SESSION 10: TAX INCENTIVES AND THE GLOBE RULES

ATI Follow-up Technical Meeting on Tax Expenditures

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BETTER POLICIES FOR BETTER LIVES

Background

- This presentation outlines **methodology for quantitative** analysis of the impact of GloBE Rules based on micro-level firm data
  - Focus on estimating undertaxed profit and potential Qualified Domestic Minimum Top-up Tax (QDMTT) revenue
  - Explain key steps and adjustments
- Does not cover: Income Inclusion Rule (IIR), Undertaxed Payments Rule (UTPR) and firm behavioural responses

GloBE Rules – Basic mechanics

Multination Enterprise (MNE) Group with ≥ EUR 750 million annual revenue

→

Income subject to jurisdictional Effective Tax Rate (ETR) < 15%

→

Qualified Rules

Qualified Domestic Minimum Top up Tax (QDMTT)

Applies in <u>source</u> jurisdiction

Income Inclusion Rule (IIR)

Applies in <u>parent</u> jurisdiction under a top-down approach

Undertaxed Payments Rule (UTPR)

Allocates top-up tax using a substance-based allocation key

KEY STEPS

GloBE rules: Top-Up Tax Calculation

$$\frac{\text{Covered taxes}}{\text{GloBE Income}} = \text{Jurisdictional ETR}$$

Jurisdictional Excess Profit =
GloBE Income – Substance Based Income Exclusion

×

Top-Up Tax %=
15%- Jurisdictional ETR

Jurisdictional Top-Up Tax = Top-Up Tax % x Excess Profits

Key steps and data sources

Analysis component	Purpose	Potential data sources
1. Scope:	Identify firms in-scope of GloBE	Country-by-Country Reports (CbCRs), commercial datasets (such as Orbis), Transfer Pricing Reports
2. GloBE income	Estimate profit is at stake	Tax returns/financial statements*
3. Covered Taxes	Estimate jurisdictional Effective Tax Rates (ETRs)	Tax returns/financial statements*
4. Substance carveout	Estimate profit carved out by Substance Based Income Exclusion (SBIE)	Tax returns/financial statements*
5. Tax incentive use	Understand which incentives (if any) are driving low ETRs	Tax returns, other tax incentive reports

* Structure of tax returns determines additional need for financial statements.

Step 1: Scope
Orbis dataset

If CbCRs not available, use Orbis to estimate scope:

- Approximate **list of MNEs** in-scope for latest year available (2021)
  - Identify firms which exceed 750m EUR in revenue in 2 of last 4 years before 2021*
- Use Orbis **ownership-link data**
  - Create list of subsidiary names for jurisdiction
  - Can be compared with publicly-available aggregated CbCR data to assess coverage

- List of subsidiary names can be matched with names in CIT tax returns, preserving ownership information for **jurisdictional blending**
  - Ultimate Parent Entity's constituent entities in jurisdiction do not fall below *de minimis* exclusion (total GloBE income < €1m or total GloBE revenue < €10m over 3 years*)

*Under the CbCR safe harbour, a company may be considered out of scope based on the current year and not the 3-year average. However, this rule is only available for the first 3 fiscal years (i.e. up to Fiscal Year 2027) and the "once out always out" approach applies: if the company leaves the safe harbour in the first year, then there is no possibility to apply the safe harbour for the 2nd and 3rd but only full GloBE rules.

Steps 2: GloBE Income

Covered taxes / **GloBE Income** = **Jurisdictional ETR**

Jurisdictional Excess Profit = GloBE Income – Substance Based Income Exclusion

×

Top-Up Tax %=
15%- Jurisdictional ETR

Jurisdictional Top-Up Tax = Top-Up Tax % x Excess Profits

Step 2: GloBE Income

1) Approximate **GloBE income** using available data as:

$$GloBE\ Income \cong \underbrace{Profit\ Before\ Tax}_{\cong\ FANIL\ +\ Covered\ Taxes}\ -\ Permanent\ Income\ Adjustments$$

where:

