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Understanding Pillar Two: Implementation and Implications – Impact on Indian HQ Groups

Jun 30, 2026

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The OECD/G20 Pillar Two framework introduces a 15% global minimum effective tax rate for large multinational enterprise groups and is reshaping international taxation even in countries that have not fully implemented the rules domestically. Where profits in a jurisdiction are taxed below 15%, a top-up tax may be imposed through a hierarchy of rules: the source jurisdiction may collect it through a Qualified Domestic Minimum Top-up Tax (QDMTT), the parent jurisdiction may apply the Income Inclusion Rule (IIR), and, failing both, other jurisdictions may impose it under the Undertaxed Profits Rule (UTPR). As implementation expands globally, Indian businesses are increasingly exposed because taxing rights can be triggered by the location of parent entities, subsidiaries, and other group companies.

This article aims to provide an overview of the implementation of Pillar Two and its implications worldwide, along with a focused analysis of its impact in India.

Pillar Two Rule Hierarchy

Once a multinational group's income and effective tax rate have been calculated, and after reducing income through the substance-based carve-out, any top-up tax required to reach the 15% minimum rate is allocated through a strict hierarchy of rules. This ensures that low-taxed income is taxed somewhere while still giving priority to the jurisdiction where the income arises.

Substance-Based Carve-Out and Its Interaction with Top-Up Tax: Under Pillar Two, the substance-based carve-out, or Substance-Based Income Exclusion (SBIE), reduces exposure to top-up tax by excluding a portion of income linked to genuine economic activity. It is calculated using eligible payroll costs and the carrying value of tangible assets, while intangible assets such as intellectual property are excluded. The objective is to ensure that the global minimum tax targets excess or mobile profits rather than routine returns arising from real operations.

The carve-out is determined by applying prescribed percentages to payroll and tangible assets and deducting that amount from GloBE income before the top-up tax is computed. During the transition period, these percentages gradually reduce over ten years, with payroll decreasing from 10% to 5% and tangible assets from 8% to 5%. As a result, only the residual income is tested against the 15% minimum tax, lowering the tax burden for businesses with meaningful employees and physical assets.

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The carve-out is intended to encourage real investment and distinguish routine business profits from profits that may reflect profit shifting. It supports activities such as hiring, manufacturing, and maintaining local operations, but its protection is limited because it applies only to tangible substance, declines over time, and does not remove Pillar Two exposure entirely. The greater the real economic substance in a jurisdiction, the greater the carve-out and the lower the potential top-up tax.

Qualified Domestic Minimum Top-up Tax (QDMTT): The first rule applied is the QDMTT. This allows the source (local) country to collect the top-up tax itself. If a jurisdiction applies QDMTT, it effectively "uses up" the top-up tax, preventing other countries from taxing the same income again. This rule gives countries the primary right to tax income generated within their borders.

Income Inclusion Rule (IIR): If no QDMTT is applied, the IIR comes next. Under IIR, the parent company's jurisdiction collects the top-up tax on low-taxed income of its subsidiaries. This ensures that, even if the source country does not act, the group's headquarters country steps in to enforce the minimum tax.

Undertaxed Payments Rule (UTPR): Finally, if neither QDMTT nor IIR applies—such as when the parent jurisdiction has not implemented the rules—the UTPR acts as a backstop. In this case, other countries where the group operates allocate and collect the remaining top-up tax, typically by denying deductions or making adjustments.

Overall, the system ensures that after accounting for real economic substance, any remaining low-taxed profits are taxed to at least 15%, with taxing rights flowing from the**local jurisdiction (QDMTT)** to the **parent jurisdiction (IIR)** and, if needed, to **other jurisdictions (UTPR)**.

Global Implementation Landscape

Although more than 140 jurisdictions have agreed to the framework in principle, implementation remains uneven. A large number of countries have already legislated or are actively implementing the rules, but differences in adoption speed, economic priorities, and administrative capacity have created a fragmented global landscape. The status of implementation of Pillar 2 in various jurisdictions is summarised below:

India and China: As of mid-2026, both India and China have not yet implemented OECD Pillar 2 rules (i.e., no enacted IIR, UTPR, or domestic minimum top-up tax), despite being Inclusive Framework members; India is taking a measured, preparatory path, evidenced by accounting standard amendments and ongoing policy evaluation before legislation, while China remains more non-committal, with no formal legislative roadmap or public implementation timeline announced.

European Union (EU): The European Union is the global leader in Pillar Two implementation, with the Directive requiring transposition by the end of 2023, the IIR generally effective from 2024, and the UTPR from 2025. Member States such as Germany, France, the Netherlands, Spain, and Italy have moved forward under a mandatory regional framework, and many have also adopted QDMTTs to retain top-up tax revenue domestically.

