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Industry & Services – OECD Pillar 2 (GloBE) rules

What's new?

On 20th December 2021 the OECD published model rules that member countries are expected to adopt in order to give teeth to the 15% global minimum tax (the Global Anti-Base Erosion Model Rules ("GloBE rules") with fiscal authorities expected to follow with part-implementation into domestic law in 2022 with effect from 2023 and more complete implementation in 2023 with effect from 2024. 137 countries have signed up in principle to be GloBE countries.

On 14th March 2022 the OECD published a comprehensive commentary and illustrative examples of what the implementation of the rules could look like. The commentary and illustrative examples are available to download from the OECD website.

On 24th May 2022 the secretary general of the OECD announced that Pillar 1 would likely be delayed until 2024 but that they remain hopeful of 2023 implementation for Pillar 2. In Europe, commencement of pillar 2 is likely to be deferred until periods commencing on or after 31 December 2023. The UK has also announced its pillar 2 implementation will commence for periods beginning on or after 31 December 2023. The US has reiterated its support for the measure and hope to pass the required bill through Congress prior to the November mid-term elections.

Implementation remains an outside bet for 2023 but still remains likely for 2024.

Who will the GloBE rules apply to?

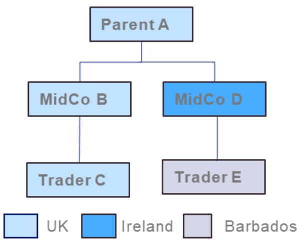
The GloBE rules apply to groups with revenue in their global consolidated accounts >EUR 750m in more than one tax jurisdiction over two of the four years before the one being considered.

Broadly GloBE will apply to those groups which already have to report under the Country by Country Reporting ("CbCR") rules and to entities in that group (a deminimis exception can apply if turnover and profit in a particular jurisdiction are below certain thresholds – see below).

Some exemptions from GloBE can apply, and exempt entities include a Governmental Entity; an International Organisation; a Non-profit Organisation; a Pension Fund; an Investment Fund that is an Ultimate Parent Entity; or a Real Estate Investment Vehicle that is an Ultimate Parent Entity.

What are the GloBE rules?

There are two main rules announced now and a third to be developed later



A) Income inclusion rule ("IIR")

- If A, the ultimate parent company, is in jurisdiction that has implemented IIR ("a GloBE country") it pays 'top up tax' for the difference between the effective tax rate per jurisdiction and the 15% minimum rate of tax in each jurisdiction for which it owns a controlling interest in any other entity. The highest GloBE sub-holding company pays for its sub-group, based on its ownership share in the low-taxed entity. The application of the IIR takes a top-down approach.

- 137 countries have signed up in principle to be GloBE countries; it is **when these countries legislate for IIR** that will be important to identify when and where entities in the group will start to bear the tax. Ordinarily this will be the parent jurisdiction, though jurisdictions can opt for the in-country entity to pay it (domestic minimum tax rule). This is the route the EU has decided to follow in its proposed Directive implementing pillar 2 and the UK is consulting on. The local jurisdiction then keeps the tax rather than it being collected overseas. Initial feedback from the EU commission is that implementation in 2024 may be difficult, other jurisdictions may implement later and this may result in tax arbitrages.

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B) Underpaid Tax Rule ("UTPR")

- **Only applies if parent co jurisdiction has not yet legislated for IIR.**
- Any top up tax not collected under the IIR will be charged on other group entities under the UTPR.
- Countries adopting this rule will apply any top up tax required in respect of low taxed constituent entities if the IIR does not get to a minimum of 15% for each jurisdiction in the group.
- Top up tax is allocated between UTPR countries: By reference to proportion of UTPR country employees and to proportion of UTPR country tangible net assets.

There is also a subject to tax rule ("STTR") which will allow countries to charge a top up withholding tax on certain types of outbound payments that are made between related parties to countries with a withholding tax rate less than 9%;.

How do I know if the effective tax rate ("ETR") of 15% is met?

The calculations can get very complex and need to be done for each constituent entity then aggregated by the jurisdiction. There is limited OECD guidance in terms of application but see the example below titled 'sample calculation' that suggests how the calculations could work where the jurisdictions have not opted for the domestic minimum tax rule. Further guidance on implementation is expected shortly.

