PILLAR TWO:
GloBE Minimum Tax

A&M | TAX
GLOBAL TAX FORUM
NAVIGATING AN ERA OF CHANGE 2024

Who We Are...

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A Global Minimum Tax System with a Common Tax Base?

Pillar Two

Essentially it is a convergence to commonality across jurisdictions rather than a common global set of rules and tax base. In March 2011, the EU proposed a concept called the common consolidated corporate tax base (CCCTB). 10 years later in December 2021 the GloBE Model Rules are issued. There is a common base emerging where multiple jurisdictions can tax multinationals upon the same income and impose domestic taxes which are designed to limit tax competition. The result is a very complex work in progress with a reliance on new domestic legislation, implementation with some retroactive effect and prospective peer reviews. Of the two largest economies in the world; the US is not participating, and China has shown no involvement at all.

The Global Stage

1 January 2024 the OECD Model Rules (IRR and QDMTT) are in force for c.25 countries, mainly EU, UK, ASIAPAC

Outside the EU the UTPR is often deferred, and with a broad 1-year tax rate extension

Other jurisdictions are reviewing:

United Arab Emirates, Singapore in 2025

Jersey, Guernsey, Bermuda are under consideration

There is significant domestic law risk for the next 2-3 years

Under Taxed Profits Rule – impact:

India and China signed the Inclusive Framework; no further developments

US, Brazil, Cayman no implementation

Compliance and Planning is made complex by lack of consolidation of the rules (Model Rules Dec 2021, Commentary March 2022, Safe Harbour Dec 2022, Administrative Guidance (Feb, July, Dec 2023)

Pillar Two Snap Shots

Scope

Who is in and who is out

Every MNC group in the world above the threshold; Find your consolidated group: Constituent Entities, UPE, POPE, JV, MOCE and Stateless

Transition

2024 to 2027

Pre-Transition Years, Safe Harbours and Elections

Info

Data & Quantitative Analysis

Tracking transactions since Nov 2021 > First year of rules

Nature of intra-group transactions; Hybrids, Tax incentives, Elections to be made

Hot spots

Areas of concern

Safe Harbours; M&A, W&I, Deferred Tax recapture; Tax Credits, Financing structures, Sandwich structures

The Charging Mechanics of Pillar Two

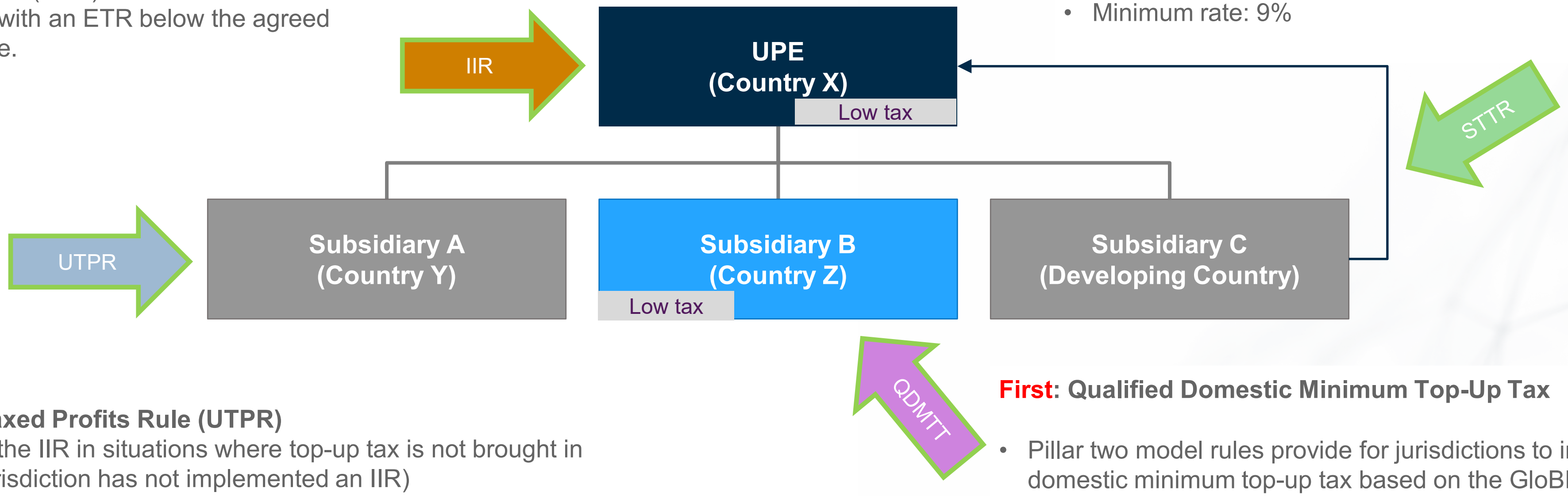
Basic ordering of taxes of the Global Minimum tax and the Subject to Tax rule

Before the GMT: Subject to tax rule (STTR)

- Not in the GMT ordering
- STTR creditable as covered tax under GloBE rules – it is a tax not a credit against GloBE Top Up tax
- Amends the Treaty-based rule for low GDP source countries to impose limited source taxation on certain covered related party payments subject to tax below agreed minimum rate
- Interest, royalties and a defined set of other payments
- Minimum rate: 9%

Second: Income Inclusion Rule (IIR)

- A Top-Up Tax is imposed at the level of the ultimate parent (UPE) for constituent entities in jurisdictions with an ETR below the agreed minimum rate.



