TOLA ASSOCIATES
TAX & CORPORATE ADVISORS

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TAXPAK

Newsletter by

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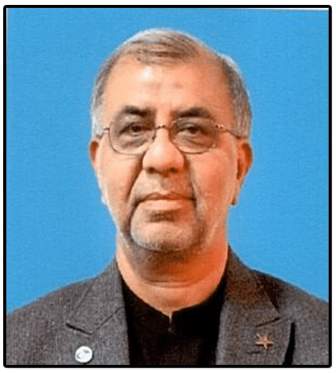
Disclaimer

Chairman's Message



Asalam-o-alaikum everyone! Hope this monthly issue of TaxPak finds you in good spirits and immaculate health! We welcome you to another edition of TaxPak, our monthly publication the purpose of which is to provide a monthly update on the ongoing tax related developments in Pakistan. Alhamdulilah, so far, we have been successful in our mission to educate about, and keep the public-at-large updated of, these developments on a monthly basis.

Moreover, we would like to apprise the readers of what information you can expect in this document. This newsletter contains an elaboration of important Notifications and Circulars issued by the Federal Board of Revenue ("FBR") and its provincial counterparts. Moreover, Notifications from the corporate regulatory body i.e., SECP are also discussed. As our main aim is to keep the masses updated regarding the developments in the Pakistani tax law, we usually discuss a (relatively) recent judgement passed by the courts of law. This edition of TaxPak consists a discussion of two judgments. The first one has been passed by the Hon'ble Appellate Tribunal Inland Revenue-Lahore, and pertains to a discussion on the date of acquisition of immoveable property gifted to spouse for the purposes of computing Capital Gain Tax on its subsequent disposal, whilst the other judgement was passed by the Hon'ble Islamabad High Court for Section 4C of the Income Tax Ordinance where in Super Tax was read down for Tax Year 2023 in terms of the Fauji Fertilizer judgment.

Towards the end of the newsletter, we have discussed our Topic of the month titled "Topic of the Month- Minimum tax implementation as per the OECD/G20 Base Erosion and Profit Shifting Project-Part I". The said topic provides an insight on the methods of computing minimum tax for Multinational Enterprises as per the GLoBE Rules.

All our readers are requested to visit our website www.tolaassociates.com , or download our mobile application in order to access previous published editions of TaxPak along with other publications, and to stay updated of future notifications. Lastly, we request our readers to circulate this e-copy within their circle, as our primary aim is to benefit the masses. Feedback is always welcomed.

Warm Regards,
Ashfaq Yousuf Tola - FCA,
Chairman
Tola Associates.

SALES TAX NOTIFICATION

1. Further amendments to the sales tax rules, 2006:

The FBR, vide SRO No. 644(I)/2024 dated 7.05.2024, issued a notification whereby, the criteria for prior approval of the Commissioner, for the purpose of filing of the electronic monthly sales tax return, was changed. Previously, the threshold was based on sales being five times more than the declared business capital, whereas now it is based on sales being five times more than the sum of the capital and liabilities declared in the balance sheet.
For further reading: FBR

SALES TAX ON SERVICES–NOTIFICATIONS

SRB

1. Amendments to the Sindh Sales Tax on Services Rules, 2011

The SRB, vide Notification No. SRB-3-4/18/2024 dated 10.05.2024, issued amendments to the Sindh Sales Tax on Services Rules, 2011 whereby an employee who earns any fee/commission as an indenter/ commission agent from the employer shall not be required to register provided that the employer is duly registered with the SRB or is e-signed up as a withholding agent under the Sindh Sales Tax Special Procedure (Withholding) Rules, 2014 and deducts and withholds the whole of the amount of Sindh sales tax payable on services of such a person and deposits the same amount in Sindh government.
For further reading: SRB

2. Amendments to the Sindh Sales Tax Special Procedure (Withholding) Rules, 2014

The SRB, vide Notification No. 3-4/19/2024 dated 10.05.2024, issued amendments to the Sindh Sales Tax Special Procedure (Withholding) Rules, 2014, whereby, the definition of the State-owned enterprise was inserted.
For further reading: SRB

Corporate Notifications:

1. Proposed amendments to the Fourth Schedule of the Companies Act, 2017

The SECP issued a consultation paper on 06.05.2024, regarding the proposed amendments to the Fourth Schedule of the Companies Act, 2017 with respect to disclosure for listed companies for Shariah stock screening. Furthermore, the last date of submission of comments was fixed for 21.05.2024.
For further reading: SECP

