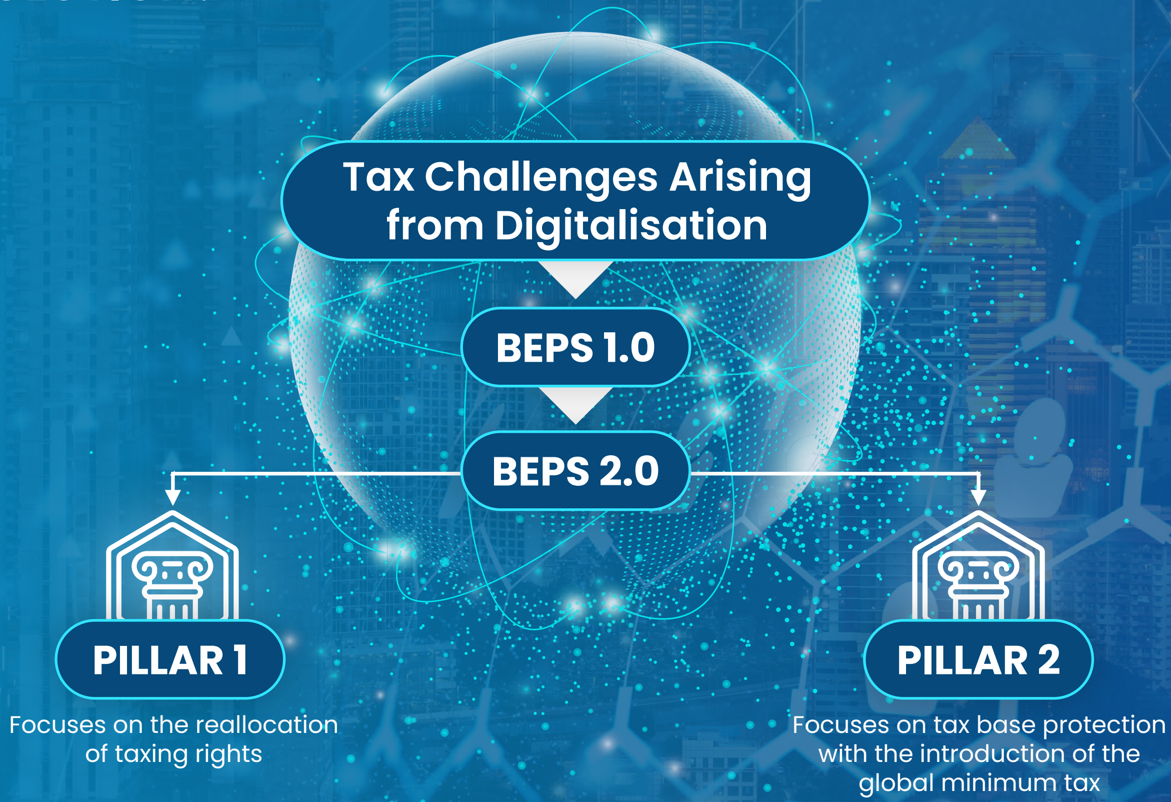
Sets the Standards and Beyond

DDTC Fiscal Research & Advisory

The Two-Pillar Solution and the Impact for Indonesian Taxpayers

2024

WHAT IS THE TWO-PILLAR SOLUTION?



Globalisation and digitalisation have resulted in economic issues worldwide, in particular, changes that render challenges in taxing income of international businesses, leading to tax avoidance by multinational enterprises (MNEs). According to the OECD/G20, this tax avoidance practice costs countries around USD100-240 billion annually or around 4-10% of state revenues lost from corporate income tax globally.

Therefore, the OECD/G20 has taken the initiative to address one of the impacts of globalisation and digitalisation, known as the Base Erosion Profit Shifting (BEPS) Project. Subsequently, through the Inclusive Framework (IF) on BEPS that consists of more than 130 countries and various active discussions, one of the agreed upon consensus is the Two-Pillar Solution. The goal is to ensure that MNEs distribute profits to market countries and pay tax at the global minimum rate of 15%.

