



Global Tax Reform: What It Means for ASEAN+3¹

September 28, 2021

I. Introduction

1. Large fiscal spending during the pandemic period has amplified the urgency to reduce tax leakages due to profit shifting practices by multinational enterprises (MNEs). The Group of 20 (G20) and the Organisation of Economic Co-operation and Development (OECD) have been spearheading efforts to form a framework for international tax reform, and have stepped up their work amid the COVID 19 pandemic.² The framework seeks to establish a more stable and fairer international tax architecture. It leverages on ongoing initiatives to address base erosion and profit shifting (BEPS), in which companies adopt tax planning strategies that exploit gaps and mismatches in tax rules to shift profits to locations with zero or low tax rates. BEPS is estimated to deprive governments of at least USD100 billion-240 billion per annum in tax revenues, equivalent to 4-10 percent of global corporate income tax revenue (OECD, 2017).

2. Achieving global consensus on such global tax reform is a complicated process. It would require economies with competing interests to find common ground and redefine the ways of doing cross-border business. While unprecedented milestones have been reached in recent months, a number of challenges still need to be addressed.

3. This note provides an overview of initiatives introduced under the proposed reform and outlines implications of the reforms for ASEAN+3 member economies. It also takes stock of the main areas of agreement and highlights key issues that remain to be resolved. Given several uncertainties surrounding the ongoing multilateral negotiations, information in this note is heavily based on the OECD/G20 Inclusive Framework (IF) statement dated July 5, 2021, various BEPS-related publications by the OECD, and informal AMRO discussions with some tax authorities in the region and with several regional tax experts in major global accounting companies.

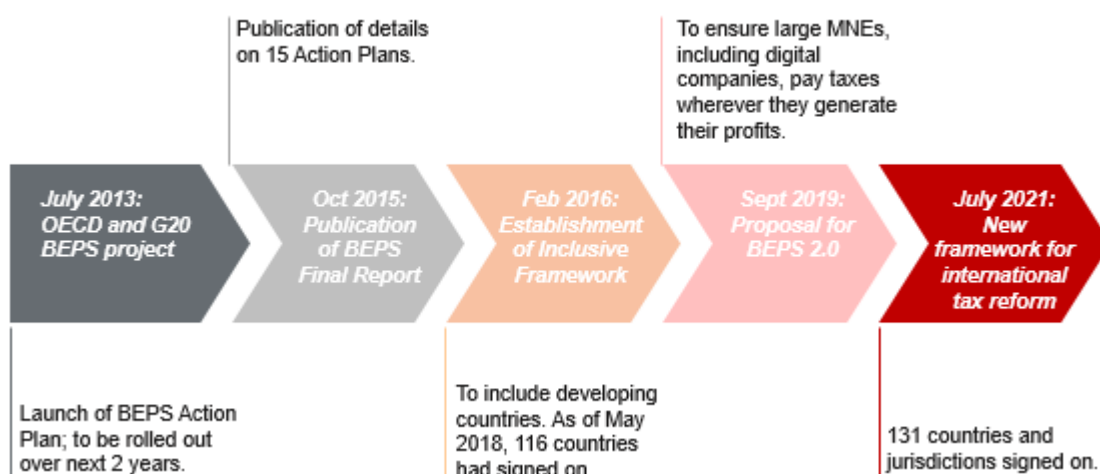
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² The first wave of initiatives was launched in the immediate aftermath of the global financial crisis in 2008. More recently, large fiscal outlays have also been introduced to battle the COVID-19 pandemic, and have provided strong impetus for global cooperation toward further reducing tax leakages, particularly with regard to increasing trade in intangibles and the proliferation of the digital economy.

II. Background of Global Tax Reforms

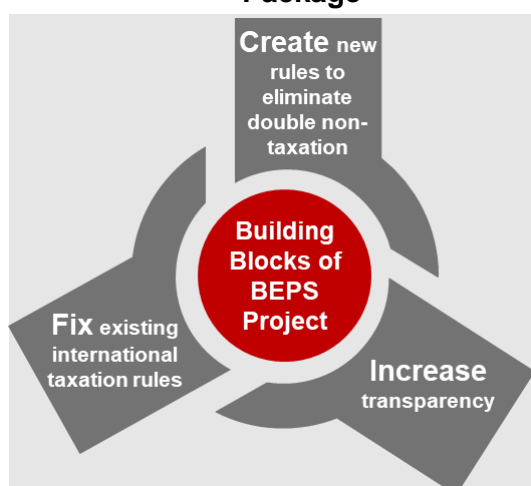
4. An OECD/G20-led initiative, the BEPS Project, has expanded to include both developed and developing economies. The BEPS Project was officially launched in July 2013, a culmination of separate efforts by the OECD and G20 (Figure 1). The BEPS Package was later published on October 2015, aiming to tackle tax avoidance, improve coherence in international tax rules and ensure a more transparent tax environment (Figure 2). The IF was subsequently established and currently comprises 140 developed and developing economies, including 10 economies from the ASEAN+3 region (Figure 3). As the rise of the digital economy has increased taxation challenges, multilateral discussions to address this issue have led to a two-pillar solution. Decisions by the IF are consensus-based.

