Pillar 2 Directive

Council Directive of 14 December 2022
on ensuring a global minimum level of taxation for
multinational enterprise groups and large-scale domestic groups
in the Union

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Brussels, 3 October 2023

Introductory remarks

G20 St. Petersburg September 2013

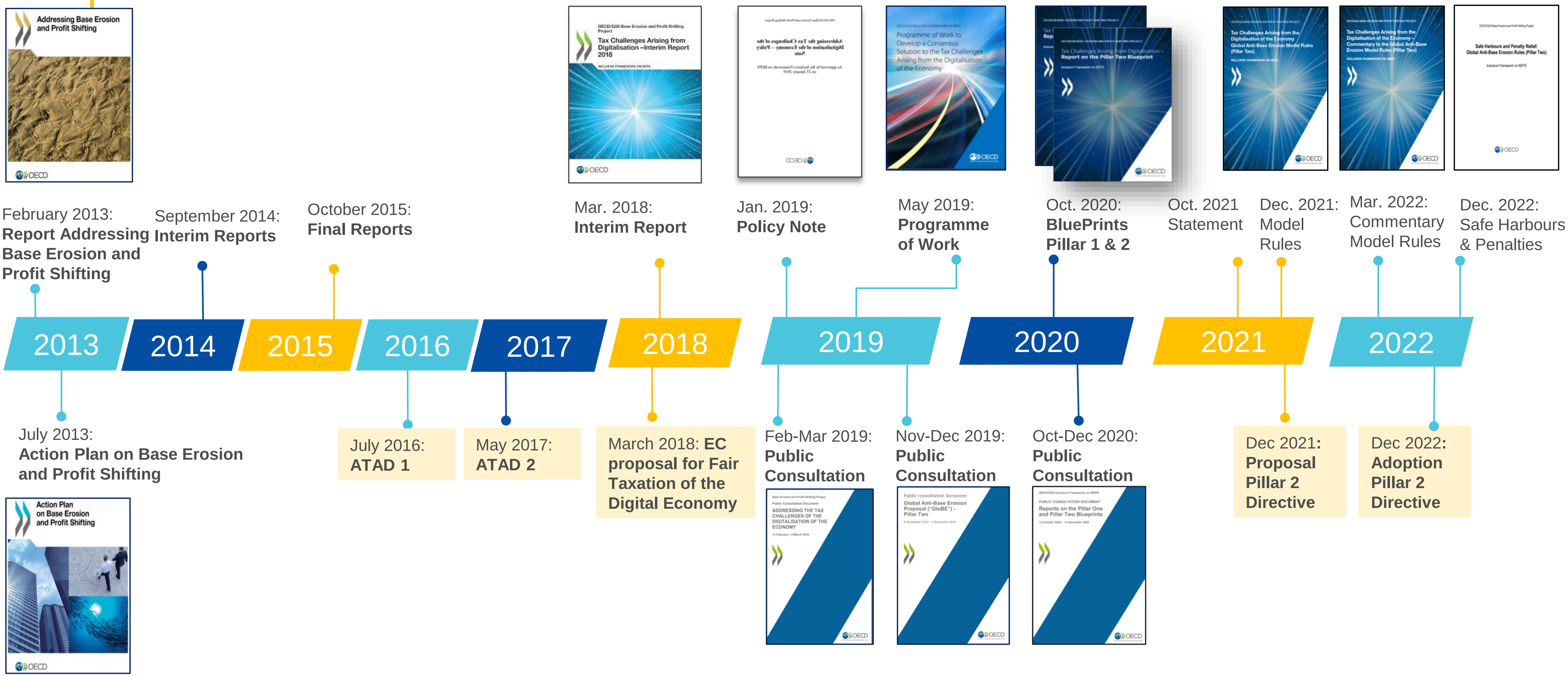
- **Addressing Base Erosion and Profit Shifting, Tackling Tax Avoidance, and Promoting Tax Transparency and Automatic Exchange of Information**

"50. *In a context of severe fiscal consolidation and social hardship, in many countries ensuring that all taxpayers pay their fair share of taxes is more than ever a priority. Tax avoidance, harmful practices and aggressive tax planning have to be tackled. The growth of the digital economy also poses challenges for international taxation.* ***We fully endorse the ambitious and comprehensive Action Plan – originated in the OECD – aimed at addressing base erosion and profit shifting with mechanism to enrich the Plan as appropriate. We welcome the establishment of the G20/OECD BEPS project and we encourage all interested countries to participate. Profits should be taxed where economic activities deriving the profits are performed and where value is created****. In order to minimize BEPS, we call on member countries to examine how our own domestic laws contribute to BEPS and to ensure that international and our own tax rules do not allow or encourage multinational enterprises to reduce overall taxes paid by artificially shifting profits to low-tax jurisdictions. We acknowledge that effective taxation of mobile income is one of the key challenges. We look forward to regular reporting on the development of proposals and recommendations to tackle the 15 issues identified in the Action Plan and commit to take the necessary individual and collective action with the paradigm of sovereignty taken into consideration.*"

Base Erosion and Profit Shifting (BEPS) – Background info

- **2012**: The issue gains visibility in the public opinion in the context of the global economic and financial crisis
- **2012-2013:**
  - Google, Starbucks e Amazon before the UK Parliament about their tax schemes (12 November 2012); (https://www.youtube.com/watch?v=VcZF_DxQ5cU)
  - Apple CEO before the US Congress (21 May 2013) (https://www.youtube.com/watch?v=Lx6YINOfjaQ)
- **2013** (February): First overarching **BEPS report** by OECD Secretariat
- **2013** (July)**: OECD BEPS Action Plan (15 actions)**
- **2013** (September) *endorsement* by G20 of the Action Plan
- **2015: OCSE/G20 BEPS Project** finalized
- **2016 - 2020:** Initially foreseen implementation

Pillar 2 – Timeline past



The 15 BEPS actions

1 - Address the Tax Challenges of the **Digital Economy** (2014);

2 - Neutralize the effects of **hybrid** mismatch arrangements (2014);

3 - Strengthen **CFC** rules (2015);

4 - Limit Base Erosion via **Interest Deductions** and other financial payments (2015);

5 - **Harmful tax practices (**transparency and substance) (2014-2015);

6 - Prevent **Treaty Abuse** (2014);

7 - Prevent the artificial avoidance of **PE** status (2015);

8 – TP 1: Intangibles (2014-2015);

9 – TP 2: Risks and Capital (2015);

10 – TP 3: Other High-risk transactions (2015);

11- Establish methodologies to collect and analyse data on BEPS (2015);

12 - Require taxpayers to disclose their aggressive tax planning arrangements (2015);

13 - Re-examine Transfer Pricing Documentation (2014);

14 - Make dispute resolution mechanisms more effective (2015);

15 - Develop a **Multilateral Instrument** (2014-2015).

