TEI

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77th Annual Conference
Scottsdale, AZ

Achieving Operational Readiness for Pillar 2 – The Time Is Now

October 26, 2022

8:30 - 9:30 AM

Moderator

Tony Valento/ VP, Chief Tax Officer/ Maxar

Vikram Gosain/ Fed'l & Int'l Tax Editor/Author/ Thomson Reuters

Fran Randall/ Partner/ Forvis

Gary Colbert/ Senior Director/ CSC Corptax

Background

Pillar Two is a global anti-base erosion (GLOBE) minimum tax regime

- Two main rules
  - **Income Inclusion Rule (IIR) -** imposes a top-up tax on a parent of a multinational group for low-taxed GLOBE Income of a constituent entity
  - **Undertaxed Profits Rule (UTPR) -** backstop that kicks in when income is not taxed under the IIR
- Terms
  - Top-Up Tax – incremental tax on GLOBE income to bring effective tax rate on Covered Taxes to 15%
    - income carve-out for mark-ups on
      - payroll (10% reduced to 5% over 10 years) and
      - assets (8% reduced to 5% over 10 years)
    - effective tax rate is determined on a jurisdictional basis
  - Globe Income - adjusted financial income of constituent entity (CE)
  - Covered Taxes – adjusted financial statement taxes per CE
  - CE – any group entity including PEs
    - need to compute financial income by CE
- Scope
  - multinational groups with annual revenue of €750 million or more in two of the prior four fiscal years
  - excluded entities – pension funds, government entities, non-profits, international organizations, investment funds or real estate investment vehicles that are ultimate parent companies
  - de minimis exclusion (per-country)
    - less than €10 million revenue and less than €1 million profit

