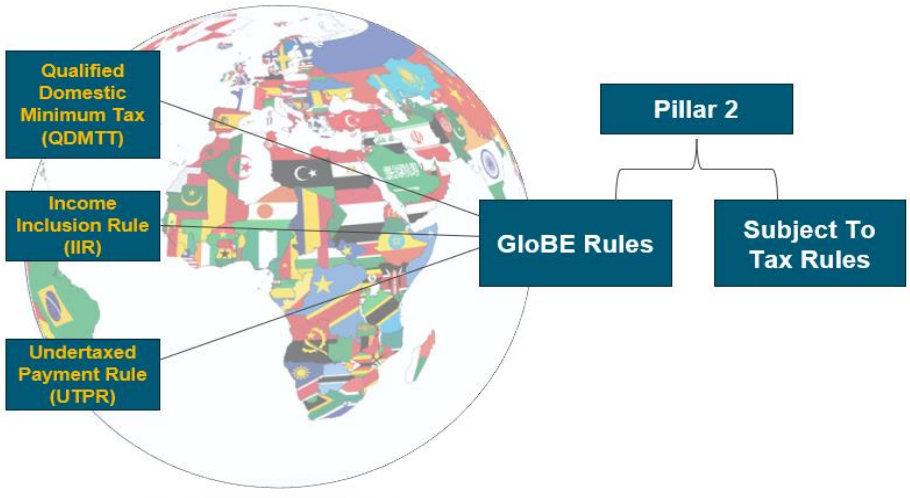
Common Approach: The jurisdictions are not required to adopt the GloBE rules, but if they choose to do so, they agree to implement them in a way that is consistent with the agreed outcomes.



(2) Key highlights of Pillar 2

Jurisdictional Blending	• Tax liability to be determined on a jurisdictional basis and will arise when the effective tax rate (ETR) of a jurisdiction in which the MNE Group operates is below the agreed minimum rate
Minimum Tax Rate	• Pillar 2 prescribes minimum rate of tax liability to be applied on MNEs, i.e., 15% under GloBE rules and 9% under STTR
Rule Order	• Under the model rules, a priority order is prescribed to be followed while applying the Pillar 2 rules
Deminimus Exclusion	• A simplification measure to exclude jurisdictions from the GloBE rules that have less than a certain percentage of the MNE Group's profit
Substance based Income Exclusion	• Provided to exclude a fixed return for substantive activities within a jurisdiction from the application of the GloBE Rules

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(3) STTR and Globe Rules

As already mentioned, Pillar Two consists of the Global Anti-Base Erosion (GloBE) Rules and a treaty-based Subject to Tax Rule (STTR). However, STTR rules works in prior to GloBE Rules. The model rules stipulate an order for applicability of the same, as provided under:

Subject to Tax Rules (STTR)

Overview

Works in priority to GloBE rules, STTR is a treaty-based rule that enables developing countries (source jurisdictions) to tax certain inter-company payments at source which are subject to nominal corporate income tax (at rates below the STTR minimum rate, i.e., **9%).** The STTR is based on an understanding that where, under a tax treaty, a source state has ceded taxing rights on certain outbound intragroup payments, it should be able to recover some of those rights where the income in question is taxed (if at all) in the state of the payee (i.e., the residence state) at a rate below 9%.

The objective is to prevent base erosion in 'developing countries' which are defined to have a gross national income per capita, calculated using the World Bank Atlas method, of USD 12,535 or less in 2019 (to be regularly updated).

Applicability

– Applicable only to covered payments, by an entity in a developing country, made to a group entity in another country, i.e., connected persons.

– Applies only if the total sum of covered income arising in the source country exceeds threshold of €250,000 or €1 mn per year (depending on the GDP of source country is above or below €40 bn).

Covered payments constitute Interest; Royalties; Payments for distribution rights for a product or service; Insurance or reinsurance premiums; Payments of guarantee or financing fees; Rental payments for industrial, commercial, or scientific equipment; Payments for services, etc.

