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TAX & CORPORATE ADVISORS

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TAXPAK

Newsletter by

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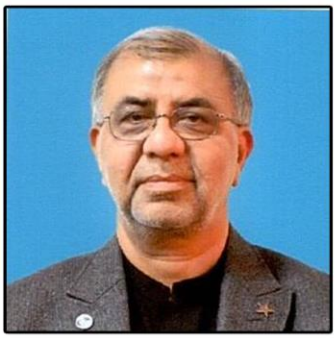
Chairman's Message



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 Karachi, wherein it was held that advance against shares cannot be termed as fictitious transactions u/s 39(3) of the Income Tax Ordinance, 2001 ("ITO"), when the same have been transacted through banking channel. The other judgement discussed, was passed by the Hon'ble Islamabad High Court ("IHC"), wherein the Hon'ble IHC set aside the recovery notice issued u/s 138 of the ITO that sought to recover alleged advance tax due u/s 147, and held that the tax department does not have the power to reject the advance tax estimates furnished by a taxpayer. The Hon'ble IHC further held that once the taxpayer has filed it's return of income for the said tax year, and it transpires that there is a shortfall of advance tax paid throughout the tax year, then the tax department can levy default surcharge u/s 205 of the ITO.

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 II". The said topic provides an insight on the implementations of 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.

FBR Notifications

A.Income Tax Notifications

1. Draft Electronic Tax Return Form

The FBR, vide SRO 895(I)/2024, dated 21.06.2024, issued draft further amendments in the Income Tax Rules, 2002 for suggestions and objections from all persons within 7 days from the date of issue. In the said Notification, draft electronic income tax returns for companies, and both, return of income and wealth statements for Association of Persons, Individuals and Salaried Individuals were notified which will be applicable for the Tax Year 2024.
For further reading: FBR

2. Draft Manual Tax Return Form

The FBR, vide SRO 896(I)/2024, dated 21.06.2024, issued draft further amendments in the Income Tax Rules, 2002 for suggestions and objections from all persons within 7 days from the date of issue. In the Notification, draft manual income tax return and wealth statement for business individuals and other than salaried employees were notified which will be applicable for the Tax Year 2024.
For further reading: FBR

B.Sales Tax Notifications

1. Withdrawal of various exemptions/ zero-rated goods.

The FBR, vide SRO 923(I)/2024 dated 29th June 2024, rescinded the following with effect from 1st July 2024, which now means that these shall be subject to levy of Federal sales tax at the standard rate:

a. Exemption on import of all goods received in the event of a national disaster/ gifts/donation received on such events;
b. Zero-Rated sales tax on MS Petrol, High Speed Diesel Oil, Kerosene and Light Diesel Oil;
c. Exemption of whole of sales tax on import of edible fruits (except apples) from Afghanistan.
For further reading: FBR

SALES TAX ON SERVICES NOTIFICATIONS

A.SINDH REVENUE BOARD (SRB)

1. Extension in payment and filing of sales tax return on services for the tax period may 2024

The SRB, vide Circular No. 03/2024 dated 15th June 2024, extended the date of payment of sales tax on services for the tax period May 2024 from 15th June 2024 to 21st June 2024, while the return submission date was fixed for 24th June 2024.
For further reading: SRB

2. Amendments in SRO No. SRB-3-4/7/2013 dated 18th June 2013

The SRB, vide SRO No. SRB-3-4/23/2024 dated 29th June 2024, further amended an earlier SRO No. SRB-3-4/7/2013 dated 18th June 2013 whereby, with effect from 1st July 2024, various services would be exempted / charged to sales tax on services, such as services provided by restaurants and caterers in farmhouses would no longer be eligible for exemption from sales tax on services. Moreover, the following services **have been removed from the exemptions list** contained therein:

a. Services provided by a foreign exchange dealer/company in consideration of spread charges as permitted by the State Bank of Pakistan in relation to the buying and selling of foreign currencies.

b. Services provided by a money exchanger in consideration of spread charges as permitted by the State Bank of Pakistan in relation to the buying and selling of foreign currencies.

c. Services by cable TV operators in rural areas having PEMRA's R category license.

Furthermore, the following services shall be exempt:

a. Medical practitioners, other than cosmetic and plastic surgery, whose fees does not exceed Rs 3,000 per consultation.

b. Education services where the fees does not exceed Rs 500,000 per annum per student.

c. Services by hospitals, clinics, other than services where indoor patients and day care patient charges does not exceed Rs 25,000 per room /bed.

