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Tax & Legal

OECD publishes Global Anti-Base Erosion Model Rules (Pillar 2)

Introduction

On December 20, 2021 the OECD published the Global Anti-Base Erosion ('GloBE') Model Rules, also known as Pillar 2. These Model Rules form part of the so-called BEPS 2.0 Project and provide governments with a template for implementing the Pillar 2 agreement that was reached in October 2021 by 137 jurisdictions in the OECD/G20 BEPS Inclusive Framework. Further guidance in the form of a Commentary and a detailed implementation framework are expected in the first half of 2022.The aim is for participating jurisdictions to implement these rules during the course of 2022.

The GloBE Rules aim to impose a global minimum tax of 15% on multinational enterprises with a revenue in excess of EUR 750 million. In doing so, the effective tax rate has to be calculated in the jurisdiction where a multinational enterprise has a taxable presence. The starting point for calculating the effective tax rate is the Financial Accounting Net Income of an entity, with certain amendments. For the purposes of calculating the effective tax rate, the income tax reported in the financial statements, including the movements in the deferred tax position, is relevant.

The Pillar 2 rules include an Income Inclusion Rule ('IIR') and an Under-Taxed Payment Rule ('UTPR') that applies as a backstop in case and to the extent the low taxed income of a multinational enterprise ('MNE') is not taxed under the IIR rules. Under the Pillar 2 rules the effective tax rate ('ETR') of entities that are part of a multinational enterprise has to be calculated per jurisdiction where the entities are present or deemed to be present. To the extent the ETR of an entity is below 15%, a Top-Up Tax is charged under the IIR to the Ultimate Parent of the MNE Group. To the extent this Top-Up Tax is not effectively charged, jurisdictions that have adopted the UTPR rules may charge tax to entities located in their jurisdiction that have made deductible payments to low taxed group entities.

This memorandum provides a general overview of the Pillar 2 provisions. A more in-depth analysis authored by KPMG International member firms will follow shortly.

Scope of Global Minimum Tax rules

General

In general, the GloBE rules apply for a multinational enterprise where the consolidated MNE Group's revenue exceeds EUR 750 million. This is determined by looking at the consolidated financial statements. A single entity located in one jurisdiction which has a permanent establishment in another jurisdiction is also deemed to be a multinational enterprise when applying the test. There is a four-year test period to determine whether the threshold is met. This is generally the case if revenue of €750 million is exceeded in two of the previous four fiscal years. Special provisions deal with the application of the threshold in situations where groups are formed or broken up.

Excluded Entities
Certain organizations, entities or arrangements are excluded from the GloBE rules. These include Government Entities, International Organizations, Non-profit organizations, Pension Funds, Investment Funds that are Ultimate Parent Entities and Real Estate Investment Vehicles that are Ultimate Parent Entities. The exclusion also applies to certain entities held (in)directly by Excluded Entities, for example an entity that operates exclusively or almost exclusively to hold assets or invest funds for the benefit of the Excluded Entity or Entities or only carries out activities that are ancillary to those carried out by the Excluded Entity.

Income Inclusion Rule (IIR)

Top-down approach & Intermediate Parents
The GloBE rules are designed to ensure that large MNE's pay a minimum level of tax on the income arising in each jurisdiction in which they operate. The minimum level of tax is set at 15%. To this end, the rules calculate the ETR applying in each jurisdiction. Where the ETR in a jurisdiction falls beneath 15%, the IIR rules determine an amount of Top-Up Tax for each constituent entity in the jurisdiction.
The income inclusion rule (IIR) is the primary rule to impose this Top-Up Tax. Under the IIR, the Ultimate Parent Entity within the MNE group will pay the Top-Up Tax in its jurisdiction of tax residence, in respect its allocable share of the Top-Up Tax of a low-taxed constituent entity. Under the top-down approach, priority is given to the parent entity at the highest point in the ownership chain. Therefore, in a multi-tiered structure, where the Ultimate Parent Entity of the MNE group is subject to a qualified IIR (i.e. one conformant to the GloBE rules design), it will pay the IIR tax in respect of the Top-Up Tax of a low-taxed constituent entity, rather than an intermediate parent entity. Where the Ultimate Parent Entity is not subject to a qualified IIR, IIR taxing rights will 'drop' down to the jurisdiction of the intermediate parent entity beneath it, to the extent it applies a qualified IIR.
An exception to the top-down rules can apply where a low-taxed constituent entity has a significant (i.e. more than 20%) minority interest holder outside the MNE group. The split-ownership rules apply to address the potential for GloBE tax leakage that would result from simply subjecting the Ultimate Parent Entity's allocable share of the low-taxed constituent entity to IIR tax.