- $FANIL = Financial\ Accounting\ Net\ Income\ or\ Loss$

2) **Sum up** income from all entities of each MNE in jurisdiction

Step 2: GloBE Income
Permanent Adjustment: dividends & certain credits

- Subtract **dividend income** from GloBE Income
  - Dividend income is excluded under GloBE to avoid double taxation
  - Exception: *short-term portfolio shareholding*, namely:
    - MNE group holds less than 10% AND
    - Constitutent Entity (CE) has held the shares for less than 12 months

- Adjust income from tax credits to match GloBE treatment
  - Deduct non-qualifying refundable tax credits from Profit Before Tax

- **Assumption:** all dividend income reported in Financial Accounts comes from holdings in excess of 10% OR of >12 months.

NB: The OECD can work with countries to identify a list of "red flags“ to highlight other adjustments which might have a material effect on the ETR and not factored in so far. These can be determined on a case by base basis.

Step 3: Covered Taxes

$$\frac{\textbf{Covered taxes}}{\textbf{GloBE Income}} = \textbf{Jurisdictional ETR}$$

Jurisdictional Excess Profit = GloBE Income – Substance Based Income Exclusion

✖

Top-Up Tax %=
15%- Jurisdictional ETR

Jurisdictional Top-Up Tax = Top-Up Tax % x Excess Profits

Step 3: Covered Taxes

1) Approximate **Covered Taxes** using available data as:

$$Covered\ Taxes \cong \overbrace{Current\ Tax\ Expense + \underbrace{\Delta DTA - \Delta DTL}_{\textbf{Deferred Tax Adjustment}}}^{\textbf{Net Tax Expense}}$$
$$-Permanent\ Tax\ Adjustments$$

where:

- ΔDTA : change in GloBE **deferred tax assets (DTAs)**, approximate as:
  $$\Delta DTA \cong 15\% \times Loss\ Carried\ Forward\ and\ Applied$$

- ΔDTL : change in GloBE **deferred tax liabilities (DTLs)**, e.g. due to accelerated depreciation; assume $\Delta DTL \cong 0$ if we average over multiple years

2) **Sum up** covered taxes from all entities of each MNE in jurisdiction

Step 3: Covered taxes
Permanent Tax Adjustments

- Adjust taxes on **distributed profits** and deemed profit distributions:
  - For distributing firms, add withholding taxes on distributed dividends to owner
  - For receiving firms, exclude withholding taxes on received dividends from subsidiaries

- Adjust taxes imposed **in lieu of a CIT** on certain transfers from subsidiaries:
  - For distributing firms, exclude withholding taxes on **interest payments** or **royalties** to recipients in MNE group (Constituent Entities, or CEs)
  - For receiving firms, add withholding taxes on **interest payments** or **royalties** from CEs

- Add taxes on **retained earnings** and **corporate equity**

- **Assumption:** We cannot separate distributed profits, dividend payments, interest and royalties to CEs/owners from those to other entities, so assume all go to them.

Step 4: Substance calculation

Covered taxes / **GloBE Income** = **Jurisdictional ETR**

Jurisdictional Excess Profit = GloBE Income – **Substance Based Income Exclusion**

×

Top-Up Tax %=
15%- Jurisdictional ETR

Jurisdictional Top-Up Tax = Top-Up Tax % x Excess Profits

Step 4: Substance carveout calculation

Calculate firms' Substance Based Income Exclusion (SBIE) using tax returns, financial statements or CbCRs (depending on data availability):

$$SBIE = SBIE\ perc_P * \boldsymbol{payroll} + \\ + SBIE\ perc_T * \boldsymbol{tangible\ assets} \,\&\, \boldsymbol{right\ of\ use\ assets}$$

where

$$SBIE\ perc_P = \begin{cases} Declines\ from\ 10\%\ to\ 5.8\% & in\ first\ 10\ years \\ 5\% & thereafter \end{cases}$$

$$SBIE\ perc_T = \begin{cases} Declines\ from\ 8\%\ to\ 5.4\% & in\ first\ 10\ years \\ 5\% & thereafter \end{cases}$$