First: Qualified Domestic Minimum Top-Up Tax

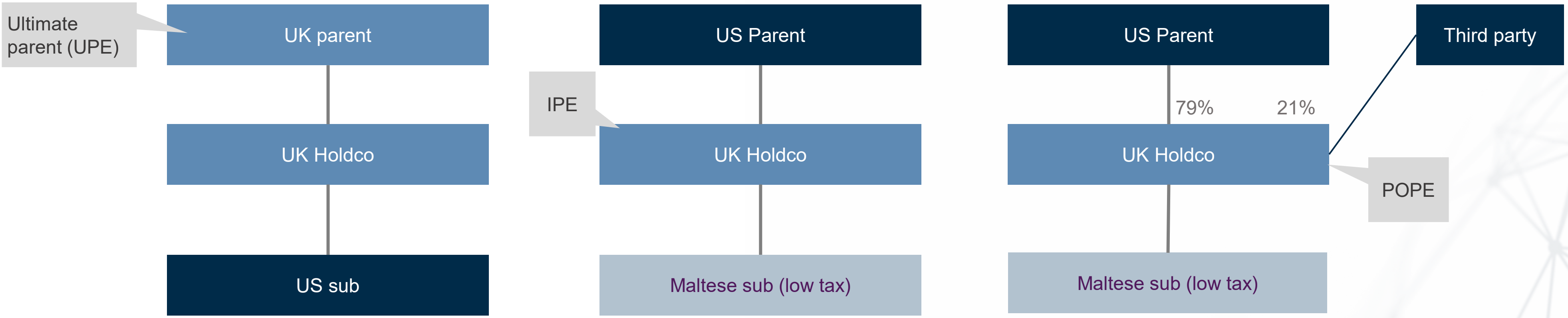
- Pillar two model rules provide for jurisdictions to introduce their own domestic minimum top-up tax based on the GloBE rules
- Direction of travel – expect jurisdictions to implement so that they retain taxing rights over income arising in their jurisdiction
- QDMTT permanent Safe Harbour – switches off IIR/UTPR if domestic Safe Harbour is qualifying

Third: Undertaxed Profits Rule (UTPR)

- Backstop to the IIR in situations where top-up tax is not brought in (i.e., UPE jurisdiction has not implemented an IIR)
- A high degree of controversy and may be subject to legal challenge

Scope for Pillar Two

Basics – Are you in scope



Qualifying multinational group

- Members in UK and another territory
- More than EUR 750m Revenue in two of previous four accounting periods
- Ultimate parent is UK parent

Intermediate parent member (IPM)

UK Holdco is IPM here as:

- US parent not expected to apply a Pillar Two IIR tax; and
- Top-up tax amounts due on profits of Maltese sub

Partially-owned parent member (POPM)

UK Holdco is a POPM here as:

- Third party has at least a 20% ownership interest in UK Holdco; and
- UK Holdco owns another group member.

Pillar Two Hot Spots

Areas of Concern

Safe Harbours Article 8 & AG	*Part-Owned Entities* Article 2	*M&A and W&I considerations* Article 4 & 6 (and others)
Reorgs & Intragroup Transfers Article 6	*Domestic Implementation and Tax incentives* AG	*Financing Arrangements* UK Domestic

Traps for the unwary (1)

Are Safe Harbours the “North Star” for the Transition Period?

Fact Pattern

- The transitional Safe Harbours are a temporary measure to simplify the 2024-2027 compliance obligation of preparing full Pillar Two calculations.
- It applies for years beginning on or before December 31, 2026, i.e., three years for most groups.
- There are three transitional Safe Harbours: simplified ETR test, routine profits test, and de minimis test. 5 insights you should know
- The Transitional CbCR Safe Harbour is available only if the taxpayer prepares a “Qualified CbC Report.”
- A Qualified CbC Report is one prepared using Qualified Financial Statements.

Concern

- Not all jurisdictions in the MNE group will meet the Safe Harbour tests.
- Commercial transactions can kick you out.
- “Once out, always out” rule.
- Claim the Perm 20% rate Safe Harbour and out of CbCR Safe Harbour.
- No Safe Harbour for new joiners in 2027
- Assess future transactions that will be impacted by the requirement to disallow stepped-up basis during the transitional period to determine whether to elect Safe Harbour for relevant jurisdiction and delay or forgo stepped-up basis for qualifying transfers.
- PBT in a Qualified CbCR is likely to include items that are treated differently under the Model Rules – and so two sets of calculations may be needed to determine the ETR under the Transitional CbCR Safe Harbor test to be lower or higher than under the GloBE rules.

