Deloitte.

Carlo L. Navarro
Southeast Asia Transfer Pricing Leader
Partner, Deloitte Philippines
Tel: +63 2 8581 9035

www.linkedin.com/in/carlo-llanes-navarro-9866638/

canavarro@deloitte.com

Scan the QR code to save Carlo's details to your contacts

BEPS 2.0: New taxing right and global minimum tax

Welcome and thank you for joining.
The event will begin shortly.

Carlo L. Navarro

Southeast Asia Transfer Pricing Leader
Partner, Deloitte Philippines
Email: canavarro@deloitte.com
Tel: +63 2 8581 9035

Carlo L. Navarro is currently Deloitte's Southeast Asia (SEA) Transfer Pricing Leader and heads Deloitte's SEA Transfer Pricing Centre located in Manila, Philippines. He specializes in transfer pricing, international corporate restructuring and planning, cross-border taxation, and tax-effective supply chain transformations.

Before joining Deloitte, Carlo led transfer pricing and international tax practices of Big 4 firms around Southeast Asia. He has over 20 years of experience working in various jurisdictions in Southeast Asia as an International Tax and Transfer Pricing practitioner, giving him practical experience in dealing with Tax Authorities of these countries.

He has assisted clients in various phases of transfer pricing engagements, from planning, documentation and audit defense to negotiating APAs and MAPs. He has an excellent reputation in handling transfer pricing audits and bilateral negotiations.

As a recognized subject matter expert, he has published various articles in international tax journals, covering issues on permanent establishments, taxation and transfer pricing aspects of business restructuring, and the latest developments in the area of transfer pricing in Southeast Asia.

Education

- International Tax Law (2003-2004), Harvard Law School, Harvard University, Cambridge, Massachusetts, USA
- Law (1993-1997), University of the Philippines
- Political Science (1989-1993), University of the Philippines

Awards and recognition

- Leading TP adviser in the Philippines (2017, 2019, 2021), Euromoney's Expert Guides, Guide to the World's Leading Transfer Pricing Advisers.
- Transfer Pricing Firm of the Year, Philippines (2018, 2020, 2021), International Tax Review.
- Leading TP Adviser in Indonesia (2011, 2013 and 2015), Euromoney's Expert Guides, Guide to the World's Leading Transfer Pricing Advisers.
- Transfer Pricing Firm of the Year, Indonesia (2016), International Tax Review.
- Tax Controversy Leader, Indonesia (2014, 2015, 2016) and Philippines (2017, 2018, 2019), International Tax Review.

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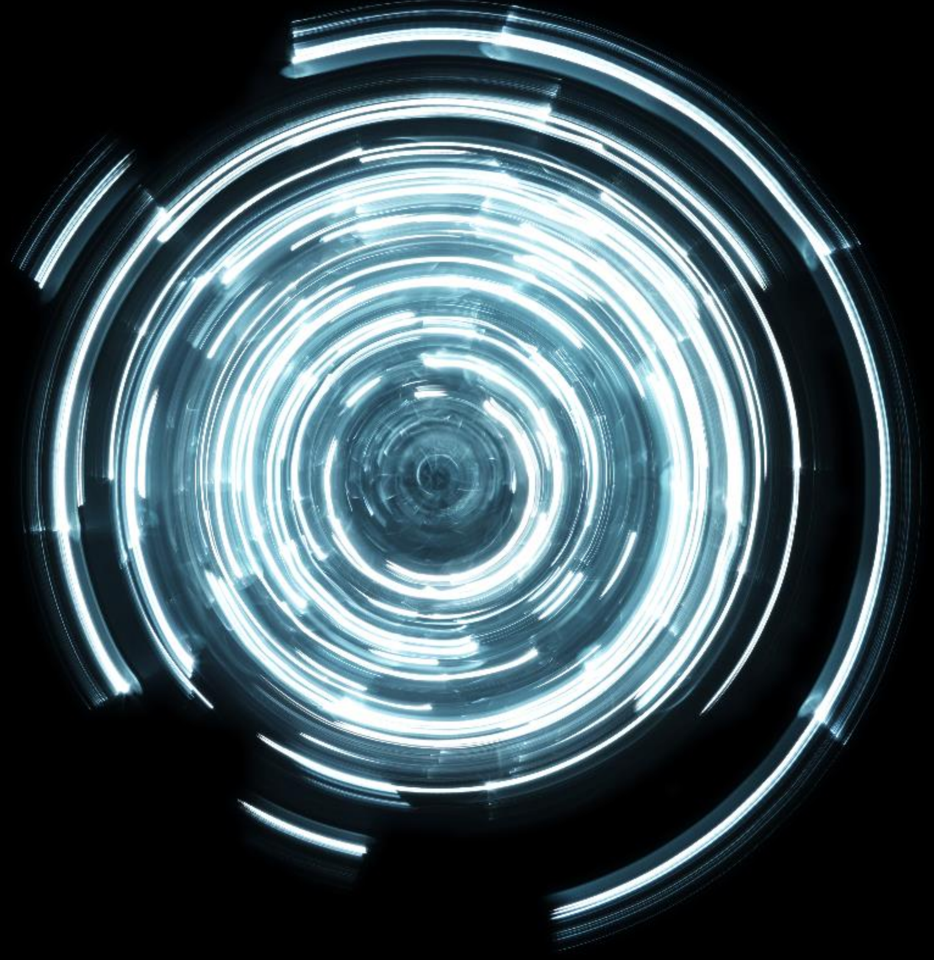
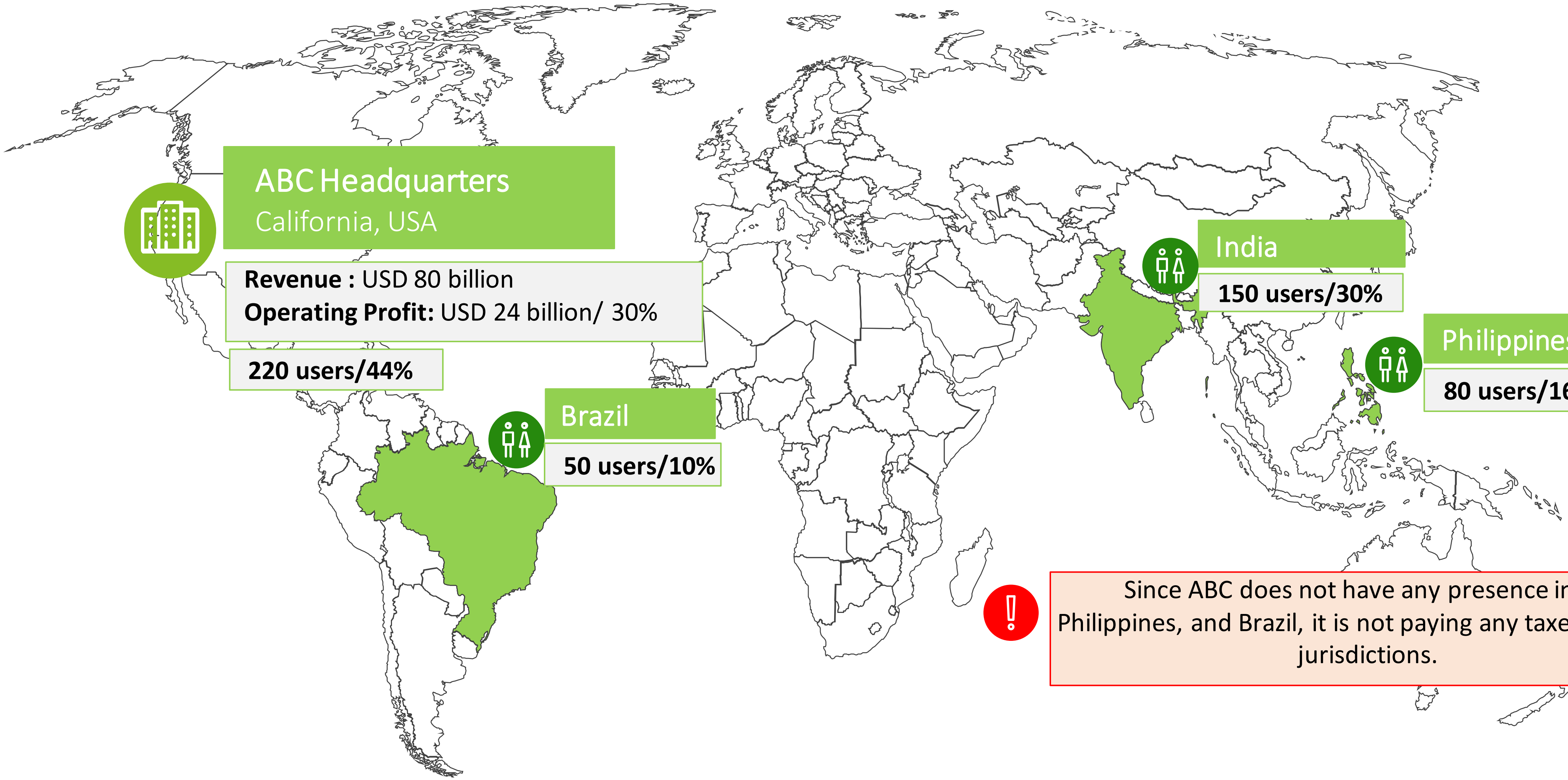