Digital economy: request for more concrete results

- 8 October 2021: Agreement on a Two-Pillar solution (https://www.oecd.org/tax/beps/statement-on-a-two-pillar-solution-to-address-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-october-2021.pdf)

- **Pillar 1**
  - Re-allocation of some taxing rights over MNEs from their home countries to the markets where they have business activities and earn profits, regardless of whether firms there have a physical presence there. Outcome statement on 11 July 2023.

- **Pillar 2**
  - Puts a floor on competition over corporate income tax, through the introduction of a global minimum corporate tax rate (15%) that countries can use to protect their tax bases. *Global Anti-Base Erosion Model Rules* published on 20 December 2021.

Pillar 2 – Policy goals

➔ Ensure multinational enterprises (MNEs) will be subject to a **minimum tax rate of 15%**

Important **policy goals** Pillar 2:

- Dealt with **remaining BEPS challenges**
- Puts a floor on **excessive tax competition** between jurisdictions

Through so-called GloBE rules (IIR + UTPR)

Pillar 2 - Design elements EU Directive

- Point of departure **OECD Model Rules**

OECD elements

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- EU Directive is **legal instrument with specific design elements**
- Compliance with the **fundamental freedoms:**
  - application IIR to domestic low-taxed entities
  - application IIR to large-scale domestic groups

EU elements

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- Qualified Domestic Top-Up Tax (QDTT)
- Exceptions from the mandatory obligation of the IIR and UTPR
- Equivalence and Exchange of Information

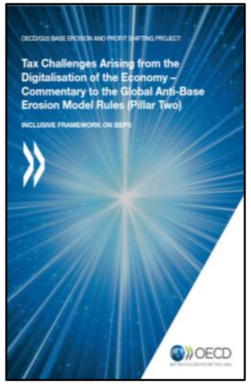
Other elements

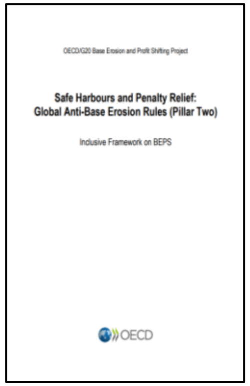
Interaction with OECD Model Rules and other related Documents

EU Pillar 2 Directive


DIRECTIVES

OECD Model Rules and other related Documents





Recital 24

"In implementing this Directive, Member States should use the OECD Model Rules and the explanations and examples in the Tax Challenges Arising from the Digitalisation of the Economy – Commentary to the Global Anti- Base Erosion Model Rules (Pillar Two) released by the OECD/G20 Inclusive Framework on BEPS, as well as the GloBE Implementation Framework, including its safe harbour rules, <u>as a source of illustration or interpretation in order to ensure consistency in application across Member States to the extent that those sources are consistent with this Directive and Union law</u>. Such safe harbour rules should be of relevance as regards MNE groups as well as large- scale domestic groups."

EU Pillar 2 Directive («P2D»)

- Chapter 1 **General Provisions**
- Chapter 2 **IIR and UTPR**
- Chapter 3 **Computation of the Qualifying Income or Loss**
- Chapter 4 **Computation of Adjusted Covered Taxes**
- Chapter 5 **Computation of the Effective Tax Rate and the Top-up Tax**
- Chapter 6 **Special rules for Corporate Restructuring and Holding Structures**
- Chapter 7 **Tax Neutrality and Distribution Regimes**
- Chapter 8 **Administrative Provision**
- Chapter 9 **Transition Rules**
- Chapter 10 **Final Provisions**

European Commission

General Provisions

Scope

Directive applies if:

1 Group requirement	• One or more Constituent Entities (CEs) located in the European Union that are members of an **MNE group** or a **large-scale domestic group**.
2 Revenue threshold	• An **annual revenue of at least 750 million euros** based on consolidated financial statements in at least 2 of the 4 consecutive fiscal years.
3 Location EU	• IIR: UPE, IPE or POPE is located in a EU MS • UTPR: CE is located in a EU MS and there is no qualifying IIR

Excluded Entities

No application Directive:

Excluded Entities

(a)	(b)	(c)
- Governmental entity; - International organisation; - Non-profit organisation; - Pension fund; - Investment entity that is UPE; - Real estate investment vehicle that is UPE	- Entity owned by one or more entities under (a), at a **minimum of 95%** and meets: i) Ownership test ii) Activities test	- Entity owned by one or more entities under (a), at **minimum of 85%** and primarily composed of excluded dividends or excluded equity gains or losses

Top-up tax

Calculation top-up tax

Top-up tax = (Top up tax % x Excess Profit) – Qualified Domestic Top-up Tax

Top up tax % =
15% - Effective Tax Rate

Excess Profit =
Qualifying Income - Substance-based income exclusion

Effective Tax Rate (ETR) = Covered Taxes / Qualifying Income

Covered Taxes:

- Starting point = **current tax expenses accrued in financial statements**
- Adjustments:
  i) bring taxes in line with **Pillar 2 purposes**
  ii) **allocation rules** for taxes
  iii) mechanism to address **temporary differences**
  iv) **Qualifying Loss Election**
  v) mechanism for **post-filing adjustments** and **tax rate changes**

Qualifying Income:

- Starting point = **financial accounting net income or loss**
- Adjustments:
  i) financial accounting income
  ii) exclusion **International Shipping**
  iii) **allocation rules** for income (relating to PE's, and Flow-through Entities)

International Shipping Income Exclusion

Excludes from the scope the profits from transportation of passengers or cargo by ships in international traffic

Based on the scope of **Article 8 OECD MC**

Exclusion also applies to certain **ancillary activities**. Must be performed primarily in connection with. Not exceed 50%.