Traps for the unwary (1+)

Comparison Transitional CbCR Safe Harbour v Model Rules (and Domestic Top Up Tax rules)

Income and Tax terms	Model Rules	Transitional CbCR Safe Harbor
Transfer Pricing adjustments	Adjustments may fall into post-filing adjustments to Covered Tax	Post year end adjustments disqualify the Safe Harbour
Hybrid Arrangements	Subject to on going process and may include the Transitional Safe Harbour provisions	Common structures may be caught by differences between tax and accounting treatment
Purchase Price Accounting	Relevant to CbCR Safe Harbour	Qualified CbCR may include the effect of purchase price accounting (PPA) adjustments relating to the purchase of shares, subject to consistency requirements
CFC tax push down	Complex CFC allocation (especially for blended CFC regimes)	Follow the qualified financial statements
PE tax allocation	Complex PE allocation	Follow the qualified financial statements

Traps for the unwary (1+)

Comparison Transitional CbCR Safe Harbour v Model Rules (and Domestic Top Up Tax rules)

Income and Tax terms	Model Rules	Transitional CbCR Safe Harbor
Dividend Income	Excluded, and all taxes reallocated to the paying entity	Excluded where received from constituent entities and treated as dividend in payor's jurisdiction.
Realized gains and losses on shares	Excluded	Included, per the qualified financial statements
Unrealised gains and losses on shares	Excluded	Included per the qualified financial statements (but then Excluded if greater than €50m)
Deferred Tax 15% calibration	Recalibrate to 15%	Follow the qualified financial statements
Deferred tax on Pre-Transitional Year transactions	Amended as per Article 9.1	Follow the qualified financial statements
Deferred tax 5 year recapture	Excluded by Article 4.4	Follow the qualified financial statements

Traps for the unwary (1+)

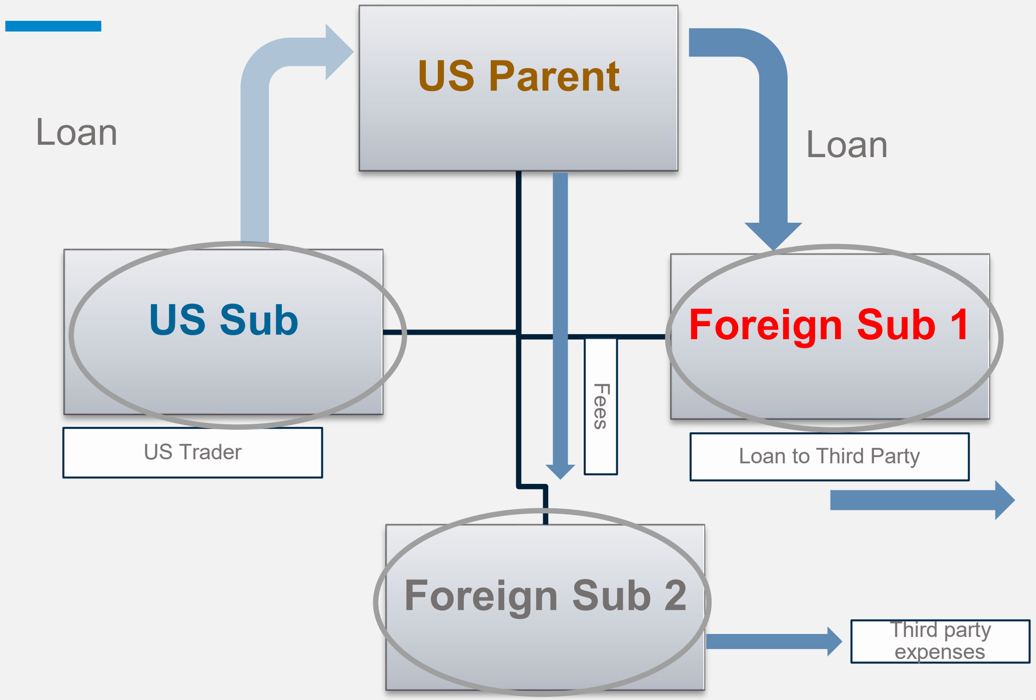
Comparison Transitional CbCR Safe Harbour v Model Rules (and Domestic Top Up Tax rules)

Income and Tax terms	Model Rules	Transitional CbCR Safe Harbor
Employee share / stock remuneration charges	Adjustment	Follow the qualified financial statements
Tax Consolidation	Adjustment	Follow the qualified financial statements
Valuation Allowances	Excluded	Follow the qualified financial statements
Equity Method Income/Loss	Excluded	Follow the qualified financial statements
Uncertain tax provisions	Excluded	Excluded
Other taxes, not defined as Covered Taxes	Excluded	Excluded