For further reading: SRB

3. Amendment in SRO No. SRB 3-4/8/2013 dated 1st July 2013

The SRB, vide SRO. SRB-3-4/24/2024 dated 29th June 2024, made further amendments to SRO No. SRB 3-4/8/2013 dated 1st July 2013, where by, subject to term and conditions, the following services would be subject to SRB at their respective rates:

Sr. No	Services by:	Rate
01	Restaurants including restaurants located in hotels, motels, guest houses and farmhouses, **where payment against tax invoices for restaurant services is received through debit or credit cards, mobile wallets or QR scanning.**	8%
02	Foreign exchange dealer/ company/ Money changer/ money exchanger	3%
03	Medical practitioners and consultants other than cosmetic and plastic surgery	3%
04	Distribution services	5%
05	Education services	3%
06	Provision of rooms/bed by hospitals and clinics for indoor patients or day-care patients	3%

Moreover, the following services provided/rendered are now taxable at 15% instead of 13%:

a. Franchise services;
b. Construction services;
c. Transportation or carriage of goods by road/ pipeline/conduit;
d. Ready mix concrete services;
e. Intellectual Property Services;

For further reading: SRB

4. Extension in conditions to avail 5% SRB on services by recruiting agents

The SRB, vide SRO. SRB-3-4/25/2024 dated 29th June 2024, made further amendments to its earlier Notification bearing No. SRB-3-4/19/2021 dated 30th June 2023, whereby, services by recruiting agents who recruit persons for employment outside Pakistan were levied at a lower rate of 5% only for the financial years 2021-2024, the same has now been extended till 2025-2026. Moreover, the filing dates have been extended till 20th July 2024, and that it would be rescinded at 23:59 of 30th June 2026 instead of 2024.

For further reading: SRB

5. Amendment in the Sindh Sales Tax Special Procedure (Transportation or Carriage of Petroleum Oils through Oil Tanker) Rules, 2018

The SRB, vide SRO. SRB-3-4/26/2024 dated 29th June 2024, removed the words "inter-city" from the rules and forms mentioned in the Sindh Sales Tax Special Procedure (Transportation or Carriage of Petroleum Oils through Oil Tanker) Rules, 2018.
For further reading: SRB

6. Amendments in the Sindh Sales Tax on Services Rules, 2011

The SRB, vide SRO. SRB-3-4/27/2024 dated 29th June 2024, made amendments in the Sindh Sales Tax on Services Rules, 2011 whereby, rules for the procedure for collection and payment of sales tax for various services such as medical practitioners and consultants, hospitals and clinics were made along with amendments in various forms for services whose rates have been increased from 13% to 15%. For further reading: SRB

7. Amendments In The Sindh Sales Tax Special Procedure (Withholding) Rules, 2014

The SRB, vide SRO. SRB-3-4/28/2024 dated 29th June 2024, made amendments to the Sindh Sales Tax Special Procedure (Withholding) Rules, 2014, whereby, the withholding agents shall maintain records for a period of 8 years for the tax periods ending on 30th June 2025 or earlier and for 6 years from the end of the financial year to which the documents relate for tax periods from 1st July 2025 and onwards. For further reading: SRB

8. Amendments in the Sindh Sales Tax Special Procedure (Online Integration of Business) Rules, 2022

The SRB, vide SRO. SRB-3-4/29/2024 dated 29th June 2024, made amendments to the Sindh Sales Tax Special Procedure (Online Integration of Business) Rules, 2022, whereby, an authorized officer of the Board, may check the documents validating transactions made through digital modes for every integrated person. Moreover, the annexure to these rules has been amended accordingly. For further reading: SRB

9. Amendments in the Sindh Sales Tax Special Procedure (Tax on Specified Services) Rules, 2023

The SRB, vide SRO. SRB-3-4/30/2024 dated 29th June 2024, made amendment to the Sindh Sales Tax Special Procedure (Tax on Specified Services) Rules, 2023 whereby services on account of advertisement by a provider who is not resident in Pakistan shall be levied at 15% sales tax on services instead of 13%, with effect from 1st July 2024. For further reading: SRB

10. BUDGETARY MEASURES FOR SINDH SALES TAX ON RESTAURANT SERVICES

The SRB, vide Circular No. 04/2024 dated 30th June 2024, issued budgetary measures for Sindh sales tax on restaurant services effective from 1st July 2024, whereby the rates on such services would be 15%. However, reduced rates of 8% would be applied subject to conditions stated therein.
For further reading: SRB

