#KPMGjosh

TAX FLASH NEWS

3 November 2021

The impact of BEPS on tax incentives in ASPAC India

Across the ASPAC region, many countries offer a range of tax incentives to attract foreign investment and to drive the development of local infrastructure. However, the introduction of a global minimum tax raises questions as to the future of such incentives.

KPMG is pleased to provide a summary of the results of our ASPAC regional survey of tax incentives. This survey and detailed commentary can be accessed via this link [here].

Introduction

On 8 October 2021, the OECD Inclusive Framework ("IF") announced that it had reached majority agreement on the building blocks and key rates for a new global tax framework, which is currently supported by 136 out of 140 IF members.

Our recent KPMG publication gives a fuller explanation of the 8 October 2021 statement [link].

Impact of a global minimum tax rate on ASPAC tax incentives

In a recent survey, we found there were more than 40 tax incentive regimes across the ASPAC region that had the potential to be impacted by the Pillar Two measures, although when sector specific variations of these incentives are factored in the number grows considerably.

It is important to note that Pillar Two is not like some of the other BEPS measures, where it simply won't affect a country that chooses not to adopt it domestically. Top up tax can apply under Pillar Two (typically at the ultimate parent company level) to neutralise tax incentives enjoyed elsewhere in the group.

The question then arises – how likely is it that countries will continue offering generous tax concessions (at a cost to their tax revenue) if another country can claw back that benefit (to benefit their tax revenue)?

Potential policy responses

With the potential neutralisation of their tax incentives under Pillar Two and no grandfathering of existing incentives, some countries in the region have already started to explore alternative options:

- It is likely the most generous tax incentives will be unwound, or else rates increased. However, with the benefit of jurisdictional blending with higher rate income or entities, it may be that incentive rates of below a certain threshold (say, 10 per cent) do not survive, but those at or above do.
- Some jurisdictions in the region are also exploring an alternative minimum tax concept for in scope multinational groups. This would allow for incentives to be maintained for out of scope taxpayers, whilst ensuring that any top up tax to get to an Effective Tax Rate (ETR) of 15 per cent is collected locally rather than in another jurisdiction.
- A move towards encouraging investment by way of grants and qualifying refundable tax credits, which have less of a reduction to the ETR than non-refundable tax credits under the current proposals.
- Other alternative non-tax incentives, which might include things like payroll incentives or a reduction of regulatory burdens.

One thing is clear – governments need to respond quickly to these measures, as uncertainty can make medium to long term business planning very challenging and could dampen investment activity.

Mitigating factors

There are some aspects of the measures which could lessen the impact on multinational groups:

- Jurisdictional blending allows for the ETR to be calculated on an aggregated basis for all group entities in the same jurisdiction (blending high tax and low tax entities). Centralising operations can optimise the advantages of jurisdictional blending.

- The formulaic substance-based exclusion for a 10 per cent fixed return on payroll costs and 8 per cent fixed return on tangible assets may also reduce the impact (tapering to 5 per cent over 10 years), particularly for manufacturing operations or headcount dependant incentives.

- For Ultimate Parent Entities that benefit from incentive rates, the delay of the Undertaxed Payment Rule start date to 2024 is helpful. Groups with limited overseas operations will have an additional five years before it applies.

Impact on India

In the context of India, the Pillar two proposals i.e. the GloBE rules as well as the STTR will have a greater impact in respect of outbound investments by Indian groups with overseas subsidiaries that avail of tax incentives. Further, STTR provisions would impact payments by Indian subsidiaries of foreign groups making covered payments which are taxed at low nominal rates.

As regards inbound structures, there are currently limited tax incentives available in India. One example is of the patent box regime which can reduce the effective tax rate below the minimum tax rate of 15%. However, the scope of this incentive is somewhat restricted and does not appear to be widely used. For certain entities enjoying other tax incentives in India, India has a concept of minimum alternative tax, which will largely ensure that the effective tax rate gets maintained at 15%.

What should multinationals be thinking about?

With the expected release of the detailed rules in late November 2021, the pressure is on for quick adoption of the measures and a proposed start date in 2023.

This leaves very little time for multinationals to work out how the measures may affect them and to re-assess their group structure, intellectual property holdings, financing arrangements and global supply chains given the potential neutralisation of existing tax benefits. Local consultation to get certainty on incentives and other policy responses will be important.

Your KPMG team can support you with impact assessments, scenario modelling, lobbying support, group structure planning and holistic data solutions.

KPMG in India Contacts:

Name: **Rajeev Dimri**
Title: HoD – Tax
Email: rajeevdimri@kpmg.com

Name: **Naveen Aggarwal**
Title: Partner – Northern India Tax Head
US – India Corridor Leader
Email: naveenaggarwal@kpmg.com

home.kpmg/in

home.kpmg/in/socialmedia

KPMG Assurance and Consulting Services LLP, Lodha Excelus, Apollo Mills Compound, NM Joshi Marg, Mahalaxmi, Mumbai - 400 011
Phone: +91 22 3989 6000, Fax: +91 22 3983 6000