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77th Annual Conference

Scottsdale, AZ

OECD G20 BEPS Pillar Two Implementation – Holistic and Practical Issues

Tuesday, October 25 9:45 am-10:45 am

Moderator

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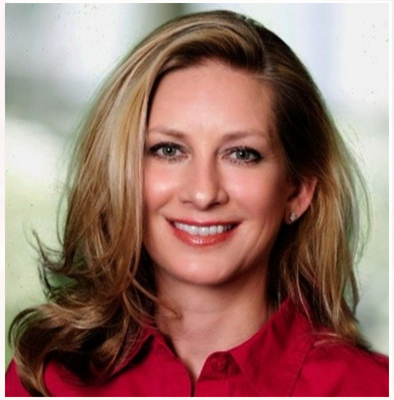

Danielle Rolfes
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KPMG

Inflation Reduction Act
15% corporate minimum tax on book income

Overview

CAMT = Tentative Minimum Tax − Regular Tax Liability + BEAT Liability

Tentative Minimum Tax = 15% x AFSI − CAMT FTCs

Regular Tax Liability = Regular Pre-Credit Liability − Regular FTCs

Company profile

Corporations with average annual adjusted financial statement income greater than USD 1b over 3 consecutive tax years

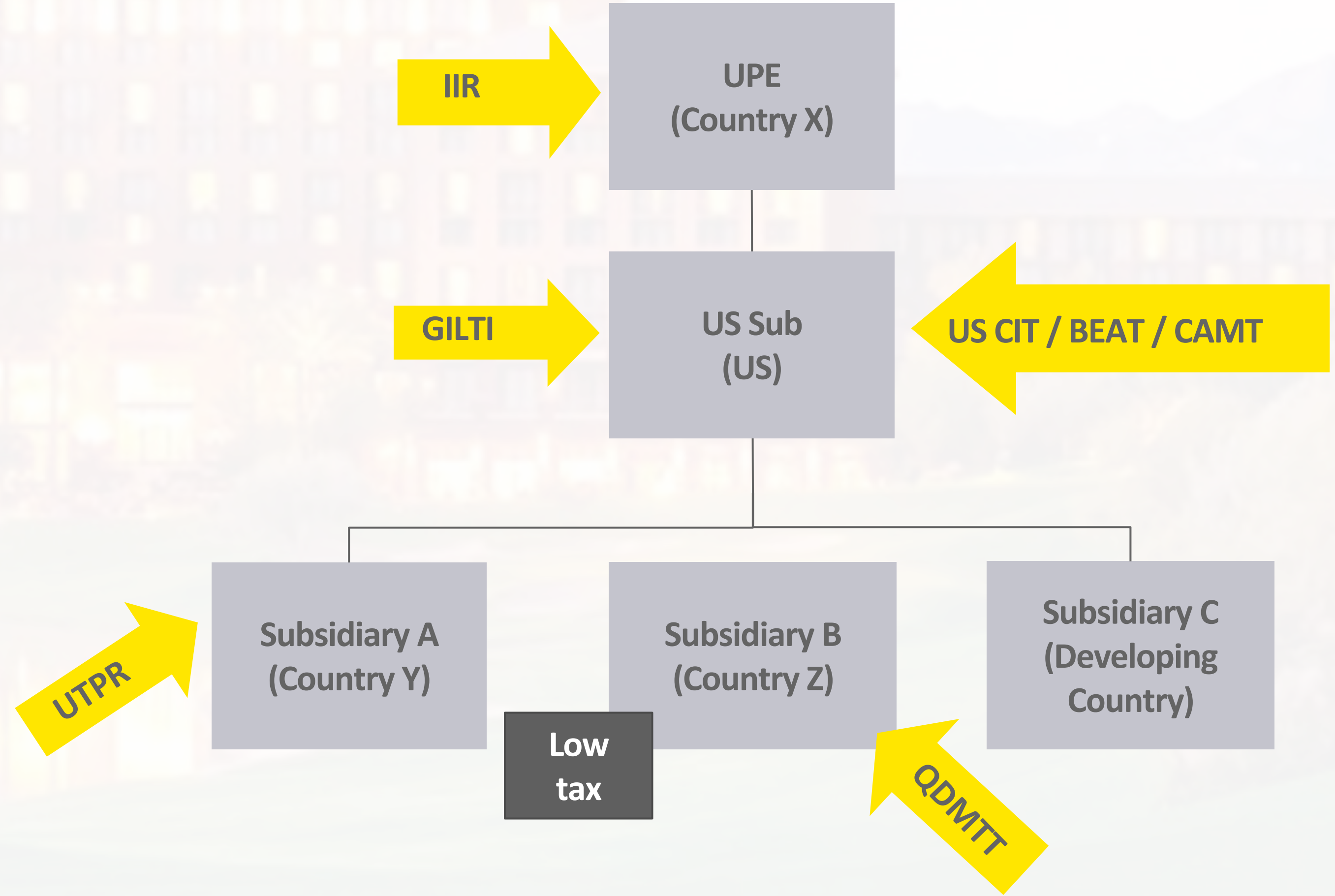
- Foreign parented companies must meet separate USD 100 million income test related to US operations
- ≈ 400 companies impacted; many companies need to perform analysis to determine if applicable

