Global minimum tax - what is the impact on companies in MESA?

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Welcome

Dr Rasheed Al-Qenae
Head of Tax
KPMG Middle East and South Asia
KPMG speakers today

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Istina Delivan
Director, Transfer Pricing
KPMG Lower Gulf
Agenda

01 Recap and timeline

02 Recent announcements on the GloBE Model Rules

03 Impact on MESA businesses

04 What we are expecting and next steps

05 Questions
Recap on BEPS 2.0
In a historic agreement, the OECD/G20 Inclusive Framework (IF) on Base Erosion and Profit Shifting (BEPS) has agreed to reform existing international tax rules and is now moving towards implementation. The statement setting out the core rules has been endorsed by 137 out of 141 IF members and by the G20 finance ministers.

Pillar 1
- Significant departure from the standard international tax rules of the last 100 years
- Pillar One will apply to multinational groups that have more than EUR20 billion of global turnover, and profitability above 10%
- For in-scope groups, the Amount A profit allocation is 25% of profits above a 10% profit margin
- Exemptions: Regulated Financial Services and Extractives

Pillar 2
- Subjects thousands of multinational groups around the world to a Global Minimum Tax of 15%
- The Global Minimum Tax will apply to multinational groups if they have revenues over EUR750 million
- Specified cross border payments taxed below 9% may be subject to new withholding taxes
- Exemptions: “Excluded Entities” and International Shipping Income
Overview of Pillar 2

Key aspects

**Mechanism** – Pillar 2 is a reference to a series of interlocking rules comprising the global minimum tax Income Inclusion Rules (IIR) (incl. domestic top up tax), Undertaxed Payments Rule (UTPR) and a separate Subject to Tax Rule (STTR).

**Revenue thresholds** – MNE Groups with consolidated group revenue exceeding EUR750 million.

**Common approach** – Not required to adopt but must respect application by others

**Exclusions** – Excluded Entities: government, non-profits, pension & investment funds

**Rate and Base** – Jurisdictionally blended 15% ETR based on financial accounting of UPE

**STTR** – IF developing the model provision for the STTR, together with a multilateral instrument (MLI) for its implementation, to be released in 2022.

**Rollout** – Commentary on GloBE Model Rules, STTR design and MLI, UTPR deferral.
Global Minimum Tax timeline

- **July 2021**: IF statement
- **Dec 2021**: Model GloBE rules finalized
- **Jan/Feb 2022**: Commentary on rules released
- **Mid 2022**: STTR MLI developed
- **Dec 2022**: Pillar 2 administration requirements finalization
- **Jan 2023**: IIR and STTR targeted to be in effect (excl UTPR)
- **Jan 2024**: Possible IIR/STTR start dates for many countries? UTPR targeted to be in effect

**GloBE domestic legislation and MLI related processes**

- **2022 onwards**: GloBE domestic legislation and MLI related processes

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Recent announcements on the GloBE Model Rules
Scope of the Global Minimum Tax

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### Testing period
- Four year test period
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In the context of a merger, look to the sum of the revenue of each group to meet the €750m threshold
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### Excluded entities
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- Certain holding vehicles owned by these excluded entities

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## GloBE Model Rules - Highlights

### Key aspects

Most of the key components of the final rules are in line with last year’s Pillar Blueprint, though with notable adaptations:

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<td><strong>Domestic alternative minimum taxes</strong></td>
<td>Making domestic minimum taxes central to the GloBE framework</td>
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<td><strong>More robust UTPR rules</strong></td>
<td>UTPR tax can be imposed (i) by denying any sort of deduction and not just related party in nature (ii) by deeming taxable income, or (iii) via a new tax</td>
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<td><strong>Safe harbors</strong></td>
<td>To be finalized by late 2022</td>
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<td><strong>De minimus exclusion</strong></td>
<td>Average GloBE Revenue&lt;EUR 10m and Average GloBE Income or Loss&lt;EUR 1m</td>
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### ETR calculation

- Use deferred tax to deal with temporary differences. These include complex provisions such as a recapture rule and retrospective recalculation of ETRs for prior years

### Limitations on jurisdictional blending

- Instances where entity level ETR calculations needed, carved out from jurisdictional blending for groups with lots of minority interests at different levels

### Simplified IIR

- Narrowed to provisions directed at JVs
Steps in application of GloBE Rules

1. Determine GloBE income on a jurisdictional basis
2. Determine Covered Taxes on a jurisdictional basis
3. Calculate jurisdictional ETR = Covered Taxes / GloBE income
4. Calculate Top-up Tax % - Minimum ETR – Jurisdictional ETR
5. Determine Excess Profit = GloBE Income – Substance Carve Out*
6. Calculate jurisdictional Top-up Tax = Top-up Tax % x excess profit

Jurisdictional Top-up Tax of a CE is then absorbed by a qualified domestic top up tax, a qualified IIR charged to a parent entity or apportioned to a subsidiary (UTPR)

*10% payroll and 8% tangible assets going down to 5% over the transition period

As shown, the centerpiece of GloBE Rules is computing “GloBE Income”, “Covered Taxes”, and ETR on a jurisdictional basis
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Impact on MESA businesses
Case study assumptions

- KSA headquartered group with a ETR of 7.5% (incl. Zakat)
- KSA adopts GloBE rules
- UAE and Bahrain do not have CIT and do not apply the GloBE rules
- Egypt adopts GloBE rules, and is a high tax jurisdiction

