

BEPS Pillar Two

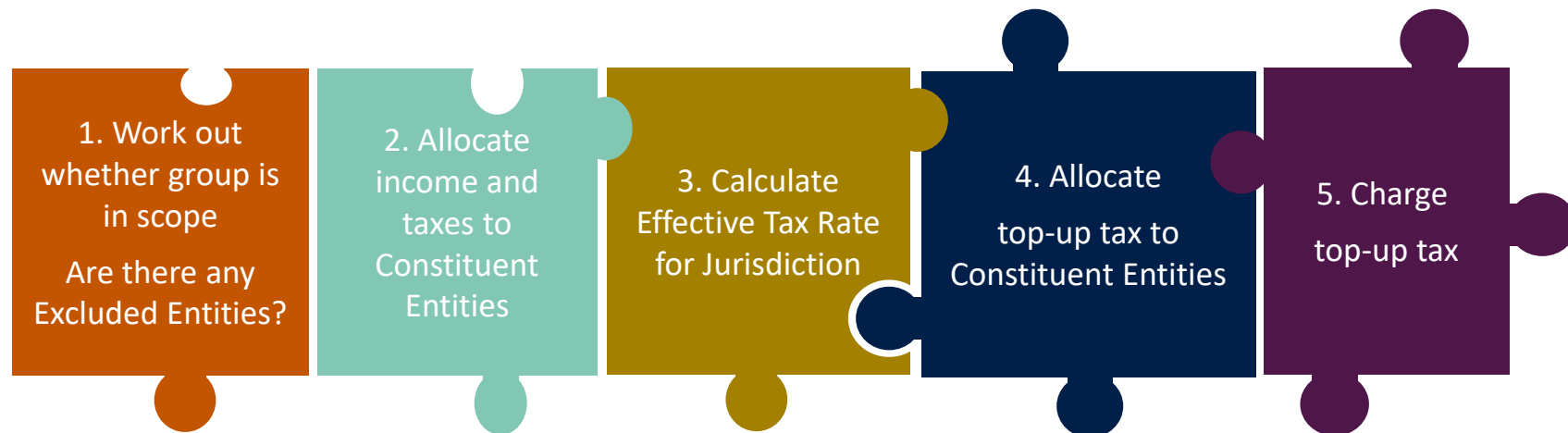
Timing Differences and Refundable Tax Credits

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Overview



2. Allocate Income and Taxes

- Calculate Constituent Entity's GloBE Income
 - Starting point: income in UPE's financial statements
 - Adjustments required – e.g. remove dividends and gains from >10% shareholdings
- Calculate Constituent Entity's Covered Taxes
 - Starting point: tax expense in UPE's financial statements
 - Taxes on income and profits only
 - Adjustments required: e.g. remove tax dividends and gains from >10% shareholdings



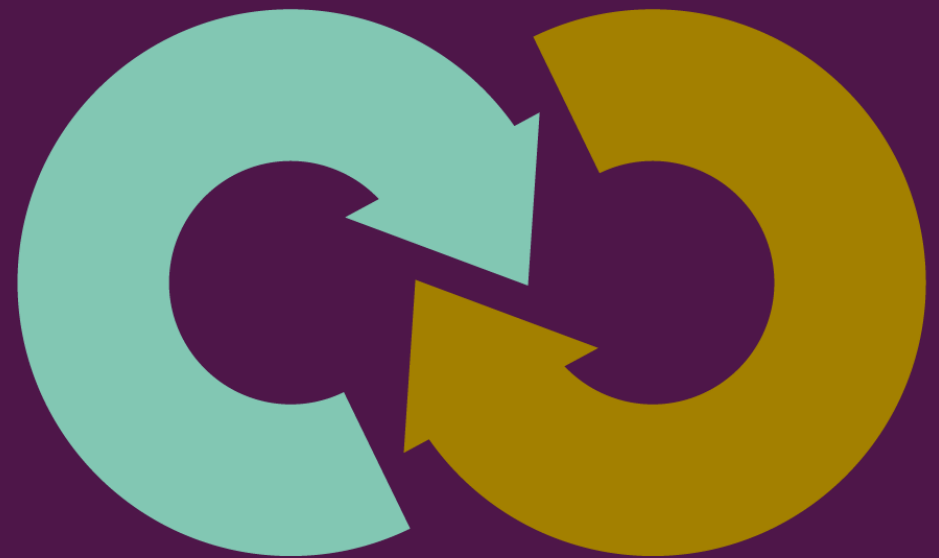
3. Calculate Effective Tax Rate

- Calculated on jurisdictional basis
- $$ETR = \frac{\text{Aggregate Covered Taxes}}{\text{Net GloBE Income}}$$
- Minimum tax rate: 15%



