QRTC, MTTC, GRANTS – HOW THE FUTURE OF MNE INCENTIVES COULD LOOK

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QRTC, MTTC, Grants - How the future of MNE incentives could look

Deloitte I 29 October 2024

Agenda & Speaker

Agenda

- Overview
- (Non-) Qualified Refundable Tax Credits
- (Non-) Marketable Transferable Tax Credits
- IFRS / US GAAP Treatment
- Limitations
- Take-Aways

Speaker

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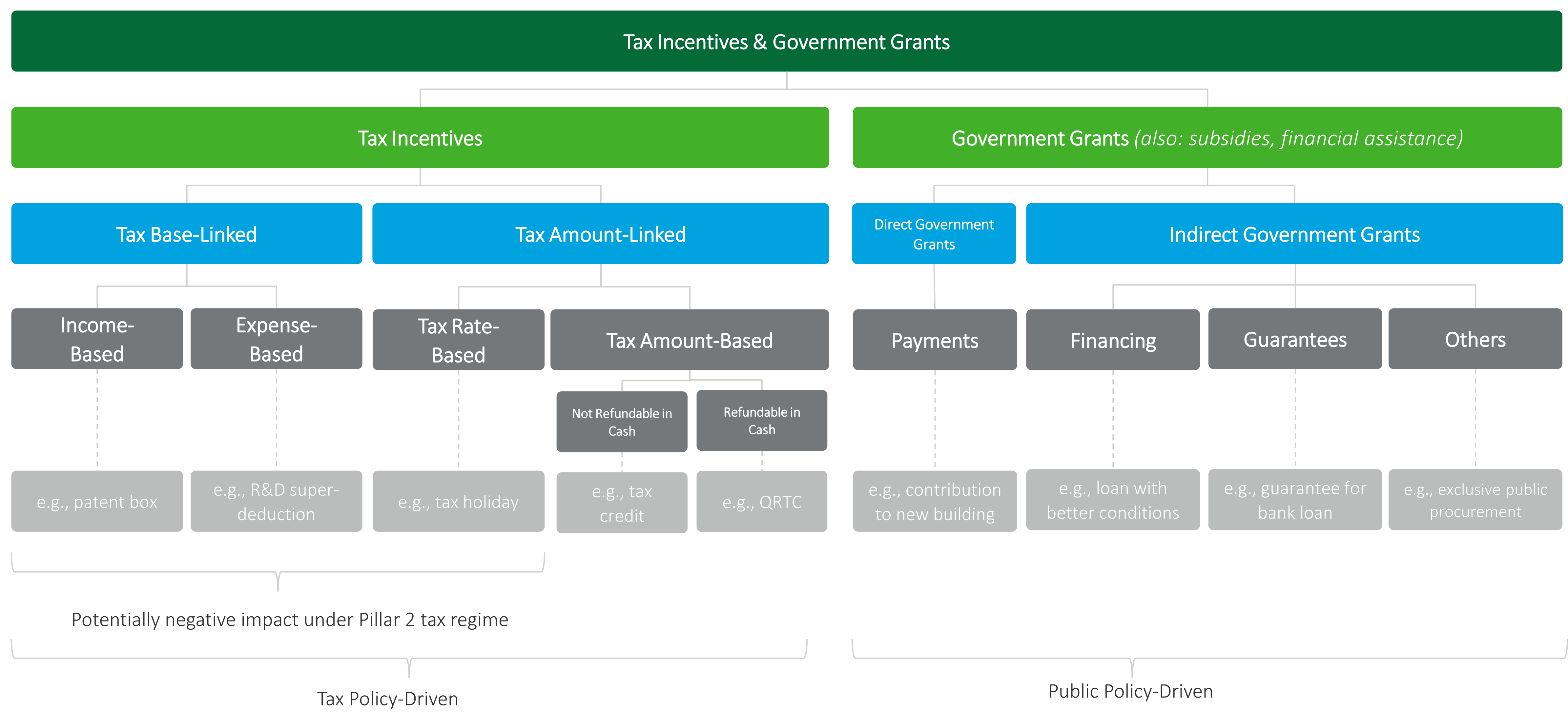
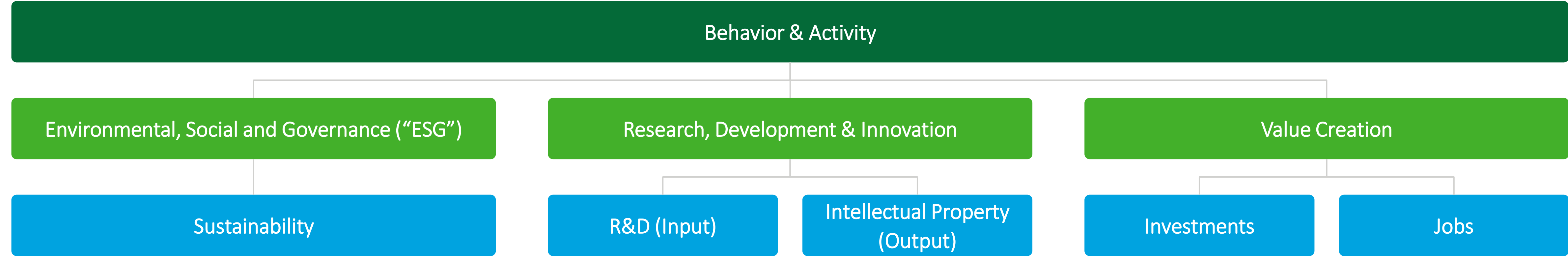
Overview (1)

