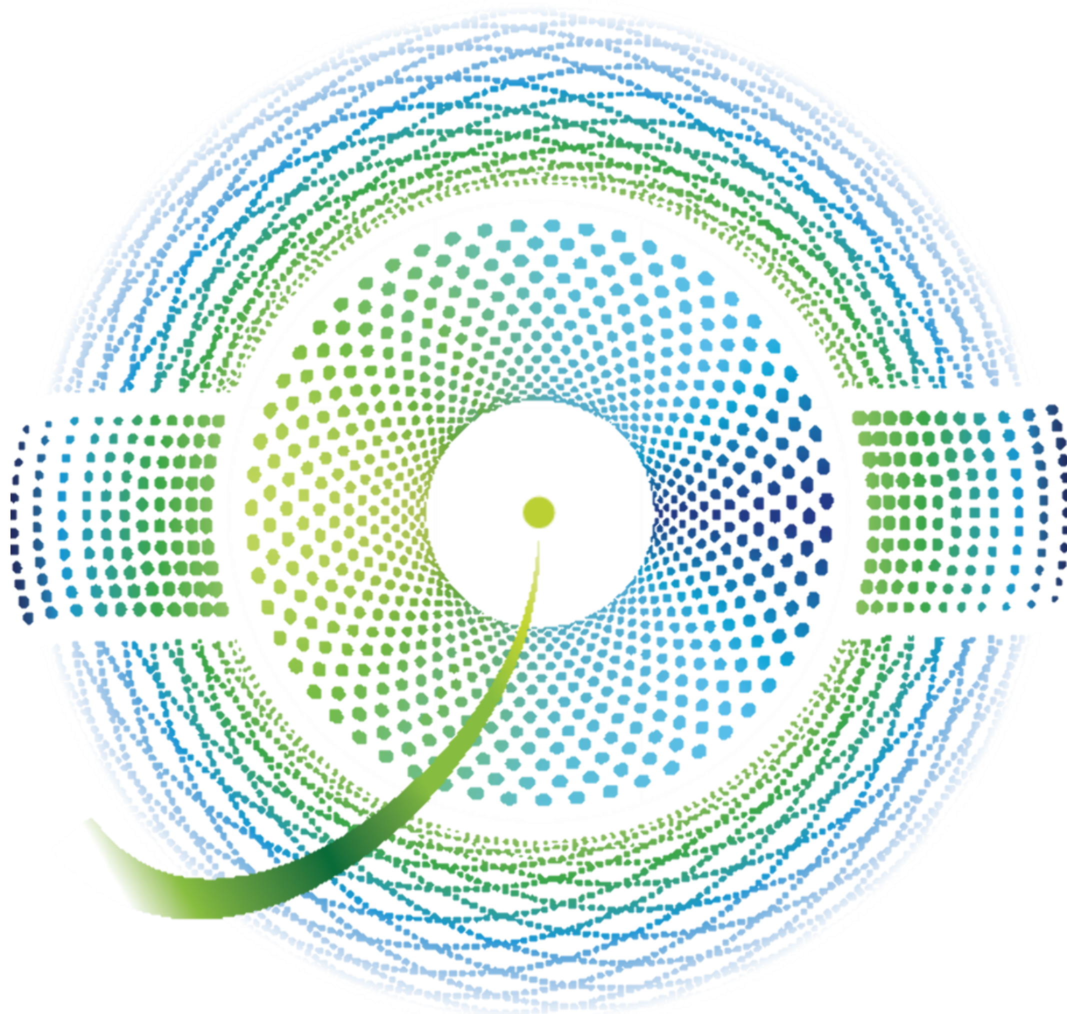
Deloitte.



Global minimum tax (Pillar Two)

Frequently Asked Questions

August 2021

In the Middle East since 1926

On 10 July 2021, the G20 endorsed the key components of the Pillar Two tax reform that was recently endorsed by 132 countries and jurisdictions, constituting the vast majority of the OECD/G20 Inclusive Framework (inclusive framework) on Base Erosion and Profit Shifting (BEPS).