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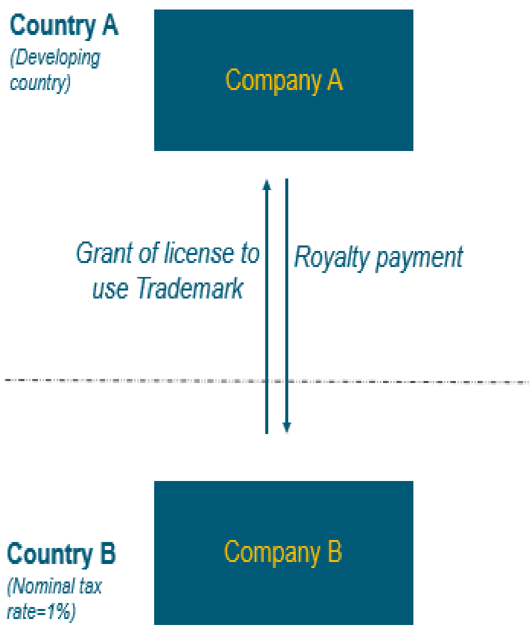
Connected persons are defined to have legal (direct or indirect ownership of more than 50% of the interests) or de facto control relationship.

Specified rate

The STTR specified rate is equal to the difference between 9% and the nominal rate applied in the resident State, further reduced by any source taxation already allocated to the source jurisdiction in accordance with other articles of the treaty.



Country A and Country B incorporated STTR provisions under their Tax Treaty	Rate
STTR rate	9%
Nominal tax rate applied in the resident jurisdiction [Country B]	1%
The payor jurisdiction [Country A] retains the 5% withholding tax right under the tax treaty	5%
STTR Specified rate [Country A to tax under STTR]	**3%**

Facts

– Company A is a company resident in Country A (a developing country) and has entered into a royalty agreement (payable in respect of the grant of license to use trademark owned by Company B) with Company B (resident of Country B). Accordingly, Country A shall be the ‘source jurisdiction’ and Country B shall be the ‘resident jurisdiction.’

– In consideration, royalty is payable by Company A to Company B.

– Country A and B has entered into a DTAA, i.e., Double Tax Avoidance Agreement or Tax Treaty, wherein the source jurisdiction retains withholding taxing rights @5% on royalty payments.

– Royalty payments are taxable @ 1% in Country B.

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Observations

In the above example, if a payor jurisdiction can impose a 5% withholding tax on a payment of Covered Income and the recipient is subject to a 1% nominal tax rate, the payor jurisdiction retains the 5% withholding tax right. However, as per the STTR, the payor jurisdiction can impose an additional tax equal to 3% of the Covered Income amount (9% - 5% - 1% = 3%).

GloBE Rules

Scope

The GloBE Rules apply to Constituent Entities that are members of an MNE Group that has annual revenue of EUR 750 million or more in the Consolidated Financial Statements of the Ultimate Parent Entity (UPE) in at least two of the four Fiscal Years immediately preceding the tested Fiscal Year.

MNE Group means any Group that includes at least one Entity or Permanent Establishment not located in the jurisdiction of the Ultimate Parent Entity whereas a Group means a collection of Entities that are related through ownership or control such that the assets, liabilities, income, expenses, and cash flows of those Entities are included in the Consolidated Financial Statements of the Ultimate Parent Entity.

Entities that are 'Excluded Entities' are not subject to the GloBE Rules. However, their revenue is still taken into account for the purposes of the consolidated revenue test. The Excluded Entities are Government entities, international organizations, non-profit organizations, pension funds or investment funds that are Ultimate Parent Entities (UPE) of an MNE Group or any holding vehicles used by such entities, organizations or funds. However, this exclusion does not affect the MNE Group owned by such entities, which will remain in scope of the GloBE rules if the group as a whole otherwise meets the consolidated revenue threshold.

Overall design

Pillar Two consists of the following rules (together the GloBE rules):

(i) **Qualified Domestic Minimum Top-up Tax (QDMTT):** QDMTT imposes a jurisdictional top-up tax on the constituent entity located in a low-taxed jurisdiction (LTJ). It allows the LTJ to collect the top-up tax computed in accordance with the GloBE rules.

QDMTT provides the right to the LTJ to collect the jurisdictional top-up tax by way of the introduction of QDMTT in its domestic tax laws. This would preserve a jurisdiction's primary right of taxation over its own income.