2. Amendments in the Companies Regulations, 2024

The SECP vide SRO dated 23.05.2024, issued draft amendments to the Companies Regulations, 2024, whereby upon grant of license for a Section 42 company, no change in the directorship or object clause of memorandum could take place unless prior approval from the Commission was granted upon application. Furthermore, currently a time limit of a of 60 days has been fixed for associations who have applied to the Commission, to get it incorporation as a public limited company. Now, through the aforesaid amendments, the Commission may grant an extension in the aforesaid timeframe for of a maximum period of 60 days, after which if the Association is still not incorporated as a Public Ltd Company, the license of the Association shall stand cancelled if this extension has lapsed.

For further reading: SECP

3. Practical guide for reporting and approval obligations under the modaraba law

The SECP issued a practical guide for compliance by the Modaraba Companies and Modarabas. In this guide, reporting obligations, approvals by the registrar and critical compliance provisions for modaraba companies and modarabas were briefly covered and explained for instance, appointment of independent directors, remuneration of the modaraba company etc.

For further reading: SECP

4. Circular for requirements for NBFCs engaged in Digital Lending

The SECP, through Circular No. 12 of 2024 dated 15.05.2024, issued certain disclosures for the NBPFCs digital lending apps such as disclaimers on the app interface, confidentiality and mandatory requirements were listed.

For further reading: SECP

5. Circular for increase of fees in the Seventh Schedule of the Companies Act, 2017

The SECP, through Circular No. 13 of 2024 dated 15.05.2024, increased the fees mentioned in the Seventh Schedule of the Companies Act, 2017 by 10% for incorporation fees, filing fee for forms other than mortgage/pledge for companies having share capital, guarantee limited companies, Section 42 companies and companies established outside Pakistan which have a place of business in Pakistan.

For further reading: SECP

6. Requirements for self-assessment declaration to be submitted by the NBFCs engaged in digital lending along with the application of digital lending app

The SECP, through Circular No. 14 of 2024, dated 22.05.2024, issued requirements for self-assessment declaration to be submitted by the NBFCs engaged in digital lending along with the application of digital lending app. The circular was enclosed with checklists for compliances, for instance, style and text of the awareness message when the app is opened, the request for consent on the main screen etc.
For further reading: SECP

CASE LAW: TRANSFER OF ASSET BETWEEN SPOUSES IS NOT A TAXABLE EVENT.

INTRODUCTION:

The Hon'ble Appellate Tribunal Inland Revenue ("ATIR") was moved by the Commissioner Inland Revenue, RTO-II, Lahore ("Appellant") against the Order passed in favour of Mrs. Aisha Asim Imdad ("Respondent") in respect of chargeability of capital gain on disposal of immovable property in terms of Section 37(1A) read with Rates provided in Division-VIII of Part-I of 1st Schedule of the Income Tax Ordinance, 2001 ("ITO") .

BRIEF FACTS OF THE CASE:

The respondent filed the income tax return for the tax year 2015 as an individual and various incomes were declared. A show cause notice under section 122(9)/122(5A) of the ITO was issued, wherein it was confronted that the Appellant was required to pay tax @ 5% on gain on sale of immovable property as per Section 37(1A) read with Rates provided in Division-VIII of Part-I of 1st Schedule of the ITO. Subsequently, the proceeding was finalized and an Order was passed against the Respondent. Following which, an appeal before the Commissioner Inland Revenue (Appeals), ("CIRA") was filed, wherein the Respondent was successful to convince the CIRA, as a result, the CIRA annulled the amended assessment order. Hence, thereby, being aggrieved of the decision passed by the CIRA, the Appellant approached the ATIR for adjudication the matter.

ARGUMENTS BY THE LEARNED APPELLANT:

The Appellant argued that the immovable property in question was acquired by Respondent from her spouse through gift in July 2013 ("Alleged date"), which was disposed off in April 2015,

following which, the Respondent was required to pay tax @ 5% on such gain as the holding period of property in the hand of the Respondent was more than one year as per section 37(1A) read with Division-VIII Part-I of First Schedule of ITO, the rate of tax on capital gain arising from sale of immovable property after holding for more than one year was 5%. Furhtermore, it was alos argued that, the CIRA wrongly admitted that the date of sale of property in question as on **June 2013 on basis of transfer letter/gift deed** despite taking into account that the allotment notice of DHA bore the date July 2013. Hence, therefore, the Respondent was liable to pay tax on capital gain.