Substance criterion to ensure that strategic or commercial management of ships is effectively carried on from jurisdiction where CE is located

Substance-based income exclusion

5% eligible payroll costs of eligible employees + 5% carrying value of eligible tangible assets

Eligible Payroll Costs not include:	Eligible Tangible Assets are:
• Costs that are capitalised an included in the carrying value of **Eligible Tangible Assets** • Costs related to **International Shipping Income**	• Property, plant and equipment; • Natural resources; • A lessee's right of use of tangible assets; • A licence or similar arrangement from the government for the use of immovable property or exploitation of natural resources that entails significant investment in tangible assets. Eligible Tangible Assets not include: • Carrying value of property that is held for **sale, lease or investment** • Carrying value of tangible assets related to **International Shipping Income**

- ➢ Special rules for allocation of Eligible Payroll Costs and Eligible Tangible Assets to **PEs and Flow-through Entities**
- ➢ **Investment entities** excluded and **stateless CEs** calculated separately.

IIR, UTPR and QD(M)TT

Pillar 2 – GloBE rules (IIR and UTPR)

GloBE Rules:
common measures for the minimum effective taxation in the form of:

Income Inclusion Rule (IIR)

- Imposing **top-up tax in respect of the low taxed income** of a constituent entity of an MNE group or a large-scale domestic group.

→ Application IIR by **the parent entity**

Undertaxed Payments Rule (UTPR)

- **Backstop to the IIR** and applies in situations where there is no qualifying IIR.

→ Application UTPR by **other constituent entities**

Income Inclusion Rule (IIR)

Application of the IIR by:

- **Ultimate Parent Entity (UPE):** an entity that owns a Controlling Interest in any other Entity and is not owned by another Entity
- **Intermediate Parent Entity (IPE):** CE that owns an Ownership Interest in another CE in the same MNE Group
- **Partially-Owned Parent Entity (POPE):** CE that owns an Ownership Interest in another CE of the same MNE Group and has more than 20% of the Ownership Interest in its profits held by third parties.

EU Fundamental Freedoms:

- IIR applies to **both domestic and foreign low-taxed CEs (**as well as to **large-scale domestic groups).**

Ordering rules:

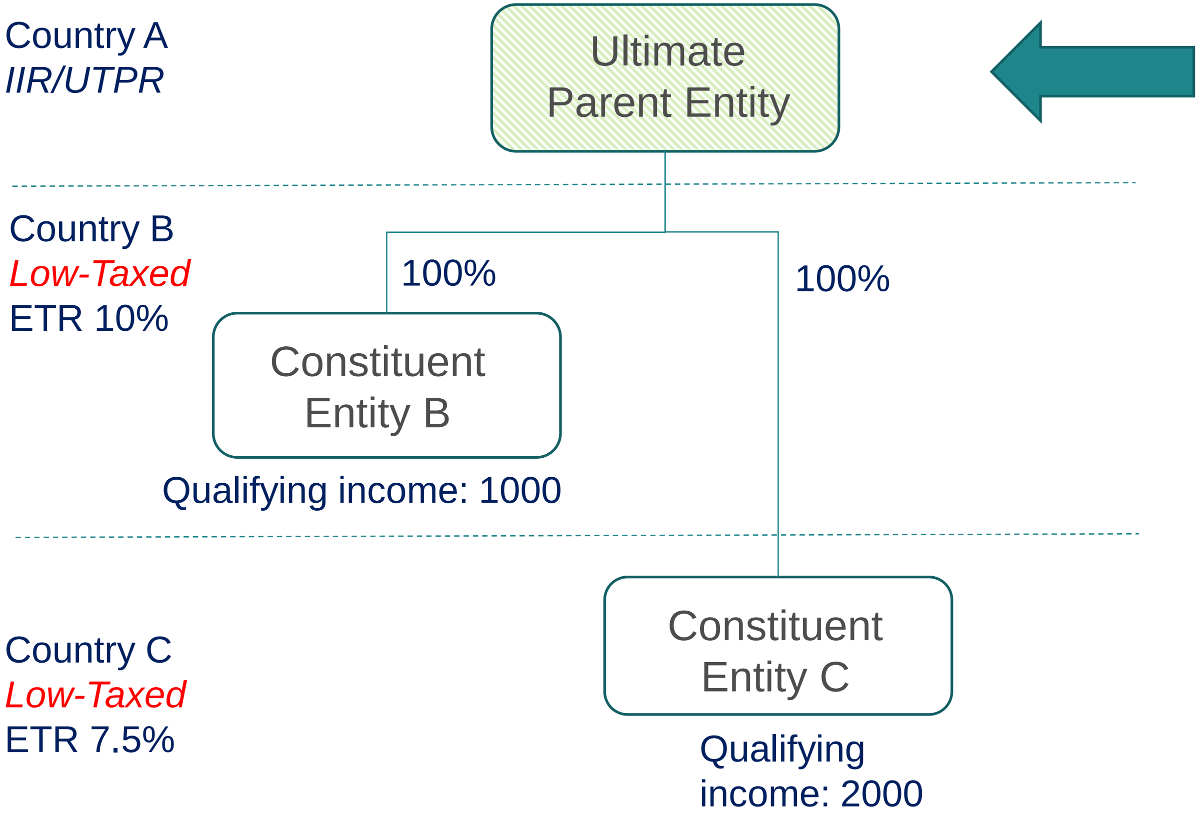
- **Top-down Approach:** give priority to the UPE or the IPE with the controlling interest at the top of the ownership chain to apply the IIR
- **Split-ownership:** push-down the primary obligation to apply the IIR to the POPE

Mechanisms:

- **Allocation:** top-up tax low-taxed CE multiplied by parent entity's allocable share in such top-up tax
- **IIR Offset Mechanism:** reduction of the Top-up Tax by an Upper-Tier Parent Entity where that amount has already brought into charge under a Qualified IIR applied by a Lower-Tier Parent Entity (so-called '*Bottom-up Approach*')

Income Inclusion Rule (IIR)