Figure 1. Key Milestones in BEPS Project



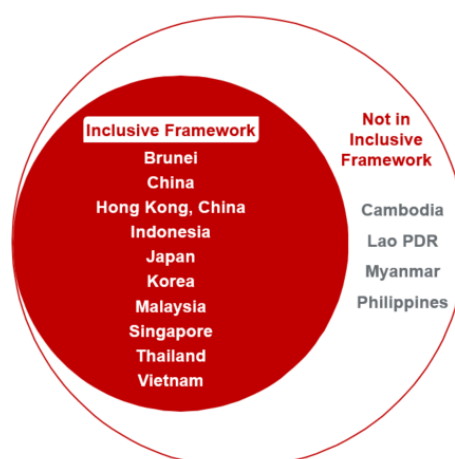
Source: AMRO illustration; adapted from OECD.

Figure 2. Building Blocks of BEPS Package



Source: AMRO illustration; adapted from OECD.

Figure 3. ASEAN+3 Participation in the Inclusive Framework



Source: AMRO illustration.

5. **Recent months saw an acceleration in global momentum toward the adoption of an international tax framework.** The Group of Seven (G7) Finance Ministers' meeting in early-June concluded with economies representing 46 percent of global GDP affirming their commitment to the proposed two-pillar solution to address BEPS practices (Figure 4). Within a month, the IF had issued a statement signed by 131 economies, and the OECD had presented a progress report to the G20 listing commitment from 132 economies. The G20 endorsed the proposed recommendations on July 10, 2021, and 134 member economies had agreed to the proposal as of August 31, 2021.

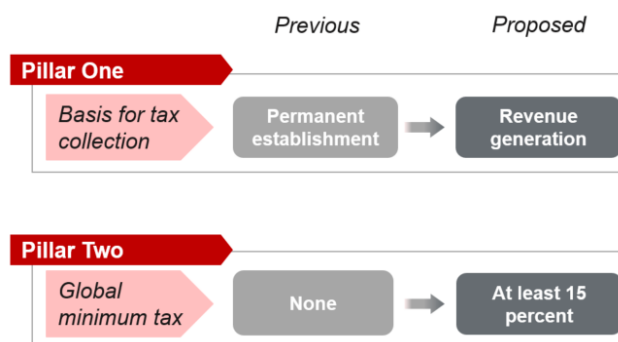
Figure 4. Key Players and Recent Developments



Source: AMRO illustration; adapted from OECD.

6. **The two-pillar solution is expected to reallocate at least USD100 billion of tax rights and generate at least USD150 billion of additional global tax revenues annually.** The new taxation framework aims to ensure that MNEs can no longer take advantage of existing taxation rules to avoid paying taxes in any jurisdiction. Pillar One provides a jurisdiction with the right to tax an MNE if revenue is generated in that jurisdiction, a shift from the taxing right that is based on where the MNE is incorporated (Figure 5). Pillar Two establishes a global minimum tax rate that large MNEs would need to pay. The OECD has estimated that the successful implementation of Pillar One could reallocate taxing rights on more than USD100 billion of profit, while the implementation of Pillar Two at a 15 percent minimum tax rate could raise an additional USD150 billion in global tax revenues per annum.

Figure 5. Key Changes in Pillar One and Pillar Two

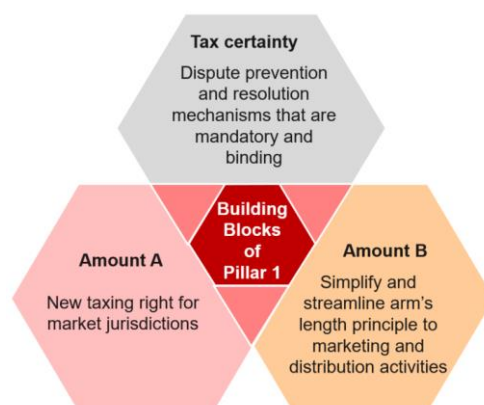


Source: AMRO illustration; adapted from OECD.

III. Pillar One

7. In response to e-commerce and other new business models that increase MNEs' business revenues, Pillar One provides a taxing right to market jurisdictions. This initiative is implemented through building blocks that comprise two quantitative components, Amount A and Amount B, and dispute prevention and resolution mechanisms which are mandatory and binding under the tax certainty principle (Figure 6).