Traps for the unwary (2)

CbCR Safe Harbour Hybrid Arrangements

Fact Pattern



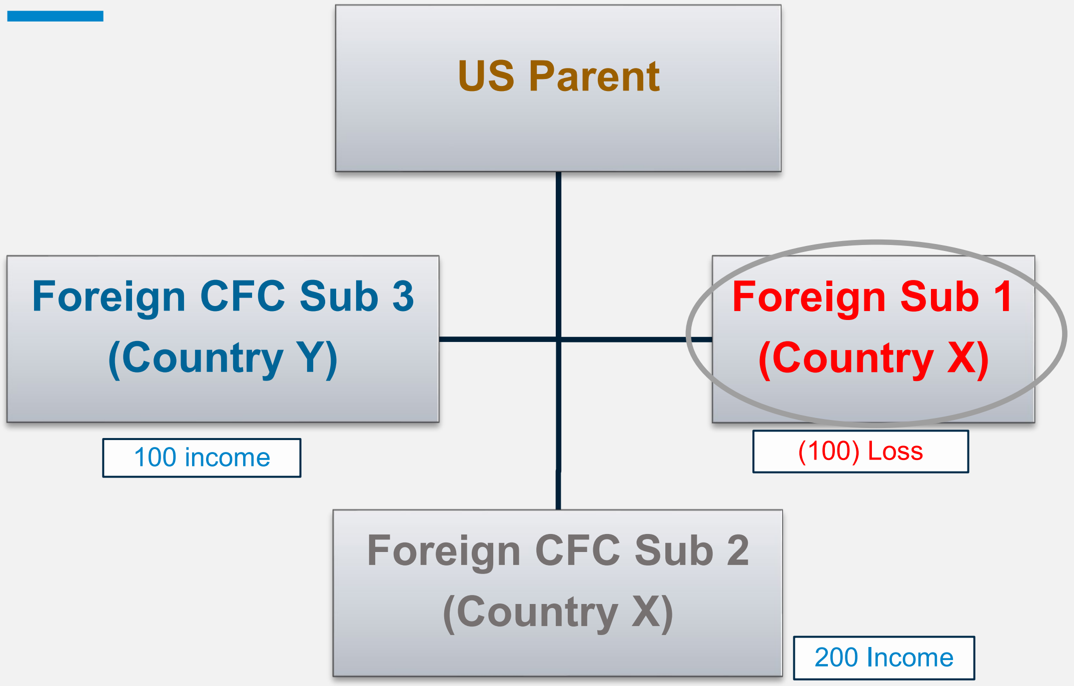
Concern

- US Sub is a Deduction, No Inclusion for CbCR purposes as the debt is disregarded. Deny the deduction for the Safe Harbour ETR.
- Foreign Sub 1 is a Deduction, No Inclusion for CbCR purposes as the debt is disregarded. Deny the deduction for the Safe Harbour ETR. Loan interest income is included in the safe harbour calculation with no Covered Tax. Another level of interest income is recognized in the US.
- Foreign Sub 2 is a Duplicate Loss Arrangement and there is no dual inclusion as the fees are disregarded for the US.
- **UTPR** transitional Safe Harbour for a low taxed UPE with no QDMTT and there is a subsidiary with a UTPR (e.g. an EU sub) +++
- This election switches off the CbCR transitional Safe Harbour for the UPE.

Traps for the unwary (2)