ARGUMENTS BY THE LEARNED COUNSEL FOR THE RESPONDENT:

The learned Respondent submitted that the property in question was gifted by spouse in **June 2013.** The Respondent further submitted that the agreement of sell with third party was executed on April 2015, and the gain arising on such immovable property was partially received, and the remaining balance amount was receivable in June 2015, but, by the end of the financial tax year 2015 i.e. 30th June 2015, the remaining amount was not received by the Respondent. As a result, the Respondent declared/booked the same as receivable in her wealth statement as on 30th June 2015, subsequently, the same was received in July 2015, thus, the property was transferred to the buyer. The learned Respondent argued that the holding period of property in hand was more than two years, hence, as per the section 37(1A) read with Division-VIII, Part-I of First Schedule of ITO, the rate of tax on capital gain arising from sale of immovable property after holding period for more than two years was 0%, and that the same was observed by the CIR (A) who had rightly annulled the order passed by the Appellant.

FINDINGS OF THE ATIR:

The Hon'ble ATIR held that the property in question was acquired by the Learned Respondent from her husband through gift and the acquisition of property was covered u/s 79 of the ITO. In terms of section 79(3), such asset has been acquired with the same character as the person disposing of the asset. As the date of acquisition in the hands of spouse was 28.11.1991 hence, the date of acquisition remains the same for the present taxpayer as well. This intent of law is evident as transfer of asset between spouses is not a taxable event. The Hon'ble ATIR further held that the learned Respondent had duly explained that property was acquired as a gift from husband on **June 2013** as evident from transfer letter whereas the learned officer wrongly noted it as July 2013. The execution of sale of such property was not completed by 15.06.2015 as per agreement to sell on account of non-payment, therefore, the Learned Respondent declared the balance amount as receivable in the wealth Statement for the Tax Year 2015. However, the final payment was received on 09.07.2015 by the learned Respondent.

As such, the Hon'ble ATIR held whether the holding period is calculated fron 28.11.1991 or 07.06.2013, the holding period is more than two years. Hence, the capital gain in such case is 0% as per section 37(1A) read with Division VIII of Part-I of First Schedule of ITO.

The Hon'ble ATIR further held that there were no contradictions between the Learned Respondent's declaration and facts of the transaction which clearly established that the property was held for more than two years for the purpose of computation of capital gains tax.

CASE LAW: THE ISLAMABAD HIGH COURT IN ITS LATEST JUDGMENT GAVE INSIGHTS THAT THE SUPER TAX SHALL BE COMPUTED AS PER THE PRINCIPLES OF FAUJI FERTILIZERS.

INTRODUCTION:

The Islamabad High Court ("IHC") was moved by M/s Pakistan Oilfields Limited and several other Petitioners from across the counrry ("Petitioners") in W.P bearing No. 2436 of 2023 and other connected Petitions against the Federation of Pakistan and others ("Respondents"). The Petitioners challenged the amendment ("impugned amendment") made in section 4C of the Income Tax Ordinance, 2001 ("ITO") regarding the retrospective applicability of the substituted Division II B of Part I of the First Schedule to the ITO, inserted through Finance Act, 2023, for the Tax Year 2023.

BRIEF FACTS OF THE CASE:

The Petitioners were aggrieved of the impugned amendment made under section 4C of the ITO, and via the writ petitions, they challenged the retrospective applicability of the substituted Division II B of Part I of the First Schedule to the ITO, introduced by the Finance Act, 2023. The Impugned Amendment revised and increased super tax rates on some income slabs for the tax year 2023, over and above the rates that would apply otherwise. The rates prescribed in Division II B owe their 'chargeability' to section 4C of the Ordinance, which remained substantially unchanged as introduced by the Finance Act, 2022. All the petitioners requested primary and dominant relief, allowing section 4C to continue to be read down as in the earlier judgment titled Fauji Fertilizer Company Limited and another versus Federation of Pakistan and others bearing W.P No. 4027 of 2022.