Relevant variables by dataset

	GloBE Income	Covered Taxes	Substance Carveout
CbCR	Profit before income tax	Income tax accrued - current year	Number of employees
			Tangible assets
Financial Statements	**Profit before tax**	Tax expense	**Payroll**
	Dividend income	Change in DTAs	**Property, plant and equipment**
	Net income	Change in DTLs	**Right of use for tangible assets**
Tax returns	Profit before tax	**Income tax payable**	
	Accelerated depreciation	**Withholding taxes**	
	Qualified Refundable Tax Credits (QRTCs)	**Non-QRTCs**	
	Losses carried forward		

Robustness checks

- Number of adjustments to GloBE Income and Covered Taxes not incorporated due to likely data limitations, e.g. gains from sales of ownership interest
- Temporary differences should average over time → **average effective tax rates (ETRs) over multiple years to assess robustness to temporary differences**
- Conduct additional checks of calculated ETRs and top-up tax amounts:
  - Identify largest contributors to top-up taxation
  - Match with detailed financial statements
  - Check if other adjustments may be driving low ETRs, such as gains from disposal of ownership interest (especially for firms in *financial industry*); revaluation of property, plant and equipment; accrued pension expenses

Step 5: QDMTT revenue and Tax Incentives
Key tasks and datasets

1) Revenue impact of Qualified Domestic Minimum Top-up Tax:
   - For each MNE group in jurisdiction, calculate top-up tax amount
   - Sum over all MNE groups
2) Impact of Tax Incentives (TIs) on GloBE Jurisdictional ETRs:
   - regress ETR on TI dummy & other firm characteristics (revenue, payroll, tangible assets)
   - for each firm, calculate covered taxes amount before application of TI, calculate top-up tax before and after (link to standard approach to estimating tax expenditures)

- **Primary datasets:** tax return information, documents filed with investment promotion agencies (including for firms in Special Economic Zones)

EXAMPLES

Examples

- Open file **ATI_Kathamndu_exercises.xlsx, Sheet1_Data_Examples**
  - **Small dataset 7 companies and 6 MNEs**
  - Contains relevant income and tax variables for calculating top-up taxes under Pillar Two

- Follow the examples in the presentation to:
  - Replicate the **GloBE variables** in blue using Excel formulae, in cells R15:X21
  - Replicate the additional variables green, in cells Z15:AA21

Example 1: low CIT rate

		No P2, low CIT
A. Profit for tax purposes		1000
B. CIT Rate		10%
C. Total Tax due	A x B	100
D. Refundable tax credit		0
E. Total Tax liability (pre-GloBE)	C – D	100
L. Effective Tax Rate	E / A	10%

- Country has CIT rate of 10%
- Firm 2 makes 1,000 income and pays 100 taxes

The GloBE rules: Top-Up Tax Calculation

Covered taxes / **GloBE Income** = **Jurisdictional ETR**

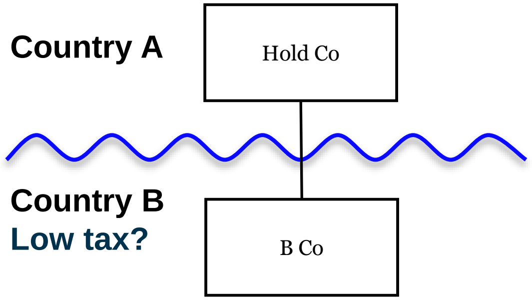
Jurisdictional Excess Profit = GloBE Income – Substance Based Income Exclusion

×

Top-Up Tax %=
15%- Jurisdictional ETR

Jurisdictional Top-Up Tax = (Top-Up Tax % x Excess Profits)

