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Analysing developments impacting business

AGREEMENT ON GLOBAL MINIMUM TAX RATE

11 October 2020

Traditionally, the taxation of business profits has been linked to a physical presence-based nexus rule. While this was sufficient in the brick-and-mortar economy, the rapid digitalisation of the economy (with growth of digital platforms like Facebook, Amazon, Netflix, Google etc) meant that the existing tax rules were not sufficient in relation to taxation of digital economy. Businesses no longer need physical presence to derive economic benefits from a jurisdiction. This raised concerns for 'market jurisdictions' having the customer / user base, which, in the absence of a taxing right, were not getting their fair share of tax revenues on the income earned by offshore businesses from their territory. While this issue was first identified around two decades ago and being deliberated on since then, efforts and concrete steps in this direction have picked pace in the past few years.

136 countries (out of the 140 members of OECD / G20 Inclusive Framework on Base Erosion and Profit Shifting, ie BEPS-IF) have joined the *Statement on the Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy* (Statement). This is a historic development on the global tax framework. It takes the development of [July 2021 \(July Statement\)](#) one step further and not only reiterates the international commitment to ensure a fair international tax regime, but also attempts to put the developing countries on an equal footing with the rest of the world. Four countries that have not yet joined the Statement are: Kenya, Nigeria, Pakistan and Sri Lanka.

The Statement

The Statement reflects agreement on changes to tax rules that are clubbed into two 'pillars' – Pillar One and Pillar Two.

➤ **Pillar One**

- **Amount A** is a new taxing right for market jurisdictions (ie, countries where customers are located), whereby once a company's profit exceeds 10% of revenues, market jurisdictions would be able to tax 25%* of the profits above that level.

(*Note: In July Statement, it was mentioned that 20%-30% of such residual profits would be allocated to market jurisdictions.)

- **Amount B** aims to standardise the remuneration of related party distributors that perform baseline marketing and distribution activities in a manner that is aligned with the arm's length principle. Amount B is aimed at simplifying transfer pricing rules and enhancing tax certainty.
- To provide **tax certainty**, an elective binding dispute resolution mechanism will be available* for issues related to Amount A for developing economies.

(*Note: In July Statement, it was only mentioned that consideration will be given to an elective binding dispute resolution mechanism.)

- The Statement also provides that countries will be required to withdraw* all **Digital Services Taxes** and other relevant similar measures with respect to all companies, and to commit not to introduce such measures in the future. No newly enacted Digital Services Taxes or other relevant similar measures will be imposed on any company from 8 October 2021 and until the earlier of 31 December 2023 or the coming into force of the implementing Multilateral Convention (MLC).

(*Note: In July Statement, it was only mentioned that the implementation package will provide for appropriate coordination between the application of the new international tax rules and the removal of all Digital Service Taxes and other relevant similar measures on all companies.)

➤ Pillar Two

- **Global anti-Base Erosion Rules (GloBE Rules)** broadly provide that if the income of an entity in the multinational group is taxed at below an agreed minimum tax rate, the residence jurisdiction of the eligible parent entity will be able to levy an additional tax to the extent of difference between the effective tax levied and the agreed minimum rate. The Statement provides for a minimum tax rate of 15%*. Now, the Statement also provides the *de minimis* exclusion for jurisdictions from the applicability of GloBE Rules – ie revenues of less than Euro 10 million and profits of less than Euro 1 million.

(*Note: In July Statement, it was mentioned that the minimum tax rate will be at least 15%.)

- **Subject to Tax Rule (STTR)** will allow source jurisdictions to impose limited source taxation on related party payments (being interest, royalties and a defined set of other payments) that are subject to tax below a minimum rate in the residence jurisdiction. The minimum rate for STTR has been fixed at 9%*.

(*Note: In July Statement, it was mentioned that the minimum rate for STTR will be between 7.5% to 9%.)

Comments

This is a landmark development in the field of international tax to ensure an equitable distribution of taxation rights amongst countries. Under Pillar One, taxing rights on more than USD 125 billion of profit are expected to be reallocated to market jurisdictions each year. Further, the new minimum tax rate under Pillar Two is estimated to generate around USD 150 billion in additional global tax revenues annually. Having said so, it appears that as part of this global commitment, India will have to let go of its 'Equalisation Levy' (popularly known as the Google Tax). These developments are likely

to come into effect in 2023. Hence, progress on this front should be closely watched out.

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