How to Incentivize?



Overview (2)

What to Incentivize?



(Non-) Qualified Refundable Tax Credits (1)

Overview

Qualified Refundable Tax Credits ("QRTC")

Art. 10.1 MR

- Paid as cash or available as cash equivalents within 4 years from when a constituent entity is eligible to the credit
- If refundable in part it is a QRTC to the extent it is paid as cash or available as cash equivalents within 4 years from when a constituent entity is eligible to receiving the credit

Art. 3.2.4 MR

- Shall be treated as income in the computation of GloBE Income (Loss) of a constituent entity – NOTE: if already recorded as "other income" in financial accounts no need to make adjustments

Art. 4.1.2 (d) MR

- Shall be added to Covered Taxes if recorded as a reduction to the current (or deferred) tax expense

In a Nutshell

$$\frac{\text{Covered Taxes}}{\text{GloBE Income (Loss)}} \uparrow$$

Non-Qualified Refundable Tax Credits

Art. 10.1 MR

- Tax credit that is not a QRTC (e.g., tax credit not refundable, refundable only after 4 years)

Art. 3.2.4 MR

- Shall not be treated as income in the computation of GloBE Income (Loss) of constituent entity

Art. 4.1.3 (b) MR
Art. 4.4.1 (e) MR

- Shall be reduced from Covered Taxes if not recorded as a reduction to the current (or deferred) tax expense

In a Nutshell

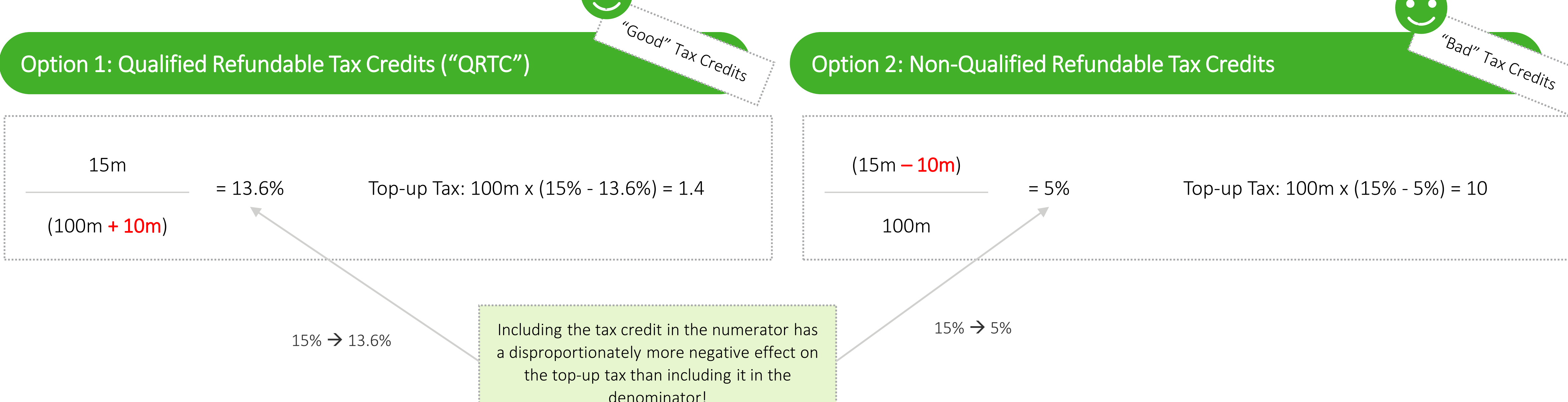
$$\frac{\text{Covered Taxes}}{\text{GloBE Income (Loss)}} \downarrow$$

(Non-) Qualified Refundable Tax Credits (2)

Case Study

Fact Pattern

- Group company A has a GloBE profit of CHF 100m and covered taxes of CHF 15m.
- Option 1: The group company is entitled for a QRTC of CHF 10m in the current year.
- Option 2: The group company is entitled for a Non-QRTC of CHF 10m in the current year.