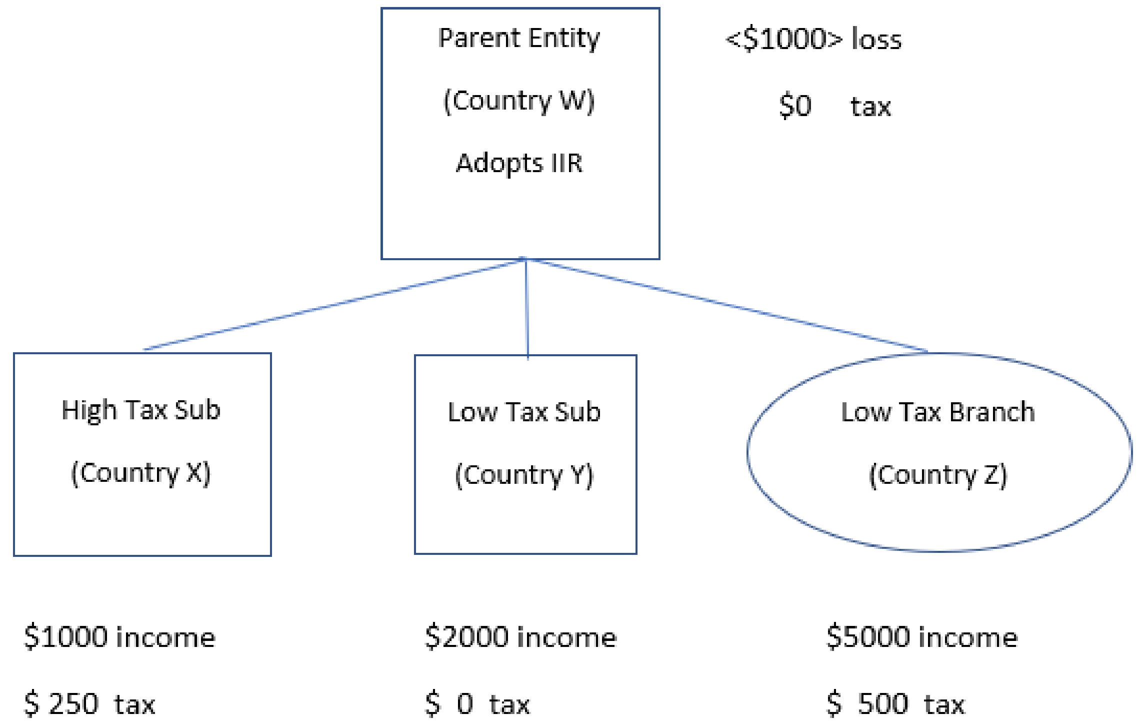
Historical Timeline

- Pillars One and Two evolved from the 2015 BEPS Action Item 1 – Addressing the Tax Challenges of the Digital Economy.
- Pillar One introduced new nexus rules – for taxing certain income in market jurisdictions
- Pillar Two was introduced in 2018 by Germany and France
  - inspired by the US GILTI rules that came out in the 2017 TCJA
- New nexus concepts
  - Pillar One – nexus without physical presence (for market jurisdictions)
  - Pillar Two – nexus based on group affiliation (for CEs in UTPR countries)
- Oct 2021 - the OECD Inclusive Framework agreed on the two-pillar solution
- Since then, the OECD issued model rules, commentary, and examples on Pillar Two
- Model rules introduced the Qualified Domestic Minimum Top-Up Tax (QDMTT)
  - allows the low-tax country to collect top-up tax instead of the parent entity country (under the IIR)

Pillar Two Basic Mechanics

- Under the IIR – the parent pays a top-up tax *under rules similar to subpart F* – for undertaxed profits of a low-taxed CE
- The UTPR applies when tax is not collected under the IIR
  - for example, if the parent country has not adopted an IIR and the low-tax country has not adopted a QDMTT
  - the UTPR allocates the top-up tax not collected by the parent to other group members
    - in countries that have enacted the UTPR rules
    - based on their relative share of
      - payroll (weighted at 50%) and
      - assets (weighted at 50%)
  - the tax is determined per entity by disallowing deductions or making similar adjustments
    - likely inspired by US BEAT rules
- The priority to tax under the GLOBE rules
  - CIT or QDMTT - tax at source country,
  - then IIR – tax at parent jurisdiction ,
  - then UTPR - tax wherever else the group has assets and payroll

IIR Example



Application of IIR to Parent Entity

High Tax Sub: No top-up tax to Parent Entity because High Tax Sub's effective rate exceeds 15%

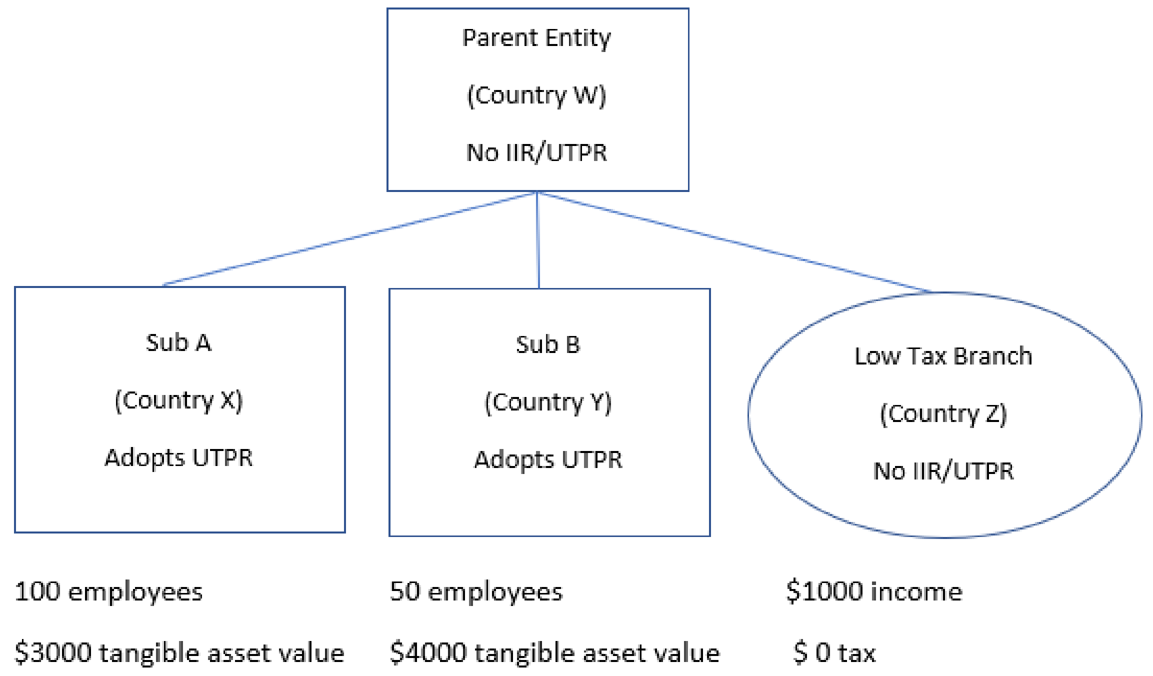
Low Tax Sub: Top-up tax to Parent Entity of $300 (($2000 times 15%) minus $0 tax paid)