Covered Taxes
Covered taxes are defined to include taxes recorded in respect of a constituent entity's net income, as well as taxes in lieu of a corporate income tax, taxes imposed under eligible distribution tax systems and on retained earnings and corporate equity. Taxes that do not qualify as covered taxes include DSTs, property taxes, etc.

Computation of GloBE income

General
As a general rule, the GloBE Income or Loss of each constituent entity in a jurisdiction is the Financial Accounting Net Income or Loss determined for the constituent entity

for the Fiscal Year, adjusted for specific items of income or expense, such as dividends and capital gains relating to Non-Portfolio shareholdings, Policy Disallowed Expenses (such as fines exceeding EUR 50,000 and bribes); Prior Period Errors and Changes in Accounting Principles; and Accrued Pension Expense. Non-portfolio shareholdings are defined as shareholdings of 10% or more.
In the case of stock-based compensation, the amount allowed as a deduction in the computation of taxable income may upon request be applied instead of the amount expensed in the financial accounts.
The Model Rules include details about when "refundable" tax credits should be treated as income or a reduction in tax liability for purposes of the GloBE rules. In particular, "Qualified Refundable Tax Credits" are treated as income (with the result that the tax offset by the credits is still treated as tax expense), while other refundable tax credits are instead treated as offsets to tax expense in computing Adjusted Covered Taxes. Qualified Refundable Tax Credits are generally refundable tax credits paid as cash or cash equivalents within four years.
With respect to assets and liabilities that are subject to fair value or impairment accounting in the consolidated financial statements, it may be elected to determine gains and losses using the realization principle for purposes of computing GloBE Income.
Profits or losses included under the equity method of accounting are excluded from GloBE Income or Loss.
Adjustments to the income reported in the financial accounts may be necessary in order to address non-at arm's length situations or Deduction/Non-Inclusion situations.
The income of a constituent entity in a jurisdiction must be based on the financial income of that entity before any consolidation adjustments eliminating intra-group transactions. As an exception to this rule, an ultimate parent entity may elect to apply its consolidated accounting treatment to eliminate income, expense, gains, and losses from transactions between constituent entities that are located, and included in a tax consolidation group, in the same jurisdiction.
In the case of mergers, demergers, liquidations or similar transactions it may be possible to claim roll-over relief when calculating the GloBE income of the entities involved.

Qualifying International shipping income may be excluded from the computation of GloBE Income.

Substance-based Income Exclusion

The Net GloBE Income for a jurisdiction is reduced by a so-called Substance-based Income Exclusion. This consists of:

i. a payroll-exclusion amounting to 5% of Eligible Payroll Costs of Eligible Employees that perform activities for the MNE Group in such a jurisdiction (subject to exceptions); and
ii. a tangible asset exclusion amounting to 5% of the carrying value of Eligible Tangible Assets located in such a jurisdiction (subject to exceptions).

The payroll exclusion initially amounts to 10%. The percentage gradually declines over a 10-year period to 5%. The tangible asset exclusion initially amounts to 8%. The percentage gradually declines over a 10-year period to 5%.

Income allocation in the case of a PE and tax transparent entities
If an entity has a permanent establishment, the entity's income that relates to the PE is allocated to the jurisdiction where the PE is located. Specific income allocation rules also apply in the case of tax transparent entities.