01

What is BEPS 2.0?

BEPS 2.0: New Taxing Right and Global Minimum Tax

Overview - Example



Since ABC does not have any presence in India, Philippines, and Brazil, it is not paying any taxes in those jurisdictions.

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Progress to date

2007-09 Global recession

2015 OECD issued 15 BEPS action reports, with Action Plan 1 to address tax challenges arising from Digital Economy

2019 Roadmap to develop a consensus solution to address tax challenges arising from Digital Economy

Oct 2020 Blueprint based on two-pillar approach

June-July 2021 G7/G20/IF member consented on two-pillar approach

October 2021: agreement reached by 136 out of the 140 Inclusive Framework members on core design features of the two-pillar solution

2022 Development of model legislation and multilateral instrument for implementation

2023 Implementation of the two-pillar solution

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The Two-Pillar Approach

The OECD continues its work towards overhauling the international tax system, with its main areas of focus being:

Pillar 1

Allocation of taxing rights to market jurisdictions

- **Amount A:** New taxing right in market jurisdiction
- **Amount B:** Standardization of remuneration of limited-risk distributors
- **Tax certainty:** Through effective dispute prevention and resolution

Pillar 2

Global minimum taxation

- **Subject-to-tax rule:** Taxation of specific types of intra-group payment
- **Income Inclusion rule:** Minimum level of taxation in each jurisdictions
- **Undertaxed payments rule:** Backstop rule and applies where income inclusion rule can not be applied

02

Pillar 1: **Amount A**

Pillar 1: New approach to allocation of taxing rights **(Amount A)**

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Amount A

Pillar 1 blueprint outlines following steps for application of the Amount A:

01

Step 1: Scope rule
Ascertain whether the MNE group will be subject to Amount A based on certain profitability thresholds

02

Step 2: Nexus rule
Define the market jurisdictions which will be entitled to Amount A

03

Step 3: Revenue sourcing rule
Determine the revenue that would be treated as derived from market jurisdictions

04

Step 4: Tax base determination rule
Determine the tax base to be used for the determination of Amount A (Calculate the MNE's profit)

05

Step 5: Profit allocation rule
Formula to calculate and allocate Amount A to market jurisdictions

06

Step 6: Elimination of double taxation rule
Identification of paying entity and elimination of double taxation arising in conjunction with existing tax rules

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Amount A

01

Step 1: Scope rule
Ascertain whether the MNE group will be subject to Amount A based on certain profitability thresholds

For an MNE group to be subject to Amount A, it must satisfy the following criteria:

Global Revenue Threshold	MNEs with global annual turnover above **20 billion Euros*** *to be reduced to EUR 10 billion by 2030
Profitability Threshold	MNEs with profitability above **10% (profit before tax/revenue)**
Carveouts	MNEs operating in the **extractives** and **regulated financial services** industries are **excluded.**