Interaction with Pillar Two

- No international tax changes, including no adoption of Pillar Two related changes to GILTI
- Does not conform with Pillar Two rules

Pillar Two: Potential interplay with the US tax system

- Local country taxes (CIT, withholding tax, STTR)
- Foreign QDMTTs
- Regular US Tax (Sub F, GILTI, Branch, etc.)
- BEAT
- CAMT
- Allocation of US taxes to Foreign Subs
- IIR
- UTPR



Interaction of CAMT and Pillar 2

Covered Tax vs. QDMTT

- CAMT is expected to be a “Covered Tax” for Pillar 2 purposes
- No expectation to consider it a QDMTT for Pillar 2 purposes
- Treasury’s Greenbook in March confirms this – in proposing a QDMTT for the US it notes that CAMT would be a Covered Tax that goes into the Pillar 2 ETR calculation

Deferred Taxes on CAMT Carryforwards

- A taxpayer that pays CAMT gets a tax credit to offset regular tax in future years, which would normally give rise to a deferred tax asset (a “DTA”).
  - This typically means deferred tax expense is reduced in the year the CAMT is paid (and the DTA is recorded), and deferred tax expenses is increased in the year the CAMT carryforward is utilized
  - However, deferred tax expense related to tax credits is not included in the GloBE ETR under Article 4.4.1(e)
  - Thus, CAMT may make US taxpayers worse off under Pillar 2, even though they are paying more tax by reason of CAMT

Allocation of CAMT to CFCs

- Because CAMT is applied to CFC income, it could be considered a CFC regime tax under Pillar 2
  - If so, some portion of CAMT could potentially be “pushed down” and treated as covered tax of CFCs for Pillar 2 purposes (similar to how GILTI will need to be pushed down)

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Interaction of CAMT and Pillar 2

CAMT and Pillar II Applied in Isolation				
	CAMT		GLoBE	
Income statement	**Year 1**	**Year 2**	**Year 1**	**Year 2**
▸Book revenue	100	0	100	0
Pretax book income || GloBE income	**100**	**0**	**100**	**0**
▸Book/tax difference	-100	100	-100	100
Taxable income	**0**	**100**	**0**	**0**
Jurisdictional / P2 tax rate	**21.00%**	**21.00%**	**15.00%**	**15.00%**
▸Current tax expense	15	6*	0	21
▸DTL	N/A	N/A	15	-15
Tax expense || adjusted covered taxes	**15**	**6**	**15****	**6**
GloBE ETR			**15.00%**	**N/A**

*Regular tax liability of 21 less 15 CAMT credit. Note, the CAMT credit may be subject to limitations on its use.