CbCR Safe Harbour Hybrid Arrangements – Impact on DCLs

Fact Pattern



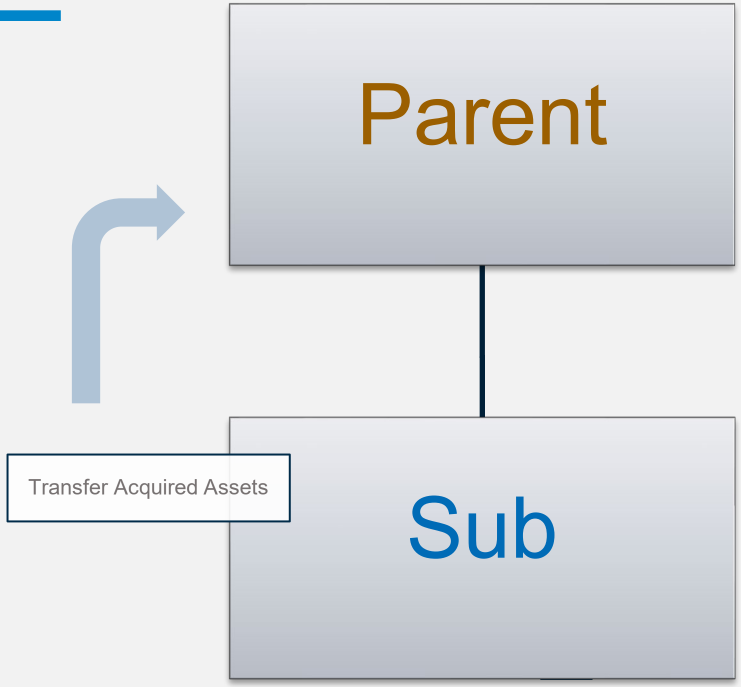
Concern

- A dual consolidated loss ("DCL") attributable to a separate unit cannot be deducted against taxable income of the domestic owner unless there is separate SRLY attributable to the unit or a domestic use election is made in the taxable year in which the DCL is not put to a foreign use and there are no triggering events.
- Does the jurisdictional blending result in a "foreign use" for purposes of the DCL rules?
- Can USP make a domestic use election with respect to Country X's DCL? Does the use of the 100 DCL constitute foreign use when it is used to reduce income for transitional safe harbour or for computation for top up tax computation
- Notice 2023-80 provides that inclusion of any item of deduction or loss comprising a 'legacy DCL' in Net GloBE Income for a particular jurisdiction will not, by itself, trigger a foreign use of such legacy DCL. However, the Notice does not provide guidance on how a foreign use should be assessed in the context of Pillar 2 for DCLs incurred in future years, nor whether the hybrid arbitrage arrangement rules constitute mirror legislation.

Traps for the unwary (3)

Asset Transfers and Globe Reorganizations

Fact Pattern



Concern

- Simple post deal rationalization
- Where the transfer is part of a ‘GloBE Reorganization’, any gain & loss is excluded in computing the entity’s GloBE Income or Loss (Article 6.3.2).
- A transfer of assets is not a ‘GloBE Reorganization’, and so the gain would be tax free under domestic law yet included in the CbCR income and ETR.
- If large enough this could disqualify the jurisdiction form the CbCR Safe Harbour
- Where the transfer is part of a ‘GloBE Reorganization’ but a Non-qualifying gain or loss arises, the gain or loss is recognized only up to the extent of the Non-qualifying gain or loss in computing its GloBE income or loss (Article 6.3.3).

Traps for the unwary (4)

Mergers & Acquisitions - Joining and leaving a MNE Group

Fact Pattern

- Certain bidders can have a competitive advantage, considerations for buy-and build strategy.

Key diligence and transaction documentation factors:

- Buyers to seek protection from historic risks – e.g. impact of transitional rules that may come alive due to the acquisition. As time progresses Pillar 2 will become more of an historic item as well (outside of the transitional rules).
- Impact of acquisition vehicle type and location.
- Impact of fund structure above.
- Links to business structures and very fact specific
    - 50/50 Joints Ventures,
    - POPEs (Partially Owned Parent Entities)
    - MOECs (minority Owned Parent Entities)

Concern

- Protection against future liabilities – fact specific whether/how SPA protection is included:
    - Specific warranties and indemnities in relation to Pillar 2, such as whether the parties have made or will make any elections or disclosures
    - Dealing with prior year adjustments under Pillar 2 (when no prior year repayments will be available)and statute of limitations
    - Confirmation re compliance with, or future compliance with any reporting or payment obligations under those rules.
- Secondary liabilities in relation to Pillar 2 may apply to acquired entities.
- Access to information (SPA item), e.g., data points for Pillar 2 calculations may be unavailable at the time of the transaction (post-close item).
- Risk allocation is key. Early days how W&I underwriters will approach Pillar 2, especially change in law risk as domestic rules come on stream over the next 2-3 years

Traps for the unwary (4)

Mergers & Acquisitions - Joining and leaving a MNE Group

Fact Pattern

Pillar 2 and tax modelling

- Information required to calculate potential Pillar 2 exposures may be detailed / complex.