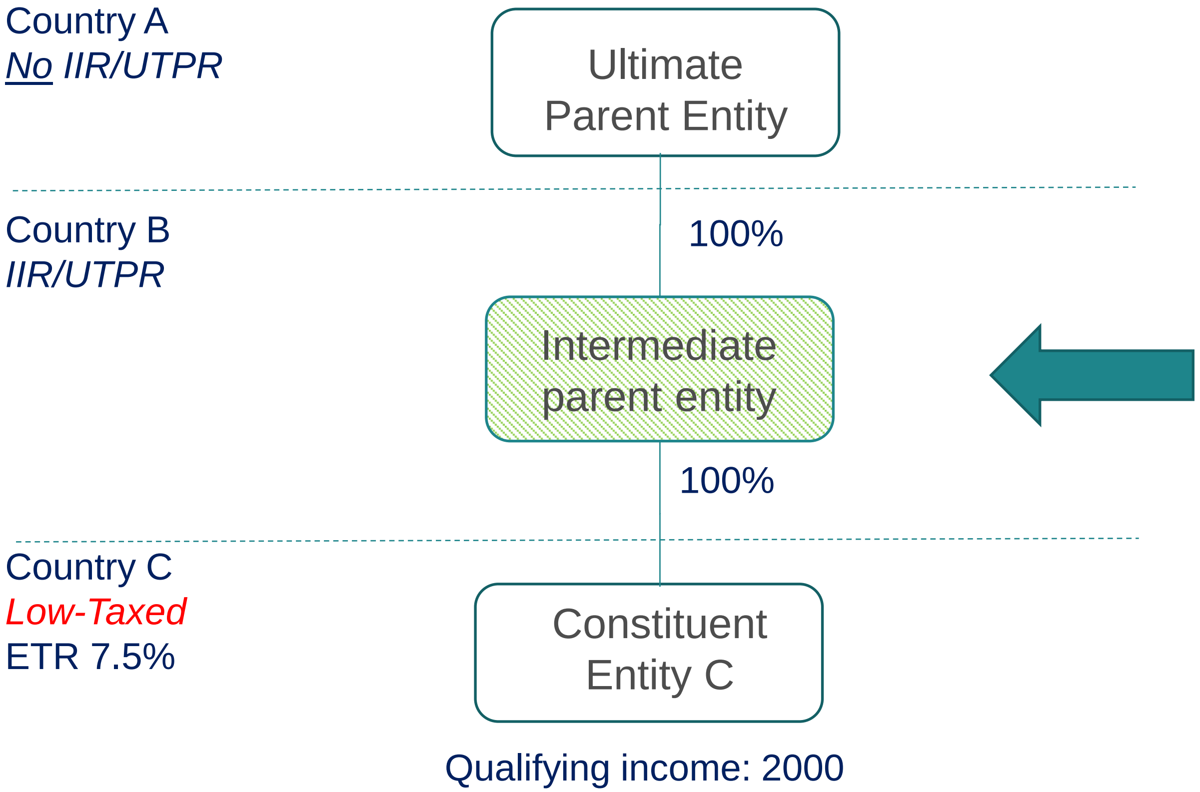
Example IIR:



- The UPE is located in a jurisdiction that applies the IIR
- **Effective tax rate** Country B: 10%
  Effective tax rate Country C: 7.5%
- **Top-up tax** Country B: 50
  [1000 * (15% - 10%)]
  Top-up tax Country C: 150
  [2000 * (15% - 7.5%)]
- **UPE is subject to the IIR in relation to CE B**: 50 **and CE C**: 150

Income Inclusion Rule (IIR)

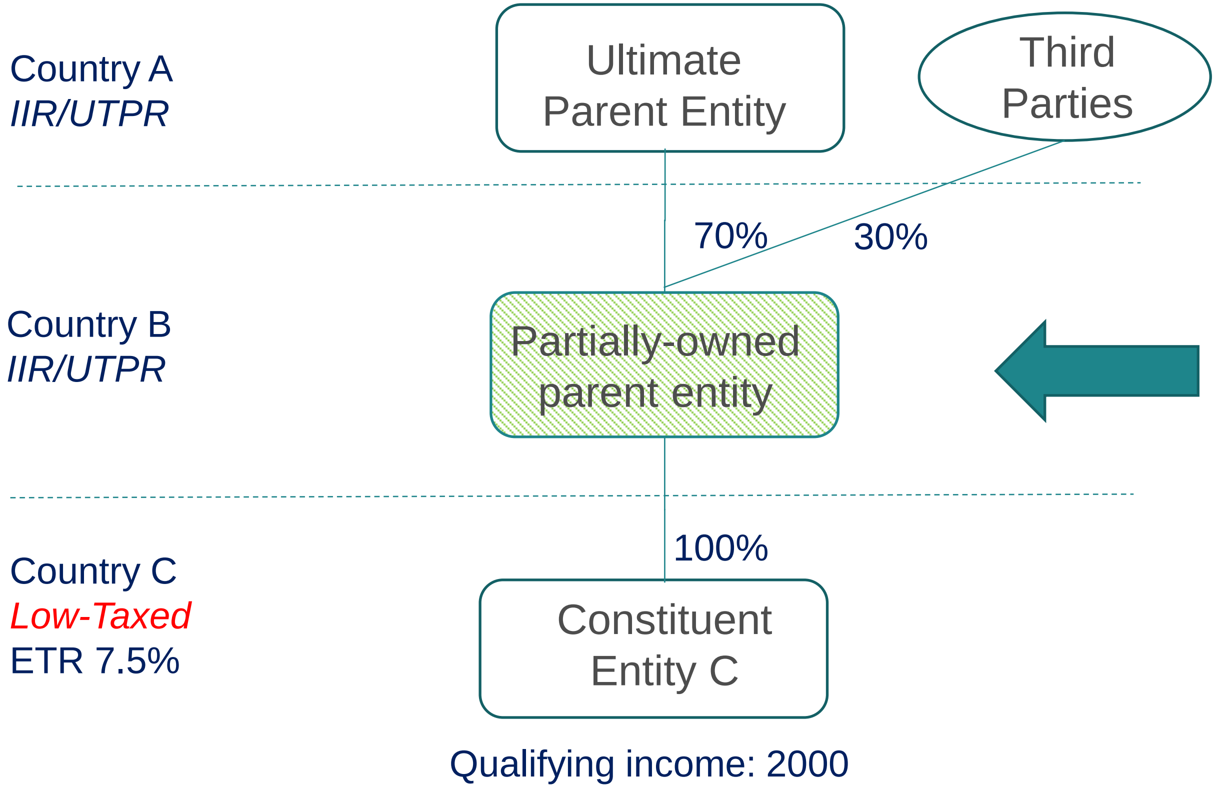
Example IIR – Intermediate parent entity (IPE):