**Under Pillar II, GLoBE recasts the DTL at 15%

Interaction of CAMT and Pillar 2

CAMT and Pillar II Applied Sequentially				
	Year 1		Year 2	
Income statement	**CAMT**	**GloBE**	**CAMT**	**GloBE**
▸Book revenue	100	100	0	0
Pretax book income || GloBE income	**100**	**100**	**0**	**0**
▸Book/tax difference	-100	-100	100	100
Taxable income	**0**	**0**	**100**	**100**
Jurisdictional / P2 tax rate	**21.00%**	**15.00%**	**21.00%**	**15.00%**
▸Current tax expense	15	15	6**	6
▸DTL	N/A	15*	N/A	-15
	Year 1		**Year 2**	
Tax expense || adjusted covered taxes	**30**		**-9**	
GloBE ETR	30%		N/A	
Top-up tax	–		9***	
Cash Tax Expense	**15**		**15**	
Total ETR for Years 1 and 2	**30%********			

*Under Pillar II, GLoBE recasts the DTL at 15%

**Regular tax liability of 21 less 15 CAMT credit (which is fully utilizable in Year 2)

***See Art. 4.1.5 for the treatment of DTLs under Pillar II and GLoBE

****100 of book income across years 1 and 2 and 30 of cash tax expense

Possible regular tax v. CAMT v. GloBE interaction fact patterns

- CAMT AFSI = GloBE FANIL
  - Generally means CAMT paid instead of GloBE
  - Differences can still arise from disparate DTA/DTL treatment
    - Forgo DTLs?
    - DTAs may result in additional overall tax
  - CAMT credit usage will not otherwise reduce Covered Tax below 15% (absent DTA/DTLs)
- CAMT AFSI > GloBE FANIL
  - E.g., stock option expense
  - CAMT is additional expense that increases GloBE ETR
- CAMT AFSI < GloBE FANIL
  - E.g., defined benefit plan expenses
  - Potential additional top up under GloBE

Pillar Two: Risks and Planning Opportunities

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- **Denial of stepped-up basis for asset transfers:**
  - Article 9.1.3. of the Model Rules provides that in the case of a transfer of assets between CEs after November 30, 2021, and before the start of the year when the GloBE rules enter into force (the Transition Year), the basis in acquired assets (other than inventory) must be based upon the disposing Entity’s carrying value of the transferred assets upon disposition, with the deferred tax assets and liabilities brought into GloBE determined on that basis.
    - Limits the ability to step-up the basis of assets without including the resulting gain in the computation of GloBE Income or Loss.
    - The gain from the sale of assets transferred after the GloBE rules are effective are included in the GloBE tax base and can create a corresponding Top-Up Tax liability. Requiring the transferee to record the historic basis of tax attributes preserves the gain and is triggered in the next transfer of the asset when (or after) the GloBE rules are effective.
    - Rule applies despite the fact that for domestic tax purposes the transferee may be entitled to a step-up in value for depreciation purposes, even of transferee paid FMV for the asset, or that the transferor may be subject to tax on the transfer in its jurisdiction at a ≥15% rate (i.e., rule is not limited to tax-free transfers).
    - The rule can have a negative impact on the ETR calculation for GloBE purposes (i.e., what deferred tax amount can be regarded as a covered tax).

Pillar 2 mitigation

- Restricting 'step-up' of IP

- *After Pillar 2 implementation*, Article 6.3.1 provides:

  "In the case of a disposition or acquisition of assets and liabilities, a disposing Constituent Entity will include the gain or loss on disposition in the computation of its GloBE Income or Loss and an acquiring Constituent Entity will determine its GloBE Income or Loss using the acquiring Constituent Entity's carrying value of the acquired assets and liabilities determined under the accounting standard used in preparing Consolidated Financial Statements of the Ultimate Parent Entity."

- Therefore, IP disposals after Pillar 2 implementation may result in accounting profits and "top up tax".