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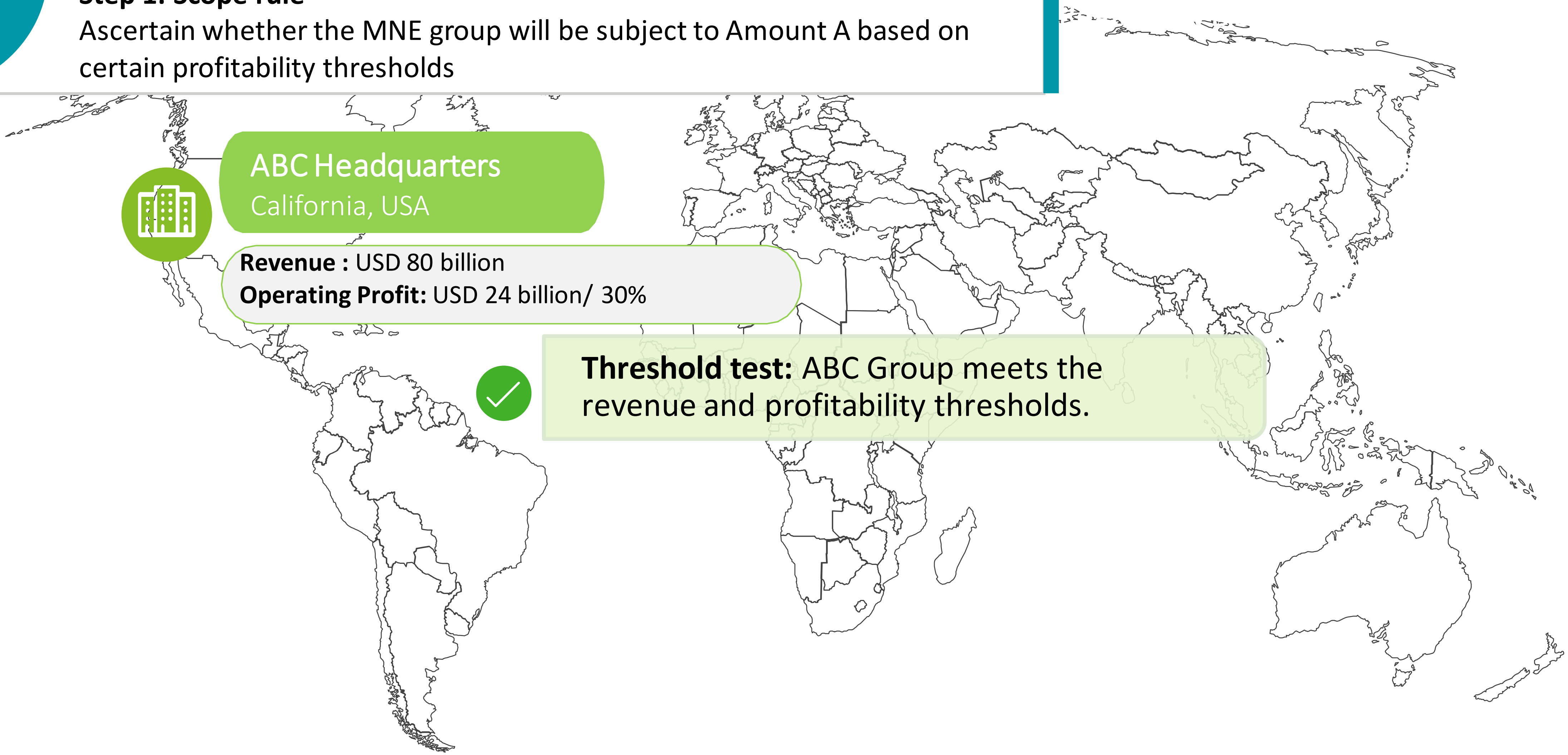
Example

01

Step 1: Scope rule
Ascertain whether the MNE group will be subject to Amount A based on certain profitability thresholds



ABC Headquarters
California, USA

Revenue : USD 80 billion
Operating Profit: USD 24 billion/ 30%

Threshold test: ABC Group meets the revenue and profitability thresholds.

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Amount A

02

Step 2: Nexus rule
Define the market jurisdictions which will be entitled to Amount A

A jurisdiction where consumers/users are located will have a right to tax a portion of an MNE's excessive profit, if **nexus** is established

Large Jurisdictions	Small Jurisdictions*
Revenue should be **at least** EUR 1 million	Revenue should be **at least** EUR 250,000 *jurisdictions with GDP of **less than** 40 billion

! The Amount A nexus cannot be used for any other tax purpose (including VAT and customs duties)

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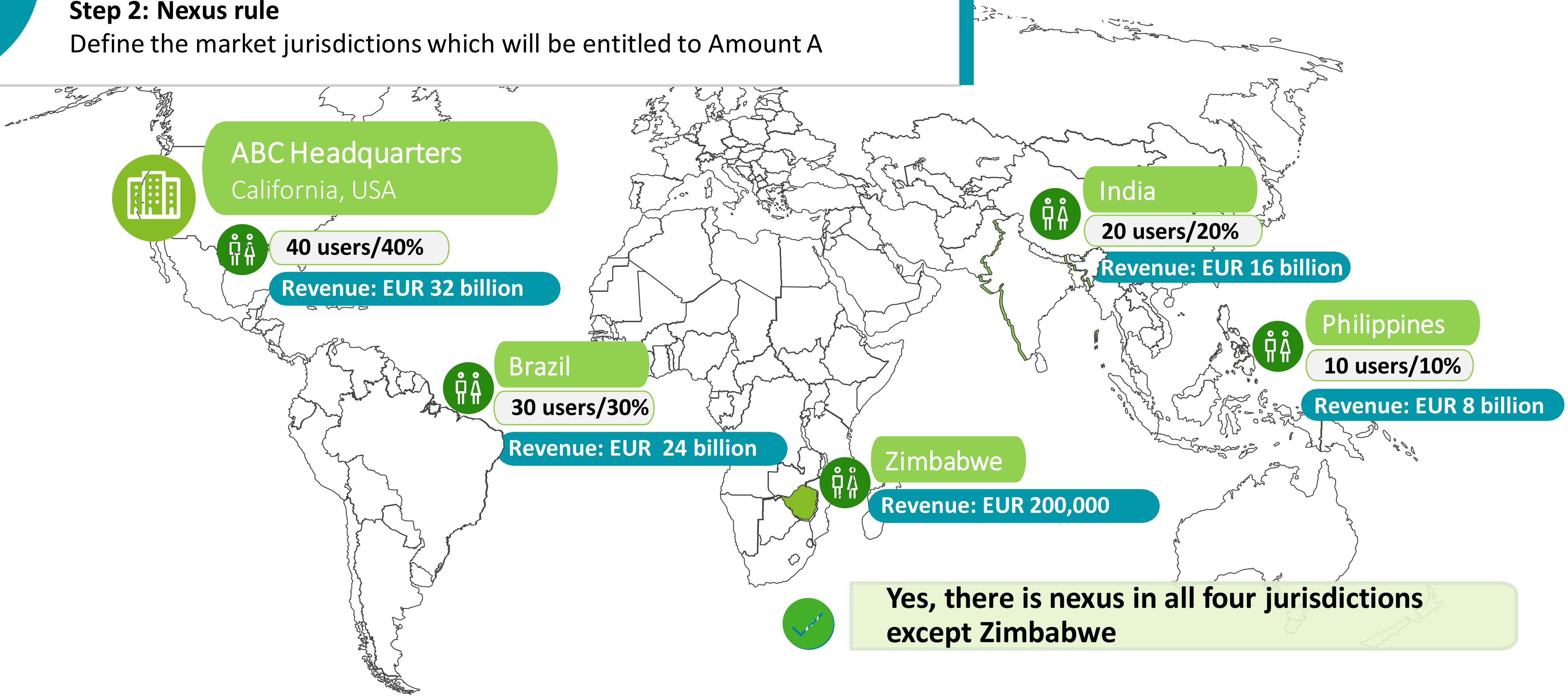
Example

02

Step 2: Nexus rule
Define the market jurisdictions which will be entitled to Amount A



Yes, there is nexus in all four jurisdictions except Zimbabwe

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Amount A

03

Step 3: Revenue sourcing rule
Determine the revenue that would be treated as derived from market jurisdictions

What

The **revenue sourcing rules** determine the revenue that would be treated as deriving from a particular market jurisdiction.