11. Amendments in the Circular No. 01/2024 dated 4th January 2024

The SRB vide Circular No. 05/2024 dated 30th June 2024, made further amendments to the Circular No. 01/2024 dated 4th January 2024, whereby where payments are made through debit/credit cards, the collecting agent would collect 15% sales tax for advertisement services instead of 13%, and 15% where over the counter payments are made under the State Bank of Pakistan's outward remittance code 1237 instead of 13% for advertisement and market research agency services.
For further reading: SRB

12. Budgetary Measures for Sindh Sales Tax on Education Services

The SRB, vide Circular No. 06/2024 dated 30th June 2024, issued budgetary measures for Sindh sales tax on education services effective from 1st July 2024, whereby educations services receiving fees per annum less than Rs 500,000/- shall not be liable to Sales tax on services and rules thereunder had been further specified.
For further reading: SRB

B. PUNJAB REVENUE AUTHORITY (PRA)

1. Extension in Filing of Sales Tax Returns

The PRA, vide Notification No. PRA/Orders.06/2023 dated 14th June 2024, extended the due date of payment and filing of Punjab Sales Tax for the tax period of May 2024 till 20th June 2024 for all services except the tele communication services.
For further reading: PRA

CORPORATE NOTIFICATIONS

1. Amendments to the Listed Companies (Code of Corporate Governance) Regulations, 2019.

The SECP, vide SRO dated 12th June 2024, issued amendments to the Listed Companies (Code of Corporate Governance) Regulations, 2019, which had been earlier published for public consultation vide SRO 71(i)/2024

dated 17.01.2024, whereby, anti-harassment policy to safeguard the rights and well-being of employees was introduced along with the role of the Board and its members to address Sustainability Risks and opportunities. These were introduced to ensure policies to promote diversity, equity and inclusion were in place so that participation of women with the board/management was implemented and that a protective environment is in place for Listed Companies. For further reading: SECP

2. Guidelines on ESG Disclosures for Listed Companies, 2023

The SECP issued guidelines on ESG Disclosures for Listed Companies, 2023 whereby, the importance, reporting requirement and need for key disclosure for ESG (Environmental, Social and Governance) were incorporated. The guidelines also presented a format of the Key ESG performance metrics which were mandatory for disclosure under various laws.
For further reading: SECP

CASE LAW:ADVANCE AGAINST SHARES CANNOT BE TERMED AS FICTITIOUS TRANSACTIONS U/S 39(3) OF THE ITO WHEN THE SAME HAS BEEN TRANSACTED THROUGH BANKING CHANNEL

INTRODUCTION:

The Appellate Tribunal Inland Revenue, Karachi ("ATIR") was moved by M/s Galadari Cement (Gulf) Limited ("Appellant") in ITA No. 2030/KB/2022 for the tax year 2019 against the order passed by the Commissioner Inland Revenue (Appeals-III), CTO, Karachi ("Respondent"). The Appellant challenged the act of adding back the advance against the shares into the income by the Respondent under the pretext of section 39(3) of the Income Tax Ordinance, 2001 ("ITO").

BRIEF FACTS OF THE CASE:

The Appellant was a Public Limited Company and was involved in manufacturing of cement. The Appellant furnished the return of income and declared loss from business to the tune of PKR 78,428,706/-, and tax refundable to the tune of PKR 201,105/-. The Appellant's case was selected for audit by the assessing officer under section 177 of the ITO. In the aftermath, the officer

observed some discrepancies and the same confronted to the Appellant through a show-cause notice. The Appellant submitted its reply, but the audit officer was not satisfied with it, hence he passed the impugned order.

The Appellant being aggrieved with the order, filed an Appeal before the Commissioner Inland Revenue (Appeals) Karachi ("Respondent"), who vide her order, confirmed the same and held that as the advance against shares was given by a person that did not hold a NTN at the time of remitting the amount through banking channel, the same fell within the taxability of Section 39(3) of the ITO as the genuineness of the transactions could not be verified because the payer of the advance did not have a NTN and hence did not file her return of income or a wealth statement.

The Appellant being aggrieved by the Order of the Respondent, preferred an appeal against the Order of Respondent before the Hon'ble ATIR, Karachi.

ARGUMENTS BY THE LEARNED COUNSEL OF APPELLANT:

The Counsel of the Appellant argued that section 39(3) of the ITO, 2001 is para-materia, and conceptually similar to section 12(18) to the ITO, 1979. He submitted that the intention of the legislature in enacting Section 12(18) and Section 39(3) is to discourage (back-dated) fictitious transactions. He further submitted that the transactions were not fictitious transactions as the same were conducted through banking channel. The counsel placed reliance on several judgments and argued that since the transactions are not fictitious the said amount of advance against cannot be added back to the income of the Appellant as settled by the superior courts from time to time.