Figure 6. Building Blocks of Pillar One

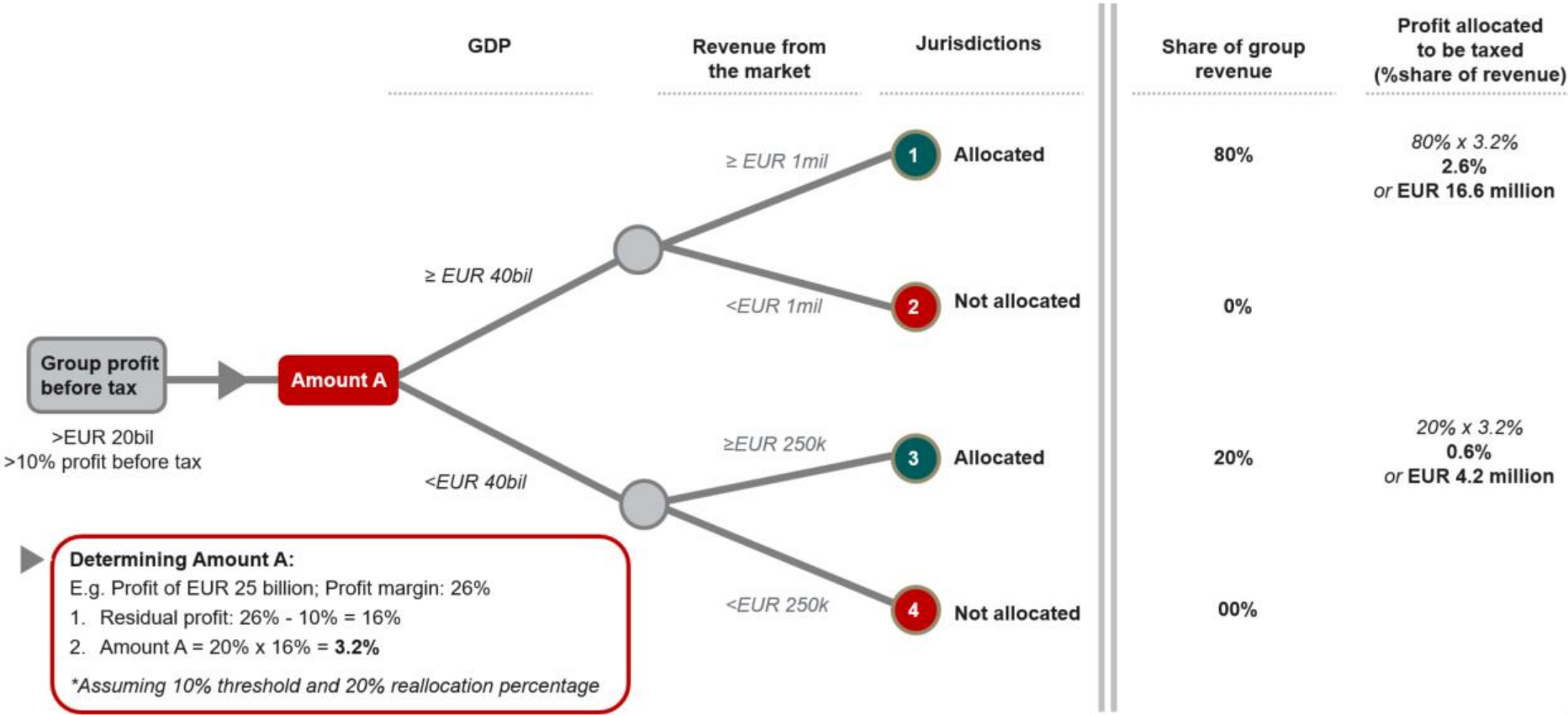


Source: AMRO illustrations; adapted from OECD.

- **Amount A reallocates a portion of profit above the threshold to economies where the revenue is generated.** It will apply to MNEs with a global turnover of above EUR20 billion and profitability of above 10 percent.³ Such companies are known as in-scope MNEs. Extractives and regulated financial services are excluded. For economies with GDP exceeding EUR40 billion, the taxing right will be established if the in-scope MNE derives at least EUR1 million from that jurisdiction. For economies with GDP lower than EUR40 billion, the nexus is set at EUR250,000. Between 20-30 percent of the in-scope MNE's residual profit, defined as profit in excess of 10 percent of revenue, will be allocated to market jurisdictions based on the share of revenue derived from these markets. Figure 7 shows an example of how Amount A is implemented.
- **Amount B defines a fixed return for baseline marketing and distribution activities based on the arm's length principle.** This would apply to all local subsidiaries or permanent establishment of MNE groups that perform those baseline activities physically in a market jurisdiction. A fixed return in the form of Amount B would simplify the administration of the current transfer pricing system for tax administrators and reduce compliance costs for taxpayers.

³ The turnover threshold is expected to be reduced to EUR10 billion, contingent on the successful implementation of Amount A and tax certainty pertaining to Amount A.

Figure 7. Example on Implementation of Amount A

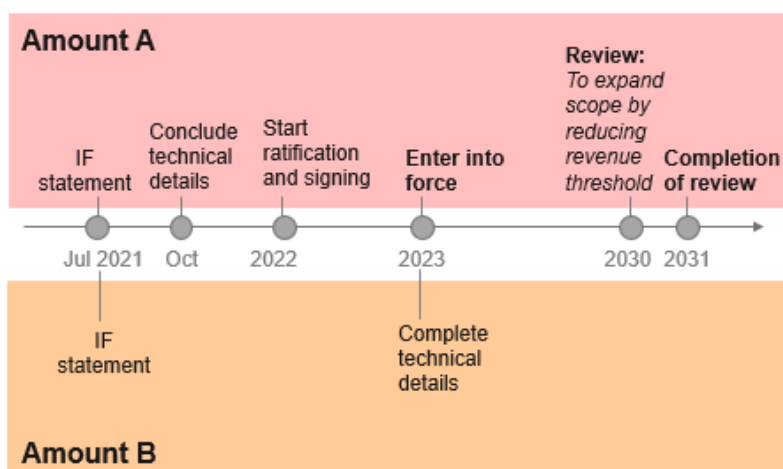


Source: AMRO illustration; adapted from OECD.

8. Many uncertainties in the Pillar One solution remain, and the earliest signs of greater clarity are expected in October 2021. The IF aims to conclude technical details about Amount A by October 2021 (Figure 8). A ratification process in individual economies is envisioned to start in early 2022 and Amount A is expected to be implemented by 2023.⁴ Technical details on Amount B are targeted to be completed by end-2022. A number of key ambiguities are as follows:

- The final implementation details of Amount A have not been finalized, including the percentage of *residual profit* in the range of 20-30 percent to be allocated, the definition of in-scope MNEs and the operationalization of the profit allocation.
- The projected timeline, of obtaining legislative approval from each IF economy within the next one year to enable Amount A to come into effect by 2023, could be overly optimistic.
- Despite an agreement among IF members to remove existing digital service taxes (DST) in individual jurisdictions when Pillar One is implemented, it is unclear if this would apply in general or only to in-scope MNEs.
- The exemption of regulated financial services also calls into question if the same treatment should apply to fintech, payment systems and private equity.