Why

These are relevant in applying the:

1. Scope rules,
2. Nexus rules, and
3. Profit allocation rule

How

1. Identify the **revenue** stream
2. Apply the sourcing principle
3. Apply the specific indicator subject to hierarchy

Example - Google

- ➢ Online advertisement
- ➢ Viewer's location
  - Based on GPS or
  - Based on IP add.

Documentation

- Functioning of internal control
- Aggregated and periodic information on the result
- Rationale for the use of indicator

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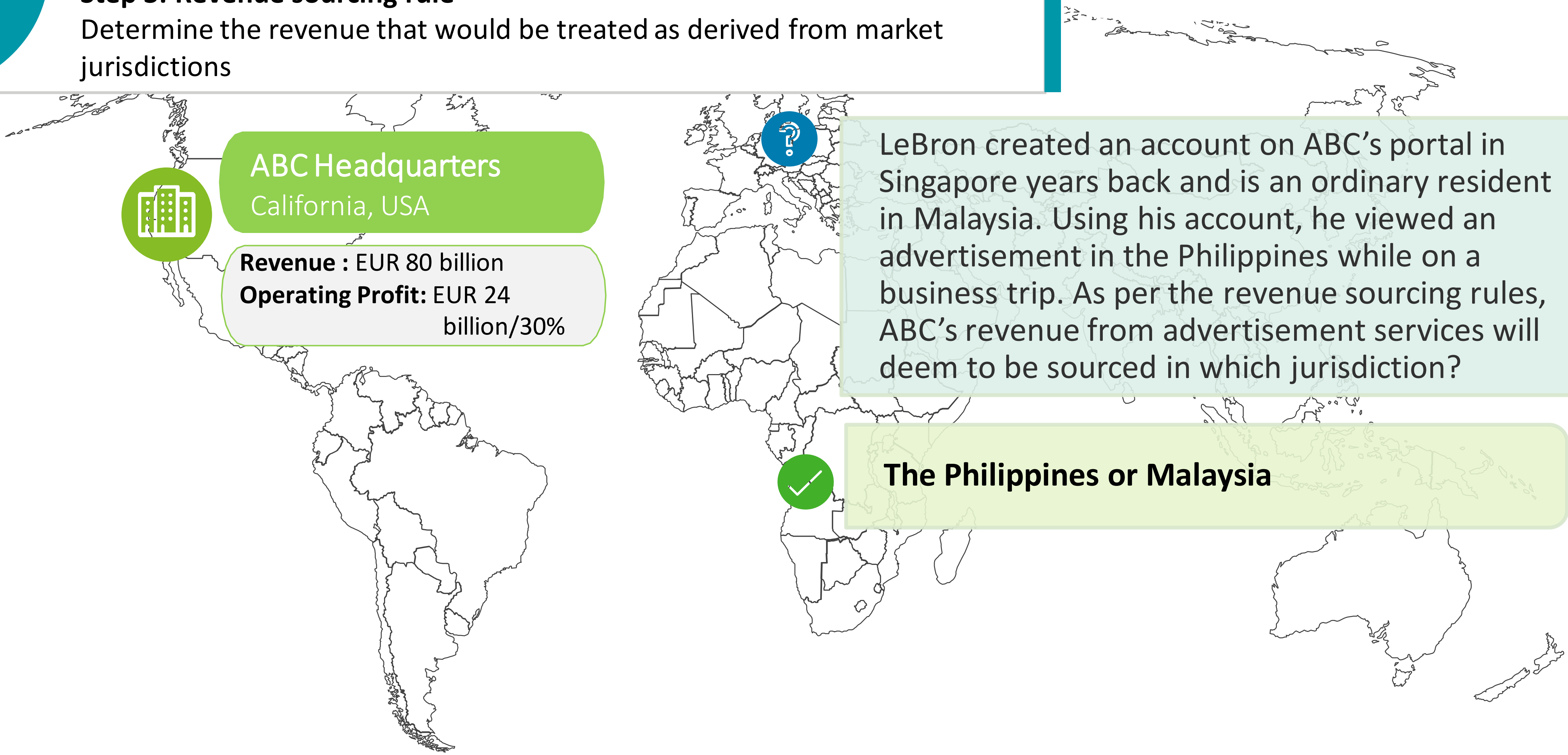
Example

03

Step 3: Revenue sourcing rule
Determine the revenue that would be treated as derived from market jurisdictions



ABC Headquarters
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Revenue : EUR 80 billion
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LeBron created an account on ABC's portal in Singapore years back and is an ordinary resident in Malaysia. Using his account, he viewed an advertisement in the Philippines while on a business trip. As per the revenue sourcing rules, ABC's revenue from advertisement services will deem to be sourced in which jurisdiction?

The Philippines or Malaysia

*Assuming operating profit = taxable profit

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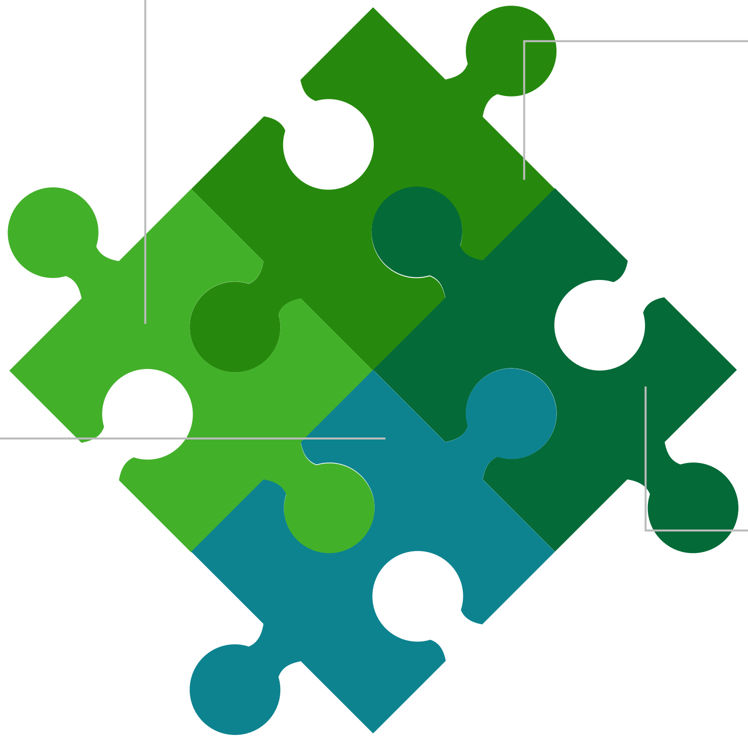
Amount A

04

Step 4: Tax base determination rule
Determine the tax base to be used for the determination of Amount A (Calculate the MNE's profit)

Consolidated financial accounts

The Amount A tax base will be quantified **using an adjusted PBT measure**, which will be derived from the group's consolidated financial accounts.