- The UPE is located in a jurisdiction that does not apply the IIR
- **Effective tax rate** Country C: 7.5%
- **Top-up tax** Country C: 150
  [2000 * (15% - 7.5%)]
- **IPE is subject to the IIR in relation to CE C**: 150

Income Inclusion Rule (IIR)

Example IIR – Partially-owned parent entity (POPE):



- Through the **Split-ownership rule, not the UPE but** the POPE is subject to IIR top-up tax
- **Effective tax rate** Country C: 7.5%
- **Top-up tax** Country C: 150
  [2000 * (15% - 7.5%)]
- **POPE is subject to the IIR in relation to CE C**: 150

Under Taxed Payments Rule (UTPR)

Subject to the UTPR :

- CEs located in the EU in relation to (domestic or foreign) low-taxed CEs.
- Not apply to CEs that are an **Investment Entities.**

Ordering rules:

- Any top-up tax under Qualified IIR related to (domestic or foreign) low-taxed CEs will have priority.

Allocation mechanism:

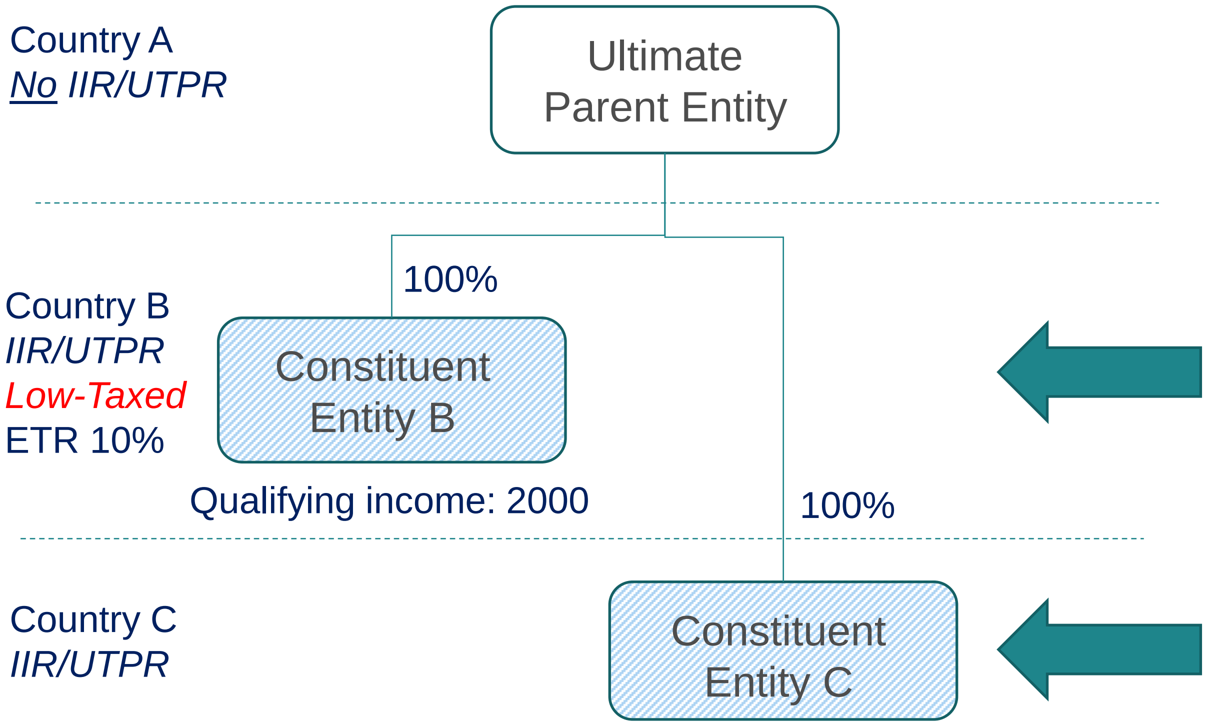
Inclusion Ratio:

- Allocation among the UTPR jurisdictions based on the **UTPR percentage:**

$$50\% \frac{\text{Number of Employees in the jurisdiction}}{\text{Number of Employees in all UTPR jurisdictions}} + 50\% \frac{\text{Tangible assets in the jurisdiction}}{\text{Tangible assets in all UTPR jurisdictions}}$$

Application of UTPR

Example UTPR across the Group:



- The UPE is located in a jurisdiction that **does not** apply the IIR
- **Effective Tax Rate** Country B: 10%
- **Top-up Tax** Country B: 100 [2000 * (15% - 10%)]
- CE B and CE C are subject to UTPR top-up tax of 100 in relation to CE B
- **Allocation** UTPR top-up tax 100 among CE B and CE C based on number of employees and tangible assets

European Commission

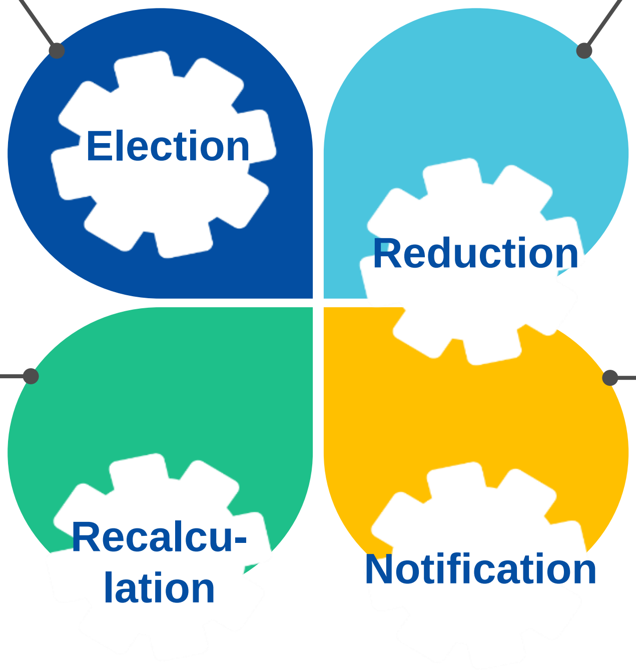
Qualified domestic top-up tax (QDTT)

1) Election

- Member State can **elect to apply the top-up tax domestically** to constituent entities located in their territory.