Low Tax Branch:

- Treated as corporation for IIR purposes
- Top-up tax to Parent Entity of $250 (($5000 times 15%) minus $500 tax paid)

Parent Entity: Will pay top-up taxes to Country W even though it has a loss for the year

UTPR Example



UTPR Results

Top-up tax from low tax branch : $1000 income times 15% = **$150**

Country X allocation:

- [50% times (100/150)] plus [50% times (3000/7000)] = 54.75%
- $150 top-up tax times 54.75% = **$82 top-up tax allocated to Country X**

Country Y allocation:

- [50% times (50/150)] plus [50% times (4000/7000)] = 45.25%
- $150 top-up tax times 45.25% = **$68 top-up tax allocated to Country Y**

Subject to Tax Rule (STTR)

- A treaty-based rule that allows source (payer) country to impose source withholding tax
  - on certain related party payments – such as interest and royalties
  - that are subject to tax in the payee country below 9%
    - minimum tax limited to 9% because rule applies to gross payment
- The STTR tax will be creditable as a covered tax under the GLOBE rules
- The idea is to help some source states, such as less developed countries with lower administrative capacities, to protect their taxing rights
- Implementation through bilateral treaties
  - a multilateral instrument is being developed to facilitate implementation
- The STTR is still in the development stages
  - model rules do not discuss

Know the steps to take to prepare for Pillar 2

Communicate with the various stakeholders in the company

Create a project plan to do some modeling

Identify risks and know your ETRs

Understand various implications from a US MNE perspective

- GloBE vs. GILTI
- Inflation Reduction Act – U.S. Corporate Alternative Minimum Tax (CAMT)

Keep updated on developments globally

Steps to Prepare for Pillar 2[1]

Step 1 – Constituent Entities Covered

- Identify MNE Groups within scope of the GloBE Rules – EUR 750M or more consolidated revenue test.
- Identify Constituent Entities (“CEs”) and Remove any Excluded Entities.
- Identify location of each CE.

Step 2 – 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 3 – Adjusted Covered Taxes

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

Step 4 – Effective Tax Rate and 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 and development of Safe Harbors.

Step 5– Income Inclusion Rule and Undertaxed Payment Rule

- Identification of UPE liable for Top-up Tax under IIR and 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.

[1] *See,* OECD’s Overview of the Key Operating Provisions of the GloBE Rules

United States	United Kingdom	The Netherlands	Germany
Pillar 2 in the U.S. remains stalled – GILTI proposed changes left out of the Inflation Reduction Act	Enthusiasm on the decline	Pillar 2 well received and supported	Announced in June 2022 they are in the process of submitting draft legislation implement Pillar 2
GILTI CbyC and ETR increase to 15.8% unlikely to be enacted in the near term	Released draft legislation and commentary for the Income Inclusion Rule with technical consultation that concluded in July 2022	Expectation is that the impact on the economy is favorable – tax revenue up EUR0.5B annually	Favorability towards Pillar 2 bolstered by its joint statement with The Netherlands, France, Italy and Spain
Conformity of GILTI with GloBE uncertain, but more likely to be addressed in 2023	Likely won't apply until accounting periods beginning on or after 31 December 2023	Still lots of uncertainty around administration	Compliance cost of Pillar 2 is expected to be considerable
Biden may be forced to act with new Congress in 2023	Acknowledges gaps in implementation exists relative to the OECD Framework	No draft legislation published to date, but noted in a joint statement it would introduce Pillar 2 "by any means necessary"	Various details still subject to great uncertainties and risks

Key Decisions:

Consider The Timeline

- Planning
  - Uncertainty
  - Risk
- Provision
  - Materiality
- Compliance
  - Precision

Data

- Source
- Organize
- Share

Roles and Responsibilities

- Jurisdictional roles
- Ownership
- HQ oversight
- Third Parties

Tools

- Flexibility
- Scale-ability
- Access

Questions?

Thank you to our speakers!

Vikram Gosain
Thomson Reuters
Vikram.Gosain@thomsonreuters.com
602.402.3492

Fran Randall
Forvis
Fran.Randall@forvis.com
703.652.0249

Gary Colbert
CSC Corptax
gcolbert@corptax.com
415.203.0495

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