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Pillar Two Mechanics & Impact Assessment

JANUARY 11, 2023

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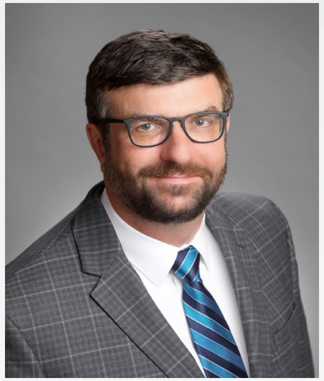
Presenters



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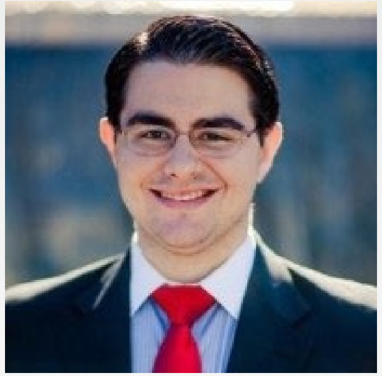

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Learning Objectives

Upon completion of this program participants will be able to

- Improve understanding of the Organisation for Economic Co-Operation & Development (OECD) Pillar Two & associated computations
- Understand various implications for U.S. multinational enterprises (US MNEs)
- Identify burdens/challenges for compliance with the Model Rules

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The Road to OECD Pillar One & Pillar Two – How Did We Get Here?

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The Road to OECD Pillars One & Pillar Two – How Did We Get Here?

- "Broken" international tax system
- Perceived abuse by multinational enterprises (MNEs)
- Original EU/OECD proposals to counter harmful tax competition
- Base erosion & profit shifting – 2012 onwards
- OECD Base Erosion & Profit Shifting (BEPS) Action Plan published 2013
- Action 1 – Digital Economy
- Relaunched as BEPS 2.0 in 2019
- October 2021 Inclusive Framework
- December 2021 – OECD model rules, commentary, & examples

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OECD Pillar Two
Global Minimum Tax Overview

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GloBE Tax Overview

- Introduces a 15% Global Minimum Corporate Tax applied on a country-by-country basis
- Global Anti-Base Erosion (“GloBE”) rules – two interlocking domestic rules
  - Income Inclusion Rule (“IIR”) – Imposes top-up tax on a parent entity in respect of the low taxed income of a constituent entity
  - Undertaxed Payment Rule (“UTPR”) – Denies deductions or requires an equivalent adjustment to the extent the low tax income of a constituent entity is not subject to tax under an IIR

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Computation of Top-Up Tax Liability (By Country)

TOP-UP TAX LIABILITY = TOP-UP TAX % × EXCESS PROFITS

- Top-Up Tax % (*the Rate*)
  - Starts with Net GloBE Income / (Loss) as denominator & applies Adjusted Covered Tax amount as numerator
  - Equals the difference of the actual effective tax rate (ETR) versus the 15% GloBE rate
- Excess Profits (the Base)
  - Starts with Net GloBE Income / (Loss)
    - De Minimis Exception – election to exclude Net GloBE Income
  - Downward adjusts GloBE Income / (Loss) for two Substance Based Income Exclusions –
    - the Payroll Carve Out: 10% of eligible Payroll expenses within GloBE parameters
    - The Tangible Asset Carve-Out: 8% of Qualified Assets net of depreciation, amortization, depletion

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GloBE Rules: Process Overview

1 Who is in scope?

Identify MNE Groups within scope
- MNE Groups are in scope if their consolidated revenue exceeds EUR 750m
- Test is based on two of the four fiscal years immediately preceding tested fiscal year
- Special rules address the effect of mergers or demergers

Identify Constituent Entities (CEs) & Excluded Entities within the Group
- Constituent Entities are those group entities subject to operative provisions of GloBE rules
- Excluded Entities are not subject to operative rules, but revenue is still taken into account for consolidated revenue test

2 Is the ETR below 15%

Jurisdictional blending approach
- GloBE tax liability arises when ETR of a jurisdiction is below the GloBE minimum rate
- Jurisdictional ETR is derived by dividing the aggregate covered taxes assigned to a jurisdiction by the aggregate tax base assigned to that jurisdiction

Determine the GloBE Income of each Consituent Entity, on the basis of its financial accounts

Determine taxes attributable to that income, including deferred tax expense

Divide covered taxes by GloBE income in jurisdiction

3 How much Top-Up Tax is due?

Amount necessary to bring the ETR up to 15% in <u>each</u> jurisdiction
- If ETR is below 15%, subtract ETR from minimum rate
- Top-Up Tax % is multiplied by the excess profit in the jurisdiction to determine Top-Up Tax
- Excess profit = GloBE Income less substance-based income exclusion