Figure 8. Implementation Timeline for Amount A and Amount B



Source: AMRO illustrations; adapted from OECD.

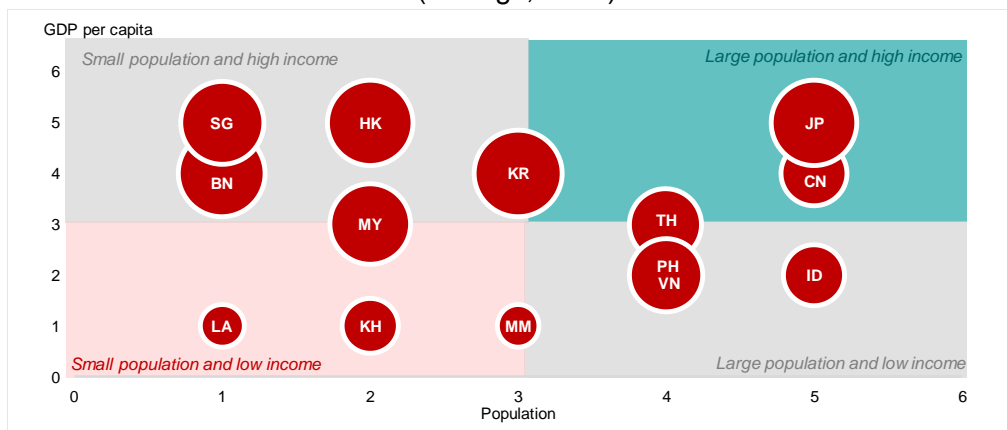
9. Within the ASEAN+3 region, the implementation of Amount A will likely benefit populous economies with high income and significant presence of a digital economy. The reform will assign proportionally more taxing rights to economies that have consumers of large amounts of goods and services provided via digital platforms. The relative size of Amount A allocation can therefore be roughly indicated by population size, income and

⁴ Amount A will be reviewed in the seventh year of implementation, with a view to expanding the coverage of in-scope companies. The review is expected to conclude within a year, with a new measure of Amount A, if any, coming into force immediately thereafter.

internet penetration.⁵ Economies with large populations and GDP, such as China and Japan, will likely receive a significant portion of the reallocated residual profit (Figure 9). Populous middle-income economies, such as Indonesia, the Philippines, Thailand and Vietnam, are expected to gain moderately. Brunei, Hong Kong, China,⁶ Korea, Malaysia and Singapore, despite having smaller populations, also stand to gain moderately, given their relatively higher incomes per capita. Cambodia, Lao PDR and Myanmar are not projected to receive significant additional tax revenue, given their small population sizes, lower income levels and shallow internet penetration. A caveat here is that MNEs' e-commerce revenue from these economies could be lifted if consumers use mobile data and social media widely for online purchases.

10. However, economies with a high concentration of international or regional headquarters of in-scope MNEs would likely see less collectible taxes. The overall impact of Amount A reallocation on tax revenue would also depend on the amount of taxes that these economies are currently collecting from in-scope MNEs. For economies that do not host many physical setups of in-scope MNEs, obtaining Amount A will affect tax revenue positively. On the other hand, for economies that are hosting the physical setups of many in-scope MNEs, the net impact on their tax revenue would depend on the Amount A that is allocated to them and the Amount A that is reallocated away from them to other economies. These host economies will, however, gain another source of taxable income in the form of Amount B, as in pre-determined profit from the MNE's physical distribution and marketing activities within the economy. Hong Kong and Singapore, as small economies that host the international or regional headquarters of several in-scope MNEs, would likely see some reduction in collectible taxes, which will be shifted to other economies. The OECD has estimated that there are only about 100 in-scope MNEs globally. As such, the net losses or gains in tax revenues will likely be small.

Figure 9. Relative Population Size and GDP Per Capita (Ratings, 2020)



Source: National authorities via Haver Analytics; World Bank; and AMRO calculations.
 Note: Size of the bubble represents internet users as a percentage of population. Ratings are assigned in ascending order with (1) representing the lowest quintile and (5) representing the highest quintile. For consistency, GDP per capita refers to the World Bank estimate using the Atlas method.

⁵ An economy will be entitled to an allocation of Amount A only if an MNE's local sales in the economy exceed the pre-determined thresholds mentioned in paragraph 7 to create a taxing *nexus*.
⁶ Thereafter, Hong Kong, China will be referred to as Hong Kong.

11. In addition, the positive impact of Pillar One on overall tax revenue will decline if the country has to forego revenue-based DST.⁷ Under the Pillar One agreement, DST will be removed to avoid double taxation on digital income. Globally, at least 26 countries and 88 countries have implemented direct and indirect digital taxes, respectively (KPMG, 2021).⁸ While none of the ASEAN+3 economies have implemented DST to date, five economies have implemented or proposed other forms of direct digital taxes (Table 1). Hong Kong, Indonesia and Singapore have announced that they are waiting for a global consensus on digital taxation rather than unilaterally implement DST in the near future.