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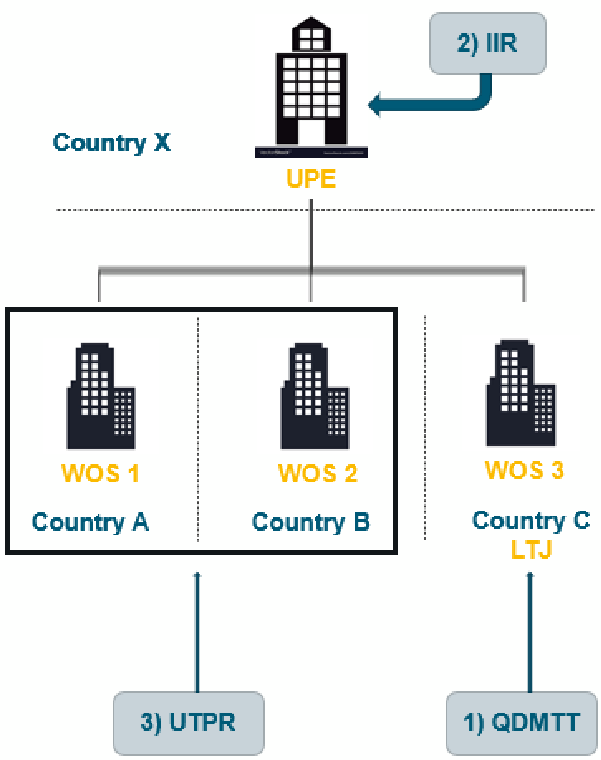
(ii) **Income Inclusion Rule (IIR):** IIR imposes a top-up tax on a parent entity in respect of the constituent entity located in low-taxed jurisdiction.

A Constituent Entity, that is the UPE of an MNE Group, located in a GloBE implementing jurisdiction that owns (directly or indirectly) an Ownership Interest in a Low-Taxed Constituent Entity at any time during the Fiscal Year shall pay a tax in an amount equal to its Allocable Share of the Top-Up Tax of that Low-Taxed Constituent Entity for the Fiscal Year.

(iii) **Undertaxed Payment Rule (UTPR):** UTPR imposes deductions or requires an equivalent adjustment to the extent the low tax income of a constituent entity is not subject to tax under an IIR.

UTPR is triggered where the UPE jurisdiction does not implement IIR or does not adopt GloBE rules. Thus, UTPR serves as a backstop to IIR. UTPR transfers the levy of top-up tax to other constituent entities of the MNE group located in the jurisdiction where the GloBE rules are implemented.

Let us understand the mechanism of these three rules from the example below:



Observations

The UPE of an MNE group located in Country X has three wholly owned subsidiaries ("WOS") in Country A, B, and C. Let's say, Country C is a low-taxed jurisdiction ("LTJ"). The priority ranking as per the model GloBE rules prescribes that:

Priority 1 – Where Country C imposes QDMTT in its jurisdiction, the jurisdictional top-up tax shall be imposed on WOS 3 (refer to the diagram above).

Priority 2 – Where Country C does not impose QDMTT in its jurisdiction, the UPE of an MNE Group located in Country X which has implemented IIR under GloBE rules shall be liable to pay a tax in an amount equal to its Allocable Share of the Top-Up Tax of WOS 3 in Country C

Priority 3 – At last where neither Country C nor Country X implements QDMTT or IIR respectively, and Country A and Country B has implemented UTPR under GloBE rules, WOS 1 and WOS 2 shall be liable to pay jurisdictional top-up (pertaining to WOS 3) tax under UTPR in their jurisdictions, i.e., Country A and B respectively.

Other Important Topics under GloBE Rules

(i) **Effective Tax Rate (ETR):** The GloBE rules will operate to impose a top-up tax using an **effective tax rate** test that is calculated on a **jurisdictional basis.** If the jurisdictional ETR is below the 15% minimum rate, the jurisdiction is treated as a low-tax jurisdiction and the constituent entities are treated as low-taxed constituent entities (LTCE). The Effective Tax Rate of the MNE Group for a jurisdiction shall be calculated for each Fiscal Year.