United Kingdom: The United Kingdom has fully implemented Pillar Two rules, with the IIR and QDMTT effective from 2024.

Brazil: Brazil has already enacted its own Qualified Domestic Minimum Top-up Tax (QDMTT) and actively pursuing to be recognized as an eligible "Side-by-Side" jurisdiction.

Japan and South Korea: In Asia-Pacific, Japan and South Korea are among the earlier adopters of Pillar Two, with Japan moving toward UTPR implementation from 2026.

Australia: Australia has fully enacted Pillar Two legislation, with IIR and QDMTT effective from 2024 and the UTPR from 2025.

Southeast Asia: Countries such as Indonesia and Thailand are actively implementing Pillar Two, with Indonesia issuing detailed regulations in 2026.

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Canada: Canada continues to make legislative progress on Pillar Two, with the UTPR still under consideration in 2026.

United States: The United States has not fully adopted Pillar Two as of 2026. In **Jan 2026**, OECD countries agreed on a **“side-by-side” framework** for the U.S. and continues to rely largely on its existing GILTI regime.

Latin America: In parts of Latin America, including Brazil, Pillar Two remains largely at the consultation stage.

Middle East and Low-Tax Jurisdictions: Jurisdictions such as the UAE, Bahrain, Kuwait, and Qatar are moving toward gradual adoption, often emphasising QDMTTs to protect their domestic revenue base.

Africa and Developing Countries: Across many African and other developing jurisdictions, adoption remains mixed, with a number of countries still evaluating or delaying implementation.

Cross-Jurisdictional Challenges

Across jurisdictions, the main challenges arising from Pillar Two can be summarised as follows:

For administrators

- Harmonising Pillar Two with different domestic tax systems and legal frameworks.
- Fragmented implementation timelines and uneven adoption of QDMTT, IIR, and UTPR.
- Heavy data, systems, and reporting requirements, including the GloBE Information Return.
- Limited administrative capacity, training, and digital infrastructure, especially in developing economies.
- Difficulty aligning existing tax incentives and domestic regimes with the minimum tax framework.
- Frequent rule changes and evolving guidance, creating uncertainty for businesses and tax authorities.
- Political, legal, and geopolitical tensions, including treaty constraints and concerns around extraterritorial rules such as the UTPR.
- Reduced effectiveness of tax competition, leading to greater reliance on subsidies and other non-tax incentives.
- Concerns that top-up tax revenue may be collected by other jurisdictions, affecting competitiveness and investment models.

For multinational enterprises

- Capturing and reconciling jurisdiction-level financial and tax data across multiple systems and reporting standards.
- Managing complex calculations, including effective tax rates, GloBE adjustments, top-up tax, and applicable exceptions.
- Meeting extensive filing and reporting obligations across multiple jurisdictions.
- Responding to uneven implementation, evolving OECD guidance, and interpretational uncertainty.
- Reassessing tax incentives, investment structures, and governance frameworks.
- Managing financial reporting impacts, including tax expense, deferred tax, earnings volatility, and ETR forecasting.
- Addressing double taxation risk, taxing-right disputes, and limited dispute resolution mechanisms.
- Coping with transition pressure, including compressed timelines, system upgrades, and reliance on interim solutions.

Despite these challenges, Pillar Two marks **a fundamental shift away from tax competition**, signaling a new era in international taxation—albeit one still under construction.

Implications for Indian Businesses

Indian-headquartered multinational groups (with ≥€750 million revenue) need to **prepare for**

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compliance even though India hasn't enacted Pillar 2 yet by

(i) assessing their jurisdiction-wise effective tax rates (ETR) to identify exposure below 15%,
(ii) building systems to monitor the compliance (Registration, Notifications, return filings etc.) **compute GloBE income and top-up tax,**
(iii) tracking where **foreign jurisdictions apply IIR/UTPR**, and
(iv) enhancing **financial disclosures and data readiness** in line with India's updated accounting standards.

In practice, this means upgrading tax reporting, modelling potential **top-up taxes abroad**, reviewing structures involving low-tax jurisdictions, and preparing for eventual Indian legislation so they do not lose tax credits or face unexpected global minimum tax liabilities.

For these groups, Pillar Two reduces the value of low-tax structures and can increase global tax costs. Offshore arrangements in jurisdictions such as the UAE, Singapore, or Mauritius become less effective because any tax rate below 15% may be neutralized through top-up taxation elsewhere. The rules also increase compliance complexity through jurisdiction-by-jurisdiction effective tax rate calculations, GloBE income adjustments, and the need to align financial and tax data across multiple systems. In practice, groups may face earnings volatility, restructuring of supply chains and holding structures, and a higher risk of double taxation or disputes where domestic tax rules do not align neatly with GloBE rules.