ARGUMENTS BY THE LEARNED COUNSELS OF THE PETITIONERS:

The counsels for the Petitioners argued that the performance of functions within the territorial jurisdiction should matter, but not the physical presence of the taxpayer / person in the territory. They argued that

the Commissioner in Karachi was performing functions relatable to the territory of Islamabad, and his physical presence in Karachi was only secondary. The counsel cited Asghar Hussain vs Election Commission of Pakistan, wherein the Supreme Court held that the High Court of the erstwhile East Pakistan had jurisdiction over the Election Commission because it was performing functions in connection with the affairs of the Federation with direct consequences for East Pakistan, and it did not matter if the Election Commission did not have its main office in East Pakistan. It was further contended that the taxes collected at Karachi were to be credited into the Federal Consolidated Fund at Islamabad. The performance of the function of collection of taxes at Karachi was relatable to Islamabad, and therefore, the High Court at Islamabad has jurisdiction to entertain the petitions from Karachi and Lahore.

ARGUMENTS BY THE LEARNED COUNSEL OF RESPONDENT:

The Learned Counsel for the Respondents objected the maintainability of the Petitions filed by the petitioners from Karachi and Lahore. She argued that petitions subject to the territorial jurisdiction of a tax circle other than Islamabad could not be maintained by the Court. She agitated that the Chief Commissioner was not performing functions within the jurisdiction of the Islamabad High Court, and therefore, no directions could be issued under Article 199 of the Constitution by this court. She further agitated that the FBR is not being directed to interpret the law by a direction to its subordinate officers, but rather to convey that one High Court has read down section 4C and that the officer should apply that interpretation.

DECISION OF THE HON'BLE IHC:

The Hon'ble IHC upheld the submissions of the Petitioners, and decided in their favour. The elaborated judgment of the Hon'ble IHC can be bifurcated under the following headers:

❖ MAINTAINABILITY OF THE PETITIONS:

The Hon'ble IHC held that the petitions for declaratory relief against retrospective application of super tax rates by the Impugned Amendment are maintainable. Furthermore, it was held that the dominant purpose of tax statutes was a question of fact to be determined in each case, therefore the presence of the Federal Government and/or FBR as may be necessary, was sufficient for cases involving vires of the statute or interpretation. Hence, the IHC could adjudicate the matter pertaining to the Impugned Amendment in this context.

❖ CONCURRENT JURISDICTION:

The Hon'ble Court placed its reliance on Sandalbar Enterprises vs CBR, Flying Kraft Paper Mills vs CBR, Trading Corporation of Pakistan vs Pakistan Agro Forestry Corporation of Pakistan, and Ibrahim Fibers Ltd vs FOP, in which the Apex courts have multiple times developed the jurisprudence regarding concurrent jurisdiction. The Hon'ble court held that the IHC had territorial jurisdiction when a Federal statute was challenged due to the Federal Capital being the seat of the Federal Government and the Federal Government being the beneficiary of the revenue generated from taxation measures.

❖ JUDGMENT IN REM:

The IHC declared that the declaratory relief granted by the Court regarding the legality of a statute was applicable to every person in Pakistan, regardless of their tax jurisdiction, office, or work location. However, in case of conflict with another High Court's judgment, the tax officer must act on the principle of abundant caution and determine the narrowest sphere identified by a cumulative reading of conflicting judgments.

❖ RETROSPECTIVITY OF THE IMPUGNED AMENDMENT:

The Hon'ble IHC further held that the impugned amendment had no retrospective application for 2023 or any period prior to its promulgation. Moreover, the Federal Board of Revenue was directed to issue an administrative instruction to the Inland Revenue officers to apply the amendment prospectively and apply section 4C in terms of the Fauji Fertilizer judgment. Further, with respect to the amendment pertaining to Super Tax payable under Section 147, it was held that the same be calculated in light og the Fauji Fertilizer case. Moreover, the said declarations and directions will apply mutatis mutandis to petroleum exploration and production companies.

TOPIC OF THE MONTH: MINIMUM TAX IMPLEMENTATION AS PER THE OECD/G20 BASE EROSION AND PROFIT SHIFTING PROJECT-PART I

INTRODUCTION:

In 2021, more than 135 jurisdictions joined a two-pillar solution to reform international taxation rules to ensure fair tax payments by multinational enterprises. For this month's edition, we will discuss about the second pillar of the minimum tax implementation while in our next edition, we will cover implementation considerations of the same.