(Non-) Marketable Transferable Tax Credits

Overview

Marketable Transferable Tax Credits ("QMTTR")

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- For the original recipient: Is transferred to an unrelated party within 15 months of the end of the year in which it satisfies the eligibility criteria for the credit, at a price that equals or exceeds the marketable price floor (80 % of the net present value of the tax credit)
- For the purchaser: Is acquired from an unrelated party at a price that equals or exceeds the marketable price floor abovementioned

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- Shall be treated the same way as QRTC

In a Nutshell

Covered Taxes / GloBE Income (Loss) ↑

Non-Marketable Transferable Tax Credits

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- Tax credit that is not an MTTR
- QRTC (e.g., tax credit not refundable, refundable only after 4 years)

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- Shall be treated the same way as Non-QRTC

In a Nutshell

Covered Taxes / GloBE Income (Loss) ↓

IFRS / US GAAP Treatment (1)

Treatment of Tax Credits Still to Be Clarified

Pillar 2 Perspective

Tax Base-Linked Incentives

Tax Rate-Linked Incentives

“Bad” Tax Credits

Adjusted Covered Taxes

GloBE Profit or Loss

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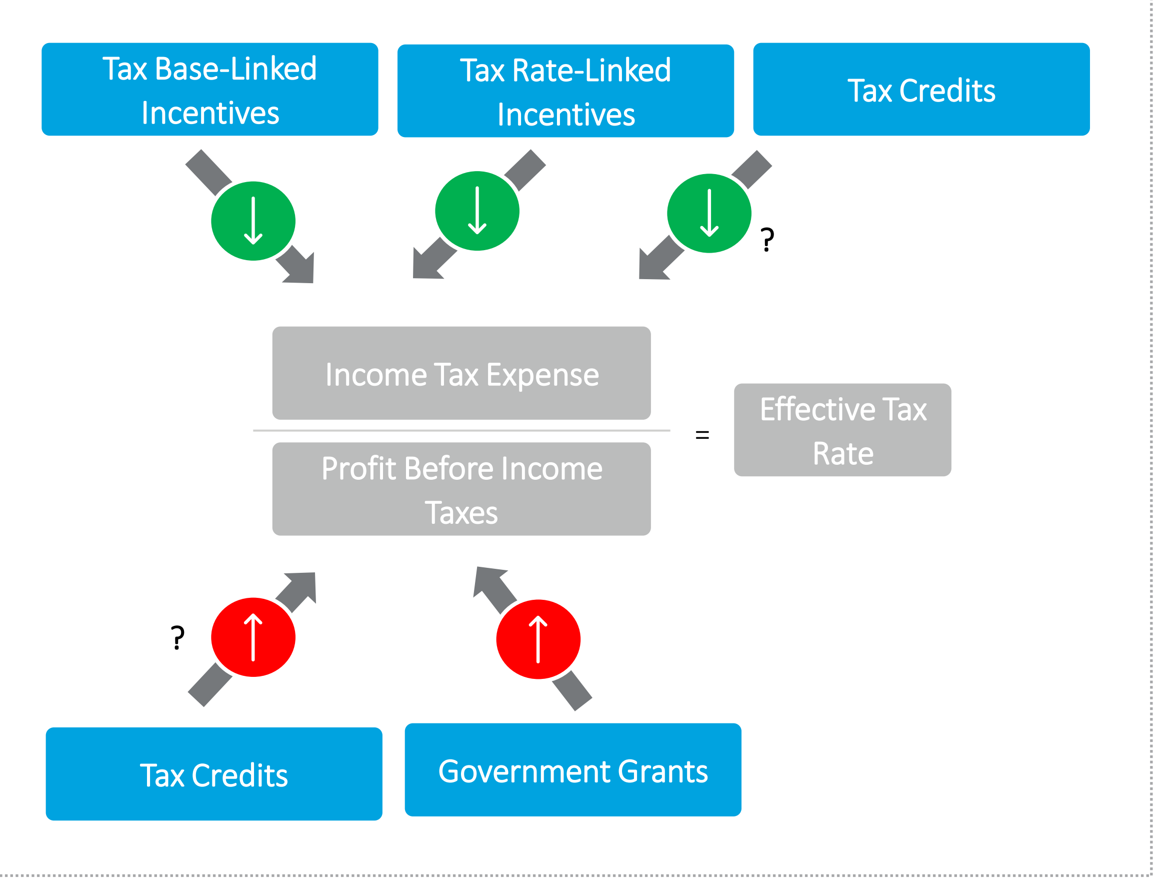
Effective Tax Rate