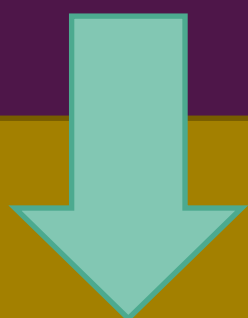
Timing Differences: Introduction

- What is a timing difference?
 - Difference between tax and accounting rules as to when income / expense is recognised
- Permanent: never resolved
 - Example: fine
- Temporary: difference unwinds over time
 - Example: first year capital allowances versus depreciation
- Deferred tax expense / liability
- Deferred tax asset / benefit



Timing Differences: GloBE Mechanism

- Deferred tax accounting
- Reflect deferred tax expense / deferred tax asset in numerator
- Add **Total Deferred Tax Adjustment Amount** to Covered Taxes


$$\text{Effective tax rate} = \frac{\text{Adjusted Covered Taxes}}{\text{Net GloBE Income}}$$

Timing Differences: Total Deferred Tax Adjustment Amount

- Start with deferred tax expense / deferred tax asset in accounts
- Adjustments:
 - Recast at 15% if local tax rate higher than 15%
 - Don't include DTE / DTA associated with excluded income
 - Don't include DTE increases resulting from tax rate rise
- Recapture if deferred tax liability doesn't unwind within 5 years
 - Exceptions
 - Must recalculate ETR for year 1, any additional top-up tax added to Year 6 liability



Timing Differences: Deferred Tax Expense

Example 1

- Facts
 - Company buys P&M for £150 and claims a 100% first year allowance.
 - The P&M is depreciated over 10 years on a straight line basis
- GloBE rule treatment
 - Deferred tax liability added to Covered Taxes in Year 1
 - Deferred tax expense deducted from Covered Taxes in Years 2-10

	Year 1	Year 2	Year 3	Year 4
Accounts				
Income	200	200	200	200
Depreciation	-15	-15	-15	-15
Profit before tax	185	185	185	185
Current tax expense	12.5	50	50	50
Deferred tax expense	20.3	-2.3	-2.3	-2.3
Total tax	32.8	47.8	47.8	47.8
ETR if current tax only	7%	27%	27%	27%
GloBE ETR	18%	26%	26%	26%
Domestic tax computation				
Profit before tax	185	185	185	185
Add depreciation	15	15	15	15
Deduct capital allowances	150	0	0	0
Taxable profit	50	200	200	200
Domestic tax @ 25%	12.5	50	50	50
Deferred tax memo				
Timing difference	135	120	105	90
Deferred tax liability (timing difference x 15%)	20.3	18	15.8	13.5
Movement in deferred tax liability (DT expense)	20.3	2.3	2.3	2.3

Timing differences: complexities

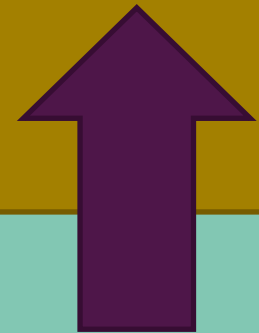
- Article 4.1.5
 - Top-up tax payable
 - No Net GloBE Income
 - Adjusted Covered Taxes less than zero and lower than Expected Adjusted Covered Taxes Amount



Qualified Refundable Tax Credits

- What is a QRTC?
 - Tax credit that becomes refundable within 4 years
 - Paid in cash / cash equivalents
- Why are QRTCs good?
 - Treated as GloBE Income
 - Don't reduce Covered Taxes
 - Results in higher ETR than tax deduction

$$\text{Effective tax rate} = \frac{\text{Adjusted Covered Taxes}}{\text{Net GloBE Income}}$$



R&D tax relief example

R&D Enhanced deduction	
Turnover	1,000,000
R & D deduction	-150,000
Other expenditure	-500,000
Profit before tax	350,000
Tax at 16%	56,000

$$\text{ETR} = \frac{56,000}{400,000} = 14\%$$

R&D tax credit	
Turnover	1,000,000
R & D deduction	-100,000
Other expenditure	-500,000
Profit before tax	400,000
Tax at 16%	64,000
Tax credit at 12%	12,000
Revised profit before tax	412,000
Tax at 16%	65,920
Tax payable (deduct credit)	53,920

$$\text{ETR} = \frac{64,000}{412,000} = 15.5\%$$

Impact on UK tax system

- Vulnerable tax incentives
 - Patent box
 - RDEC?
- Conversion of tax incentives to QRTCs?
 - Fraud risk
 - Complexity
 - Review of QRTCs?