The GloBE rules: Top-Up Tax Calculation



- Example Country B
  - GloBE Income: **1000**
  - Substance carve-out: **0**
  - Adjusted Covered Tax: **100**
  - **50 of QDMTT revenue**

$$\frac{100}{1000} = 10\%$$

1000-0=1000 × **15%**- 10%=5%

Jurisdictional Top-Up Tax = (5%*1000)-0=50

Example 1: low CIT rate

		P2, low CIT
A. Profit for tax purposes		1000
B. CIT Rate		10%
C. Total Tax due	A x B	100
D. Refundable tax credit		0
E. Total Tax liability (pre-GloBE)	C – D	100
F. GloBE Income		1000
G. SBIE		0
H. Jurisdictional Excess Profit	F – G	1000
I. Top-up Tax %	15% - (E/F)	15%-10%=5%
J. Jurisdictional Top-up Tax	I x H	50
K. Total Tax liability (post-GloBE)	E + J	100 + 50
L. Effective Tax Rate	K / A	15%

- Under GloBE, pays 100 CIT and 50 top-up
- Total tax rate rises from 10% to 15% under GloBE

Example 2A: non-qualifying refundable tax credit

		No P2, TC
A. Profit for tax purposes		1000
B. CIT Rate		15%
C. Total Tax due	A x B	150
D. Refundable tax credit		100
E. Total Tax liability (pre-GloBE)	C – D	50
		-
		-
		-
		-
		-
		-
L. Effective Tax Rate	E / A	5%

- Firm receives 100 in non-qualifying refundable tax credits
- Tax of 150 is offset against tax credits
- Overall effective tax rate is 5%

Example 2A: non-qualifying refundable tax credit

		P2, TC
A. Profit for tax purposes		1000
B. CIT Rate		15%
C. Total Tax due	A x B	150
D. Refundable tax credit		100
E. Total Tax liability (pre-GloBE)	C – D	50
F. GloBE Income		1000
G. SBIE		0
H. Jurisdictional Excess Profit	F – G	1000
I. Top-up Tax %	15%-(E/F)	15%-10%=10%
J. Jurisdictional Top-up Tax	I x H	100
K. Total Tax liability (post-GloBE)	E + J	150
L. Effective Tax Rate	K / A	15%

- Firm 3 receives 100 in non-qualifying tax credits
- Tax of 150 is offset against the tax credits
- Top-up tax % = $15\%-\left(\frac{50}{1{,}000}\right)=10\%$
- Top-up tax = 10%* 1,000= 100
- Total tax rate rises from 5% to 15%
- Value of the credit is nullified

Example 2B: Qualified Refundable Tax Credits

		No P2, QRTC
A. Profit for tax purposes		1000
B. CIT Rate		15%
C. Total Tax due	A x B	150
D. Refundable tax credit		100
E. Total Tax liability (pre-GloBE)	C – D	50
L. Effective Tax Rate	E / A	5%

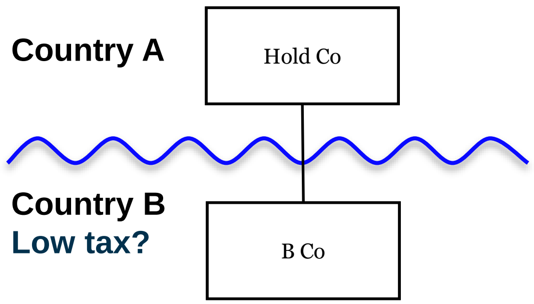
- Qualified Refundable Tax Credits (QRTCs) treated differently to other credits under the rules (aligned with financial accounts)
- Firm 4 receives 100 in QRTCs
- Tax of 150 is offset against QRTC
- Total tax rate is 5%

Example 2B: Qualified Refundable Tax Credits

		P2, QRTC
A. Profit for tax purposes		1000
B. CIT Rate		15%
C. Total Tax due	A x B	150
D. Refundable tax credit		100
E. Total Tax liability (pre-GloBE)	C – D	50
F. GloBE Income	A+D	1100
G. SBIE		0
H. Jurisdictional Excess Profit	F – G	1100
I. Top-up Tax %	15%-((D+E)/F)	15%-13.64%=1.36%
J. Jurisdictional Top-up Tax	I x H	15
K. Total Tax liability (post-GloBE)	E + J	65
L. Effective Tax Rate	K / A	6.50%