Purchase price accounting adjustments

- Acquisition of US LLC
- Section 338 election of US Target

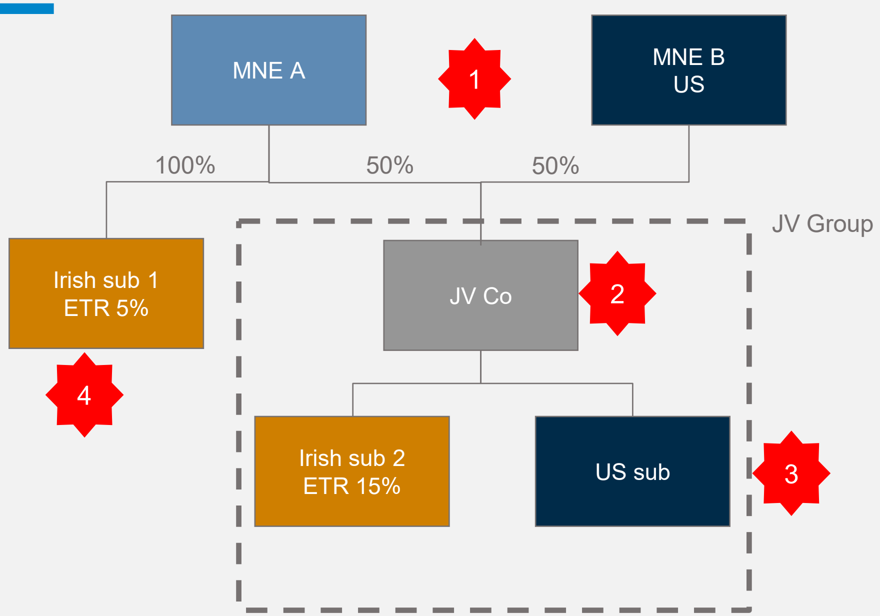
Concern

- Impact of acquisition vehicle type and location.
- Impact of fund structure above.
- Links to business structures and very fact specific
  - 50/50 Joints Ventures,
  - POPEs (Partially Owned Parent Entities)
  - MOECs (minority Owned Parent Entities)
- Consider impact of purchase price accounting adjustments.

Traps for the unwary (5)

Joint Venture Ownership structures - 50/50 JV

Fact Pattern



Special rules for transitional Safe Harbour

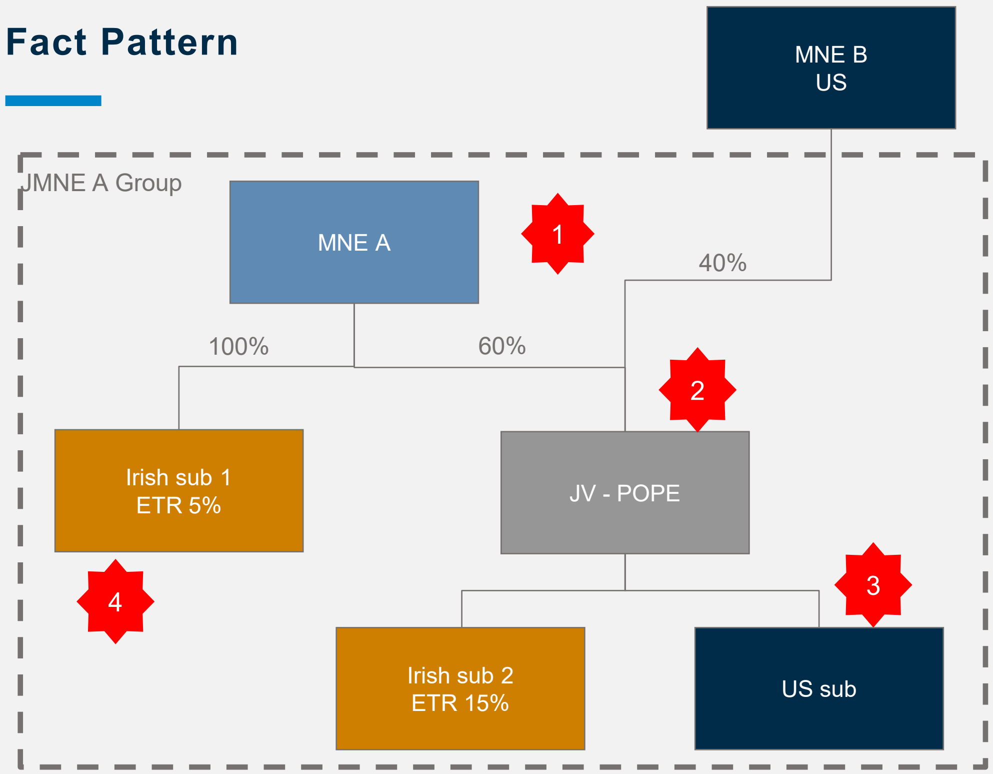
Concern

1. MNE A & MNE B collect Top Up Tax of JV Co Group via IIR
2. JV is 50% held by each investor & not consolidated on a line-by-line basis.
3. JV Group and subs treated as a separate MNE Group for Top Up Tax calculations & Transitional CbCR Safe Harbour
   - If the JV entity is subject to a Pillar 2 Top Up Tax, or is subject to an adjustment as a result of the under-tax payments rules, who should bear the additional tax liability?
   - The parties may agree to shift the risk and the cost to one or more parties where the risk only arises because of that party's, tax residence, or attributes.
4. No jurisdictional blending for Irish sub 1 & Irish sub 2.