“Good” Tax Credits

Government Grants

IFRS / US GAAP Perspective



IFRS / US GAAP Treatment (2)

Pro’s and Con’s

	Reduction Income Tax Expense	Other Income (or Reduction from Related Expenses)
Pro’s	• Reduced effective tax rate (“ETR”) – but could also be perceived as a negative message	• Increased operating profit
Con’s	• No positive impact on operating profit	• Especially under IFRS government grants may be presented as a reduction of expenses (e.g., R&D spending)

Limitations (1)

Switzerland

Art. 27 Federal Constitution

Under constitutional law, it must be clarified whether the new instruments are in line with the principle of economic freedom under art. 27 of the Federal Constitution (BV, SR 101). In the Federal Supreme Court's previous case law on art. 27 of the Federal Constitution, cases were qualified as a violation of economic freedom if there was **direct competition and one of the competitors was obviously favored based on a criterion or if a competitor was even completely excluded from competition**. This is particularly evident when larger companies are favored over smaller ones. However, the provision on economic freedom in art. 27 BV does not contain a general ban on state aid, but in its current form serves in particular to prevent the obvious state favoritism of individual companies in direct competition with other companies. If, for example, only Ferris wheels of a certain size were permitted at a funfair, the state would categorically exclude providers of small Ferris wheels.

Art. 27 Economic freedom

[1] Economic freedom is guaranteed.

[2] Economic freedom includes in particular the freedom to choose an occupation as well as the freedom to pursue a private economic activity.

Limitations (2)

European Union (1)

EU State Aid Rules

The European Union restricts its Member States from providing State aid that gives preferential treatment to certain businesses. Any breaches result in the Member State being obligated to recoup the subsidy, along with interest, from the benefited business.

For State aid to be illegal, it must (i) constitute an advantage; (ii) be granted by a Member State and (iii) be given to an undertaking. Moreover, **the advantage must be granted on a selective basis and must distort or may potentially distort trade or competition in the internal market**. Sometimes, the aspects of advantage and selectivity are considered jointly. An advantage granted by a state can take a variety of forms, such as tax incentives, grants, interest rate reductions and so on. Therefore, any tax advantages and grants provided by a Member State that are discriminatory are considered selective and, thus, must be prohibited. In the context of tax incentives, it is clear that any such measure adopted by a Member State must comply with the strict EU State aid rules. The same applies to subsidies provided by states in the form of cash grants. However, there are a number of exceptions to the prohibition of State aid. These include aid with a social character given to individual consumers without discrimination and aid for damage caused by natural disasters or exceptional occurrences. Moreover, certain types of aid may be compatible with the internal market. This includes aid that promotes economic development in areas of economic depression or high unemployment, or aid that facilitates the development of certain economic activities or areas. The EU Commission continuously monitors all State aid systems. If the Commission determines that State aid is incompatible with the internal market or is being misused, it can require the state to modify or abolish the aid. In this respect, the Guidelines on Regional State Aid apply. The Guidelines aim to prevent the misuse of public funds to shift jobs within the European Union, ensuring fair competition in the single market.

It could be argued that the European Union has recently shown signs of loosening its approach towards State aid rules. This is particularly noticeable in the recent TCTF extending and modifying State aid rules set in the previous temporary crisis framework, adopted to mitigate adverse effects of Russia’s war on Ukraine, which now aligns with the GDIP to bolster support for sectors vital to transitioning to a net-zero economy. These new State aid provisions are meant to simplify and accelerate this process. The permitted aid is temporary, set to end by 2025, and limited in-scope to prevent distortion of competition within the internal market. However, these aid limits can be reconsidered on a case-by-case basis if the beneficiary could demonstrate an equivalent investment possibility in a third-country jurisdiction outside the European Economic Area.