Constituent entities in jurisdictions that contain any of the following features may give rise to a top-up tax in any year:

- Tax rate lower than 15% (whether or not an exemption under current CFC rules applies);
- Life Insurance Policyholder tax returns include in an increase in liabilities but not in financial accounting income;
- Significant reductions to valuation allowances (increases to deferred tax assets);
- Substantial uncertain tax position provisions made in a year;
- Untaxed permanent items in income that do not fall within a GloBE exclusion;
- After 5 years, reductions to deferred tax arising if timing differences from non-excluded items have not unwound.

Otherwise, where the minimum tax rate is >15% in most jurisdictions it will be an increased compliance burden rather than an increased tax burden (see below).

Filing requirements

GloBE returns will need to be filed no later than 15 months from the end of the reporting period. If implementation runs to schedule, the **first return** benefits from an extension to this period to 18 months and would be due by **30 June 2024** for 31 December 2022 year end groups. Both the EU and the UK have announced that their introduction of the GloBE rules will commence for accounting periods beginning on or after 31 December 2023. For these regions, if the first return relates to the year ended 31 December 2024, the first report would be due by 30 June 2026.

Over 2022 the GloBE team at OECD will develop a **standard form template for** the information will be that necessary to calculate the Effective Tax Rate for each jurisdiction, the Top-up Tax for each entity and the allocation of the Top-Up Tax under either IIR or UTPR as appropriate.

It is likely to be the **data collection** and **compliance burden** rather than the additional top-up tax that will be the concern for most groups.

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Complexities

The Pillar 2 rules are complex and will cause an administrative burden on MNE groups. The safe harbour provisions will be crucial in this respect.

Pillar 2 requires each entity recast their deferred tax amounts at the minimum tax rate and does not provide recognition for the actual rate of tax in relation to the underlying timing difference when determining the annual effective tax rate, this will result in top up tax in respect of both timing and permanent differences. The outcome of this is double taxation.

In certain cases, Pillar 2 applies top up tax in circumstances where there is no net GloBE income.

Simplifications

A current de minimis by jurisdiction of an average of the current and last 2 years GloBE Revenue (<EUR 10m) or GloBE profit (<EUR 1m) can apply by election, but does not decrease the compliance burden, instead it sets the top-up tax in that jurisdiction to zero.

Pillar 2 includes a formulaic substance based carve out which is designed to approximate the level of substance in the jurisdiction. This is based 5% of the MNE group's payroll costs and tangible assets in the jurisdiction. There is an increased percentage amount in the transition period from commencement that lasts for 10 years. In the first year the carve-out for payroll costs is 10% and for tangible assets it 8%.

There are proposals for safe harbours which would reduce the GloBE calculations. These could be based on CbCR profits and taxes with either a higher tax rate hurdle or some other factors. The OECD will do further work on this in 2022 and this could be crucial in determining the work required and complexity of administering the regime.

What do I need to do next?

- Consider whether your group is in scope (>EUR 750m consolidated gross income);
- If in scope, carry out a high-level impact analysis to determine whether there are likely to be in-scope jurisdictions within your Group and the size of any potential top-up tax;
- Identify data sources and collection mechanisms/procedures;
- Determine where computations will be carried out (local or group), aggregated and top up taxes agreed, paid and charged, taking account of how different jurisdictions implement the rules;
- Identify whether there are benefits to applying for any of the GloBE elections;
- Review transfer pricing methodology and adjustments;
- Consider whether excess tax is being suffered and restructure if appropriate.

What can Mazars do to help?

Over the next year or so, more detail will emerge from the OECD and more local jurisdictions will implement local laws. Heads of Tax are being asked to provide an assessment of the impact of the new rules. Mazars can help you do this by

A) Assisting in calculating the potential top up tax due under existing arrangements;

B) Reviewing your CbCR reporting processes and controls;

C) Assessing Pillar Two readiness and identify gaps;

D) Highlight key risk areas and potential Pillar Two impact and summarise proposals and prioritisation;

E) Design roadmap and implementation plan for Pillar Two compliance and optimisation if appropriate.

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We can help you with any of the above individually or put this together as a draft Pillar Two impact and readiness Report with the following objectives:

1) A blueprint to be Pillar Two compliance ready;
2) A report for the board and other management stakeholders.

It would cover an ETR assessment and impact analysis, highlighting areas of attention and operating model options.

