OECD “Pillar Two”: towards EU implementation

European Commission, Directorate General Taxation and Customs Union (DG TAXUD)

Commission Expert Group Platform for Tax Good Governance

Meeting of 8 December 2021
Timeline - past

- **February 2013:** Report Addressing Base Erosion and Profit Shifting
- **September 2014:** Interim Reports
- **October 2015:** Final Reports
- **March 2018:** ATAD 1
- **May 2017:** ATAD 2
- **March 2018:** EC proposal for Fair Taxation of the Digital Economy
- **January 2019:** Programme of Work
- **May 2019:** Interim Report
- **October 2020:** IF and Blue Prints Pillar 1 & 2
- **October 2020:** Statement 136 Countries
- **July 2014:** Action Plan on Base Erosion and Profit Shifting
- **July 2016:** ATAD 1
- **May 2017:** ATAD 2
- **March 2018:** ATAD 1
- **February-Mar 2019:** Public Consultation
- **November-Dec 2019:** Public Consultation
- **October-Dec 2020:** Public Consultation
- **July 2014:** Draft Directive
Ensure multinational enterprises (MNEs) will be subject to a **minimum tax rate of 15%**

**Important policy goals** Pillar 2:

- **Dealt with remaining BEPS challenges**
  - Through so-called GloBE rules (IIR + UTPR)

- **Puts a floor on excessive tax competition between jurisdictions**

- **Protect the rights of developing countries to certain base-eroding payments**
  - Through so-called STTR
## Timeline - future

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<td>EU Directive to implement GloBE Rules (IIR and UTPR)</td>
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<td>Coming into effect of the IIR; the UTPR coming into effect in 2024</td>
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Design elements of EU Directive to implement Pillar 2

- Point of departure: **OECD Model Rules & Commentary**

- **EU Directive** - legal instrument with specific design elements
- Compliance with the **fundamental freedoms** – application IIR to domestic entities too
- Option in the Model Rules for **Domestic Minimum Top-up Tax** will be addressed in the Directive

- Implementation Framework:
  - Administrative procedures
  - Safe Harbours
  - Conditions for US GILTI co-existence
Design elements Pillar 2
Pillar 2

Income Inclusion Rule (IIR)
- Imposing a **top-up tax** on a parent entity in respect of the low taxed income of a constituent entity of an MNE group

Undertaxed Payments Rule (UTPR)
- **Backstop** to the IIR and applies in situations where there is no qualifying IIR in the jurisdiction of the UPE
- **Exclusion of MNEs** with maximum EUR 50 million tangible assets abroad and operate in no more than 6 jurisdictions (for period of 5 years)

Subject to Tax Rule (STTR)
- Allows source jurisdictions to impose **limited source taxation** on certain related party payments that are subject to tax below a minimum rate

GloBE Rules → National legislation

Tax Treaties
The UPE is located in a jurisdiction that applies the IIR.

The agreed minimum tax rate is 15%.

UPE is subject to IIR top-up tax relating to CE B1 and CE B2:
- CE B1: EUR 50 \( (1000 \times (15\% - 10\%)) \)
- CE B2: EUR 100 \( (2000 \times (15\% - 10\%)) \)
Income Inclusion Rule (IIR) – ‘Bottom-up approach’ for IPEs

- The UPE is located in a jurisdiction that does not apply the IIR.
- The agreed minimum tax rate is 15%.
- CE B and CE C are considered as IPEs.
- Through the ‘Bottom-up approach’, CE C is subject to IIR top-up tax in respect of CE D1 and CE D2:
  - CE D1: EUR 50 \( (1000 \times (15\% - 10\%)) \)
  - CE D2: EUR 100 \( (2000 \times (15\% - 10\%)) \)
- CE B will apply the IIR Offset Mechanism.
Income Inclusion Rule (IIR) – Split-ownership rule

- The UPE is located in a jurisdiction that applies the IIR
- The agreed minimum tax rate is 15%
- CE C is a POPE
- Through the Split-ownership rule, CE C is subject to IIR top-up tax in respect of CE D1 and CE D2:
  - CE D1: EUR 50 \((1000 \times (15\% - 10\%))\)
  - CE D2: EUR 100 \((2000 \times (15\% - 10\%))\)
- UPE & CE B will apply the IIR Offset Mechanism
Under Taxed Payments Rule (UTPR)

- The UPE is located in a jurisdiction that does not apply the IIR
- The agreed minimum tax rate is 15%
- As there is no Qualified IIR, the UTPR applies as a 'backstop' rule
- CE B and CE C are subject to UTPR top-up tax in respect of (low-taxed) CE B:
  - CE B: EUR 50 \( (1000 \times (15\% - 10\%)) \)
- Allocation among CE B and CE C based on number of employees and tangible assets; UPE not entitled to a share of top-up tax
Operation of the GloBE rules in the EU
There is a MNE Group with a consolidated group revenue of EUR 750M or more.

**Identification taxpayer in EU**

**Situation 1**

The UPE, IPE or POPE is located in a EU Member State.

- Yes
- No

**Situation 2**

A CE is located in EU and the UPE, IPE and POPE are not subject to a qualifying IIR related to (domestic or foreign) low-taxed CEs

- Yes
- No

The ‘safe harbour’ provisions do not apply (expected Tax Administrative Guidance safe harbour or County-by-Country Report ETR safe harbour)

- Yes
- No

**Identification CEs in Low-taxed jurisdictions**

**Calculation taxable amount**

**Income Inclusion Rule (IIR)**

In Situation 1, based on EU Pillar 2 Directive the UPE, IPE or POPE located in EU is subject to the IIR.