Table 1. Selected ASEAN+3 Economies: Cross Border Direct Digital Taxes

	Tax Category	Coverage	Effective date
Hong Kong	Digital PE	The activities of a fixed place of business form an essential and significant part of the in-scope MNE's e-commerce business as a whole or whether those go beyond preparatory or auxiliary activities.	27 March 2020
Indonesia	Digital PE	Overseas e-commerce companies with a significant presence, as measured by consolidated gross revenues, the sales amount and/or the size of the active user base in Indonesia.	Enacted in 2020 but postponed
Vietnam	Digital PE	Overseas suppliers of e-commerce business, digital-based business or other services.	1 January 2021
Malaysia	WTH	Non-resident individuals who derive income from e-commerce transactions.	13 May 2019
Thailand	WTH	E-commerce suppliers of goods and services, including online advertising, gaming and shopping.	Proposed in 2019

Source: IRBM (2019), Bunn, Asen and Enache (2020), KPMG (2020, 2021), EY (2021a), Rebecca (2021),

IV. Pillar Two

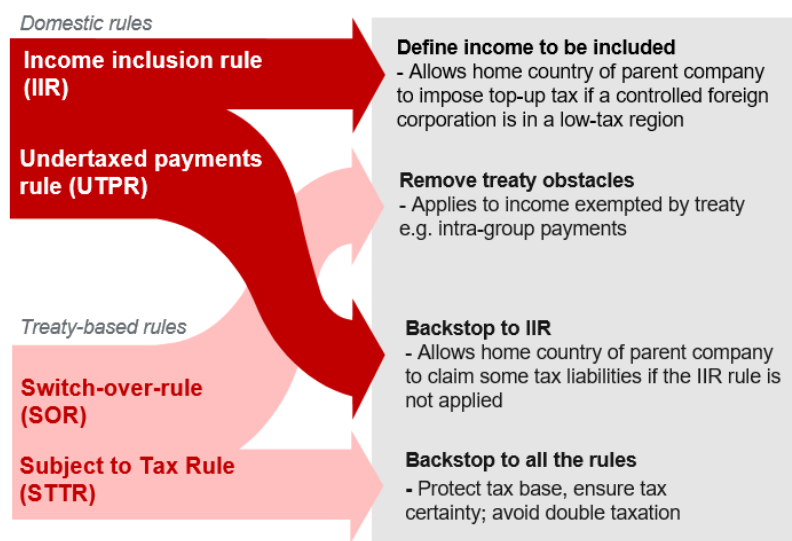
12. Pillar Two aims to ensure that MNEs are subject to a minimum amount of corporate tax regardless of which economy they operate in. It also seeks to cope with different tax systems and business models, ensure transparency and a level playing field and minimize administrative and compliance costs while avoiding double taxation. These objectives are achieved through a number of interlocking rules (Figure 10). The rules define income that is subject to taxation and remove treaty obstacles which may exempt otherwise taxable income.⁹

⁷ DST is imposed on gross revenues that are derived from the selling of digital goods and services or are based on the number of digital users within a country. This Analytical Note defines DST and other digital taxes, such as digital permanent establishment rule (Digital PE) and withholding taxes (WTH), mainly with reference to Bunn, Asen and Enache (2020). DST is a direct tax, while other forms of digital taxes are indirect ones in the forms of value-added taxes (VAT) or goods services taxes (GST) on the purchase of digital goods or services.

⁸ Bunn, Asen, and Enache (2020) also mentions another category of digital tax, that is, tax preferences for digital business, which are tax incentives offered to digital business models, such as research and development tax credits and intellectual property development incentives. However, we consider that this measure will result in tax revenue losses, not tax revenue gains.

⁹ IF countries do not have to adopt the interlocking domestic rules, but if they do, they will need to implement the rules in a way that is consistent with other provisions of Pillar Two. Notwithstanding the positions of individual countries on these rules, they have to accept the application of the domestic rules by other IF members.

Figure 10. Interlocking Rules Underlying Pillar Two



Source: AMRO illustration; adapted from OECD.

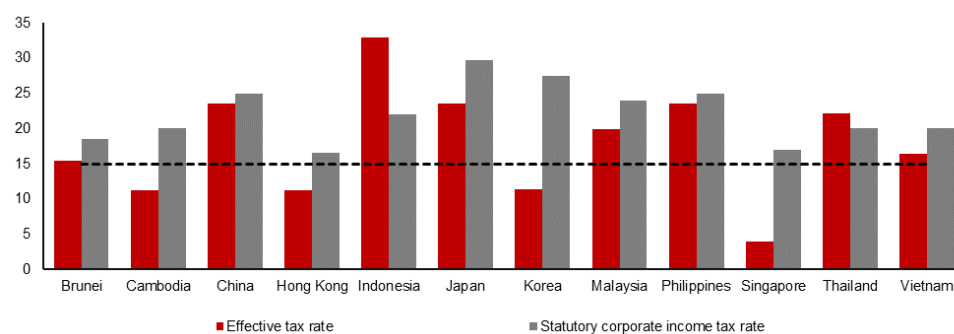
13. The current proposed tax-rate floor is an effective tax rate (ETR) of at least 15 percent. Rules in Pillar Two define ETR as the overall covered tax rate paid by a company on its financial accounting net income. The minimum tax rate would apply to MNEs that generate at least EUR750 million in annual revenue as stated in the Country-by-Country report filed by MNEs for each tax jurisdiction which they do business. The primary rule under Pillar Two is the income inclusion rule (IIR), which allows the home country of an MNE to impose top-up tax if the MNE's controlled foreign corporation operating outside that country is taxed below the ETR. Countries are also free to apply the IIR to MNEs that are headquartered in their jurisdiction even if they do not meet the revenue threshold.¹⁰

14. Some regional economies with low corporate tax rates could be adversely affected by Pillar Two. The ETRs for different MNEs in different host economies can vary significantly depending on a range of factors, such as the type of industry and the tax rate, as well as foreign direct investment (FDI) and other development strategies of the host economy. The complex shareholding structures of MNEs across jurisdictions are expected to complicate the calculation of each firm's ETR. An example in Figure 11 shows the average ETRs of American MNEs that operate in ASEAN+3 economies.¹¹ These rates are below 15 percent in Cambodia, Hong Kong, Korea and Singapore, indicating that on average, American MNEs in these economies will need to pay the difference between 15 percent and their ETRs to the United States government as a top-up tax. Ceteris paribus, these economies will be less attractive to existing MNEs and potential investors as the attractiveness of their tax incentives diminishes.