Pillar Two, the key components of which are commonly referred to as the "global minimum tax" or "GloBE," introduces a minimum effective tax rate of at least 15%, calculated based on a specific rule set. Groups with an effective tax rate below the minimum in any particular jurisdiction would be required to pay top-up tax to their head office location. The tax would be applied to groups with revenue of at least EUR 750 million.

The global minimum tax attempts to limit tax competition by introducing a globally uniform floor, below which the effect of low tax rates or fiscal policy measures would be largely obviated.

This article is intended to provide high level answers to some of the most frequently asked questions on the global minimum tax (Pillar Two), which is a notably evolving topic.

1. How will the global minimum tax operate?

The global minimum tax consists of three principle rules: the income inclusion rule (IIR), the undertaxed payments rule (UTPR), and the subject to tax rule (STTR).

The IIR will apply in priority to the UTPR, which will act as a backstop to the IIR. The IIR and UTPR will operate differently but in a complementary fashion. They will reference a broadly similar calculation methodology and ruleset. Both rules will refer to the same minimum effective tax rate, which, as outlined above, will be at least 15% and calculated based on a uniform set of rules specific to the global minimum tax. In combination, the IIR and UTPR are referred to as the GloBE.

The STTR is a treaty-based rule and fundamentally different from the IIR and UTPR. The STTR will reference a rate of 7.5% to 9% and apply in priority to both the IIR and the UTPR. However, the STTR is narrower in scope and may face implementation obstacles.

2. What is the income inclusion rule?

The IIR is similar in operation to controlled foreign company (CFC) rules. The IIR will be applied by and collected in the jurisdiction of the head office. It will apply in respect of each jurisdiction in which the group has a subsidiary or branch. However, it will not apply to the head office jurisdiction itself.

Under the IIR, the effective tax rate of each jurisdiction, calculated in accordance with specific global minimum tax rules, will be determined based on all of the consolidated companies or branches in that jurisdiction. It will then be compared with the minimum tax rate of at least 15%. Top-up tax will be charged to the head office to make up for any shortfall.

3. What is the undertaxed payments rule?

The secondary rule under the global minimum tax is proposed to be the UTPR. The UTPR will apply after the IIR and serve as a backstop to the IIR.

One scenario in which the UTPR would apply is where the jurisdiction in which a group is headquartered has an effective tax rate below the minimum tax rate. This is because the IIR itself does not apply to the headquarters' jurisdiction. Any top-up tax then would be collected under the UTPR by the countries in which other group companies are located.

The implementation of the UTPR could be delayed, such that the IIR is implemented before the UTPR. This could offer a temporary reprieve for groups that have their headquarters in low tax jurisdictions.

4. What is the subject to tax rule?

The STTR is a treaty-based rule, which may override treaty benefits in existing treaties in respect of certain payments where those payments are not subject to a minimum level of tax in the recipient jurisdiction.

There are several key differences between the STTR, the IIR, and the UTPR:

- Firstly, the STTR may apply irrespective of the size of the group (i.e., the EUR 750 million threshold may not apply).
- Secondly, the STTR only applies to certain categories of related party payments.
- Thirdly, the STTR does not reference the same calculation methodology or rate as generally applied under the global minimum tax. The STTR applies on a payment-by-payment basis and is triggered where the full amount of a payment will not be subject to tax at a nominal rate of least 7.5% to 9%.

Where the STTR applies, treaty relief that would otherwise have been provided may be denied, with the maximum applicable withholding tax being 7.5% to 9%. The STTR applies before the IIR and UTPR and any tax collected under the STTR should be factored into the global minimum tax calculations used for the purposes of the IIR and UTPR.

The STTR is a treaty-based measure and is anticipated to be enacted bilaterally following a request from either party to a treaty. It also is anticipated that the majority of jurisdictions requesting the introduction of the STTR will be developing countries. Accordingly, treaties entered into between larger economies are less likely to be affected by the STTR or may not be affected at all.

5. Most of the jurisdictions we operate in have tax rates above 15%, will the global minimum tax affect us?

Whether top-up tax will apply under the global minimum tax will depend on the group's effective tax rate calculated in accordance with the global minimum tax rules in each jurisdiction where it has consolidated subsidiaries or branches.