Losses will be preserved and carried forward to subsequent years

- Earnout mechanism
- Economic loss vs profit shortfall

Limited number of book-to-tax adjustments

- Tax expenses
- Dividend income/loss
- Penalties, fine and illegal payments

Segmented basis to compute Amount A tax base

- Exception, rather than a rule

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Amount A

05

Step 5: Profit allocation rule
Formula to calculate and allocate Amount A to market jurisdictions

To identify the amount to be taxed in market jurisdictions with nexus, the following steps should be performed:

1 **Isolate residual profit from routine profit**	PBT to revenue ratio i.e., 10 percent
2 **Determine the allocable tax base**	25 percent of the excess profit over 10 percent will be reallocated to market jurisdictions
3 **Allocate the allocable tax base among market jurisdictions.**	Identify an appropriate allocation key to distribute the allocable tax base to market jurisdictions (with nexus) based on in-scope revenue

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Amount A

05

Step 5: Profit allocation rule
Formula to calculate and allocate Amount A to market jurisdictions

Example: ABC's consolidated accounts:

	Amount in USD
Revenue	80 billion
PBT	24 billion
PBT margin	30%

1 Isolate residual profit from routine profit

24 billion - (80 billion x 10% threshold) = **16 billion**

2 Determine the allocable tax base

16 billion residual profit x 25% reallocation percentage = **4 billion**

3 Allocate the allocable tax base among market jurisdictions

Country	Revenue	Allocation	Amount A
Brazil	24 billion	24/80 x 4 billion	1.2 billion
India	16 billion	16/80 x 4 billion	0.8 billion
Philippines	8 billion	8/80 x 4 billion	0.4 billion
US	32 billion	32/80 x 4 billion	1.6 billion

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Amount A

06

Step 6: Elimination of double taxation rule
Identification of paying entity and elimination of double taxation arising in conjunction with existing tax rules

1. Qualitative test to identify the group entity making "material and sustained contribution" to residual profit based on FAR analysis
2. Quantitative profitability test to determine whether paying entity can bear Amount A tax liability
3. Allocate, in order of priority, the amount A tax liability to the entities having connection where Amount A is located
4. Remaining Amount A tax liability will be borne by other paying entities on a formulaic pro-rata basis
5. Paying entity will be entitled for tax relief via **credit** or **exemption** method

BEPS 2.0: New Taxing Right and Global Minimum Tax

Amount A

06

Step 6: Elimination of double taxation rule
Identification of paying entity and elimination of double taxation arising in conjunction with existing tax rules

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4 Elimination of double taxation

Particular	US	Brazil	India	Philippines
Amount A	1.6	1.2	0.8	0.4
ALP based	24	0	0	0
Total taxable profit	25.6	0	0	0
Potential double counting	4	-	-	-
Exemption/ credit	4	-	-	-
Total taxable profit after elimination	**21.6**	**1.2**	**0.8**	**0.4**

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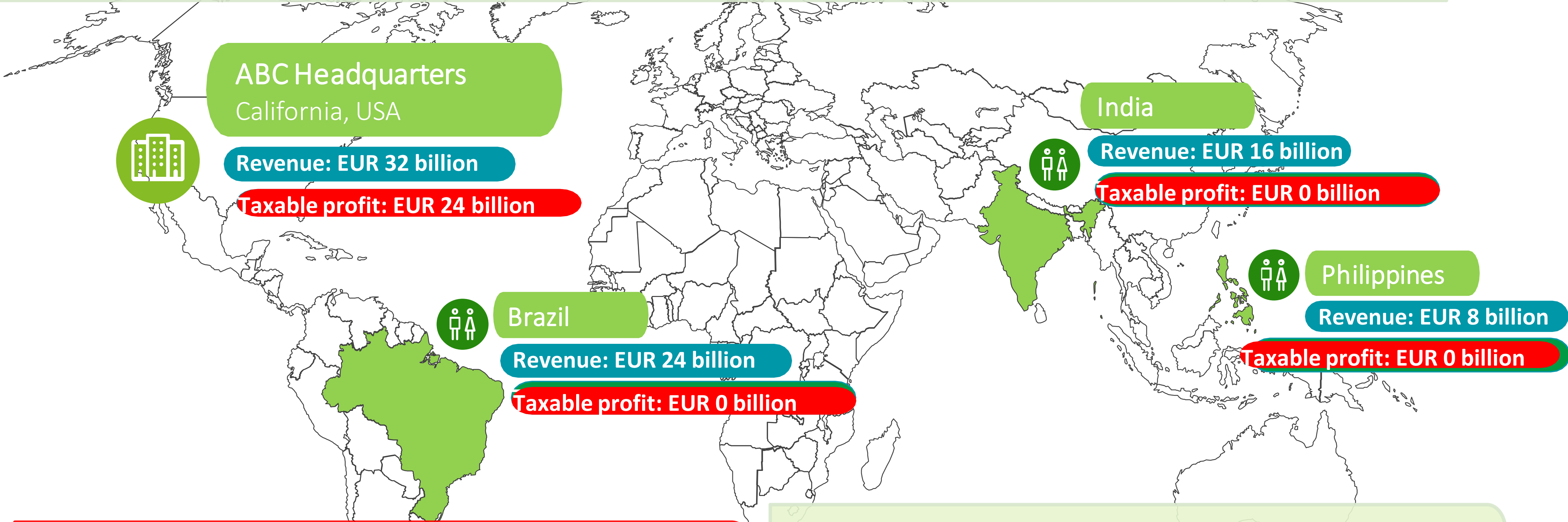
Amount A: Example

Impact of the Implementation of Amount A Rules



Before BEPS 2.0

ABC does not pay any taxes in Brazil, Philippines, and India.