For Indian subsidiaries of foreign multinational groups, low Indian tax outcomes arising from SEZ benefits, tax holidays, or deductions may no longer provide a meaningful group-level advantage because the parent jurisdiction may collect the shortfall. This weakens the value of India's traditional tax incentives for large MNEs and may influence investment and transfer pricing decisions by shifting the focus from tax efficiency to business substance, including employees, assets, and operational presence. Strategically, Indian-headed groups must strengthen tax governance and data systems, foreign groups may reassess how they structure Indian operations, and India itself faces the policy question of whether to adopt measures such as a QDMTT to retain taxing rights and revenue.

Sector-Specific Implications in India

Manufacturing

The implementation of Pillar Two reduces the importance of low-tax jurisdictions in business decision-making. For the manufacturing industry, this creates a more level playing field by limiting tax-driven competition and encouraging companies to compete based on operational strengths such as efficiency, innovation, and supply chain capability rather than tax advantages.

With tax considerations becoming less dominant, manufacturers can make more strategic location decisions based on business fundamentals like access to markets, infrastructure, skilled labor, and energy resources. This shift supports stronger and more resilient supply chains, enabling companies to optimize operations for long-term sustainability rather than short-term tax benefits.

Pillar Two also rewards companies with substantial economic presence through mechanisms such as the substance-based income exclusion, which considers tangible assets and workforce. As manufacturing is inherently asset- and labor-intensive, firms can benefit by maintaining real production activities, reducing exposure to additional taxes while reinforcing their operational footprint.

In addition, the reduced effectiveness of aggressive tax planning allows companies to simplify their structures and shift focus toward core business operations. Under Pillar 2, sustainable incentives such as qualified tax credits, subsidies, grants, and expenditure-based incentives are preferred because they do not significantly reduce the effective tax rate (ETR) below 15%. Instead of lowering taxes, they are often treated as income or receive favorable treatment in ETR calculations. The Indian HQ multinational enterprises can renegotiate with the Government to provide such incentives that will allow benefits while ensuring the ETR remains at or above 15%, thereby avoiding top-up tax.

Overall, despite added compliance requirements, Pillar Two provides greater tax predictability and encourages long-term investment in productive capacity, automation, and sustainability.

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Global Capability Centres

Pillar Two's global minimum tax of 15% reduces the benefits of low-tax jurisdictions, making tax less important in GCC location decisions. For GCCs, this means that traditional tax incentives such as SEZ benefits, expense-based incentives or operating in low-tax countries become less valuable. As a result, companies are shifting focus toward talent, scale, and operational efficiency.

This change is transforming GCCs from cost-driven service centers into strategic hubs that deliver higher-value work like R&D, innovation, and product development, while low-value activities decline.

Pillar Two also has implications for transfer pricing and operating models. Traditional cost-plus arrangements used by many GCCs are being reassessed to ensure alignment with actual functions, risks, and assets. This may lead to recalibration of margins and greater scrutiny of whether GCCs truly reflect their assigned economic roles. In parallel, the new regime introduces significant compliance requirements, including detailed jurisdiction-wise tax reporting and effective tax rate calculations, increasing operational complexity for multinational groups.

Overall, GCC competitiveness is now driven more by capabilities and value creation than by tax advantages.

Distributors

OECD Pillar Two affects even routine entities like distributors. Although limited-risk distributors typically earn low, stable margins under transfer pricing, they may still face top-up tax if their effective tax rate falls below 15%.

The substance-based income exclusion (SBIE) offers limited relief since distributors usually have modest payroll and tangible assets. Traditional models where distributors earn low margins and profits are shifted to low-tax principal entities are becoming less efficient under Pillar Two.

As a result, companies are revisiting transfer pricing policies, often increasing distributor margins and reallocating profits toward market jurisdictions to maintain acceptable ETRs. Low-profit models like commissionaire structures are especially exposed and may be replaced with more efficient setups.

Overall, Pillar Two is pushing businesses to align transfer pricing with global tax outcomes, reducing the benefits of low-tax structures and requiring closer coordination between tax, finance, and operations.

Conclusion

If India does not implement Pillar Two in the near term, Indian-headquartered groups should act now to map jurisdiction-wise effective tax rate exposure, identify where foreign IIR or UTPR rules could apply, and quantify potential top-up tax leakage outside India as from 2025 lot of key jurisdictions have implemented Pillar 2 rules. They should also strengthen data, systems, and governance to support GloBE calculations, registrations, notifications, and return filings across relevant jurisdictions. Existing structures involving low-tax jurisdictions, tax holidays, or incentive regimes should be reassessed to determine whether they still deliver value once foreign top-up taxes are considered. At the same time, groups should align finance, tax, and business teams on Pillar Two readiness, including financial statement disclosures and scenario modelling. Most importantly, they should prepare for eventual Indian adoption so that implementation, when it comes, does not create disruption, missed credits, or unexpected global tax costs.

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