While the headline rate of tax of a jurisdiction is relevant to this calculation, it is not determinative. We anticipate that the global minimum tax will be relevant and significant to a number of jurisdictions that have headline rates of tax exceeding 15%.

Various factors could influence the application of the global minimum tax; in particular, book-tax differences such as exclusions, exemptions, and incentives that are offered under a jurisdiction's domestic rules but are not offered under the global minimum tax rules.

6. How may GCC countries be impacted and respond to this?

It is important to note that that Pillar Two or the GloBE rules concern the taxation of non-resident/foreign group companies (so called extra-territorial taxation); conversely, these rules do not apply to domestic entities.

The OECD confirmed that countries/IF members (e.g. the UAE, Bahrain, Saudi Arabia, Oman and Qatar) are not required to adopt the GloBE rules. However, if they chose to do so, the rules have to be implemented in line with the Pillar Two proposal. We note that in an official statement issued on 26 July 2021, the UAE Ministry of Finance (MoF) stated that it is supportive of the Pillar Two proposal.[1] It is therefore likely that IF members will introduce the GloBE rules. This could be in the form of a separate/additional legislation similar to CFC legislation. This is the first potential impact/change.

The second impact concerns the taxation of domestic entities and thus changes to domestic tax laws and income tax regimes respectively. We note that the statutory tax rates in a number of GCC countries are below the proposed global minimum tax rate of 15% (e.g. the UAE, Bahrain and Qatar). Accordingly, profits of business in these countries could be subject to top-up tax abroad unless domestic tax law changes are made to tax such profits. The more likely outcome is that countries will engage in domestic tax policy reforms to protect the local tax base from foreign tax claims.

Based on the above, GCC countries may engage in major policy reforms (i.e. adoption of the GloBE rules and substantive tax law changes) which will likely have a major impact on businesses in the region (see below question #12). Specific details regarding what these changes may look like would likely only be determined once the GloBE provisions have been finalized.

7. Are any industries excluded from the global minimum tax?

The global minimum tax applies fairly broadly. At this stage of negotiations, it appears that global shipping likely is to be excluded. Fund vehicles subject to certain conditions also are likely to be excluded.

It will be necessary to consider the applicability of exclusions on a case-by-case basis. Other industries are generally in scope of the global minimum tax.

[1] http://wam.ae/en/details/1395302955194

8. We currently benefit from tax incentives that are offered under statute or have been guaranteed by particular tax authorities; can we still benefit from these?

The global minimum tax itself should not directly alter any tax incentives that are offered under domestic laws. However, where a tax incentive results in a group falling below the global minimum tax rate, top-up tax could apply. This may have the effect of reducing or eliminating the benefit of the incentive.

Whether incentives continue to be useful partly may depend on the effective tax rate of a group prior to utilizing the incentive. For example, if the effective tax rate of a group in a particular jurisdiction is 30% before opting into an incentive, but 16% after utilizing the incentive, no top-up tax would be applicable, assuming a global minimum tax rate of 15%.

If the starting effective tax rate was 16.5% and subsequently reduced to 8.25% by an incentive, the global minimum tax then could apply to increase the effective tax rate to 15%, which would nullify the majority of the benefit provided by the incentive.

While the introduction of the global minimum tax itself should not directly interfere with domestic tax law, it is anticipated that a number of jurisdictions will respond to the tax by amending their own laws. Accordingly, it is possible that certain incentives may be discontinued by jurisdictions, or jurisdictions could introduce their own domestic minimum taxes that could override incentives.

9. When will the global minimum tax be effective?

The global minimum tax is intended to be effective in 2023.

The IIR, in theory, can be introduced with only changes to domestic law. Provided there are no political stumbling blocks, a 2023 timeline could be achieved.

The UTPR is still under development. However, its final form likely is to be implementable through domestic law changes only. However, its introduction may be deferred. If the UTPR is deferred, it may become effective in 2024, 2025, or 2026.