Effective Tax Rate = Total of Adjusted Covered Taxes of each Constituent Entity located in the jurisdiction / Net GloBE Income of the jurisdiction

Where,

– Adjusted Covered Taxes are the taxes attributable to the income of a Constituent Entity.

  The amount of a Constituent Entity's Covered Taxes is determined by taking the Constituent Entity's current taxes for the Fiscal Year, adjusted to reflect certain timing differences. Covered Taxes are allocated from one Constituent Entity to another in certain cases. To the extent there are changes in tax liability after filing, additions or reductions to taxes are identified and allocated to a particular jurisdiction and time period.

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– the Net GloBE Income of a jurisdiction for a Fiscal Year is the positive amount, if any, computed in accordance with the following formula:

Net GloBE Income = GloBE Income of all Constituent Entities – GloBE Losses of all Constituent Entities

Under the OECD Model Rules, the jurisdictional net GloBE income is the total GloBE income of all constituent entities in the jurisdiction, less any GloBE losses of constituent entities in the jurisdiction.

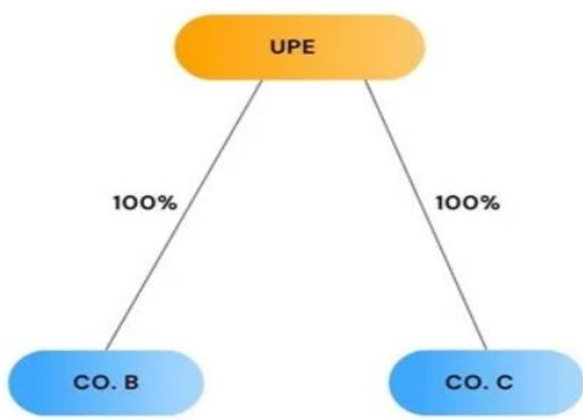
If there is a net GloBE loss, this means the ETR need not be calculated. In most cases this would mean no top-up tax would be due.

(ii) **Jurisdictional Blending:** The ETR computation is determined on a **jurisdictional blending basis**. **Jurisdictional blending** allows all the profits, losses, and taxes of the Constituent Entities of the MNE Group located in the same jurisdiction to be blended for purposes of the effective tax rate calculation.

Note - For the purpose of determining the applicability of the GloBE Rules, global revenue is considered. However, for determining ETR, the calculation is done on jurisdictional basis.

Let us understand the above concepts with the help of following example:

UPE Co. (Country A) has wholly owned subsidiaries B Co. and C Co. in Country B.



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Details related to both the subsidiaries are as follows:

Particulars	Company B	Company C
GloBE income	5,000,000 euros	10,000,000 euros
Adjusted covered taxes	1,000,000 euros	1,000,000 euros
Investments in qualifying local tangible assets and payroll costs	10,000,000 euros	20,000,000 euros

The calculation of ETR:

Adjusted Covered Taxes of Country B (i)	2,000,000 euros
Net GloBE Income in Country B (ii)	15,000,000 euros
ETR (i)/(ii)	13.3333%

Thus, the ETR of the above MNE group for Country B is 13.3333%.

Further, if Company B had incurred losses of 5,000,000 euros, the net GloBE income for Country B would have been 5,000,000 euros instead of 15,000,000 euros. This is because of the concept of jurisdictional blending.

(iii) Substance-based Income exclusion (SBIE) or Substance-based carve-outs: The Net GloBE Income for the jurisdiction shall be reduced by the Substance-based Income Exclusion for the jurisdiction to determine the Excess Profit for purposes of computing the Top-up Tax.

The GloBE rules provides the SBIE amount for a jurisdiction which is the sum of the payroll carve-out and the tangible asset carve-out for each Constituent Entity in that jurisdiction. The amount of this substance-based income exclusion is equal to the sum of (i) 5% of the carrying value of tangible assets located in the jurisdiction and (ii) 5% of the payroll costs for employees who perform activities in the jurisdiction. The GloBE rules also provide for a 10-year transition period in recognition of the potential impact of the GloBE rules on existing incentives and existing investment. It shall be 8% of carrying value of eligible tangible assets and 10% of eligible payroll costs, both will phase down to 5% over 10 years.