The counsel further contended that the term law is not confined to only statutes, but it also includes judicial pronouncements laid down by the superior court from time to time, thus the judicial pronouncements relating to section 39(3) must be read hand in hand alongside section 39(3) of ITO.

ARGUMENTS BY THE LEARNED COUNSEL OF RESPONDENT:

The Learned DR argued that the orders passed by the earlier authorities i.e. assessing officer and CIR(A) had been passed on sound reasonings, and the CIR(A) rightly had confirmed the order. The DR further agitated that the transactions were not genuine as the Director who had made the advance against shares was not a NTN holder at the time when the transactions were made.

FINDINGS OF THE ATIR:

The Hon'ble ATIR held that since the transactions at hand were done through banking channel, the same cannot be termed as fictitious by any stretch of imagination. In addition thereto, the Hon'ble ATIR held that the Section 39(3) of ITO cannot be read in isolation. It has to be read alongside the judicial pronouncements made by the superior courts of law, and the Honorable Appellate Tribunals, in order to arrive at a fair and just conclusion in the instant case.

It was further held that the intention of legislature for enacting section 39(3) is to prevent fictitious transactions, and the intention of the legislature cannot be ignored. Since the transactions were made through banking channel, the same cannot be termed as fictitious transactions. Therefore, the Hon'ble Tribunal held that the transactions pertaining to the advance against shares are not fictitious, and same cannot be added back into the income of the Appellant under section 39(3) of the ITO.

In the light of the foregoing, the Appeal succeeded on this ground, and the demand became annulled. The Hon'ble ATIR deleted the addition of PKR 58,602,950/- made by the respondents on account of advance against shares u/s 39(3) of the ITO, from the income of the Appellant.

CASE LAW: HON'BLE IHC'S JUDGEMENT WHERE IN IT WAS HELD THAT THE TAX DEPARTMENT DOES NOT HAVE THE POWER TO REJECT THE ADVANCE TAX ESTIMATES FILED BY THE TAXPAYER, AND THE TAX DEPARTMENT CANNOT RECOVER THE ALLEGED ADVANCE TAX LIABILITY THROUGH COERCIVE RECOVERY MEASURES.

INTRODUCTION:

The Islamabad High Court ("IHC") was moved by M/s Motorway Operation and Rehabilitation Engineering (Pvt.) Limited ("Petitioner") in W.P bearing No. 1157 of 2024 against the Federation of Pakistan and others ("Respondents"). The Petitioners challenged the unwarranted recovery of advance tax by the Respondents under section 147 of the Income Tax Ordinance, 2001 ("ITO" or "2001 Ordinance") through s recovery notice issued under Section 138 of the ("impugned notice").

BRIEF FACTS OF THE CASE:

The Petitioner was aggrieved of the impugned recovery notice issued by the Respondent on 29-03-24, in which the Petitioner was called upon to pay its liability to the tune of PKR 786,234,002/- as advance tax liability under section 147, for the 3rd Quarter of 2024 ("said quarter").

The Petitioner had paid the amount to the tune of PKR 178,175,829/- as advance tax on 25-03-2024, for March quarter, on the basis of its estimates filed under section 147(6) of ITO.

the respondent re-calculated the Petitioner's liability for the said quarter on the basis of amended assessment under section 122(5A) of the ITO.

Pursuant thereto, the Respondent issued a revised notice to the Petitioner under section 147 of the ITO with the an increased tax demand of the advance tax liability. Thereafter, the Respondent issued the impugned recovery notice on 29-03-2024 to the Petitioner to pay the overdue tax amounting to PKR 786,234,002/-.

The Petitioner being aggrieved and dissatisfied with the impugned notice challenged the vires of the impugned Recovery Notice by filing a Writ Petition before the Hon'ble IHC.

ARGUMENTS BY THE LEARNED COUNSEL OF THE PETITIONER:

The Counsel for the Petitioners argued that the order dated 29-03-2024 is not an appealable order, and the Respondent did not have any jurisdiction to question the veracity of the estimate for the March, 2024 quarter filed by the Petitioner. The counsel further submitted that if the Respondent did not agree with the figure paid as advance tax for the said quarter assessed by the taxpayer vide the estimates filed by the taxpayer, the Respondent had an option to impose default surcharge under section 205 of ITO upon the Petitioner, at the stage once the returns had been furnished. The counsel placed reliance on judgments reported as 2011 PTD 1996, and 2023 PTD 1095.