Taxable amount under IIR = top-up tax – IIR Offset Mechanism

Nb. In Situation 2, the UPE, IPE and POPE could be subject to IIR in relation to the CE located in EU if it is low-taxed.

**Under Tax Payment Rule (UTPR)**

In Situation 2, based on EU Pillar 2 Directive the CE located in EU is subject to the UTPR as a backstop:

The taxable amount under UTPR = top-up tax that has not already been subject to an IIR

- Allocation based on the UTPR percentage:
  - Substantial assets in the jurisdiction (10%)
  - Tangible assets in the jurisdiction (5%)
  - Exclusion of MNE Groups in initial phase

**Calculation top-up tax:**

\[
((15\% \times \text{ETR}) \times (\text{Qualified Income} – \text{Substance-based income exclusion})) – \text{Domestic Minimum Top-up Tax}
\]

- Substantial-based income exclusion: excluding income equal to 5% tangible assets and 5% payroll.
- Domestic Minimum Top-up Tax: the top-up tax could be charged locally.
- The Minimis Exclusion: when profits in a jurisdiction are below EUR 1 million and revenues below EUR 10 million, the qualifying income is deemed to be zero.
1. Identification Taxpayer in EU

• The MNE Group has a combined group turnover of **at least 750 million euros** based on consolidated financial statements.

• **Excluded Entities** are not subject to the GloBE Rules: governmental entities, international organisations, non-profit organisations, pension funds, investment funds and real estate investment vehicles.

• **Application IIR**
  
  Situation 1
  UPE, IPE or POPE is located in a EU MS

• **Application UTPR**
  
  Situation 2a
  The UPE, IPE and POPE are located in a jurisdiction outside the EU with no qualifying IIR and a CE is located in EU.

  Situation 2b
  The UPE and low-taxed CE are located in the same jurisdiction outside the EU with/without a qualifying IIR and a CE is located in EU.
2. Identification CE’s in Low-Taxed Jurisdictions

ETR = \frac{\text{Covered Taxes}}{\text{Qualifying Income}}

- Qualifying Income:
  - Starting point = \text{financial accounting net income or loss}
  - Adjustments (in accordance with the tax policy objectives of Pillar Two):
    i) financial accounting income
    ii) exclusion \text{International Shipping}
    iii) allocation rules for income (relating to PE’s, and Flow-through Entities)

- Covered Taxes:
  - Broad definition and includes taxes imposed on income or profits as well as taxes that are functionally equivalent to such income tax
  - Starting point = \text{current tax expenses accrued in financial statements}
  - Adjustments:
    i) ensuring taxes in financial accounts are brought in line with taxes for \text{GloBE purposes}
    ii) allocation rules for taxes
    iii) mechanism to address \text{temporary differences}
    iv) \text{GloBE Loss Election}
    v) mechanism for \text{post-filing adjustments} and \text{tax rate changes}
2. Identification CE’s in Low-Taxed Jurisdictions

Country A (EU MS)
- Low Taxed
- IIR

Ultimate Parent Entity

Constituent Entity A

100%

Country B
- Low Taxed

Constituent Entity B

100%

Compatibility EU Fundamental Freedoms

IIR applies to both domestic and foreign low-taxed CEs.

Example: UPE is subject to IIR top-up tax in respect of both CE A and CE B as well as itself.
3. Calculation of Taxable Amount – Top-up Tax

- Calculation **Top-up Tax**: 
  
  \[ \left[ (15\% - \text{ETR}) \times (\text{Qualified Income} - \text{Substance-based income exclusion}) \right] - \text{Domestic Minimum Top-up Tax} \]

- **Substance-based Income Exclusion**: excluding income equal to 5% tangible assets and 5% payroll. Transitional rule for the first 10 years; 8% of the carrying value of tangible assets and 10% of payroll (declining annually 0.2 percentage points for the first five years, and 0.4 percentage points for tangible assets and 0.8 percentage points for payroll for the last five years).

- **Domestic Minimum Top-up Tax**: Effective tax based on GloBE rules included in domestic law of a jurisdiction. It provides that the top-up tax could be charged locally.

- **De Minimis Exclusion**: when profits of MNE groups’ constituent entities in a jurisdiction are below EUR 1 million while revenues below EUR 10 million, the qualifying income of the constituent entities in this jurisdiction is deemed to be zero. Take the average of the current and the two preceding years into account.
3. Calculation of Taxable Amount - IIR

- Calculation of taxable amount under **IIR**:  

  Top-up Tax – IIR Offset Mechanism

- **IIR Offset Mechanism**: The upper-tier Parent Entity reduces the Top-up Tax to the extent it has already been brought into charge under a qualified IIR applied by the lower-tier Parent Entity.
3. Calculation of Taxable Amount - UTPR

- Calculation of taxable amount under **UTPR**:  
  \[
  \text{Top-up Tax amount} \times \text{UTPR percentage}
  \]

- Any IIR top-up tax will have priority

- Allocation among the UTPR jurisdictions based on the **UTPR percentage**:
  \[
  \frac{50\% \times \text{Number of Employees in the jurisdiction}}{\text{Number of Employees in all UTPR jurisdictions}} + \frac{50\% \times \text{Tangible assets in the jurisdiction}}{\text{Tangible assets in all UTPR jurisdictions}}
  \]

- Exclusion **MNEs in initial phase**: the UTPR Top-up Tax shall be **reduced to zero** if the following conditions are met:
  i) MNE is not located in more than 6 jurisdictions;
  ii) The net book values of tangible assets in 5 of these jurisdictions does not exceed EUR 50 million; and
  iii) MNE is within the scope of the GloBE Rules for no more than 5 Fiscal Years.