Traps for the unwary (6)

Joint Venture Ownership structures - POPE

Fact Pattern



Concern

1 MNE A consolidates POPE on a line-by-line basis

- MNE A collects Top Up Tax of POPE via IIR
- POPE collects Top Up Tax of POPE subs via IIR

2 POPE and subs treated as part of MNE Group A for Top Up Tax calculations & Transitional CbCR Safe Harbour.

- If MNE resides in a non-Pillar 2 jurisdiction could result in the jurisdiction of the JV becoming entitled to levy a Top Up Tax.
- Pro-rata impact on minority JV partner
- Possible over-ride by QDMTT in POPE jurisdiction

3 Jurisdictional blending between MNE A and JV Co

- Jurisdictional blending for Irish sub 1 & Irish sub 2
- Data access

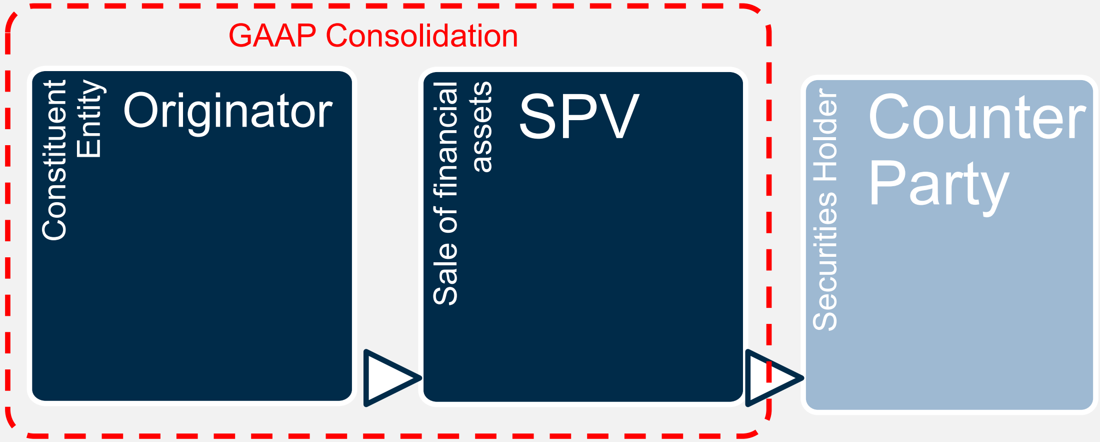
4 Risk of Top Up Tax in Irish sub 2 caused by low ETR in Irish sub 1

Traps for the unwary (7)

Financing Arrangements

Fact Pattern

- When considering the consolidated accounts of an originator who has securitised assets you will normally consolidate the SPV and get the following position:



Concern

- Many securitizations may fail to qualify for accounting derecognition and are therefore consolidated within the MNE group for Pillar Two purposes despite being orphaned from a legal standpoint.
- Many domestic tax regimes provide for bespoke treatment for limited recourse securitization arrangements (Luxembourg, Ireland, UK) such that they recognize tax on very small cash margins and not volatile accounting results e.g. those arising from swaps or other hedging arrangements accounted for on a fair value basis though p/l or aspects where Pillar Two imposes an arm’s length result not required under domestic tax law.
- Now anyone holding even a junior tranche of securities issued by the SPV could consolidate – this leaves a lot to think about as if the SPV has a GloBE ETR below 15% it can be liable for the Top up Tax, or it might be liable for the taxes of other MNE group entities. Any tax claim is a significant issue for the SPV.
- This is not dealt with in the Model Rules or Guidance.
- The UK has determined the only GloBE compliant solution is to exclude such SPV from the scope of the Domestic Top up Tax.

Traps for the unwary (8)

The IIR sandwich

Fact Pattern

- A US sandwich could have a significant impact where an intermediate entity has an Income Inclusion Rule (“IIR”) in effect for 2024
- Applies also for other non-GloBE adoptees eg. Brazil.
- Non-GloBE MNEs often assume Pillar 2 can effectively be ignored in 2024 in respect of their home jurisdiction income as UTPR will not come on stream until 2025 (earliest).
- This broadly correct unless there is a sandwich structure (or a Permanent Establishment) of a foreign affiliate that is in the GloBE rules in 2024
- And worse, this may trigger transition into the Pillar 2 regime in 2024. Tax attributes (credits and deferred tax assets) are brought in at 15% at 1 Jan 2024.

Concern

- The MNE home jurisdiction will need to be included in the GloBE Information Return to some extent.
- MNE calculates the Simplified ETR or Routine Profits test for the entire home jurisdiction in 2024, to determine whether the CbCR Safe Harbour applies.
- This is highly recommended ….
- If the home jurisdiction income is not eligible for the Transitional Safe Harbour a full Pillar 2 ETR calculation would be required …..
- … with much more extensive GIR information even if the actual Top-Up-Tax is small due to the **UTPR Safe Harbour**…
- … plus, the value of deferred tax and tax credit attributes created in 2024 (and 2025) would effectively be lost, if and when the full GloBE Model Rules apply to the home jurisdiction.