ARGUMENTS BY THE LEARNED COUNSEL OF RESPONDENTS:

The Learned Counsel for the Respondents argued that the impugned recovery notice was issued on the basis of the amended assessment order passed on 21-03-2024 under section 122(5A) of the ITO, and in this regard, the Petitioner's case was of no estimation of advance tax. He further contended that it is rather an estimation which is on the lower side or erroneous. Lastly, he appended that there is no mechanism provided in the law for withdrawing the impugned recovery notice.

DECISION OF THE HON'BLE IHC:

The Hon'ble IHC in the light of the precedent set forth in the judgment reported as 2023 PTD 1095 held that the ITO allowed taxpayers to file an estimate of their advance tax payable under section 147(6) and pay the amount they believe was due. However, the ITO did not grant taxation authorities the authority to recover the amount due under section 147. Instead, the ITO relied on taxpayer's self-assessment, and taxation authorities could reassess tax returns in compliance with the ITO and seek recovery of non-payment or short payment of advance tax u/s 147 based on this reassessment. Moreover, Section 147(6) allows taxpayers to self-assess advance tax liability, and in the event that the estimate filed by the taxpayer under section 147(6) is incorrect, a remedy is provided under section 205 to impose a default surcharge to the extent of short payment to penalize the taxpayer.

Moreover, the Finance Act, 2018 added a proviso to section 147(6) of the Ordinance, giving taxation authorities authority to affect recovery if they find an estimate misconceived. This new amendment conferred a power to taxation authorities, which previously did not exist. This change in law indicated that the notice issued before this change in section 147(6) was devoid of legal authority..

The Hon'ble IHC allowed the petition to the extent that the demand created through the impugned notice has been set aside. However, it was further held that the department can re-determine the advance tax owed by the petitioner after filing returns, and if the determined amount exceeds the already paid amount, a default surcharge may be imposed.

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

INTRODUCTION

This month's edition will discuss about the implementation considerations in order to apply the second pillar of the minimum tax implementation. A recap of the second pillar of the two-pillar solution is that it comprises of the following:

- 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). (Both have been explained in detail in the previous month's edition.

IMPLEMENTATION CONSIDERATION

The global minimum tax has a common approach meaning that countries are not required to adopt it, but if they do, they must implement and enforce it consistently with the agreed-upon model rules made by the Inclusive Framework. Under the common approach, Inclusive Framework members accept that each member can apply the GloBE rules to an MNE Group's operations in their jurisdiction including agreement as to rule order and the application of any agreed safe harbours. The outcomes of the common approach create the framework for a set of interlocking domestic rules that apply a global minimum tax to in-scope MNE Groups in a coordinated manner.

This coordinated approach creates a harmonized system of domestic rules that collectively ensure a global minimum tax is applied to eligible multinational enterprises, with several countries already starting to incorporate the global minimum tax framework into their laws. Based on the experiences of these countries, Governments follow a two-step approach before implementation: First, they consult with stakeholders to determine whether the global minimum tax applies to multinational enterprises operating in their jurisdiction and decide whether to adopt some or all of the GloBE rules into their domestic law, and Second, they address practical and legal issues, draft rules that align with the Inclusive Framework's agreements, and ensure consistent application of the global minimum tax. Therefore, there are two stages which governments generally proceed through- (a) Decide; and (b) Implement, both of these have been elaborately discussed in the upcoming paragraphs.

A) DECIDE – IMPACT ASSESSMENT AND REFORM OPTIONS

If a country decides to evaluate the impact of the GloBE rules, it will conduct separate analyses for multinational enterprises' domestic and foreign operations. To support this assessment, the Inclusive Framework Secretariat has provided all member countries with estimates of potential revenue increases from implementing the GloBE rules, which can serve as a foundation for their evaluation. Then, after evaluating the impact of the GloBE rules on domestic operations, a jurisdiction may also assess the rules' impact on foreign operations of in-scope MNE Groups with a presence in their jurisdiction. If the jurisdiction is the headquarters for in-scope MNE Groups, they may consider implementing an Income Inclusion Rule (IIR) to raise revenue and provide compliance benefits for taxpayers. Even if no in-scope MNE Groups are headquartered there, adopting the IIR could attract future headquarters. The jurisdiction might also consider applying the IIR to MNE Groups below the EUR 750 million threshold. Jurisdictions without many ultimate parent entities may adopt the Undertaxed Payment Rule (UTPR) as a 'backstop' tax to ensure MNE Groups pay a minimum 15% tax in each jurisdiction, dividing the remaining top-up tax among adopting jurisdictions based on substance.

Where a jurisdiction decides to proceed with the introduction of some parts or all of the global minimum tax rules, it may also consider whether there are any existing rules that may become duplicative and that could be eliminated or adapted. For the domestic operations, the following questions play an important role in this decision:

a) What are the domestic profits of in-scope MNE Groups?