- Firm receives 100 in QRTCs, **treated as income under GloBE**
- Tax of €150 is offset against QRTC
- Top-up tax % = $15\% - (\frac{150}{1,100}) = 1.36\%$
- Top-up tax = 1.36%* 1,100= 15
- Total tax rate rises from 5% to 6.5%
- QRTCs can continue to be effective at reducing ETR

The GloBE rules: substance carveout



- Example Country B
- GloBE Income: **1000**
- Adjusted Covered Tax: **100**
- 10,000 payroll expenses
- 5% of payroll expenses are included in SBIE
- Substance carve-out: **500**
- No QDMTT

$$\frac{100}{1000} = 10\%$$

15%- 10%=5%

1000-**500**=500 × 15%- 10%=5%

Jurisdictional Top-Up Tax = (5%*500)-0=25

Example 3: substance carveout

		Firm 2: no SBIE	Firm 5: SBIE
A. Profit for tax purposes		1000	1000
B. CIT Rate		10%	10%
C. Total Tax due	A x B	100	100
D. Tax credit		0	0
E. Total Tax liability (pre-GloBE)	C – D	100	100
F. GloBE Income		1000	1000
G. SBIE		0	500
H. Jurisdictional Excess Profit	F – G	1000	500
I. Top-up Tax %	15%-(E/F)	15%-10%=5%	15%-10%=5%
J. Jurisdictional Top-up Tax	I x H	50	25
K. Total Tax liability (post-GloBE)	E + J	150	125
L. Effective Tax Rate	K / A	15%	12.5%

- Firm 5 has 10,000 payroll expenses
- 5% of payroll expenses are included in SBIE (10% in 10yr transition period):

SBIE = 5%* 10,000

- Under Pillar 2, SBIE reduces firm's total tax rate from 15% to 12.5%
- The SBIE allows the ETR to fall below 15%
- **The greater the substance, the lower the ETR can be**

Example 4: Jurisdictional Blending

- Tax incentives targeted to narrow categories of income or expenditure – **less affected – an example (Firm 5):**

MNE no. 6

IP income

EUR 500 ✖ 5%

Intellectual Property Regime

Non-IP income

EUR 1000 ✖ 20%

GloBE Income = EUR 1500
Covered Taxes= EUR 225
GloBE ETR=15%

No top-up tax due to blending

Country A
Statutory tax rate (STR)=20%
Intellectual Property (IP) regime= 5%

Exercises

- Open file **ATI_Kathamndu_exercises.xlsx, Sheet3_Data_Exercises**
  - **Small dataset of 8 more companies (7 MNEs)**
  - **Contains relevant variable for calculating top-up taxes under Pillar Two**

- Using the formulae you derived using the examples in the presentation:
  - Calculate the **GloBE variables** in blue using Excel formulae, in cells **R2:X7**
  - Calculate the **additional variables** green, in cells **Z2:AA7**
  - Calculate total qualified domestic minimum top-up tax in cell X12

Questions

- Does your jurisdiction offer reduced CIT rates or tax holidays as tax incentives?
- Has your jurisdiction considered the impact of GloBE on such tax incentives?
- Has your jurisdiction considered the potential revenue from a Qualified Domestic Minimum Top-up Tax?
- Which government departments would have the data required to conduct an impact assessment of GloBE, including potential Qualified Domestic Minimum Top-up Tax revenue?