(Source: Chand/Romanovska: The Impact of Pillar Two on Corporate Tax Incentives and Incentives Post-Pillar Two – The Potential Rise of Tax Credits and Subsidies, International Tax Studies 9/2023)

Limitations (3)

European Union (2)

Foreign Subsidies Regulation ("FSR")

Objective

- EU State Aid Rules (see slide before) is limited to subsidies by EU Member States;
- However, the Foreign Subsidies Regulation ("FSR") which came into force on 12 July 2023, enables the EU commission to review also subsidies from third countries to companies operating in the EU (extraterritorial effect)

In-Scope Entities

- Private & public entities;
- All business sectors;
- EU & non-EU entities

In-Scope Entities

- Exclusive/special rights;
- Grants;
- Contracts with public providers;
- Debt forgiveness / debt rescheduling / capital injections; debt to equity swaps;
- Tax incentives;
- Guarantees;
- Loans

Launch of Review by EU Commission

- (1) On the EU Commission's own initiative
- (2) Exceeding a size-related notification threshold in the case of M&A
  - At least one of the merging undertakings, target or JV in EU;
  - EU turnover > EUR 500m;
  - Aggregated foreign contributions in last 3 years > EUR 50m
- (3) Participating in a public procurement procedure with a certain minimum size

Consequences

- If a non-Member State subsidy distorts the internal market, the EU Commission can oblige companies to take certain remedial measures. These include the sale of certain assets or the publication of research and development results.
- In the case of mergers or public procurement procedures, the EU Commission can then prohibit a merger or the award of a contract in the public procurement procedure. Even without a prohibition of the merger or the awarding of a contract in the public procurement procedure, even carrying out a detailed in-depth review leads to considerable delays in the economic process.
- Failure to report a qualifying M&A deal or public bid can lead to penalties amounting to as much as 10% of the combined global revenue of the involved parties.

Limitations (4)

World Trade Organization

International Trade Law

In a similar way to EU state aid law, the international trade law of the World Trade Organization (WTO) must also be considered. Of particular importance is the Agreement on Subsidies and Countervailing Measures ("ASC"). According to the ASC, export and import subsidies are frowned upon, i.e., **subsidies whose granting depends on the export or non-import of goods**.

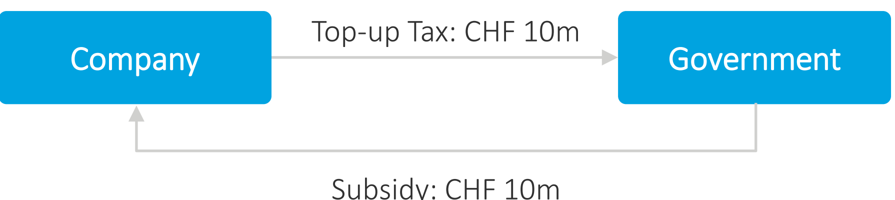
Specific subsidies are also frowned upon, which adversely affect the interests of other member states - for example, because an industry in another member state is harmed. The planned support instruments - even if they are certainly considered to be subsidies under the ASC- do not the aforementioned requirements, as they are neither import or export subsidies nor do they provide for specific subsidies that affect the interests of other WTO member states. In addition, Switzerland's bilateral treaties and bilateral free trade agreements may also contain provisions on subsidies that distort competition. However, there are no apparent requirements that would entail further obligations in addition to the WTO obligations, the constitutional requirements and the political requirements for state aid within the EU, which would have to be considered when introducing a subsidy instrument in the following form.

Limitations (5)

OECD

OECD Model Rules

The OECD Model Rules do not allow member states to provide benefits which are **directly linked to Pillar 2 taxes**: " [...] *the jurisdiction shall not provide any benefits that are related to the IIR or the UTPR that it has implemented. This rule is intended to provide a level playing field in all the jurisdictions that have adopted these rules. The word "benefits" is comprehensive enough to cover any kind of advantage provided by a jurisdiction, including tax incentives, grants, and subsidies and the phrase "related to such rules" is intentionally drafted with broad language to take into account different mechanisms through which the benefit is provided*".



OECD is currently working on new administrative guidance which will also address this topic in more details.

Take-Aways

Key Messages

Pillar II is not the end of tax incentives, but the beginning of new instruments. However, the framework is still developing.

For Pillar II in-scope MNEs, there will be ‘good’ and ‘bad’ tax incentives.

Tax professional need to get familiar with non-tax incentives like subsidies (and build-up relationships with the administration in charge).

Q&A

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