The second pillar of the two-pillar solution comprises of:

- Global minimum tax (up to 15% top-up tax on low-taxed income as per the Global Anti-Base Erosion ("GLoBE") Model Rules) and;
- Subject to Tax Rule (STTR). STTR is a treaty based rule that allows jurisdictions to "tax back" certain different categories of cross-border intra-group covered income that are subject to nominal corporate tax rates below 9%.

THE GLOBE RULES

The GLoBE rules introduced in domestic law are aimed to create a global minimum tax system, ensuring large multinationals pay at least 15% tax on income in every operating jurisdiction. The rules, in simpler terms, require:

- Calculating income and taxes by jurisdiction
- Paying top-up tax if effective tax rate is below 15%
- Bringing total tax on excess profits in low-tax jurisdictions up to 15%

Top-up tax is either collected by the low-tax jurisdiction itself, under "Qualified Domestic Minimum Top-up Tax" ("QDMTT"), or, where no QDMTT applies, by another implementing jurisdiction through the imposition of either:

- An Income Inclusion Rule (IIR) which imposes top-up tax on a parent entity in respect of the low taxed income of a constituent entity; or
- An UTPR which denies deductions or requires an equivalent adjustment in a subsidiary jurisdiction in order to produce an equivalent incremental increase on the taxes paid by the MNE Group.

Furthermore, the GloBE Model Rules set out the detailed terms of the global minimum tax. They are complemented by a Commentary and Administrative Guidance. The rules are drafted as a legislative template for jurisdictions to introduce into domestic law. They define which multinational enterprise (MNE) groups are in scope and outline the methodology for calculating their jurisdictional effective tax rate (ETR) and any resulting top-up taxes. These rules are designed to accommodate a diverse range of MNE groups and different tax systems. The core provisions are supplemented with more detailed rules addressing specific structures, transactions, and tax regimes including different tax consolidation, income allocation and entity classification rules that may not be equally relevant for all jurisdictions.

It is pertinent to mention that countries part of the Inclusive Framework on BEPS have decided that adopting the GloBE rules is optional, but if a country chooses to implement them, it must do so in a way that aligns with the agreed-upon outcomes and follows the established rule order, ensuring consistency and coherence in its application. The global minimum tax shall start to apply from the 2024 with the introduction of the IIRs. Many jurisdictions have also announced plans to introduce QDMTT. However, the UTPR is not expected to take effect before 2025. The OECD has initiated a joint initiative with the United Nations Development Program ("UNDP") to assist developing countries in implementing the global minimum tax through Tax Inspectors Without Borders (TIWB), TIWB's expertise in tax audit capacity building will complement international efforts to enhance tax cooperation and support developing countries' domestic resource mobilization. Specifically, TIWB will offer support in:

- Analyzing the impact of the GloBE rules;
- Drafting guidance, laws, and regulations for implementation into the domestic laws.

Once implemented it would further assist in conducting risk assessments, administering the rules in practice and help developing countries effectively implement the global minimum tax.

GLOBAL MINIMUM TAX

The global minimum tax, as outlined in the GloBE rules, applies to multinational enterprise (MNE) groups with annual revenues of at least EUR 750 million, operating across international borders. By limiting the scope to these large MNE groups, the global minimum tax achieves a balance between maintaining its overall impact and revenue benefits and reducing compliance and administrative costs for smaller entities. The EUR 750 million revenue threshold is similar to the threshold used for Country-by-Country Reporting (CbCR) under BEPS Action 13, ensuring consistency in approach.

Multinational Enterprise (MNE) Groups within the scope of the rules must calculate their effective tax rate (ETR) to determine if it meets the 15% minimum rate. This calculation is done on a jurisdictional basis, starting with the financial accounts of each local entity used in the MNE Group's consolidated financial statements. This approach simplifies compliance and administration by leveraging existing financial systems and audit processes. Adjustments are made to align income with the local tax base and ensure correct allocation is made between jurisdictions. The adjusted income and taxes are then used to calculate the ETR. If it's below 15%, a top-up tax is required to bring the total tax up to 15%. However, a "substance-based income exclusion" is applied to exclude a fixed return from substantive activities, focusing the global minimum tax on "excess income" susceptible to BEPS risks, such as intangible-related income.

The resulting top-up tax is collected under three types of provisions: the QDMTT, the IIR and the UTPR. These provisions are applied in accordance with an agreed rule order that is embedded in the design of the GloBE rules and operates as follows:

- **The low-tax income is first subject to tax in the local jurisdiction.** The additional tax payable may be collected through the imposition of a QDMTT, which allows the jurisdiction where the low-tax profits have arisen to impose an additional amount of tax on the MNE Group's excess profits in order to bring the ETR on those profits up to the 15% minimum rate.