¹⁰ Additionally, Pillar Two rules provide a *formulaic substance-based carve-out* that will exclude at least 5 percent of the income of the carrying value of tangible assets and payroll. In the next five years, this carve-out is expected to increase to at least 7.5 percent. In addition to tangible assets and payroll, international shipping income would also be excluded.

¹¹ ETRs of American MNEs are used as proxies, given their large presence in a wide range of industries globally, including within the ASEAN+3 region.

Figure 11. Average ETR of US MNEs and Statutory Corporate Income Tax Rate
(Percent, 2018)



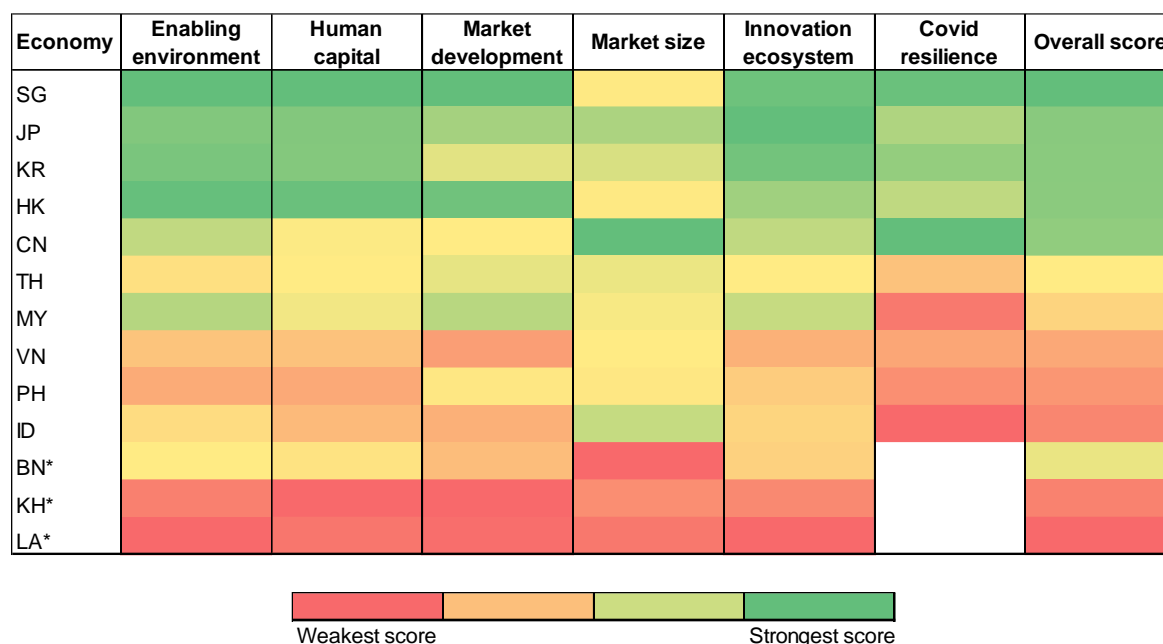
Source: US Internal Revenue Service, AMRO calculations.

Note: ETR is estimated as the corporate tax paid divided by profit before tax as reported in the parent company's Country-by-country Report. ETR can be higher or lower than the statutory corporate income rate due to various adjustments, such as depreciation and non-deductible expenses, to calculate taxable profits from accounting profits.

15. The appropriate tax policy response of regional governments to address risks arising from Pillar Two implementation is not straightforward. In the example above, as American MNEs will need to pay a top-up tax to the U.S. government, regional tax authorities can choose to respond by increasing their statutory corporate tax rates, which will add to tax revenues. However, the higher corporate tax rate could disproportionately raise the cost of business for domestic firms, including small and medium enterprises. The other policy option is to reduce tax incentives for the MNEs. This strategy will increase the ETR and allow the host government to recover some revenues that it has foregone due to the tax incentives. To calibrate the appropriate response, the host government could come up with a combination of these two policy options, and should also take into account the benefits and adverse impacts to fiscal and industrial policies as well as the detailed financial information of the MNEs, especially with regard to their ETRs. In addition, the host government's strategy will likely be affected by the actions of other governments and the MNEs, further complicating the policy decision.

16. As tax incentives will become less important in attracting MNEs, country competitiveness in the areas of non-tax measures would be increasingly significant going forward. We construct an FDI Market Attractiveness Score to gauge how well regional economies will likely perform based on the multitude of non-tax factors that could affect MNEs' investment. The overall score is derived from major indicators in the World Economic Forum's Global Competitiveness Index (GCI), including strength of institutions, human capital, macroeconomic stability, level of market development, market size and innovation ecosystem, and from Bloomberg's Covid Resilience Ranking. Figure 12 shows that the non-tax factors of Singapore, Hong Kong and the "Plus Three" economies are attractive, while the competitiveness of the other ASEAN economies is lower and has been weighed down by the pandemic.