To determine if a top-up tax applies to multinational enterprises' (MNEs) domestic operations in a jurisdiction, the first step is to identify in-scope MNEs (those with €750 million or more in revenue)

and their income. However, some jurisdictions lack detailed data to accurately identify these operations. In such cases, the Inclusive Framework Secretariat can assist by providing centralized, aggregated data from Country-by-Country Reports (CbCR) to estimate the number of MNEs and their income. While this data doesn't provide specific information for a detailed assessment, it gives a broad indication of the revenue scope. This can be supplemented with local tax filings, financial statements, or other regulatory data. In some cases, subsidiaries may need to provide additional information, such as transfer pricing documentation, to help determine if they're part of a larger MNE Group.

b)Do MNE Groups have in-scope excess profits?

The jurisdiction does not need to consider the position of large MNE Groups with only a small presence within its jurisdiction. This is because the GloBE rules do not apply to an MNE Group unless the MNE Group has more than EUR 10 million of revenue or EUR 1 million of profit in the jurisdiction. Furthermore, the GloBE rules only apply top-up tax on excess profit arising within a jurisdiction. Even if an MNE Group has low-tax profit, its operations may not be impacted by the global minimum tax if it has sufficient payroll costs and tangible assets in the jurisdiction. Sometimes, the domestic tax system may have deliberately provided tax incentives to encourage investment in tangible assets and job creation. Even though such incentives may produce a low tax outcome, this may not trigger any top-up tax under the global minimum tax if the MNE Group has sufficient investments in the jurisdiction to rely on the shelter provided by the substance-based income exclusion.

c)Are there any low-taxed domestic profits?

After determining the amount of excess profits generated by multinational enterprises (MNEs) in a jurisdiction, the next step is to **evaluate** if these profits are likely to be taxed at a low rate.

To make this assessment, the jurisdiction must consider both the prevailing tax rate and the tax base to determine if a low tax rate, tax base adjustments, or a combination of both could result in low-tax profits for MNEs.

If the jurisdiction offers preferential tax rates or base modifications, the terms of these incentives may indicate whether they are likely to be available to larger MNEs, given the nature of their operations, or if they are subject to limitations that would minimize their impact on the MNE's effective tax rate (ETR). The basis for determining the tax rate and tax base is as follows:

a) Tax rate: The starting point for determining the expected tax rate on a MNE's domestic operations is the statutory corporate income tax rate, which includes national and sub national taxes. If the jurisdiction's statutory rate is below 15%, top-up tax will likely apply to the

MNE's domestic profits under the GloBE rules. However, most jurisdictions have statutory rates above 15%. Effective tax rates (ETRs) below 15% are often due to tax incentives or lower rates for specific income types. If a jurisdiction has special income categories taxed below 15%, it may indicate a risk of low-tax profits for MNEs operating in that jurisdiction.statutory rates above 15%. Effective tax rates (ETRs) below 15% are often due to tax incentives or lower rates for specific income types. If a jurisdiction has special income categories taxed below 15%, it may indicate a risk of low-tax profits for MNEs operating in that jurisdiction.

b) Tax base: Even in jurisdictions with tax rates above 15%, low-taxed profits may still occur due to tax credits or differences between the domestic tax base and the global minimum tax base. These differences occur when local tax systems exclude certain income categories (like capital gains or exempt income) or allow excessive deductions beyond actual economic expenditure. However, tax regimes that only provide accelerated deductions (like accelerated depreciation or immediate expensing) are unlikely to result in low-tax profits, as the GloBE rules generally ignore timing differences. Exceptions may apply for intangible asset expenses with timing differences exceeding five years. In most cases, adjustments to the tax base that may trigger ETRs below 15% will be easy to spot as they will be deliberate features of the tax system such as tax incentives.

d)Reform options

After assessing the profits of in-scope MNEs within their jurisdiction and the potential for low-tax profits (below 15% ETR), a jurisdiction will consider whether changes to their tax system are necessary to align with the GloBE rules. If it already has a high tax rate and broad tax base with few incentives for MNEs, it may choose not to make changes, as low-tax profits are likely limited or only applicable to out-of-scope taxpayers. However, they may still benefit from the global minimum tax implementation by others, through reduced tax competition and profit shifting pressures. If low-tax excess profits are likely, the jurisdiction may make targeted changes to their domestic law, such as reducing tax incentives or implementing a general minimum corporate income tax, to increase the ETR above 15%. These changes may have broader effects and also impact out-of-scope taxpayers.

e)QDMTT

Jurisdictions may consider implementing a Qualified Domestic Minimum Top-up Tax (QDMTT) as a complement or alternative to reforming their domestic tax regime. However, this alone may not achieve a jurisdiction's policy objectives if they consider their tax incentives inefficient and in need of reform. Failure could lead to additional administrative costs and a complex investment environment.