After BEPS 2.0

Profits are allocated to market jurisdictions, and taxed accordingly.

02

Pillar 1: **Amount B**

Pillar 1: New approach to allocation of taxing rights **(Amount B)**

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Amount B

Establish a fixed return for “baseline” or routine marketing and distribution activities

Simplifications to the current TP rules and does not replace the arm’s length principle

Applicable to all taxpayers meeting prescribed profile without any threshold

Reduce disputes

Increase certainty

Focus on needs of low-capacity countries

Technical work to be completed by end of 2022

Pillar 1: New approach to allocation of taxing rights

Q&A

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Amount A and Amount B: Tax Disputes

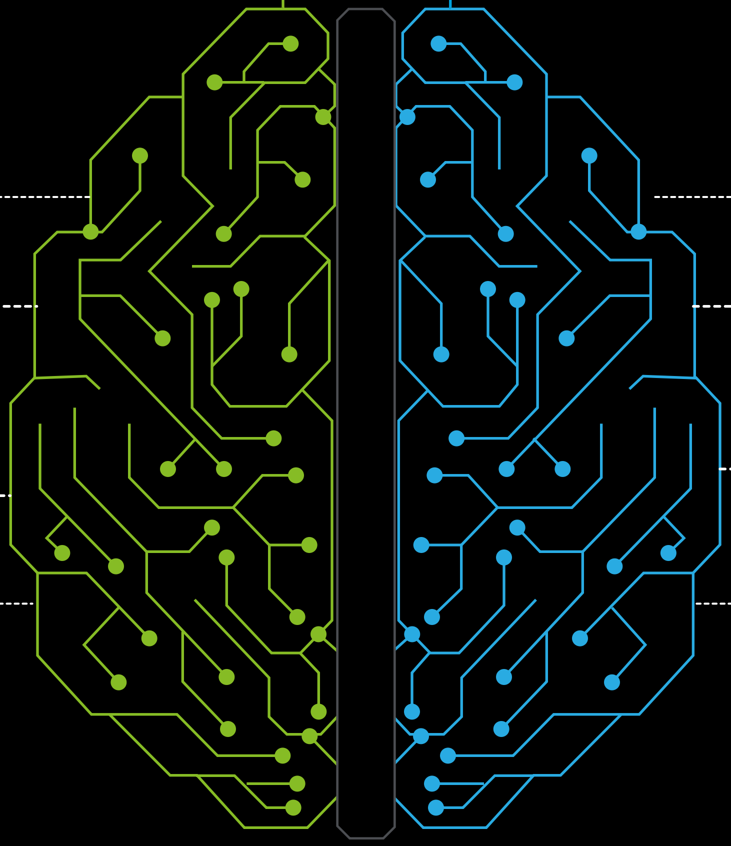
Dispute resolution for Amount A
(Dispute resolution framework)

1. Validation of self-assessment return by Competent Authority

2. Independent validation or panel review

3. Determination panel

4. General MAP procedures



Dispute resolution beyond Amount A
(Areas of future development)

A new binding resolution process for **all disputes** related to **TP** and **permanent establishment** adjustments

Amount B application creating **risk of double taxation** also subject to binding dispute resolution

Elective binding dispute resolution in developing economies with no or low levels of MAP disputes

MAP enhancement, development of International Compliance Assurance Programme, joint audits, standardized benchmarks, improved processes for bilateral and multilateral APAs, etc.

03

Pillar 2: Global Minimum Taxation

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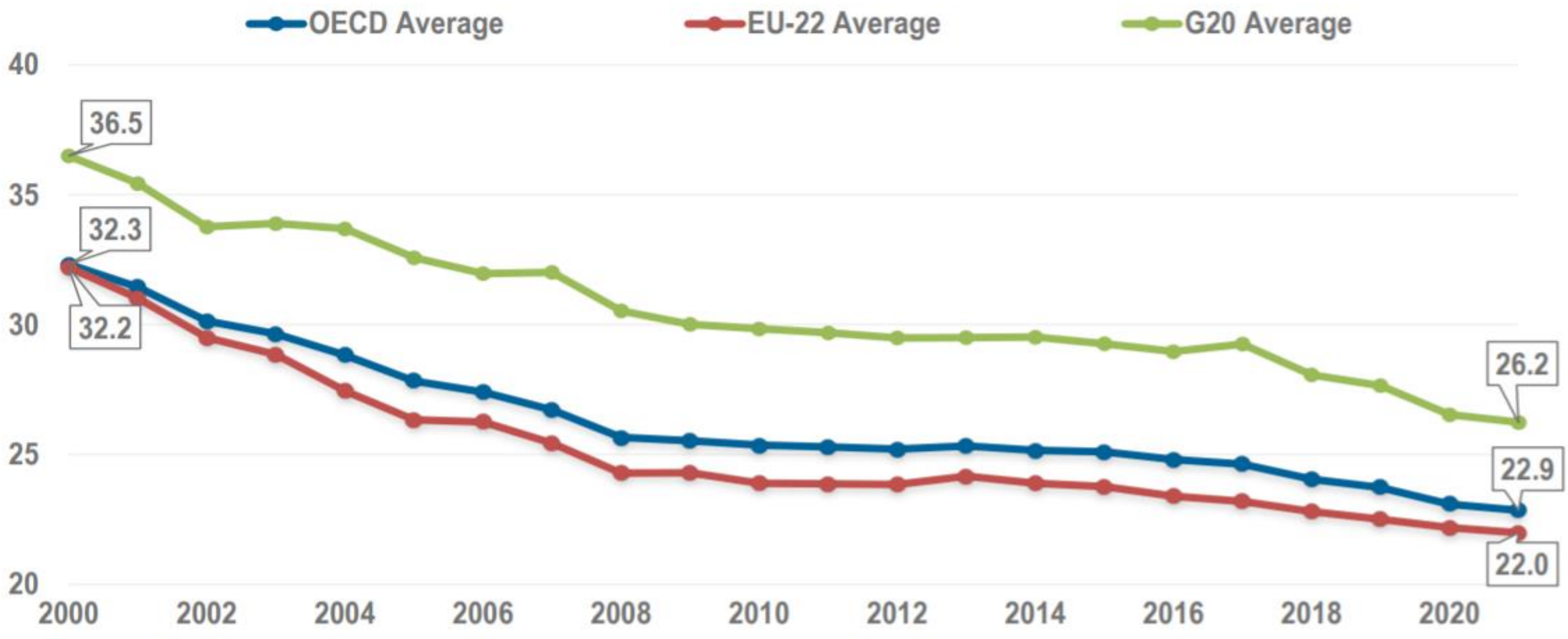
Pillar 2 - Need