KEY ELEMENTS OF THE TWO-PILLAR SOLUTIONS

PILLAR 1	PILLAR 2
Taxing rights over 25% if the residual profit of the largest and most profitable MNEs would be re-allocated to the jurisdictions where the customers and users of those MNEs are located	GloBE rules provide a global minimum tax of 15% on all MNEs with annual revenue over 750 millione euros
Tax certainty through mandatory and binding dispute resolution, with an elective regime to accommodate certain low-capacity countries	Requirement for all jurisdictions that apply a nominal corporate income tax rate below 9% to interest, royalties and a defined set of other payments to implement the “Subject to Tax Rule” into their bilateral treaties with developing Inclusive Framework members when requested to, so that their tax treaties cannot be abused.
Removal and standtill of Digital Services Taxes and other relevant, similar measures	Carve-out to accomodate tax incentives for substantial business activities
The establishment of a simplified and streamlined approach to the application of the arm’s length principle in specific circumstances, with a particular focus on the needs of low capacity countries	

PILLAR 1

- The main focus is the reallocation of taxing rights to the market country without relying on physical presence
- Using market revenue as the allocation key
- Introducing new nexus and profit allocation methods
- Introducing tax certainty mechanisms
- Implemented through multilateral convention (MLC)
- Pillar 1 consists of two main components:
  - **Amount A,** the amount of profits of MNEs that will be reallocated to certain jurisdictions as part of the effort to nullify digital services tax (DST) or similar taxes.

OBJECTIVE

To provide a fairer profit distribution by reallocating the taxing rights on the share of residual profits of MNEs covered by Pillar 1 (amount A allocation) to the market country regardless of physical presence in the market country by introducing new nexus and profit allocation methods.

SCOPE

Multinational enterprises (MNEs) with consolidated turnover exceeding EUR20 billion and profits above 10% (profit before tax/turnover). After 7 years, the cap is lowered to EUR10 billion.
Exclusions: extractive industries and regulated financial services

NEXUS

Multinational enterprises (MNEs) with consolidated turnover exceeding EUR20 billion and profits above 10% (profit before tax/turnover). After 7 years, the cap is lowered to EUR10 billion.

AMOUNT A ALLOCATION METHOD

Amount A is allocated by a certain formula, i.e. 25% of residual profit (total profit minus 10% revenue) allocated to the market country based on the percentage of local sales compared to total sales.

DOUBLE TAXATION ELIMINATION

Marketing & distribution safe harbour (MDSH) mechanism to prevent over-allocation of Amount A (double counting) and elimination of double taxation mechanism to resolve double taxation effects due to Amount A allocation.

TAX CERTAINTY

Early certainty mechanism through the establishment of a panel. Meanwhile, the dispute resolution mechanism is implemented through MAP and panel establishment.

  - **Amount B,** the application of the simplified arm's length principle (ALP) for marketing and distribution by MNEs.

Highlights

MLC Pillar 1 will be open for signing by the end of 2023, with entry into force planned for 2025

Pillar 1 may be applied globally if at least 30% of member states of the IF on BEPS representing at least 60% of ultimate parent entities (UPEs) sign and ratify MLC Pillar 1

IF on BEPS states have agreed to postpone the implementation of the DST until the end of 2024 or until MLC Pillar 1 comes into force (whichever occurs first) and may be extended until the end of 2025 if agreed by the states

PILLAR 2

- The main focus is to prevent BEPS issues other than the digital economy and eliminate corporate tax rate competition by implementing the global minimum tax.
- Consists of GloBE rules and subject to tax rule (STTR)
- Implemented through domestic provisions and multilateral instrument (MLI)

Scope: MNEs with consolidated turnover of >EUR750 million
Exclusions: Government entities, international organisations, non-profit organisations, pension funds or investment funds and International Shipping income

GloBE Rules

SUBJECT TO TAX RULES (STTR)	QUALIFIED DOMESTIC MINIMUM TOP-UP TAX (QDMTT)	INCOME INCLUSION RULES (IIR)	UNDERTAXED PAYMENT RULES (UTPR)
The provision that allows the source country to tax payments of interest, royalties, rents, services, certain other costs that are not taxed or are subject to a tax rate of less than 9%. Tax imposed = the difference of 9% - tax imposed on such income. STTR MINIMUM RATE OF 9% (creditable in the calculation of GLOBE income)	The minimum tax under domestic tax laws implemented and administered as per the GloBE Rules	The provision that requires the "parent" of an MNE Group (or part of an MNE Group) to pay a top-up tax on its subsidiaries that are subject to an effective tax rate of less than 15%.	The applicable provision if the IIR provisions cannot be applied because the parent entity with an ETR <15% or does not apply IIR in its domestic provisions. UTPR is applied by the country of domicile of the subsidiary of an MNE covered by Pillar Two with an ETR>15%. The top-up tax imposed under UTPR is the same as the top-up tax under IR.

