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International Taxation I OECD's Two-Pillar Solution to Address the Tax Challenges

The exponential growth of digital businesses globally without having the need of being physically present in any taxing jurisdiction has changed the age-old taxation landscape. Exploiting the gaps and mismatches between taxation of various nations by the multinational corporations have led to domestic tax base erosion and profit shifting (BEPS). In order to keep pace with the digital revolution and taxing the international businesses by adopting a harmonised approach, check tax avoidance and curb the profit shifting to low tax jurisdictions was the need of the hour. The G20 and OECD (Organisation for Economic Co-operation and Development) nations undertook the bold project to address these issues, India being one of those 140 nations.

Recently, i.e. in July 2021, the OECD member countries agreed to adopt a two-pillar approach to address the taxation challenges from digitisation of the economies. This aims at taxing the global profits of large multinational enterprises (MNEs). The taxation plan is comprised of a two-pillar arrangement, wherein Pillar 1 deals with the nexus of market jurisdictions to tax the income of the 'in-scope MNE' and Pillar 2 deals with the 'global minimum tax' provision. On 13 October 2021, the OECD submitted its two-pillar solution to the G20 Finance Ministers and the Central Bank Governors. The same aims to ensure a fairer distribution of profits and taxing rights among countries with respect to the largest MNEs.

Pillar 1: An enterprise would be liable to taxation in its source market jurisdiction if it meets the nexus test in a particular jurisdiction. Once the nexus is established, the revenue and profitability criteria need to be established to tax a particular MNE in that jurisdiction.

a. Nexus Rule: If an MNE derives a revenue of minimum EUR 1 million from a particular market jurisdiction, then the 'nexus' is established. For economies having GDP of less than EUR 40 billion, the minimum revenue required to meet the nexus is EUR 2,50,000 (1/4th of 1 million).
b. Revenue and profitability criteria: After satisfying 'a' above, MNE having a global turnover of EUR 20 billion along with profitability of 10% (PBT) will be covered under Pillar 1; 25% of the residual profits beyond the abovesaid 10% profits will be allocated to the relevant market jurisdiction (nexus of jurisdiction depends upon the MNE's consumer base, i.e. where its goods and services are consumed.)
c. The relevant measure of profit/loss will be determined with reference to the 'accounting income.' Carry forward of losses will be allowed.
d. Double taxation of profit allocated to market jurisdictions will be relieved using either the exemption method or credit method.
e. The multilateral convention (MLC) requires the member nations to remove the 'Digital Services Taxes' and such similar levies once the MLC comes into force.

Pillar 2: It introduces a global minimum corporate tax rate set at 15%. The new minimum tax rate will apply to companies with revenue above EUR 750 million and is estimated to generate around USD 150 billion in additional global tax revenues annually. Further benefits will also arise from the stabilisation of the international tax system and the increased tax certainty for taxpayers and tax administrations.

The OECD member countries are aiming to sign this MLC during 2022, with its effective implementation in 2023, which will bring more certainty and help ease trade tensions.

Weblink https://www.oecd.org/g20/topics/international-taxation/oecd-secretary-general-tax-report-g20-finance-ministers-october-2021.pdf

Therefore

The MLC will ensure a fairer distribution of profits and taxing rights among countries while also ensuring a minimum global tax for the most profitable corporations. This would prove a major victory for effective and balanced multilateralism. It is a far-reaching agreement which ensures that international tax system is fit for its purpose in a digitalised and globalised world economy.