2) Reduction top-up tax

- The top-up tax shall be **reduced** by qualified domestic top-up tax.
- It provides that the **top-up tax could be charged locally**.



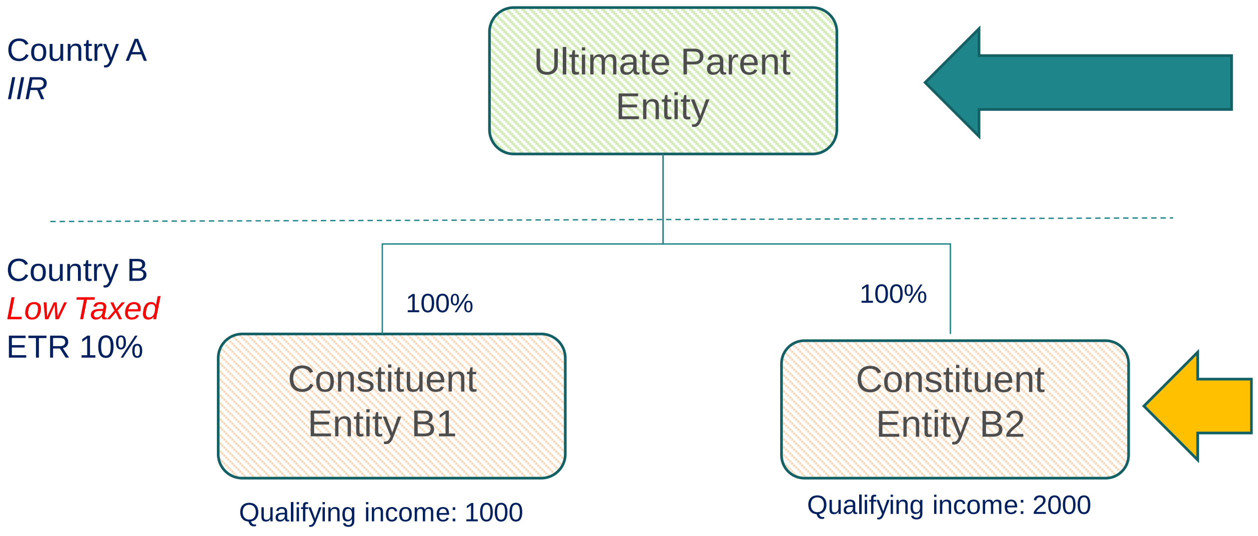
3) Recalculation

- If **not fully paid within the 4 following fiscal years**, the QDTT not paid shall be added to jurisdictional top-up tax.

4) Notification

- Member States shall notify the Commission of this election **within 4 months of the adoption of their national laws.**

Qualified domestic top-up tax (QDTT)



- The UPE is located in a jurisdiction that applies the IIR
- Country B applies the QDTT. CE B1 and CE B2 are **subject to QDTT** :
  - CE B1: EUR 50 (1000 * (15% - 10%))
  - CE B2: EUR 100 (2000 * (15% - 10%))
- UPE is subject to IIR top-up tax relating to CE B1 and CE B2. **The QDTT levied in Country B reduces the IIR top-up tax in Country A.**

Some other provisions

De *Minimis* Exclusion

The top-up tax of a jurisdiction shall be **equal to zero** for a fiscal year if:

- the average qualifying revenue of the CEs located in that jurisdiction is **less than EUR 10 000 000**; and
- the average qualifying income or loss of that jurisdiction is **less than EUR 1 000 000**.

- Take the **average** of the current and the two preceding years into account.
- At **election of Filing CE**
- Shall not apply to **stateless CEs or investment entities**

European Commission

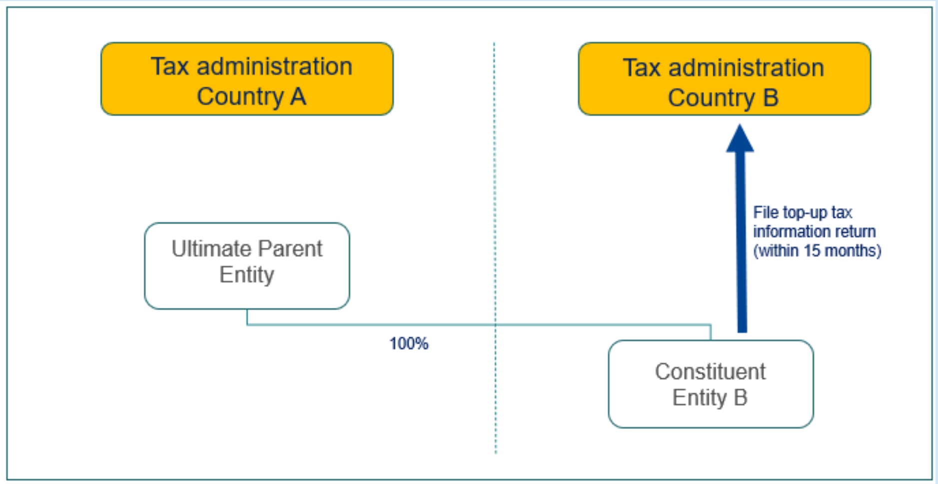
Safe Harbours

At the election of the filing CE, the top-up tax due shall be **deemed to be zero**, if the CE's fulfils the conditions of a **qualifying international agreement on Safe Harbours**

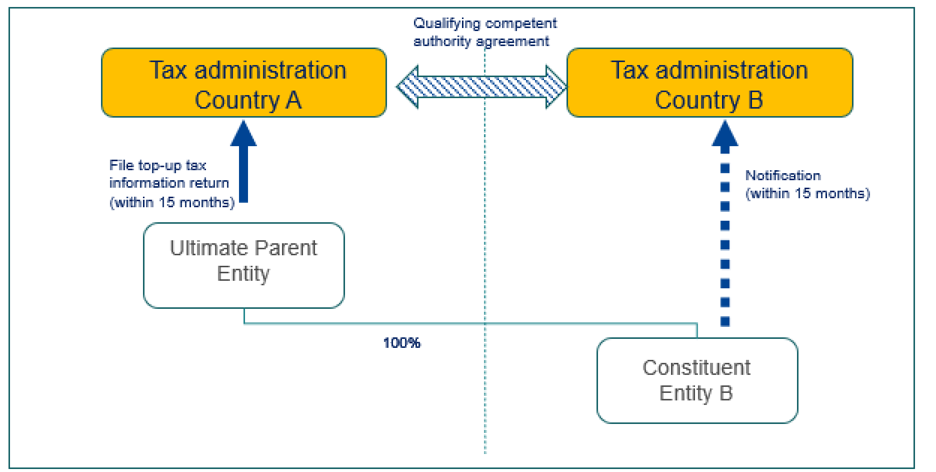
- On **20 December 2022**, the OECD issued the *Safe Harbours and Penalty Relief: Global Anti-Base Erosion Rules (Pillar Two).*
- This document includes details of two safe harbours and penalty relief for the Pillar Two GloBE rules.
- On 17 July 2023 other 2 Safe Harbours were agreed:
    - UTPR Safe Harbour
    - QDMTT Safe Harbour