The STTR, which is a treaty-based rule, allows a jurisdiction to deny treaty benefits in certain circumstances and will impact the operation of treaties. Therefore, its implementation would require a multilateral instrument. While the drafting of such an instrument and in-principle agreement can be achieved relatively quickly, we have observed delays in ratifying the previous multilateral instrument that was used to implement certain minimum standards in the OECD's previous Base Erosion and Profits Shifting project.

A significant coordinated effort will be required to implement the STTR in order for it to be effective in 2023.

10. Our group has tax losses in a number of jurisdictions, do these count for minimum tax purposes?

The availability of losses incurred prior to the implementation of the global minimum tax and the basis under which they are recognized is still uncertain. In particular, it is unclear whether the losses will be limited based on a particular lookback period, whether they may be limited to operating losses only, and whether they will be calculated based on local tax law or the global minimum tax rules.

If local tax losses are available, but they are not recognized for purposes of the global minimum tax, groups may be required to pay top-up tax, which could partially or entirely offset the benefit of the tax losses.

11. Our head office location already applies CFC rules, could the IIR still apply?

While the IIR is similar to CFC rules, there are very few limitations to the IIR, meaning it may apply more broadly than certain CFC rules. For example, the IIR applies irrespective of the level of substance or activity that a group operates within a jurisdiction. Albeit, some relief will be provided with an exclusion of at least 5% of tangible assets and payroll. This exclusion will be at least 7.5% during a five-year transition period.

The IIR still could be significant even where groups are already subject to CFC rules.

12. What should finance/tax teams do to prepare?

Given the global support and endorsement, we may see major changes (depending on the country involved) taking effect starting from 1 January 2023. (please refer to question #6).This practically leaves business and finance/tax team 18 months to prepare.

Finance/tax teams should work on developing a roadmap. In a first step, business should gain a good understanding of the proposed changes to fully assess the implications. Broadly, the changes may have implications on, or require changes to, the legal structure, business model, contracting and (transfer) pricing, accounting, profit and systems & data, organization (e.g. tax function). We therefore recommend to perform a qualitative and at least a high level quantitative impact assessment to ascertain the implications for the business. In zero tax countries a CIT readiness project should be considered as well.

Thought should also be given to establishing whether the business has appropriate systems, governance and a tax strategy to respond to these developments. Given the time it can take to implement such measures, early consideration to these areas may be critical to ensure compliance and preserve shareholder value.

Deloitte has developed a bespoke Pillar Two/CIT readiness offering. Please reach out to us and request for our Pillar Two brochure or contact a member of the core team to discuss how we can support you.

This document is confidential and prepared solely for your information and that of other beneficiaries of our advice listed in our engagement letter. Therefore, you should not, refer to or use our name or this document for any other purpose, disclose them or refer to them in any prospectus or other document, or make them available or communicate them to any other party. In any event, no other party is entitled to rely on our document for any purpose whatsoever and thus we accept no liability to any other party who is shown or gains access to this document.

Deloitte & Touche (M.E.) LLP ("DME") is the affiliate for the territories of the Middle East and Cyprus of Deloitte NSE LLP ("NSE"), a UK limited liability partnership and member firm of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee ("DTTL").

Deloitte refers to one or more of DTTL, its global network of member firms, and their related entities. DTTL (also referred to as "Deloitte Global") and each of its member firms are legally separate and independent entities. DTTL, NSE and DME do not provide services to clients. Please see www.deloitte.com/about to learn more.

Deloitte is a leading global provider of audit and assurance, consulting, financial advisory, risk advisory, tax and related services. Our network of member firms in more than 150 countries and territories, serves four out of five Fortune Global 500® companies. Learn how Deloitte's approximately 300,000 people make an impact that matters at www.deloitte.com.

DME is a leading professional services firm established in the Middle East region with uninterrupted presence since 1926. DME's presence in the Middle East region is established through its affiliated independent legal entities, which are licensed to operate and to provide services under the applicable laws and regulations of the relevant country. DME's affiliates and related entities cannot oblige each other and/or DME, and when providing services, each affiliate and related entity engages directly and independently with its own clients and shall only be liable for its own acts or omissions and not those of any other affiliate.

© 2021 Deloitte & Touche (M.E.). All rights reserved.