These provisions must be included in tax treaties to be implemented. STTR MINIMUM RATE OF 9% (creditable in the calculation of GLOBE income)

These provisions must be included in domestic provisions to be implemented.

The minimum tax rate for QDMTT, IIR and UTPR is 15%.

GloBE Rules Mechanism & Highlights

$$\frac{\text{Adjusted Covered Tax (Calculated on a jurisdictional basis)}}{\text{GloBE income (based on financial account calculated on ajurisdictional basis)}} = \text{Jurisdictional ETR}$$

1. **Jurisdictional ETR**
2. Top-up Tax Percentage
   Min. rate (15%)-jurisdictional ETR
3. Excess Profit
   GloBE income-substance based income exclusion (SBIE)
4. Jurisdictional top-up tax: (top-up tax% x excess profit) - Qualified Domestic Minimum Top-up Tax (QDMTT)

More than 50 countries have undertaken measures towards Pillar 2 implementation

Model rules and commentary STTR as well as MLI have been issued

MLI for STTR implementation have been open for signing since 2 October 2023

THE SITUATION IN INDONESIA

In general, developing countries will gain additional tax revenues and significantly influence the negotiation of tax treaties if the Two-Pillar Solution is implemented. Indonesia, as a developing country and a member of the IF on BEPS, will participate to guarantee its tax sovereignty. Pillar 1 will allow taxing rights for Indonesia, which has, to date, been a market country. Next, for Pillar 2, Indonesia has expressed its commitment by starting to formulate domestic provisions through a Minister of Finance Regulation.

Timeline Implementation of Pillar 2 in Indonesia

2021: The legal basis for signing and implementing multilateral agreements/treaties has been included in the HPP Law.

2022: The implementing regulations of the Pillar 2 have been included in Gov. Reg. 55/2022

2023:
1. Draft MoF Regulation (RPMK) is being formulated to apply GloBE rules
2. The impacts of the Pillar 2 on Indonesia are being analysed

2024:
1. GloBE rules (IIR & QDMTT) are expected to take effect
2. The possible re-design of incentives for taxpayers affected by Pillar 2 is being analysed

2025: UTPR takes effect

IMPLICATIONS FOR TAXPAYERS

Taxpayers constituting MNEs will undoubtedly be greatly affected by the implementation of the Two-Pillar Solution. MNEs with a consolidated turnover of >EUR750 million that have been earning significant profits from market countries (low-tax jurisdictions) are bound to pay income tax at a minimum rate of 15%.

If the taxpayers, including the abovementioned MNEs, have received tax incentives in Indonesia, they remain subject to top-up tax, either in the country of domicile of the parent or in the country of domicile of the subsidiary through QDMTT.

It can be concluded that the Two-Pillar Solution renders major impacts on companies, in particular, the tax team. Companies need to ensure a balance between the optimisation of the commercial aspect and tax compliance to be in line with future government policies as well as the mapping of the tax risks arising from the implementation of the global consensus.

Moreover, taxpayers are to review all transactions and business schemes that fall within the scope of international tax and anti-tax avoidance provisions, in particular, business activities involving entities outside Indonesian jurisdiction.

WHAT TO BE PREPARED?

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Tax Risk Management & Business Taxation Decision Making

Understanding the implications of the Two-Pillar Solution is crucial for strategic decision makers in companies. Comprehensive information and alternative scenarios for efficient risk management are increasingly necessary.

Simulations and Fiscal Projections under the Two-Pillar Regime

Not only will the Two-Pillar Solution change the scenario of profit allocation model within multinational groups, but also the internal market price-setting, tax burden as well as the impact on future tax incentives scenarios. Simulations and fiscal projections may approximate the extent to which companies should anticipate the Two-Pillar regime.

Compliance, Documentation & Operating Model

The implementation of the Two-Pillar Solution requires closer intercompany coordination, in particular, in terms of relevant data and information, tax governance, transaction and arrangement schemes, reporting and the renewal of contractual terms.

Global Monitoring & Benchmarking Study

The response by each country to the Two-Pillar Solution is varied and dynamic. Therefore, the measures your company will undertake are heavily influenced by how and when the country where your business partner is located implements the Two-Pillar Solution.

Pillar 2 & Impact for Tax Incentives

Pillar 2 also impacts taxpayers that are currently and will utilise incentives that reduce their effective tax rates. These include tax burden impacts, investment reporting scenarios and so forth. Further, the government is highly likely to modify the tax incentive regime to be in line with Pillar 2 while remaining competitive.

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