If you would like to discuss how Mazars can help you, please contact your usual contact or in the UK:

Vesko.Petkov@mazars.co.uk (I&S Tax – Corporate Tax)

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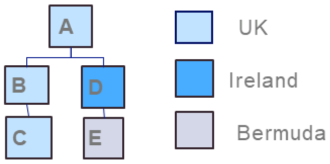
Sample calculation

In their consultation document, HMRC in the UK have used a 10-step process for the calculations which has been followed below.



1) **Allocate entities to a jurisdiction** – mostly by tax residence or place of incorporation. Branches are a separate entity, and tax transparent entities are dealt with separately.

2) **Calculate entity GloBE income** – The entity's financial accounting net income or loss is adjusted to arrive to the entity's GloBE income or loss. A number of adjustments are to be considered such as removing net tax expenses and excluding dividends. Adjustments must also be made between entities to ensure transactions are consistent with the Arm's Length Principle. Data relating to all of these potential adjustments will need to be obtained.

An example of how the financial accounting net income (not including the OCI result) is adjusted is shown in the table below.

GloBE income/(loss)

	A	B	C	D	E	UK
Financial accounting net income/(loss)	167,500	30,000	125,000	8,750	190,000	322,500
Total taxes expense (inc Deferred?)	(2,500)	10,000	25,000	1,250	0	32,500
Dividends received	(155,000)					
Gains on >10% sub	(50,000)	0	0	0	0	(50,000)
Deferred gains on reorganisations			0			0
Aysymmetric forex gains or losses						
Prior period errors or changes in accounting policy						
Accrued pension expense						
GloBE Income pre-transfer pricing	(40,000)	40,000	150,000	10,000	190,000	150,000
Transfer pricing adjustments	0	10,000		0	(10,000)	0
GloBE Income post-transfer pricing	(40,000)	50,000	150,000	10,000	180,000	160,000

There are several GloBE elections that could be made, some of which include:

- to apply consolidated accounting treatment to eliminate income, expense, gains and losses from transactions between entities that are located, and included in a tax consolidation group, in the same jurisdiction,
- to swap accounting expenses for the tax deductible amount for share based payments,
- to move to realisations basis for gains and losses (this comes with a current year + 4 year look back period true up)

There is a need to **transfer price transactions** and **allocate financial profits** between a company and its permanent establishments in line with current transfer pricing allocations.

3) **Calculate adjusted covered taxes –** covered taxes are equal to the current tax expense accrued in an entity's financial accounting net income or loss, they are income or profit based taxes from the income statement. Adjustments are made for 'Additions' and 'Reductions', deferred tax and income or profit taxes charged to OCI or equity.

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Adjusted covered taxes

	A	B	C	D	E	UK
Covered taxes						
Current tax expense	(2,500)	10,000	100,000	1,250	0	107,500
	(2,500)	10,000	100,000	1,250	0	107,500
Adjustments to covered taxes						
Additions or reductions						
Deferred tax adjustment	0	0	45,000	0	0	45,000
Uncertain tax position (general provision)			(25,000)			(25,000)
Taxes included in equity or OCI						
	0	0	20,000	0	0	20,000
Adjusted Covered Taxes	(2,500)	10,000	120,000	1,250	0	127,500

- A separately tracked **GloBE** regime can be elected to obtain a **deferred tax asset** for losses if that is beneficial (which, due to the 5 year deferred tax recapture test, if >5 year utilisation it may be)
- Additions and Reductions include amounts on **uncertain tax positions**, amounts in respect of **tax credits,** and amounts adjusted as a result of **GloBE elections**.

The **deferred tax** adjustment is subject to a **recapture test after 5 years**. If the unwound timing difference does not relate to an exempted category* then a negative adjustment is made to the Adjusted Covered Deferred taxes in that year. * Exempt categories include insurance reserves and deferred acquisition costs as well as R&D, fair value accounting on unrealised net gains and other long-term differences.