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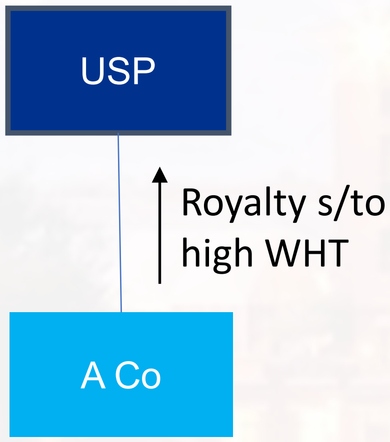
Some potential strategies to mitigate P2 impact:

- Option Premium with respect to IP
- Franking low-tax income via a branch structure
- Franking low-tax income via company migration

Using FTC carryforwards always reduces P2 ETRs

Article 4.4.1(e) excludes from a constituent entity's total deferred tax adjustment amount "deferred tax expense with respect to the generation and use of tax credits." → Using FTC carryforwards to offset foreign source income earned by the Main Entity artificially reduces its ETR for GLoBE purposes.



Facts

- USP receives a $100 royalty, subject to $20 withholding tax.
- In Year 1, USP has $50 net foreign source income (FSI), subject to pre-credit U.S. tax of $10.5 USP claims an FTC of $10.5, and has a $9.5 FTC carryforward.
- In Year 2, USP has $100 of foreign source income and $0 foreign tax USP uses the $9.5 FTC carryforward against its pre-credit U.S. tax of $21, resulting in net U.S. tax of $11.5.

Analysis

- No DTA is created for GloBE for the creation of a tax credit. Art. 4.4.1(e).
  - Year 1 ETR: ($20 WHT + $10.5 U.S. tax – $10.5 FTC) / 50 = 40%
  - Year 2 ETR: ($21 – $9.5 FTC) / 100 = 11.5%
- By comparison, financial accounting ETR:
  - Year 1 ETR: ($20 WHT – $9.5 DTA) / 50 = 21%
  - Year 2 ETR: ($11.5 + $ 9.5 DTA) / 100 = 21%

General and branch basket c/fs also create exposure to CAMT for in scope taxpayers

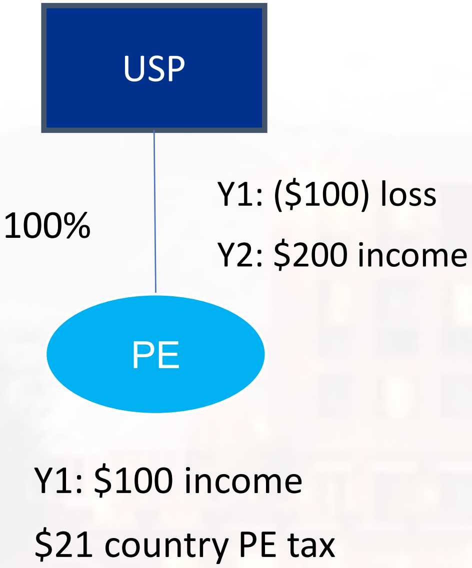
This example involves FTC carryovers from high-taxed income, but we get the same result if FTCs carry forward because a domestic loss offset foreign source income attributable to the main entity.

Domestic losses in worldwide tax systems

An MNE that incurs a domestic loss should not be treated less favorably because it is resident in a worldwide tax system

- —In a worldwide system, a domestic loss that offsets income attributable to a Constituent Entity located elsewhere for GloBE purposes produces an FTC carryforward. Using the carryforward does not increase covered taxes and so will drive an artificially low ETR
- —In a territorial system, the same domestic loss produces an NOL. Using the NOL increases covered taxes

Example of ODL offsetting branch income



If USP is resident in the United States:

— <u>Year 1</u>: On its U.S. return USP has:

$0 TI

$100 overall domestic loss (ODL) balance

$21 FTC carryforward

→ PE GloBE ETR: 21 / 100; U.S. GloBE ETR: 0 / (100)

— <u>Year 2</u>: USP has $200 U.S. source income, 50% is recaptured as branch basket FSI

→ U.S. GloBE ETR: (42 pre-credit tax expense - 21 FTC carryforward) / 200 income = 10.5%; top-up tax triggered