Exceptions
- De minimis exclusion
- Substance-based income exclusion (excluded routine return on tangible assets & payroll)

4 Where is the Top-Up Tax paid?

Jurisdictional Top-Up Tax allocated to CEs in low-tax jurisdictions in proportion to GloBE income for fiscal year

Income Inclusion Rule
- Identify parent entity liable for Top-up Tax
- Determine amount of Top-up Tax paid by the parent entity

UTPR
- Backstop mechanism
- Ultimate Parent Entity (UPE) jurisdiction
- UTPR limitation

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OECD Pillar Two GloBE Rules – Calculation Overview

Step One – Constituent Entities Covered

- Identify MNE Groups within scope of the GloBE Rules – EUR 750m or more consolidated revenue test
- Identify CEs & Remove any Excluded Entities
- Identify location of each CE

Step Two – Determine GloBE Income or Loss

- Determination of Financial Accounting Net Income
- Adjust Financial Accounting Net Income or Loss to GloBE Base
- GloBE Income or Loss allocated to Permanent Establishments or through Flow-through Entities where necessary

Step Three – Adjusted Covered Taxes

- Identification of Covered Taxes
- Adjust Covered Taxes for temporary differences & losses & allocate to other CEs as necessary
- Take post-filing adjustments into account

Step Four – Effective Tax Rate & Top-Up Tax

- Computation of jurisdictional Top-Up Tax for low-taxed jurisdictions
- Allocation of the Top-Up Tax between Low Taxed CEs
- Exceptions for De Minimis Exclusion & development of Safe Harbors

Step Five – Income Inclusion Rule & Undertaxed Payment Rule

- Identification of UPE liable for Top-Up Tax under IIR & determination of Top-Up Tax paid by UPE under IIR
- Identification of the remaining amount, if any, that is allocable under the UTPR
- Liability for residual Top-Up Tax in the UTPR Jurisdictions through a UTPR adjustment

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OECD Pillar Two Implications for US MNEs

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Pillar Two – Implications for US MNEs

- GloBE vs. GILTI
  - Qualifying IIR or not
- Increased tax provision/compliance costs
- Challenges around the sourcing of data for the provision/compliance processes
- Inflation Reduction Act – U.S. Corporate Alternative Minimum Tax (CAMT)
  - Qualifying Domestic Minimum Top-Up Tax (QDMTT) or not
- Transfer Pricing

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Latest Updates/Developments

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Latest Updates & Developments

- November 17, 2022 – In the Autumn Statement 2022, the U.K. government announced that for accounting periods beginning on or after December 31, 2023, it will legislate to introduce
  - An IIR
  - A QDMTT
  - These will be included in the Spring Finance Bill 2023
- On December 15, 2022, the EU unanimously adopted the Pillar Two directive which requires EU member states to implement Pillar Two in their domestic legislation with effect from December 31, 2023

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Latest Updates & Developments

- On December 20, 2022, the OECD published the Safe Harbours & Penalty Relief: Global Anti-Base Erosion Rules (Pillar Two)

- December 20, 2022 – OECD released a public consultation document on the Pillar Two – GloBE information return

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Safe Harbours Overview

- Safe Harbours & Penalty Relief: Global Anti-Base Erosion Rules (Pillar Two)
  - Transitional Country-by-Country Reporting (CbCR) Safe Harbour
    - Revenue & income below de minimis threshold
    - ETR that equals or exceeds an agreed rate
    - No excess profits after excluding routine profits
    - Applied using CbCR & qualified financial statement data
  - Transitional Penalty Relief Regime
  - Simplified Calculations Safe Harbours
  - Routine profits test (where excess profits is nil)
    - De minimis test
    - ETR test (using simplified income, revenue, & tax calculations)
    - Applied using the GloBE rules

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Pillar Two – Operational Readiness /Key Decisions

Pillar Two – Operational Readiness/Key Decisions

- **Consider the Timeline**
  - Planning
    - Uncertainty
    - Risk
  - Provision
    - Materiality
  - Compliance
- **Data**
  - Source
  - Organize
  - Share
- **Roles & Responsibilities**
  - Jurisdictional Roles
  - Ownership
  - HQ Oversight
  - Third Parties
- **Tools**
  - Flexibility
  - Scalability
  - Access

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Final Observations

- Know the steps to take to prepare for Pillar 2
- Communicate with the various stakeholders in the company
- Create a project plan to model
- Identify risks & know your ETRs
- Understand various implications from a US MNE perspectives
- Stay updated on developments globally

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QUESTIONS

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