Filing obligations (art. 44)

1. CE files top-up information tax return:



2. UPE or designated filing entity files top-up information tax return:



European Commission

Recent developments (July 2023)

Pillar Two – GloBE Rules

Overview of the GloBE Information Return

GloBE Information Return

- **Single, comprehensive return** which reduces the burdens of having multiple, differing or duplicative information requirements in each implementing jurisdiction
- **Transitional simplified reporting requirements** that allow MNEs to report their GloBE calculations at a jurisdictional level
- **Targeted dissemination approach** where the more detailed information is made available to implementing jurisdictions where a Top-up Tax liability may arise

Next steps - Administrative framework

- **Exchange of information**, XML Schema and Competent Authority Agreements
- **Administrative mechanisms** to facilitate coordination and consistent application of the GloBE Rules

Elections (art. 45)

Tax administration Country

File top-up tax information return
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Election

Filing Constituent Entity

Election

Election **five year period** as referred to in Articles 2(3), 16(3), 16(6), 16(9), 42 and 43.

Election **one year period** as referred to in Article 16(7), 22(1), 25(1), 28(2), 30(1) and 40(1).

Automatically renewed unless the filing CE revokes the election at the end of the period

Penalties (art. 46)

Breach of national rules adopted pursuant to this Directive

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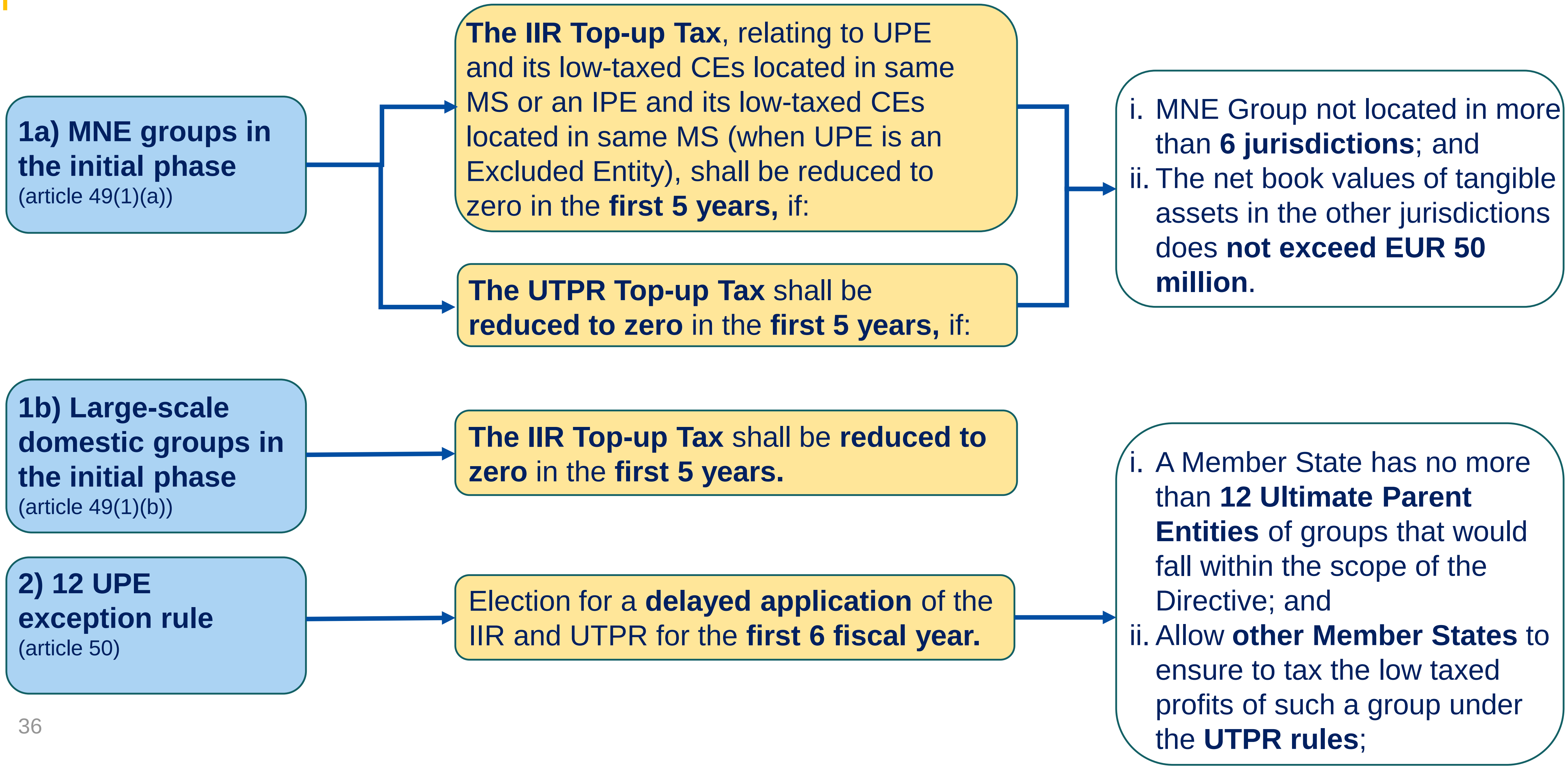
Penalties (Effective, proportionate and dissuasive)