- If a low-tax jurisdiction doesn't have a Qualified Domestic Minimum Top-up Tax (QDMTT), the Ultimate Parent Entity (UPE) of the MNE Group will be responsible for paying the top-up tax under a Qualified Inclusive Rule (IIR). However, if the UPE is located in a jurisdiction that doesn't implement the Qualified IIR, the top-up tax will be levied on the next highest entity in the ownership chain that is located in a jurisdiction with a Qualified IIR, ensuring that the tax is still paid.

- The UTPR is a backup plan to ensure companies pay the right amount of tax. If the main method (IIR) doesn't work, the tax is shared among countries that use UTPR. Each country collects its share of the tax by not allowing companies to deduct certain expenses or using a similar method, and the share is calculated based on what's fair, so each country gets the right amount of tax.

The GloBE rules therefore preserve the local jurisdiction's primary taxing rights over its own income. The Qualified Domestic Minimum Top-up Tax (QDMTT) enables a jurisdiction to impose an additional tax on the excess profits of a Multinational Enterprise (MNE) Group, if those profits have an effective tax rate (ETR) below 15%. This top-up tax doesn't change the overall tax cost for the MNE Group, as they would have faced the same tax liability in another jurisdiction through either the Income Inclusion Rule (IIR) or Undertaxed Payment Rule (UTPR). The QDMTT simply ensures that the MNE group pays the minimum tax due, without affecting their overall after-tax costs.

STEPS THAT AN MNE GROUP MUST GO THROUGH IN ORDER TO CALCULATE ITS TOP-UP TAX LIABILITY:

Step 1: Determine whether the MNE Group is within scope

Procedure to identify Groups within scope:

1. Determine whether the Group is internationally active:

This is determined by analyzing whether the Group has entities or permanent establishments in more than one jurisdiction. Then it's checked whether this Entity is part of a global group with operations in multiple countries. If 2 entities are controlled by the same parent company and such

results to a combined financial report, then it shall be considered that they are part of the same group. A group is considered global if it has entities or activities in more than one country (i.e., a multinational enterprise or MNE Group). This approach uses accounting rules to define the group's scope, similar to Country-by-Country Reporting (CbCR).

Furthermore, using a consolidation test provides a clear and consistent standard that builds on existing accounting practices. It makes it easy to determine which groups and entities are included. It is pertinent to mention that the GloBE rules only apply to entities that are part of a group, and not to standalone entities. However, the rules also apply to internationally operating entities with a Permanent Establishment (PE) in another jurisdiction, even if they are not part of a larger group. This rule is important to prevent large domestic entities from establishing branches in foreign jurisdictions instead of subsidiaries, solely to avoid being subject to the GloBE rules.

2. Determine whether the MNE Group passes the revenue threshold:

The MNE Group must meet a revenue threshold of EUR 750 million for the GloBE rules to apply. The threshold is based on the revenue reported in the Consolidated Financial Statements of the MNE Group. The revenue threshold is the same as the one used for Country-by-Country Reporting (CbCR). Unlike CbCR, the global minimum tax threshold is based on a four-year test. The four-year test provides more stability and predictability, especially for MNE Groups with revenues close to the threshold.

The four year test checks if the MNE Group had revenues of EUR 750 million or more in at least two of the four fiscal years preceding the tested fiscal year, excluding the current year's revenue. This ensures that MNE Groups know early on whether they'll be subject to the GloBE rules for that year or not.

3. Identify any excluded entities to exclude them from the application of the rules, but do not exclude their revenue from the revenue threshold calculation

An MNE Group consists of entities that consolidate their financial accounts and are subject to the GloBE rules. However the following are not required to consolidate for financial reporting purposes, such as:.

a. Governmental organizations
b. Investment funds

However, the aforementioned entities will be required to consolidate with controlled subsidiaries under applicable accounting standards. To prevent these entities from becoming subject to the

GloBE rules due to accounting treatment, the rules provide a specific exclusion. This exclusion ensures that these entities are not subject to the operative provisions of the GloBE rules, despite consolidating with controlled subsidiaries. The rules on Excluded Entities only apply to entities within the consolidated group.