Calculation of the ETR of a Jurisdiction

General
The GloBE rules prescribe that the ETR of the MNE Group for a jurisdiction is calculated for each Fiscal Year. The ETR of the MNE Group for a jurisdiction is equal to the sum of the Adjusted Covered Taxes of each constituent entity located in the jurisdiction (numerator) divided by the Net GloBE Income of all constituent entities of that jurisdiction for the Fiscal Year (denominator).
The Top-Up Tax Percentage is equal to 15% (the GloBE Minimum Rate) minus the ETR. The Top-up Tax for a jurisdiction (if any) is allocated to the constituent entities in the Low-Tax Jurisdiction in proportion to their GloBE Income. Finally, the resulting Top-up Tax of each low tax constituent entity is charged to a Parent Entity under the IIR, or, to the extent not picked up under the IIR, to Constituent Entities located in a UTPR Jurisdiction under the UTPR rules.

Calculation of the Adjusted Covered Taxes
The Adjusted Covered Taxes of a constituent entity for the Fiscal Year is equal to the current tax expense accrued in its financial accounts with respect to covered taxes for the Fiscal Year; the increase or decrease in covered taxes recorded in equity or other comprehensive income and covered taxes paid that relate to uncertain tax positions and adjusted for movements in the deferred tax position ('Total Deferred Tax Adjustment Amount'). Deferred tax expense accrued in the financial accounts is recast at the 15% Minimum Rate if the applicable tax rate is higher than 15%. Qualifying investment tax credits that have been recorded as a reduction to the current tax expense may be added back to the current tax expense. Current tax expense that is not expected to be paid within three years after the end of the Financial Year is disregarded. Current taxes and deferred taxes relating to income excluded from the computation of GloBE Income or Loss are not taken into account. The same applies to current tax expenses relating to an uncertain tax position. A deferred tax asset relating to an economic loss may be recalculated at the 15% Minimum Rate if the rate in the jurisdiction is lower than 15%. To the extent a deferred tax liability has been taken into account for the purposes of calculating the Adjusted Covered Tax and such an amount is not paid within the five subsequent Fiscal Years, the amount must be recaptured (subject to exceptions, for example in the case of R&D expenses and FX results). In certain specific situations, Covered Taxes that have been recorded in the financial accounts of a constituent entity should be re-allocated either in part or in whole to another constituent entity irrespective of the jurisdiction in which this entity is a resident. This could apply for

example in respect of taxes at the level of a controlling entity that relates to passive CFC income, in the case of PEs or in the case of tax transparent entities.

GloBE Loss Election
Instead of calculating and applying the Total Deferred Tax Adjustment Amount, a filing constituent entity may, subject to certain conditions, make a GloBE Loss Election for a jurisdiction. This results in a GloBE Loss Deferred Tax Asset in each Fiscal Year in which there is a net GloBE Loss for all of the constituent entitles of the MNE Group in the jurisdiction. This may be particularly relevant for no/low tax jurisdictions.
The GloBE Loss Deferred Tax Asset is equal to the net GloBE Loss in a Fiscal Year of all the constituent entities of the MNE Group in the jurisdiction multiplied by the 15% Minimum Rate. The unused balance of the GloBE Loss Deferred Tax Asset is carried forward to subsequent Fiscal Years.

De minimis exclusion
Upon request and subject to conditions, the Top-up Tax for the constituent entities located in a jurisdiction is deemed to be zero for a Fiscal Year if, for such a Fiscal Year:

i. the Average GloBE Revenue of such jurisdiction is less than EUR 10 million; and
ii. the Average GloBE Income or Loss of such jurisdiction is a loss or is less than EUR 1 million.