Exceptions from the Mandatory Obligation of the IIR and UTPR

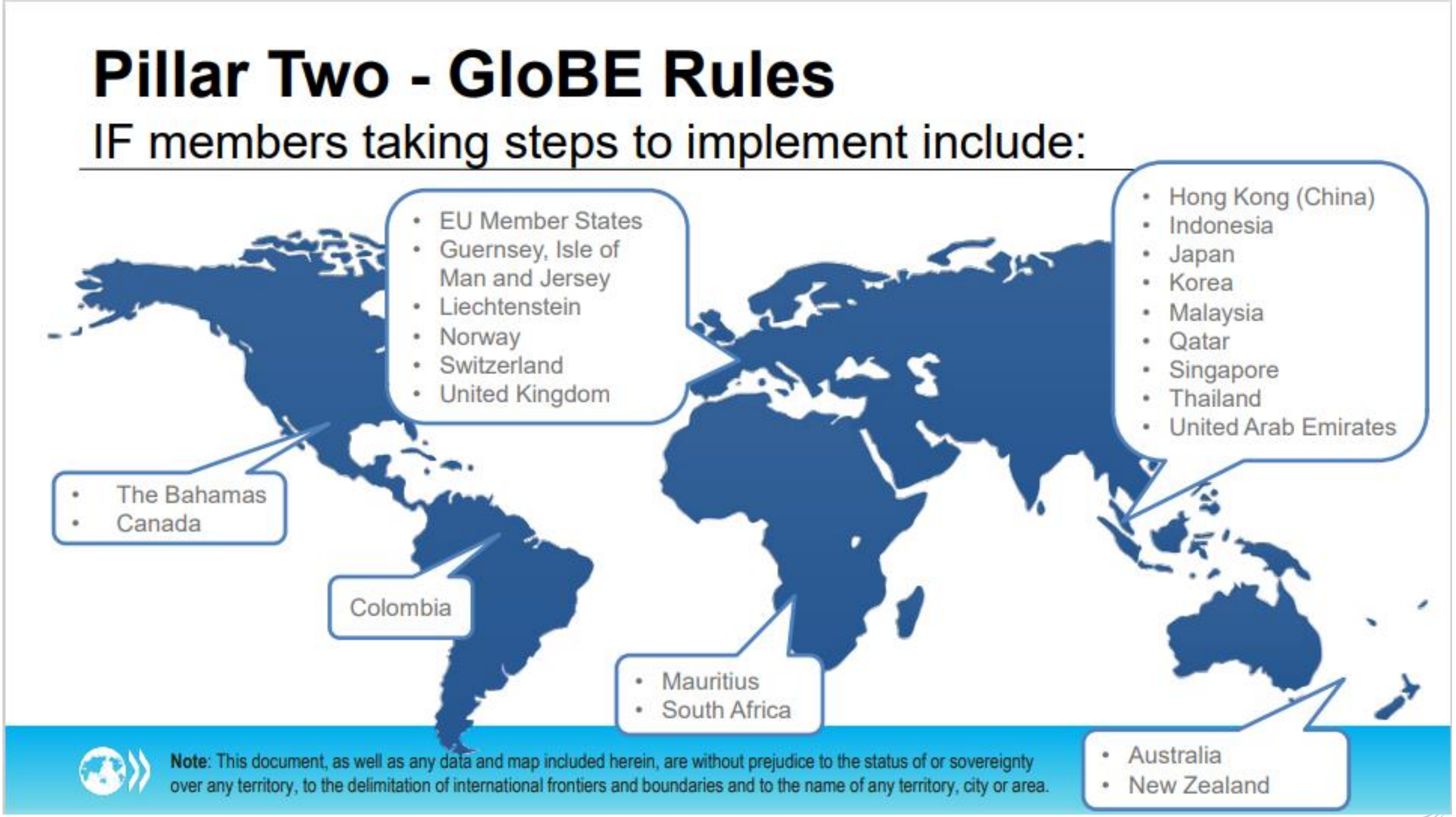


Equivalence and Exchange of Information

Conditions for equivalence (of a third-country jurisdiction) (article 52 Directive)**:**

i. Set of rules	Enforces a **set of rules** in accordance with which the parent entity of an MNE group shall **compute and collect** its allocable share of top-up tax in respect of the low-taxed constituent entities
ii. Rate	Establishes **a minimum effective tax rate of at least 15%** below which a constituent entity is considered as low-taxed
iii. Jurisdictional Blending	Only allows the blending of income of entities located within the same jurisdiction
iv. Relief	**Provides for relief for any top-up tax that was paid** in a Member State in application of the IIR

Implementation – state of play globally



Useful links OECD Documents

Document	Date	Weblink
• Pillar Two Model Rules	20 Dec. 2021	https://www.oecd-ilibrary.org/taxation/tax-challenges-arising-from-digitalisation-of-the-economy-global-anti-base-erosion-model-rules-pillar-two_782bac33-en
• Commentary to the Pillar Two Model Rules	14 Mar. 2022	https://www.oecd-ilibrary.org/taxation/tax-challenges-arising-from-the-digitalisation-of-the-economy-commentary-to-the-global-anti-base-erosion-model-rules-pillar-two-first-edition_1e0e9cd8-en
• Illustrative Examples	14 Mar. 2022	https://www.oecd.org/tax/beps/tax-challenges-arising-from-the-digitalisation-of-the-economy-global-anti-erosion-model-rules-pillar-two-examples.pdf
• Safe Harbours and Penalty Relief	20 Dec. 2022	https://www.oecd.org/tax/beps/safe-harbours-and-penalty-relief-global-anti-base-erosion-rules-pillar-two.pdf
• Public Consultation – GloBE Information Return	20 Dec. 2022	https://www.oecd.org/tax/beps/public-consultation-document-pillar-two-globe-information-return.pdf
• Public Consultation – Tax Certainty for the GloBE Rules	20 Dec. 2022	https://www.oecd.org/tax/beps/public-consultation-document-pillar-two-tax-certainty-for-the-globe-rules.pdf
• Administrative Guidance	2 Feb 2023	International tax reform: OECD releases technical guidance for implementation of the global minimum tax - OECD
• GloBE Information Return	17 Jul 2023	Tax Challenges Arising from the Digitalisation of the Economy – GloBE Information Return (Pillar Two) (oecd.org)
• Administrative Guidance (II)	17 Jul 2023	Tax Challenges Arising from the Digitalisation of the Economy – Administrative Guidance on the Global Anti-Base Erosion Model Rules (Pillar Two), July 2023 (oecd.org)