Traps for the unwary (9)

Application to credits in the US

Fact Pattern

- Pillar 2 rules provide two different treatments for tax credits: inclusion in the computation of Worldwide Income or Loss OR a reduction of ‘Covered Taxes’.
- Application is largely determined by reference to the local rules applicable to that specific credit.
- If an IRA credit can only be claimed as an offset of the entity’s tax liability in a given period, it should in principle be treated as a reduction of Covered Taxes.
- IRA credits for which a cash refund can be obtained within 4 years may qualify as a ‘Qualifying’ Refundable Tax Credits, which are treated as income. We understand that only tax-exempt entities are eligible for a refund as well as certain IRA credits by election: Section 45X advanced manufacturing credits, 45V production of clean hydrogen credits, and 45Q carbon oxide sequestration credits.
- IRA credits for which a cash refund can be obtained after 4 years of being eligible may qualify as a Non-Qualified’ Refundable Tax Credits, which reduce Covered Taxes.
- If an IRA credit can be sold to unrelated parties, it may qualify as a ‘Transferable Tax Credit (TTC)’. A ‘Marketable’ TTC is included in the worldwide income or loss, whereas a Non-Marketable TTC is treated as a reduction of Covered Taxes. Whether the Marketability condition is met depends on facts.

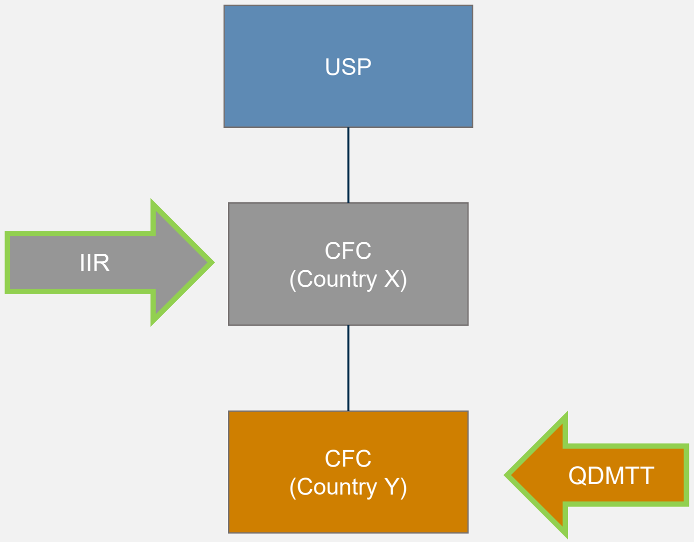
Concern

- If US group entities subject to Pillar 2 benefit from tax credits in the US, such as the R&D tax credit, general business credits, and/or the IRA renewable energy tax credits this can cause the ETR for Pillar 2 purposes to decrease.
- A Qualifying Refundable Tax Credit generally gives rise to a more beneficial outcome under Pillar 2.
- The treatment of a qualifying transferable tax credits as similar to Qualifying Refundable Tax Credits is generally good news for US groups that benefit from IRA renewable energy transferable tax credits.
- It is important to analyze the qualification of tax credits to determine the ETR in the US. Application is largely determined by reference to the local rules applicable to that specific credit.

Traps for the unwary (10)

Impact on US foreign tax credits

Fact Pattern



Concern

- Certain Pilar 2 taxes are not creditable under U.S. tax rules.
- If CFC in Country X owes taxes on IRR where the computation of IRR takes into account USP's U.S. tax liability that relates to income subject to IRR is not creditable under Notice 2023-80.
- However, if CFC in Country Y imposes QDMTT where U.S. tax liability of USP is not taken into account in computing QDMTT, the QDMTT paid by CFC in Country Y tax creditable by USP under section 960(d).
- In most cases, the Notice would disallow both an FTC and a deduction for IIRs and certain Domestic Minimum Top-up Taxes. No guidance provided for UTPRs.
- Future treasury regulations is expected to provide additional guidance.

Take-Aways

How does this unfold for you

Scope based on revenue threshold and structure

Scope is vital for many groups with non-linear corporate structures, volatile earnings and gains

Accounting considerations are crucial, and new territory for many groups

Private capital from Private Equity, Credit and Family Offices will need to focus on unfamiliar territory

Safe Harbours qualification

Transitional Safe Harbours intended to provide a runway into the Model Rules

There are many complexities with even these simplified approaches and high risk around qualification for Transitional Safe Harbours

Permanent Safe Harbours are not light touch. QDMTTs rely on peer review by fiscal authorities

QDMTT may be the long game

This is the core design element intended by OECD and are only slightly less complex than the Multinational Rules

Significant risk of higher taxes overall and for double tax due to interaction with CFC rules

QDMTTs are in effect a parallel domestic tax code that does allows for certain credits and incentives

Future is incentives and compliance and double taxation

The future is more complex with countries adopting none, some or all of the Model Rules

Transitional period for the GMT rules run continuously from November 2021 to the Transitional year (whenever this is ..)

Double tax is inevitable, as is tax competition in new forms

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