Figure 12. FDI Market Attractiveness Score
(Score, 2019 - 2021)



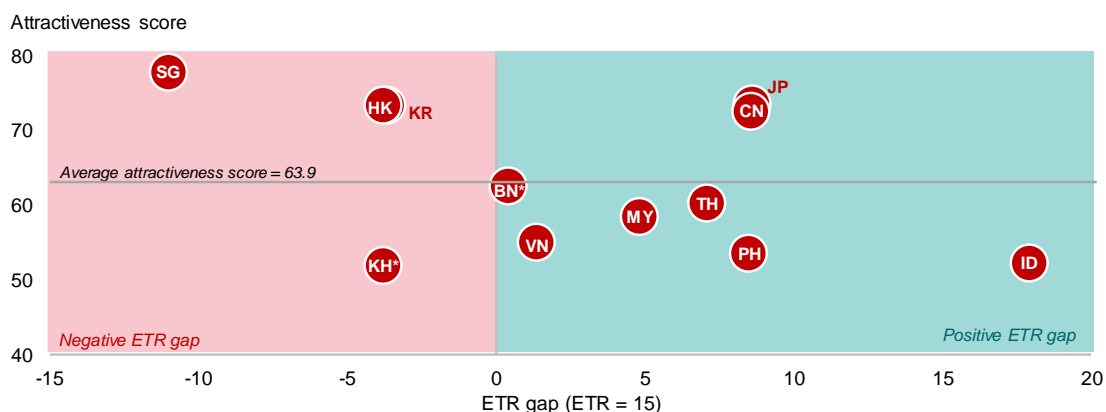
Source: World Economic Forum GCI (2019), Bloomberg's Covid Resilience Ranking as of July 27, 2021; AMRO calculations.
Notes: Overall score is estimated as a simple average of economic competitiveness and the Covid resilience score. For economies with an asterisk, the Covid resilience score is unavailable and is thus omitted from the calculation of the overall score.

17. The challenges ahead differ somewhat among regional economies with different levels of ETRs and non-tax attractiveness. Figure 13 plots the FDI Attractiveness Score against the average ETRs of American MNEs operating in the region.

- This figure indicates that the non-tax-related strengths of Singapore, Hong Kong and Korea will likely mitigate adverse impacts on MNEs' investments arising from Pillar Two should these economies choose to raise statutory corporate income tax rates or streamline tax incentives.¹²
- Economies with lower-than-average FDI attractiveness score and ETRs that are below or marginally above current proposed rate, such as Cambodia, and Brunei, would likely need to raise their value propositions further to continue attracting FDI from American MNEs.
- In Indonesia, Malaysia, the Philippines and Thailand, the ETRs of the American MNEs are above 15 percent and the authorities may not make significant changes to their corporate income tax rates. Nonetheless, it will still be important to raise their non-tax attractiveness from the current moderate level.
- An essential caveat is that the illustrative analysis set out in paragraphs 14-18 is based on the average ETRs of American MNEs. The overall impact of Pillar Two implementation on each economy will also depend on the types and overall composition of MNEs operating in the host economy.

¹² Even if the host authorities choose not to do so, non-tax competitiveness would remain the key differentiating factor among investment destinations as companies would still face a higher tax burden overall due to the top-up tax that they must pay to the government of their home country.

Figure 13. FDI Market Attractiveness Score and ETR Gap
(Score; Percentage point, 2021)



Source: OECD Tax Statistics; World Economic Forum GCI (2019) Bloomberg's Covid Resilience Ranking as of 27 July 2021; AMRO calculations

Notes: ETR gap refers to the difference between taxes paid by American MNEs in each economy and the proposed global minimum tax rate of 15 percent. The attractiveness score is the average of the World Economic Forum GCI score and Bloomberg's Covid Resilience Ranking. For economies with an asterisk, the attractiveness score reflects the GCI score as the Covid Resilience score is unavailable.

18. Some operational details of Pillar Two require further clarification. Pillar Two is expected to be implemented in tandem with the Stopping Harmful Inversions and Ending Low-tax Developments (SHIELD) and Global Intangible Low-taxed Income (GILTI) in the U.S.¹³ These different measures stipulate differing thresholds, which need to be resolved in the implementation. Operational challenges, such as the calculation of the ETR for each MNE, may also arise from the interaction of the two pillars. With a uniform global ETR, it is unclear if certain incentives, such as value-added tax rebates or R&D tax credits, could still be effective in attracting foreign investment. The lack of certainty over policy implementation parameters and operational details makes it difficult to anticipate the policy responses from governments around the world and the subsequent business reactions by firms to these changes.

V. Policy Suggestions

19. As the implementation of global tax reform is subject to a number of uncertainties, upcoming decisions by the IF, regional and other authorities will play a major role in legal and procedural preparations. While more detailed technical guidelines are expected to be published by October 2021, the implementation mechanism and timeline would highly depend on each economy's state of readiness. In the meantime, some preparations could facilitate implementation down the road. For example, authorities would need to identify the necessary legal changes in tax codes and investment laws. They may also need to identify stabilization clauses¹⁴ in their existing investment agreements to

¹³ SHIELD is an imposition of a low effective tax rate agreed upon in multilateral agreements that deny corporate deductions by reference to payments made to related foreign parties. Meanwhile, GILTI refers to foreign income earned by US MNEs from intangible assets such as patents, trademarks, and copyrights.