General and branch basket c/fs also create exposure to CAMT for in scope taxpayers

If USP was resident in a jurisdiction that exempted PEs:

— <u>Year 1</u>: USP's $100 NOL carryforward creates a $21 DTA for book and $15 DTA for GloBE

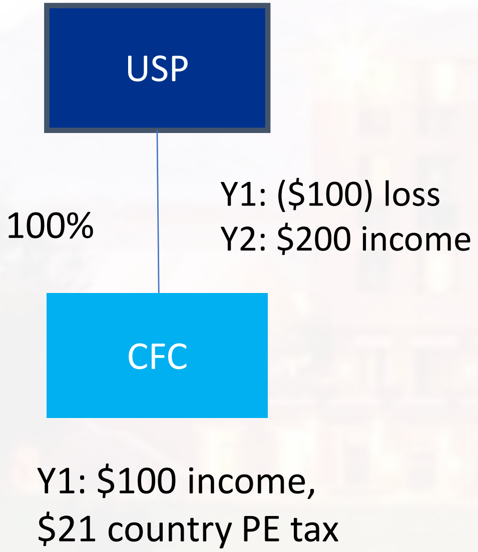
→ GloBE ETR of (15) / (100) (Article 4.1.5 is not triggered)

— <u>Year 2</u>: Using the NOL carry forward results in $21 current tax expense + $15 reversal of DTA

36 / 200 = 18% GloBE ETR

ODLs that offset income that is attributable to a different jurisdiction generally result in an FTC carryforward in lieu of the NOL carryforward that would exist for a resident of a territorial jurisdiction. The Implementation Framework includes work to allocate the taxes of worldwide jurisdictions in the context of losses and FTCs.

Example of ODL offsetting GILTI



If ODL offsets current law GILTI:

— Year 1: On its U.S. return, USP has $0 TI, a $100 ODL balance, and $0 FTC carryforward

→ U.S. GloBE ETR: 0 / (100)

→ Country Y GloBE ETR: 21 / 100

— Year 2: USP has $200 U.S. source income, 50% is recaptured as GILTI basket FSI, and $50 net GILTI inclusion (after section 250 deduction)

→ U.S. GloBE ETR: (42 pre-credit tax expense – 10.5 excess current year GILTI FTCs) / 200 income

= 15.75%, so that top-up tax is barely avoided

Application of BBBA GILTI revisions:

— Year 1: Same as above

— Year 2: USP has $200 U.S. source income, 50% is recaptured as GILTI basket FSI, and $50 net GILTI inclusion (after section 250 deduction)

→ U.S. GloBE ETR: (42 pre-credit tax expense – 21 GILTI FTCs) / 200 income

= 10.5%, so that 3.5% top-up tax is owed

* Example assumes no timing differences between GloBE income or loss and U.S. taxable income and no U.S. expenses allocable to GILTI

Treatment of Pre-Transition Credits

- An area that needs clarification is the treatment of pre-transition credits
- The transition rule in Art. 9.1.1 favorably provides that an MNE Group shall take into account "***all*** of the deferred tax assets and deferred tax liabilities reflected or disclosed in the financial accounts of all of the Constituent Entities in a jurisdiction for the Transition Year" (emphasis added)
- On its face, Article 9.1.1 includes DTAs attributable to pre-transition GBCs and FTCs carryforwards. When such carryforwards are used, deferred tax expense is increased. Thus, one would expect taking into account pre-transition DTAs for credits would mean that an entity's Total Deferred Tax Adjustment Amount would be increased in the year the carryforward is used
- The Commentary adds uncertainty, however, by providing that pre-transition DTAs are "available for use in applying Article 4.4." Article 4.4.1(e) excludes from the Total Deferred Tax Adjustment Amount "deferred tax expense with respect to the generation and use of tax credits"
  - The stated reason for allowing all DTAs is to avoid complex recalculations at transition
  - If all the requirements of Article 4.4 had to be satisfied, the allowance of all pre-transition DTAs would be meaningless

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