A QDMTT allows a jurisdiction to levy a top-up tax only on excess profits, using the same tax base as the GloBE rules. In contrast, other minimum corporate income taxes are treated as Covered Taxes under the GloBE rules.

An example from the OECD guidelines has been reproduced below for an easier comprehension of the difference between a qualified and non-qualified minimum tax. In the example, a taxpayer with taxable income of 100 and a Substance Based Income Exclusion (SBIE) of 25 would have a top-up tax liability of 3.75 under the GloBE rules. Alternatively, a non-qualified minimum tax ensuring a 15% effective tax rate would impose a tax of 5, eliminating the GloBE rules liability.

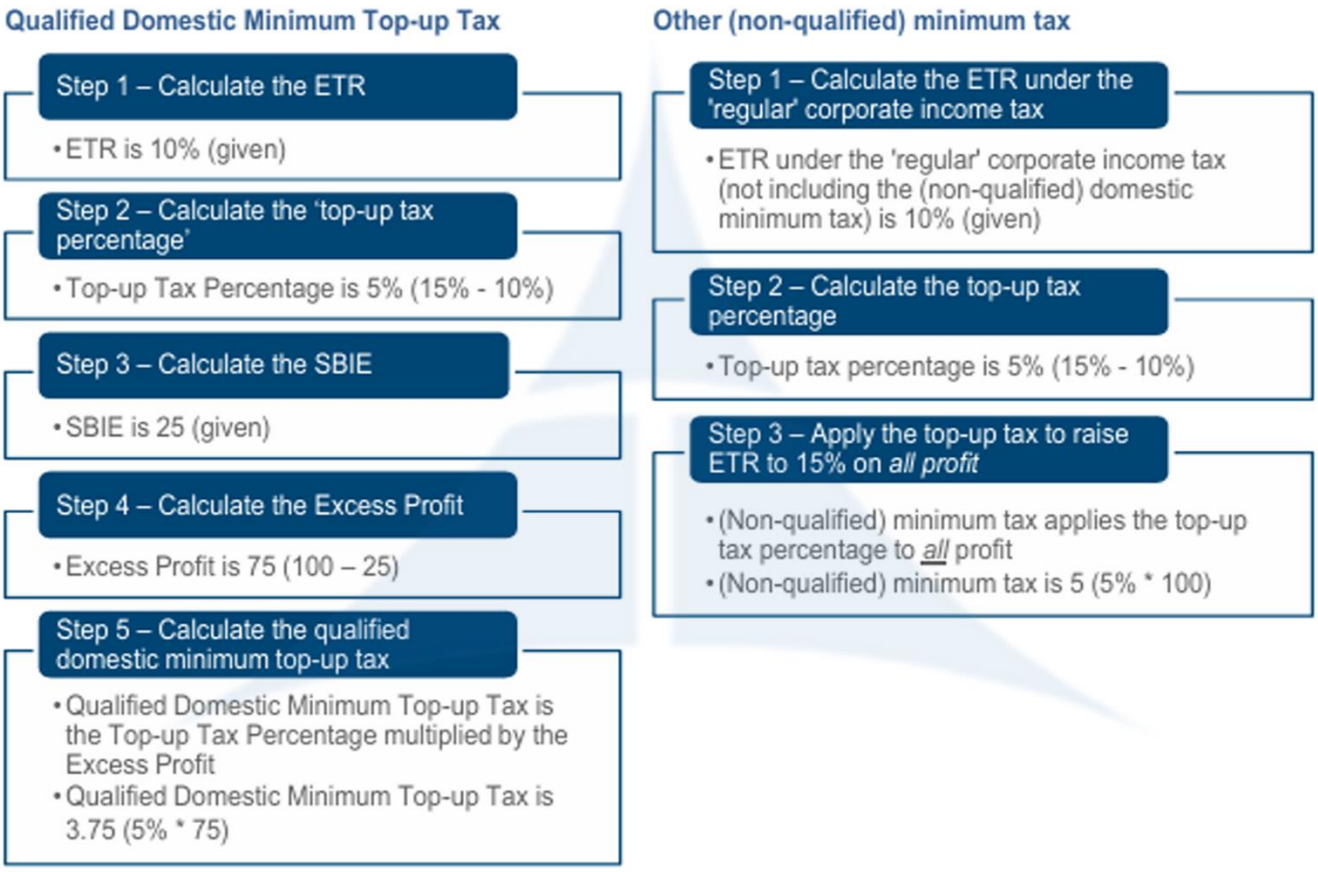


**Figure taken from the MINIMUM TAX IMPLEMENTATION HANDBOOK (PILLAR TWO) © OECD 2023.*

Further explanation to the above example is that a QDMTT can discharge GloBE rules liability with a lower tax amount (3.75) as compared to a non-qualified minimum tax (5). This is because a non-qualified tax must raise the effective tax rate (ETR) to 15% to prevent a GloBE liability, whereas a QDMTT uses the same calculation mechanics as the GloBE rules. The QDMTT is designed to be simple, cost-effective, and neutral in terms of competitive position, as it only alters the jurisdiction receiving the top-up tax. Implementing a QDMTT requires minimal additional work due to the aligned design and shared mechanisms. Administration costs are also low, as jurisdictions can

rely on the common GloBE Information Return and exchange mechanisms. Additionally, the QDMTT offers flexibility, such as applying to entities below the EUR 750 million threshold or imposing a 15% top-up tax on all profits, making it attractive to jurisdictions with limited MNE operations.

B)Implement – Legislating for consistent and coordinated outcomes

1. LEGISLATIVE TECHNIQUE

a) Direct incorporation or incorporation by reference

The GloBE rules can be integrated into domestic law through various methods. Some countries, like Japan and the UK, have chosen to incorporate the substance of the Model Rules into their legislation, an approach known as 'full form legislation'. This requires adapting the structure and language to align with domestic legislative standards while ensuring consistency with the Model Rules. Alternatively, jurisdictions like Liechtenstein and New Zealand are adopting a 'reference approach', cross-referencing the Model Rules in their legislation. This approach incorporates the rules by reference, maintaining consistency while respecting sovereignty and allowing for easier updates. It also reduces the demand on legislative resources.

b) Introduce the Model Rules through a combination of primary and secondary legislation