A substance carve-out based on assets and payroll costs allows a jurisdiction to continue to offer tax incentives that reduce taxes on routine returns from investment in substantive activities, without triggering additional GloBE top-up tax.

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(iv) Top-up Tax: The Jurisdictional Top-up Tax for a jurisdiction for a Fiscal Year is equal to the positive amount, if any, computed in accordance with the following formula:

Jurisdictional Top-up Tax = (Top-up Tax Percentage X Excess Profit) + Additional Current Top-up Tax – Domestic Top-up Tax

Where,

– the Top-up Tax Percentage for a **jurisdiction** shall be the positive percentage point difference, if any, computed in accordance with the following formula:

Top up Tax Percentage = Minimum Rate – Effective Tax Rate [ETR]

– the Excess Profit for the jurisdiction is the positive amount, if any, computed in accordance with the following formula:

Excess Profit = Net GloBE Income – Substance Based Income Exclusion

Note: The Top-up tax percentage is calculated based on the aggregate profits, i.e., Net GloBE income. However, it is applied to the excess income, i.e., Net GloBE income – substance-based income inclusion in order to provide the benefits of incentives to MNEs.

Continuing our example, we refer to the information collated below:

Minimum tax rate (i)	**15%**
ETR (ii)	13.333%
Net GloBE Income in Country B (iii)	15,000,000 euros
Substance-based income exclusion [2] (iv)	1,500,000 euros
Top up Tax Percentage (i) - (ii)	**1.6667%**
Excess Profit (iii) - (iv)	**13,500,000 euros**
Top-up tax for Country B*	**225,004 euros**

*Assuming there is no additional top-up tax or any tax payable under a qualifying domestic top-up tax.

[2] calculated@5%of eligible tangible assets and eligible payroll costs

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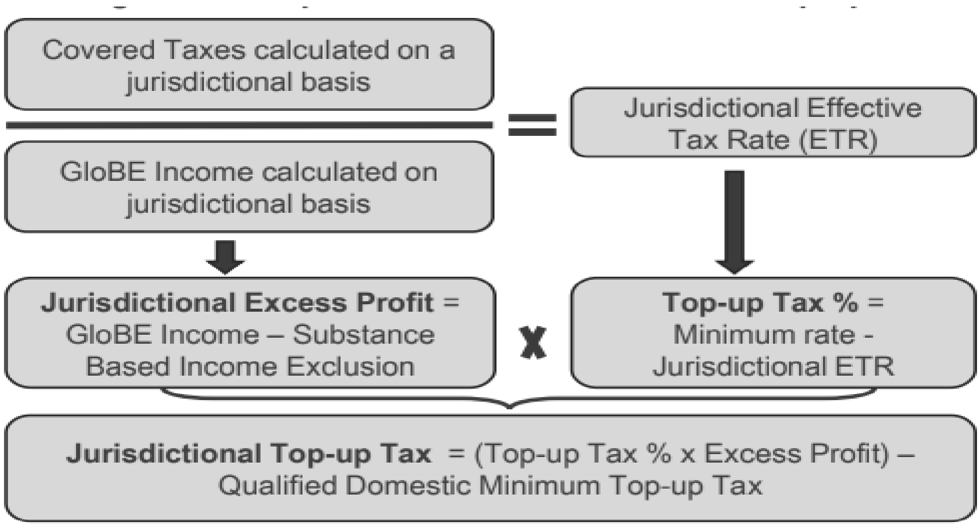
The concepts explained in the earlier points are summarized as under:



(v) **De-minimis Exclusion:** The GloBE rules, at the election of the Filing Constituent Entity, provides a jurisdictional exclusion for LTCEs of an MNE Group on meeting the following criterion:

– the Average GloBE Revenue of such jurisdiction is less than EUR 10 million; and

– the Average GloBE Income or Loss of such jurisdiction is a loss or is less than EUR 1 million

The policy intent underlying the above exclusion is to avoid the complexities of a full ETR computation in cases where the amount of any Top Up Tax would not seem to justify the associated compliance and administrative costs.

Resources: The discussion on Pillar One and Pillar Two contained in this chapter is primarily based on the content available at the website http://www.oecd.org

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