¹⁴ Stabilization clauses are provisions that protect long-term investment projects from legislation changes in the host country. An example of a stabilization clause is a freezing clause that ensures that agreed terms in investment contracts will still apply even when there are changes to the legislation after the contract has been signed.

anticipate potential conflicts between new domestic regulations with foreign investors' rights under current international investment law.

20. ASEAN+3 economies could take this opportunity to examine and fine-tune their tax systems, taking into account the evolving global and domestic environments. The current revenue threshold of EUR750 million under Pillar Two is expected to mitigate the impact of the global tax reform on government revenues and FDI prospects. For example, about 1,800 MNEs in Singapore would meet this revenue threshold¹⁵. With fewer MNEs in emerging and developing economies likely to meet the revenue threshold, the immediate impact from Pillar Two is likely to be quite limited. Nonetheless, a global minimum tax would ultimately reduce the attractiveness of tax incentives and erode their effectiveness in attracting FDIs. Any recalibration of the ETR should be based on a comprehensive review of tax incentive structures (see Table 2 in the Appendix for an overview of tax incentives offered by ASEAN+3 economies) and of tax revenues collected from the MNEs. If it is essential for the host authorities to recoup some of their tax losses, they might carefully consider redesigning existing tax incentives, such as the choice of incentive instrument. The eventual mix of tax policies would need to strike a balance between preserving government revenue and supporting investment and economic growth.

21. The most important policy response is to enhance non-tax competitiveness. With the attractiveness of low tax rates diminishing, FDI promotion strategy needs to focus more on non-tax considerations. Imperative factors include a strong infrastructural and dynamic investment ecosystem, such as the availability of skilled workers, intellectual property protection, crisis resilience and macroeconomic stability. Further development of these non-tax competitiveness factors would hinge on buttressing structural reforms to strengthen the fundamental drivers of the economy.

22. Global and regional cooperation and coordination would be crucial to ensure effective implementation of the global tax reform. The global tax reform will affect tax revenue, FDI strategies and long-term growth potential. Its impacts on regional economies will likely be quite varied. Notwithstanding country-specific considerations, close collaboration and coordination should be encouraged to avoid individual economies taking unilateral actions which may disadvantage their regional peers.

¹⁵ Estimate provided by Singapore's Minister of Finance to the Singapore Parliament on July 5, 2021.

Appendix 1

Summary of Key Parameters for Pillar One and Pillar Two

	Pillar One	Pillar Two
Key details	<ul style="list-style-type: none"> • New taxing nexus • Reallocation of tax revenue 	<ul style="list-style-type: none"> • New global tax floor • New tax revenue
Scope <ul style="list-style-type: none"> • Consolidation basis • Revenue • Profit margin 	<ul style="list-style-type: none"> • MNE Group • ≥EUR20 billion • ≥10% 	<ul style="list-style-type: none"> • MNE Group • ≥EUR750 million • N/A
Measurement	Financial accounting income - losses will be carried forward	
Exclusions	Regulated financial services and extractives	<ul style="list-style-type: none"> • Government entities, international organizations, non-governmental organizations, ultimate parents or holding vehicles of the pension/investment funds of an MNE group • International shipping income
Substance-based carve-outs	Income	≥ 5% of the carrying value of tangible assets and payroll

Table 2. Tax Incentive Instruments in ASEAN Economies

	Income Tax Exemption	Tax Rate Reduction	Tax Allowance	Tax Credit	Trade Tax Exemption
Brunei	✓		✓		✓
Cambodia	✓		✓		✓
Indonesia	✓	✓	✓		✓
Lao PDR	✓	✓	✓		✓
Malaysia	✓	✓	✓		✓
Myanmar	✓	✓	✓		✓
Philippines	✓	✓	✓	✓	✓
Singapore	✓	✓	✓		✓
Thailand	✓		✓		✓
Vietnam	✓	✓	✓	✓	✓

Sources: AMRO (Forthcoming).

Note: The list shown here is by no means exhaustive

Glossary

<i>controlled foreign corporation/entity</i>	A foreign company that is either directly or indirectly controlled by a resident taxpayer.
<i>financial accounting net income</i>	The profit (or loss) before income tax that is determined using the relevant financial accounting standard. Certain items of income are removed, and certain items of expense are added to the profit (or loss) before income tax to arrive at the tax base for Pillar Two.
<i>formulaic substance based carve-out</i>	A portion of expenditure that is needed to carry out substantive activities is excluded to focus on “excess income”, such as intangible-related income, which is most susceptible to BEPS risks. The carve-out is based on expenditures for payroll and tangible assets as they are generally expected to be less mobile and less likely to lead to tax-induced distortions.
<i>covered taxes</i>	Any tax on an entity’s income or profits, including a tax on distributed profits, retained earnings and corporate equity; any taxes imposed in lieu of a generally applicable income tax; and taxes paid under Controlled Foreign Corporation rules.
<i>market jurisdictions</i>	Jurisdictions where market activities such as the sales and purchase of goods and services, including intangibles, take place.
<i>(tax) nexus</i>	The relationship between taxable profit and the activities carried out in obtaining that profit that enable a tax authority to impose tax on a taxpayer.
<i>ratification</i>	The act of signing that accords formal consent to an agreement, thereby making it officially valid.
<i>residual profit</i>	Profit in excess of the pre-determined profit margin to qualify for Amount A/that will trigger the reallocation of Amount A. Currently, this refers to the difference between profit before tax and the profitability threshold of 10 percent.

Reference

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