4) **Aggregate the income and taxes** found in steps 2 and 3 by jurisdiction

GloBE income/(loss)

	D	E	UK
Financial accounting net income/(loss)	8,750	190,000	322,500
Dividend income received			(155,000)
Total taxes expense (inc Deferred?)	1,250		32,500
Gains on >10% sub			(50,000)
Deferred gains on reorganisations			
Aysymmetric forex gains or losses			
Prior period errors or changes in accounting policy			
Accrued pension expense			
Transfer pricing adjustment		(10,000)	10,000
GloBE Income	10,000	180,000	160,000

Adjusted covered taxes

	D	E	UK
Covered taxes			
Current tax expense	1,250		107,500
	1,250	0	107,500
Adjustments to covered taxes			
Additions or reductions			
Deferred tax adjustment			45,000
Uncertain tax position (general provision)			(25,000)
Taxes included in equity or OCI			
	0	0	20,000
Adjusted Covered Taxes	1,250	0	127,500

5) Calculate the **effective tax rate** ("ETR") by dividing the Adjusted Covered Taxes by the GloBE income

Effective tax rate (ETR) and top up tax

	D	E	UK
GloBE income	10,000	180,000	160,000
Adjusted Covered Taxes	1,250	0	127,500
Jurisdictional ETR	12.5%	0.0%	80%
Jurisdictional top up percentage	2.5%	15.0%	0.0%
Tangilbe assets	1,000	20,000	
Payroll expenses	1,000	10,000	
	2,000	30,000	
Adjustment to GloBe income (10% or 8%)	180	2,600	
Adjusted GloBe Income	9,820	177,400	
Top up tax (Adjusted GloBe Income x top up %)	246	26,610	0

6) If the ETR is less than 15% calculate the top-up percentage (15% less the jurisdictional ETR).

7) Calculate the top-up tax by adjusting GloBE income by a percentage which reduces over 10 years of tangible net assets (8% falling to 5%) + payroll (10% falling to 5%) and applying the top-up rate to the adjusted GloBE income.

8) Attribute the top up tax to entities in a jurisdiction by reference to their total contribution to profit (not required in this example as these jurisdictions only have one entity).

9) Attribute the top up tax under IIR wherever possible. Here all the top-up tax is allocated to ultimate parent company A assuming that the UK has implemented the IIR legislation and the local jurisdiction has not implemented the domestic minimum tax charge.

10) To the extent not all the top up tax is attributed under IIR, allocate the remainder under UTPR.

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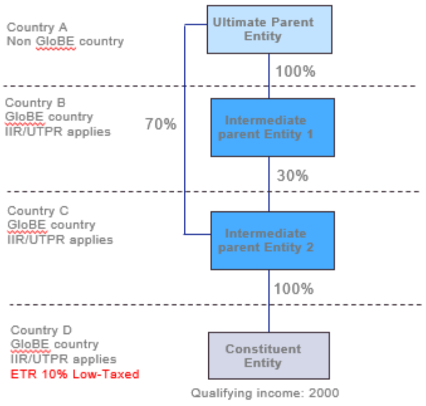
Application of IIR and UTPR

Scenario 1 – IIR



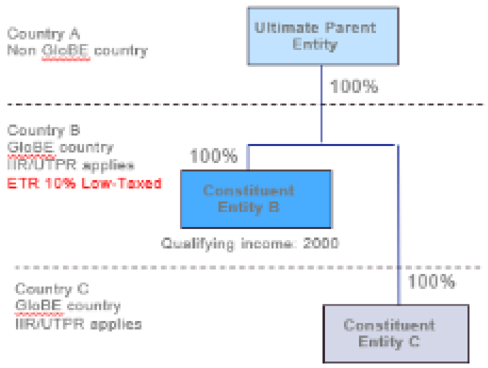
Ultimate parent company is located in a jurisdiction which is not a GloBE country and therefore IIR does not apply

Intermediate parent entity (IPE) 1 does not own a controlling interest in IPE 2 and therefore will apply for a reduction to top up tax (IIR offset mechanism).

IPE 2 owns a controlling interest in Trading Entity and is located in a GloBE country, therefore IPE 2 is subject to the IIR in relation to the Trading Entity.

Effective tax rate Country D: 10%
Top-up tax 100 = [2000 * (15% - 10%)]

Scenario 2 – UTPR



Ultimate parent company is located in a jurisdiction which is not a GloBE country and therefore IIR does not apply

Effective tax rate Country B: 10%
Top-up tax Country B: 100 = [2000 * (15% - 10%)]

Constituent Entity B and C are subject to UTPR top up tax of 100 in relation to Constituent Entity B.

Top up tax is allocated based on the number of employees and tangible assets.

UTPR implementation timing has not yet been agreed and may run later then currently scheduled in 2024.