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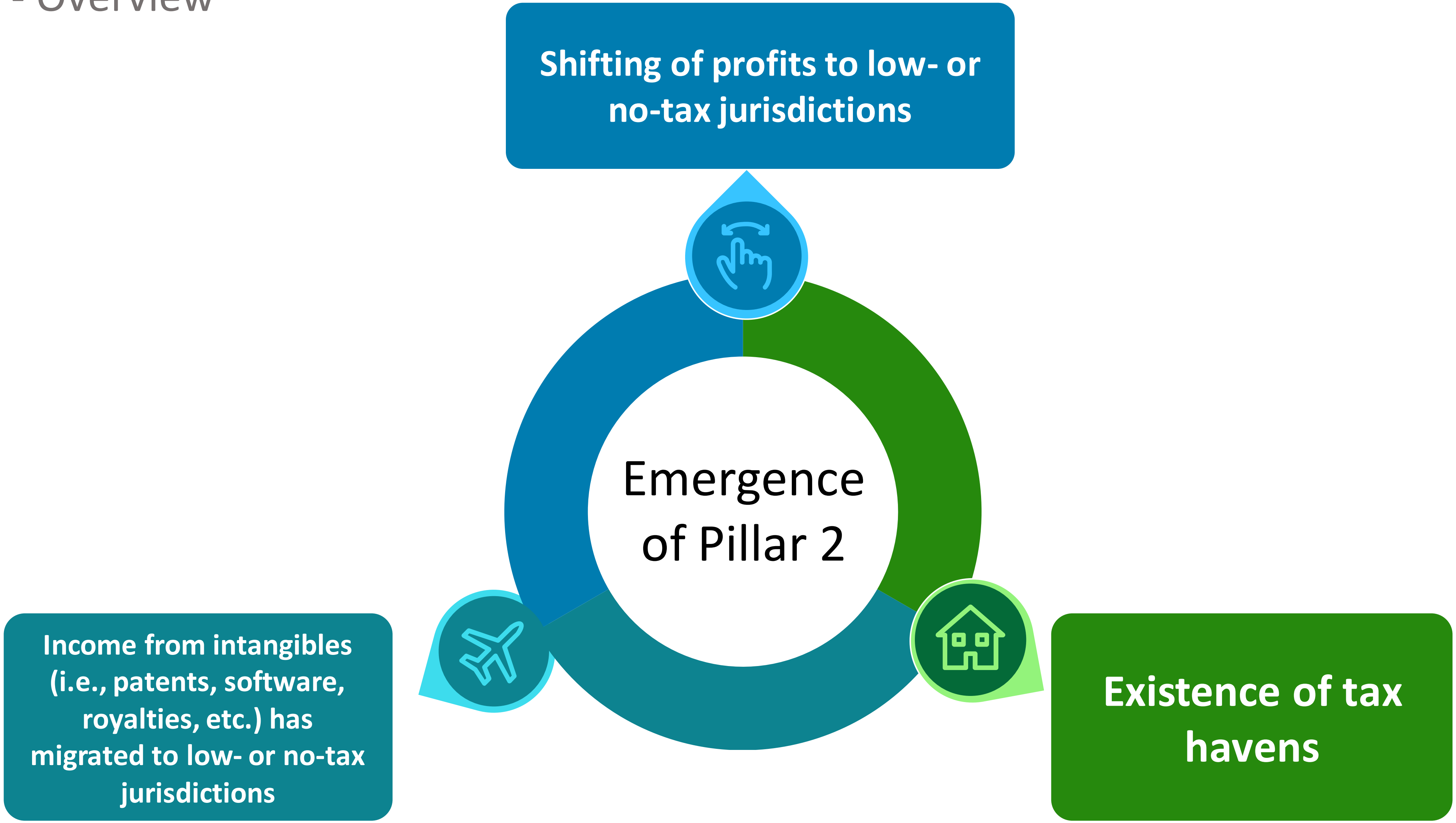
Pillar 2 - Overview



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Pillar 2 – Key Elements

Priority rule	**Subject to tax rule (Treaty-based rule)** Source country taxation of specific types of **intra-group payments** Gross level taxation (not a tax on net profits)	Threshold?
Main rule	**Income inclusion rule (GloBE)** **Large multinational groups** pay a **minimum level of tax in each country** in which they operate *Includes the **switch-over rule** to bring overseas permanent establishments within scope of IIR	Group revenues of €750 million+
Backstop rule	**Undertaxed payments rule (GloBE)** (backstop)	

All rules operate as a 'top up' to a minimum rate

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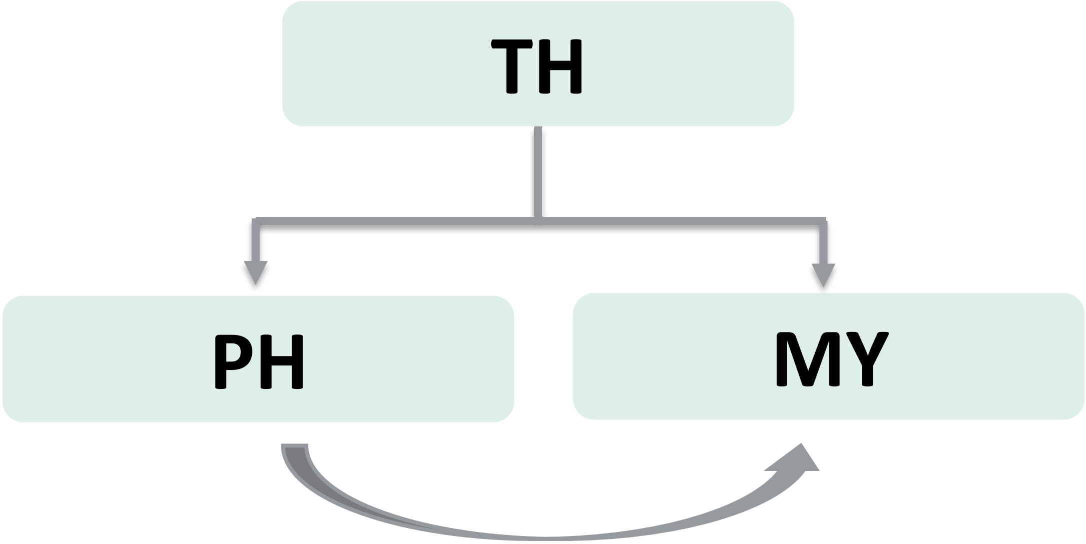
Pillar 2 - Subject to Tax Rule

Minimum tax rate is 9%

Applies to payments between connected parties (based on common control)

Applies to interest, royalty, rent. technical fees, etc.