Under-Taxed Payment Rule (UTPR)

The UTPR operates as a backstop to the IIR, to be applied where insufficient Top-Up Tax is taxed under the IIR. Central to the application of the UTPR is the determination of the Total UTPR Top-Up Tax Amount. This is an aggregate 'pool' of all the Total Top-Up Tax of low-taxed constituent entities, across the MNE group, which is not adequately taxed by the IIR or otherwise excluded. Under the UTPR, constituent entities of an MNE Group resident in a jurisdiction that has adopted the UTPR regime into law, will be denied a deduction (or required to make an equivalent adjustment under domestic law) in an amount, resulting in those constituent entities having an additional cash tax expense equal to the UTPR Top-up Tax Amount for the Fiscal Year allocated to that jurisdiction.
The Total UTPR Total Top-Up Tax Amount is allocated over jurisdictions in which the MNE has constituent entities, and which have adopted the UTPR into law (UTPR jurisdictions). It is left open to the tax authorities of UTPR jurisdictions how they go about ensuring that the constituent entities in their jurisdiction have an additional cash tax expense equal to the allocation for the fiscal year. This could be by way of denial of tax deductions (of any type), deemed taxable income, or a new tax.
The allocation mechanism for the Total UTPR Total Top-Up Tax Amount references the relative 'substance' of constituent entities in UTPR jurisdictions. A given jurisdiction's UTPR Percentage (i.e. the share they are allocated of the Total UTPR Total Top-Up Tax Amount) is determined by calculating (i) the jurisdiction's number of employees as a proportion of the total employees in UTPR jurisdictions, and (ii) the value of the tangible assets in the jurisdiction as a proportion of the total value of tangible assets in all UTPR

jurisdictions. Each of these proportions is given a 50% weighting when determining the UTPR percentage.
The Top-Up Tax is reduced to zero during the initial phase of an MNE Group's international activity. Generally, an MNE Group is in its initial phase of its international activity if, for a Fiscal Year, it has constituent entities in no more than six jurisdictions; and the sum of the Net Book Values of Tangible Assets of all constituent entities located in all jurisdictions does not exceed EUR 50 million.

Other provisions

The Model Rules include detailed provisions regarding corporate restructurings and holding/joint venture structures (Chapter 6); Tax neutrality and distribution regimes (Chapter 7); Administrative and filing requirements (Chapter 8); Transition rules (Chapter 9) and Definitions (Chapter 10). In this memorandum we will not elaborate further on these detailed provisions. The Pillar 2 rules currently do not provide for any adjustments that could arise from the Pillar 1 rules.

Comments by KPMG Meijburg & Co

The Netherlands government fully supports the BEPS 2.0 project. The government expects to raise a substantial amount of additional corporate income taxes on the basis of the Pillar 2 rules. It is not yet clear how the rules will be included in the current Netherlands tax regime. In this respect it is also relevant how the EU will respond. The European Commission is expected to publish a proposal for a Pillar 2 implementing EU Directive on December 22, 2021. The OECD is set to provide more guidance in the form of a Commentary and a Pillar 2 implementation framework during the course of 2022 and, moreover, publish a model provision for a Subject to Tax Rule together with a multilateral instrument for implementation in 2022. The OECD also announced that public consultations will be held in the first quarter of 2022. Clients should start analyzing the impact of the rules on their current structure and potentially prepare to engage in the public consultations.

In its press release the OECD notes that the Commentary (to be published in early 2022) will address co-existence of Pillar Two and United States (US) Global Intangible Low-Taxed Income (GILTI) rules. Recent legislative developments in the US where the Build Back Better bill, among other things proposing to align GILTI to Pillar Two standards, could not (yet) be adopted could raise questions about potential impact on the Pillar Two global consensus. Given the work still to be done at OECD and EU level, it remains to be seen whether the rules could already take effect as from 2023.

The BEPS 2.0 Project also contains a so-called Pillar One solution, providing for new profit allocation and nexus rules for MNEs with worldwide revenue greater than EUR 20 billion and profitability above 10%. The Pillar One Model Rules for domestic legislation and accompanying Multilateral Convention are expected early in 2022.

KPMG Meijburg & Co
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The information contained in this memorandum is of a general nature and does not address the specific circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.