There are three categories of Excluded Entities:

a. Category 1: Entities carrying out activities in the public interest (e.g. governmental and non-profit organizations).

b. Category 2: Tax-neutral investment vehicles (e.g. pension and investment funds).

c. Category 3: Certain asset-holding companies controlled by excluded entities (to avoid structural distortions).

Moreover, the Excluded Entities are not subject to the operative provisions of the GloBE rules even though they remain as members of an MNE Group, and their revenue is considered when assessing whether the group meets the EUR 750 million revenue threshold. Ensuring consistency with the CbCR threshold and avoids the need for additional rules to address the treatment of revenues from transactions between Excluded Entities and the rest of the Group and Anti-avoidance rules to prevent fragmentation.

Step 2: Allocate income of Constituent Entities on a Jurisdictional Basis:

Allocation based on jurisdictional basis can be done by the following measures:

- Identify the location of each Constituent Entity within the Group and allocate the income to these Constituent Entities:

- Identify the Constituent Entities within the MNE Group and their locations based on legal and local tax treatment. This location is usually based on where the Constituent Entity is liable for income tax under domestic law on the basis of its residence, place of incorporation, or a similar factor. Certain Constituent Entities may not be liable for tax anywhere and may be treated as “Stateless Entities”.

- Determine the income of each Constituent Entity using the Financial Accounting Net Income or Loss (FANIL) from consolidated financial statements. The basis for determination of the FANIL is the financial accounts used for the preparation of the MNE Group’s consolidated financial statements. All these financial accounts regardless of the standard they are following will show the bottom-line net income or loss expense attributable to intra-group transactions.

- Income of transparent entities are re-allocated to the owners of those transparent entities in proportion to their ownership and as per local tax treatment.

Step 3: Calculate the GloBE Income

The GloBE Income of each Constituent Entity is determined by making certain adjustments to its FANIL in order to arrive at a determination of its GloBE Income (or Loss). The adjustments made to convert FANIL to GloBE Income are intended to better align the tax base for the global minimum tax with those that are typically applied for local tax purposes. The full list of adjustments is set out in Article 3.2 of the Model Rules. The adjustments fall into three basic types as mentioned below.

1. Adjustments to better align with taxable income

The adjustments are made in the FANIL to align financial accounting and taxable income. Furthermore, these adjustments address common differences, such as exempting intra-group dividends or calculating deductions for stock-based compensation. The GloBE rules incorporate similar adjustments to preserve policy choices, preventing double taxation and ensuring full deductions for employment expenses, thereby aligning with jurisdictional policies.

2. Adjustments to ensure correct allocation of income between jurisdictions

The adjustments address income misallocation among entities in different jurisdictions, ensuring accurate computation of GloBE Income or Loss. For instance, cross-border intra-group transactions must be valued at arm's length prices to prevent mispricing, which distorts income computation in both jurisdictions. Additionally, an anti-abuse provision targets certain intra-group financing arrangements designed to evade top-up tax under GloBE rules, neutralizing their impact and protecting jurisdictional blending integrity.

3. Other policy based adjustments

Illegal payments are not allowed as an expense in the computation of the GloBE Income or Loss (payments of fines and penalties are allowed up to a maximum amount of EUR 50,000). Disallowance of these expenses is part of the fight against corruption and prevents the public from sharing the economic burden of the expenditure through decreased tax revenues.

Step 4: Determine Adjusted Covered Taxes

This is done by calculating taxes associated with the GloBE Income or Loss for each Constituent Entity. These figures are derived from current tax expense from financial accounts, deferred tax adjustments and tax benefit of losses.

Step 5: Compute the Effective Tax Rate and calculate the Top-up Tax

Method for calculating the Effective Tax Rate for all Constituent Entities located in the same jurisdiction and determining the resulting Top-up Tax:

1. **Computation of the ETR:**

GloBE Income or Loss and Covered Taxes are added together to compute the jurisdictional effective tax rate (ETR). A simplified methodology for calculating ETR may be available under a safe harbor, for example, CbCR transitional safe harbor. The calculation of ETR is not required when the MNE Group has limited operations in a jurisdiction, specifically when the MNE Group's revenue is below EUR 10 million and income is below EUR 1 million.