Gross basis



Payment of interest

However, interest is not taxable in Malaysia

Therefore, PH may withhold 9% of the income under STTR

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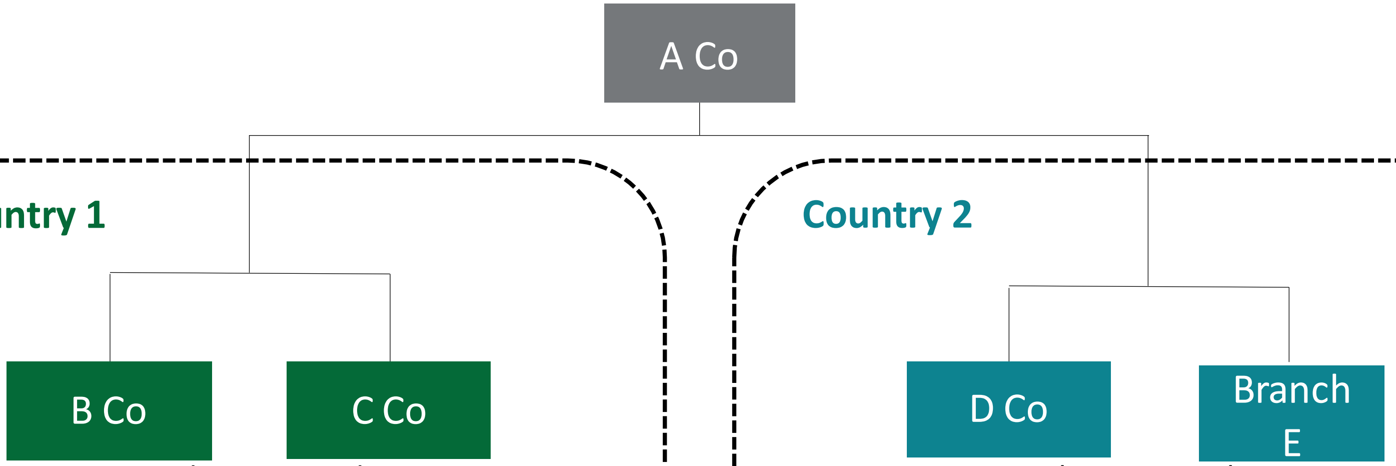
Pillar 2 – Income Inclusion Rule

Minimum tax rate of **15%** on **a jurisdictional basis**



Country 1

- B Co: profit \$100, tax \$10. ETR 10%
- C Co: profit \$100, tax \$40. ETR 40%
- ETR for Country 1: **25%**

No top-up tax

Country 2

- D Co: profit \$100, tax \$15. ETR 15%
- Branch E: profit \$100, tax \$5. ETR 5%
- ETR for Country 2: **10%**

Top-up tax applies

- Country A implemented the IIR
- B Co, C Co, D Co, and E Co earned an income of \$100 each but paid different amounts of tax
- In Country 1, the blended ETR is >15%, so there is **no top-up tax**
- In country 2, the blended ETR is <15%, so **top-up tax applies**

Intra-country blending is allowed but not inter-country

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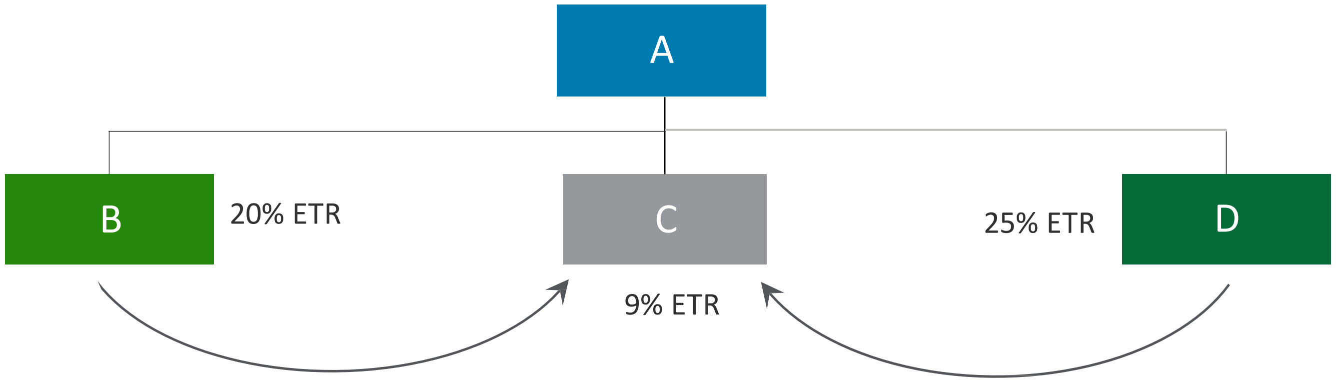
Pillar 2 – Undertaxed Payment Rule

Secondary rule / backstop: Applies only where the income inclusion rule has not been applied

Minimum rate	15 %
Effective tax rate of grey country	9%
Blue country A does not follow IIR	
Taxes which would have been paid /allocated in **country C** by **country A** by application of IIR, will be paid by its group entity in **Country B** and **Country D**	



No tax will be allocated to countries with an effective tax rate below the minimum rate
Amounts are **subject to cap** equal to domestic tax rates multiplied by deductible intragroup payments made

Pillar 2: Global Minimum Taxation

Q&A

04

BEPS 2.0: Next steps

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Next Steps

Pillar 1

Early 2022 - Text of a Multilateral Convention (MLC) and Explanatory Statement to implement Amount A of Pillar One

Early 2022 – Model rules for domestic legislation necessary for the implementation of Pillar One

Mid 2022 – High-level signing ceremony for the Multilateral Convention

End 2022 – Finalisation of work on Amount B for Pillar One

Pillar 2

November 2021 – Model rules to define scope and mechanics for the GloBE rules

November 2021 – Model treaty provision to give effect to the subject to tax rule

Mid 2022 – Multilateral Instrument ("MLI") for implementation of the STTR in relevant bilateral treaties

End 2022 – Implementation framework to facilitate coordinated implementation of the GloBE rules

2023 – Implementation of the Two-Pillar Solution

05

Key takeaways

BEPS 2.0: New Taxing Right and Global Minimum Tax

Potential Implications on PH Tax Landscape

01 Reforms in the current tax incentive framework. Decrease incentive rate and movement to non-tax incentives such as subsidies or grants could be an alternative.

02 Impact on the fixed returns of entities engaged in routine marketing and distribution activities.

03 Proposal to levy VAT @ 12 percent on foreign digital service suppliers which could lead to trade retaliation.

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Carlo L. Navarro
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Thank you for joining.
Any questions?