Case study findings

- Domestic top up tax payable in KSA with respect to KSA Co’s excess profits (top up tax rate 7.5% = 15% - 7.5%)
- UAE Co and Bahrain Co’s Top up Tax subject to IIR in KSA
- KSA shall pay tax that is equal to its allocable share of top up tax of Bahrain Co (90%) and UAE Co (100%)
- Egypt Co’s GloBE income not subject to IIR as its ETR is greater than 15%
Case study assumptions

- KSA headquartered group with a ETR of 7.5% (incl. Zakat)
- KSA and UAE introduce GloBE rules
- Qatar does not introduce GloBE rules
- Bahrain does not have CIT and does not apply the GloBE rules
- Egypt Co applies the GloBE rules and its ETR is above 15%

Case study findings

- Top up Tax of KSA Co will be picked up under domestic top up tax regime in KSA
- KSA does not own more than 80% of the UAE Co hence taxing rights drop down to the intermediate parent company i.e. UAE Co
- UAE Co shall pay tax under the IIR, equal to its allocable share of top up tax of Bahrain Co (90%) and Qatar Co (100%)
- UAE Co will also pay domestic top up tax on the low taxed excess profits of UAE Co
Case study assumptions

- Bahrain, UAE and Qatar do not adopt GloBE rules
- KSA applies GloBE rules, including domestic top-up tax

Case study findings

- Top up Tax of KSA Co will be picked up under domestic top up tax regime in KSA
- KSA Co will also pay total top up tax under IIR on 68% of Qatar Co's Top up Tax
- The remaining 32% of total top up tax with respect to Qatar Co's excess profits (i.e. 100% - 68%) as well as the excess profits of Bahrain Co and UAE Co are taxed in KSA under the UTPR – 100% jurisdictional allocation of UTPR to KSA (UTPR applicable only from 2024 onwards)
Impact on MESA businesses

What are countries likely to do?

Countries that have nor or low corporate income tax (CIT), below the minimum level of 15% will need to make some key decisions, such as:

— Implement domestic top-up tax and/or IIR,
— Implement (or amend) CIT regulations.

An overview of the current CIT and transfer pricing (TP) regime in MESA countries is provided in the table below.

Table: ME country summary of IF members and their CIT and TP regimes

<table>
<thead>
<tr>
<th>IF Members</th>
<th>Support for Pillar 2</th>
<th>CIT regime in place</th>
<th>CIT rate above or equals to 15%</th>
<th>TP documentation requirements (LF/MF)</th>
<th>CbCR only</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bahrain</td>
<td>✓</td>
<td>✓</td>
<td>✗</td>
<td>✗ (except foreign O&amp;G companies)</td>
<td>✓</td>
</tr>
<tr>
<td>Egypt</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✗</td>
<td>✓</td>
</tr>
<tr>
<td>Jordan</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Oman</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✗</td>
<td>✓</td>
</tr>
<tr>
<td>Qatar</td>
<td>✓</td>
<td>✓ (1% foreign profit split)</td>
<td>✓</td>
<td>✗</td>
<td>✓</td>
</tr>
<tr>
<td>Saudi Arabia</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✗ (except Zakat rate)</td>
<td>✓</td>
</tr>
<tr>
<td>UAE</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✗ (except branches of foreign banks and O&amp;G companies)</td>
<td>✓</td>
</tr>
<tr>
<td>Kuwait</td>
<td>✗</td>
<td>✓ (for foreign owned companies)</td>
<td>✓</td>
<td>✗</td>
<td>✗</td>
</tr>
<tr>
<td>Pakistan</td>
<td>✗</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Sri Lanka</td>
<td>✗</td>
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</table>
04

What we are expecting and next steps
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1. Announcements from Middle East countries
   The Model Rules added a new concept of **domestic top-up tax** allowing jurisdictions to effectively duplicate the model for top-up tax to ensure that tax is collected by the local jurisdictions not and ceded to another jurisdiction under the IIR or UTPR.

2. Release of commentary on GloBe rules
   The Model Rules **include complex provisions**, commentary on the Model Rules are expected to be released soon to allow businesses to prepare for the implementation of these provisions in local countries.

3. STTR design
   A **model treaty provision** and commentary for the design of the STTR along with an **MLI** to facilitate the adoption of the STTR.

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   **Filing obligations**, notification requirements and **penalties** to be released along with the development of safe harbors.
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### Immediate
1. Identify GloBE provisions that are potentially relevant to your organization
2. Model the financial and tax impact of the final GloBE rules on group entities, based on prior/latest financial data
3. Inform Board and Management Committees of the potential financial and compliance impact of the new GloBE rules
4. Monitor local tax legislation for unilateral actions, such as introduction of CIT, modification of incentives

### Short term
1. Prepare internal stakeholders for a range of possible impacts
2. Understand the potential system issues in collating data
3. Engage the tax teams to work closely with finance and accounting
4. Consider the need for any additional resources to support in any restructurings (i.e., qualified project managers) and involve the appropriate departments for implementation and integration/transition

### Medium and long term
1. Consider the impacts on pricing of intercompany transactions
2. Consider the need to reconcile disclosures under different transparency frameworks (e.g. GloBE Information Return, EU public CBCR, ESR, etc.).
3. Engage with policymakers in relevant jurisdictions
4. Consider mitigating actions to take such as changes to organizational structure, domicile, reinsurance, and capital deployment
What actions should you consider?

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