Another approach is to enact core provisions in primary legislation and supplement with secondary legislation or guidance. A simplified version of the Model Rules could focus on defining scope, ETR calculations, and charging mechanisms, while leaving details like definitions and corporate structures to secondary legislation or regulations. This 'skeleton legislation and detailed regulations' approach allows for efficient incorporation of future guidance and faster implementation. By granting the Ministry of Finance or tax administration authority to release further regulations, the jurisdiction can ensure consistent outcomes with other jurisdictions and make it easier for primary legislation to meet the common approach requirements.

2. ENSURE CONSISTENCY

a)Applying Agreed Administrative Guidance and Safe Harbours

In 2022, a Commentary to the Model Rules was issued and updated over time with the prime role to ensure consistency in implementing and applying the GloBE rules. As the Inclusive Framework updates the Commentary with new Administrative Guidance, jurisdictions should ensure their domestic legislation aligns with the latest Commentary version. The GloBE rules also allow for safe harbours, which exempt MNE Groups meeting certain requirements from ETR and Top-up Tax calculations, providing tax certainty and transparency. To achieve consistency, jurisdictions can

include an interpretive clause referencing the Commentary or incorporate the Commentary, Administrative Guidance, and safe harbours into domestic law, effective after a specified timeframe following their publication by the Inclusive Framework.

b)Giving effect to qualified rule status

The Model Rules' has specified the agreed rule order hence, ensuring effective and comprehensive minimum tax application while preventing double or over-taxation. The rules modify application in one jurisdiction if another jurisdiction has an applicable "qualified" rule, such as deactivating a jurisdiction's rules if a Qualified IIR applies at the ultimate parent entity level. To implement the rule order, jurisdictions must identify "qualified" rules. The Inclusive Framework will develop a peer review process to consistently determine qualified status, providing certainty and efficiency. A transitional self-certification approach will be used initially, with more detailed reviews and ongoing monitoring of legislative changes that may impact qualified status.

c)Administration

The Inclusive Framework has developed tools to facilitate coordinated administration of the GloBE rules, including the standardized GloBE Information Return (GIR) released in July 2023. The framework allows jurisdictions to collect or access necessary information, with local filing as the default mechanism. However, central filing in a single jurisdiction with exchange of information mechanisms is also possible, deactivating local filing requirements. The Inclusive Framework is developing exchange agreements, IT tools, and an XML schema for efficient information exchange. Moreover, work is underway on improving tax certainty, coordinated compliance approaches, and practical guidance on tax administration, which may be included in future updates or materials.

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