APPENDIX SLIDES

Glossary

- DTA – Deferred Tax Assets
- DTL – Deferred Tax Liabilities
- ETR – Effective Tax rate
- FANIL – Financial Accounting Net Income or Loss
- IIR – Income Inclusion Rule
- MNE – Multinational Enterprise
- QRTC – Qualified Refundable Tax Credit
- QDMTT – Qualified Domestic Top-up Tax
- SBIE – Substance-Based Income Exclusion

GloBE Income and Covered Taxes
Income and tax concepts in FS and TR

- Profit before tax in individual Financial Statements (FS) differs from income concepts used in Tax Returns (TR):
  - **Permanent differences**
    - Many items deducted for purposes of FS but not for TR (e.g. entertainment expenses, fines), others excluded for TR and not FS (e.g. dividend income, capital gains income)
  - **Temporary differences (~average out over time)**
    - Loss Carry Forward and Accelerated Depreciation
    - Others: e.g. development in R&D immediately deducted in tax reporting, while for financial reporting purposes they are ‘activated’ and depreciated over time
- GloBE starts with FS income:
  - accounts for most common permanent differences, e.g. **dividends** and **capital gains**
  - uses **deferred tax accounting** to deal with temporary differences
- Methodology incorporates selection of adjustments given data limitations

Step 2-3: GloBE Income and Covered Taxes

GloBE Method - Treatment of LCF

- Example: STR=10%
- 100 loss in Year 1, 150 profit in Year 2 and 100 profit in Year 3
- **Under GloBE**, loss creates **DTA of -15,** which reverses in Year 2, adding to Covered Taxes (5+15=20)
- GLoBE ETR is **13.33%** in Year 2 (20/150)

	Year 1	Year 2
Profit before tax	**-100**	**150**
LCF	-100	0
Taxable Income	**0**	**50**
Curr. Tax Ex. @10%	**0**	**5**
DTA (Acc.) @10%	**10**	**0**
DTA (GloBE) @15%	15	0
GloBE Calculation		
GloBE Income	-100	150
Covered Taxes	-15	20
ETR	**15%**	**13.33%**
Top-up-tax rate	0%	1.67%
Top-up tax	**0**	**2.5**

NB: A deferred tax asset that has been recorded at a rate lower than the Minimum Rate may be recast at the Minimum Rate in the Fiscal Year such deferred tax asset is recorded, if the taxpayer can demonstrate that the deferred tax asset is attributable to a GloBE Loss (art. 4.4.3).

Step 2-3: GloBE Income and Covered Taxes

GloBE Approach - Treatment of AD

- Example: AD for firm A, STR=10%
- 100 profit in Years 1-3
- Asset of 100 depreciated using AD in Year 1, normally 20% each year
- **Under GloB**E, AD creates **DTL of 8** which **reverses in Year 2** onwards, reducing Covered Taxes (8-6=2)
- GLoBE ETR is **5%** in Years 1-2 (4/80)

	Year 1	Year 2
Profit before tax	**100**	**100**
Dep. (tax)	**100**	**0**
Dep. (accounting)	**20**	**20**
Taxable Income	**0**	**100**
Curr. Tax Ex. @10%	**0**	**10**
DTL (GloBE) @10%	8	6
GloBE Calculation		
GloBE Income	80	80
Covered Taxes	8	8
ETR	**10%**	**10%**
Top-up-tax rate	5%	5%
Top-up tax	**4**	**4**

NB: The starting point for the Total Deferred Tax Adjustment Amount is the amount of deferred tax expense accrued in the financial accounts of a Constituent Entity if the applicable tax rate is below the Minimum Rate or, in any other case, such deferred tax expense **recast at the Minimum Rate** (Source: par. 70 of the Commentary).

CbCR safe harbours*

To estimate if company falls under CbCR safe harbours in 2024-2027, apply simplified ETRs determined as the ratio between simplified tax and simplified income:

$$GloBE\ Income \cong Profit\ Before\ Tax\ in\ CbCR$$

and

$$Covered\ Taxes \cong Adjusted\ Income\ Tax\ Expense\ from\ Qualified\ FS$$

If ETR below 15%, company falls under CBCR safe harbour in every previous year.

* Relevant if CbCRs available or if concepts can be approximated using tax returns/financial statements. Covered taxes are a jurisdiction’s income tax expense as reported in the Group’s Qualified Financial Statements, after eliminating any taxes that are not Covered Taxes and uncertain tax positions reported in the MNE Group’s Qualified Financial Statements. There are two additional tests for the company to be eligible for the safe harbour which are the *de minimis* test and the routine profits test.