2. **Computation of the top-up tax**

The top-up tax percentage is calculated as the difference between the 15% minimum rate and the jurisdictional effective tax rate (ETR), and is then applied to the GloBE Income or Loss in the jurisdiction, after deducting a substance-based income exclusion. This exclusion is calculated based on a percentage of tangible assets and payroll expenses, and is intended to carve out income that is generated by substantive activities. The top-up tax is only applied to the excess profit (the income exceeding the substance carve out), bringing the MNE Group's total tax on its excess profits up to the 15% rate.

Once the top-up tax is calculated, it is allocated to each constituent entity in the low-tax jurisdiction which has GloBE Income for the Fiscal Year and in proportion to such income.

Step 6: Charge the Top-up Tax under QDMTT, IIR or UTPR

Once the value is ascertained, the Top-up Tax is imposed under QDMTT, IIR or UTPR in accordance with agreed rule order and allocation mechanisms

QDMTT

If a jurisdiction has a domestic minimum tax that is consistent with the GloBE rules it is then considered a "Qualified" Domestic Minimum Top-up (QDMTT), such domestic tax offsets the top-up tax liability on this income under the GloBE rules. The QDMTT reinforces a jurisdiction's primary right of taxation over its own income.

IIR

If the jurisdiction where the low-taxed Constituent Entity is located does not have a QDMTT, the jurisdiction where the UPE of such entity is located might collect the top-up tax under the IIR. Under the IIR, the minimum tax is paid at the level of the parent entity, in proportion to its ownership interests in those entities that have been allocated top-up tax. Generally, the IIR is applied at the level of the UPE but may apply further down in the ownership chain if the UPE is not subject to an IIR. Rules also provide the IIR to be applied by an intermediate parent entity in which there is a significant minority interest, to minimize leakage of top-up tax on low-taxed income. As mentioned above, in the computation of the top-up tax any QDMTT paid in another jurisdiction shall be deducted, and in the case of the QDMTT Safe harbor reduced to zero and thus eliminated

UTPR

The GloBE rules use the UTPR to ensure minimum tax is paid when income is routed through multiple entities to avoid tax. This rule applies when income is taxed too low in a jurisdiction. To fix this, resident entities in that jurisdiction must pay extra tax, which can be done by denying deductions or using another method. The amount of extra tax is calculated based on the entities' share of tangible assets and employees in that jurisdiction. This ensures the rule is workable and targets entities that can afford to pay the extra tax. The same calculations are used to determine the tax rate and amount, whether under the primary rule (IIR) or the backup rule (UTPR). However, the backup rule requires more international cooperation and information sharing, which is why it's a last resort.

AGREED RULE ORDER

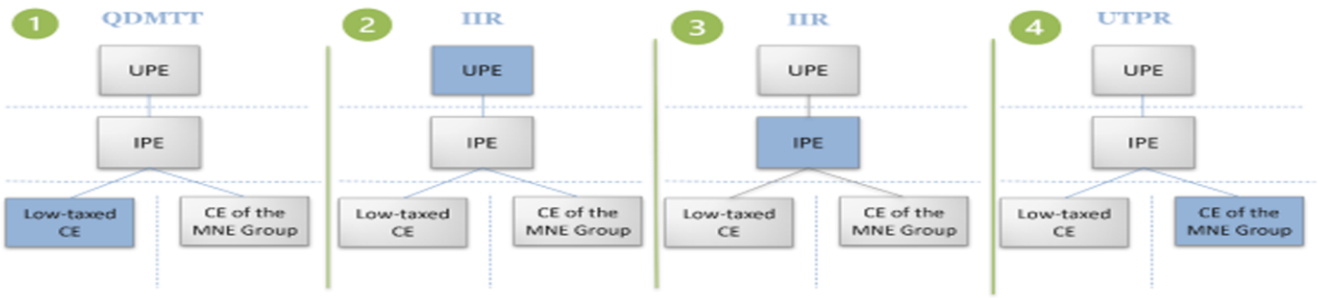


Image taken from the OECD/G20 BASE EROSION AND PROFIT-SHARING PROJECT

For easier understanding, the above image implies that:

1. The low-taxed jurisdiction collects top-up tax under QDMTT (if available).
2. If not, the UPE's jurisdiction applies IIR (if available).
3. If not, the next entity in the ownership chain with an IIR (intermediate parent entity) col lects top-up tax.
4. If none of the above apply, jurisdictions with UTPR collect top-up tax, allocated based on a substance-based key.

In short, the top-up tax is collected by the most relevant jurisdiction, following a specific order of priority.

DISCLAIMER