Tax Newsflash

【Global Tax Reset II Series】

OECD Pillar Two: Information return and safe harbors published

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On 20 December 2022, the OECD published an implementation package in respect of the implementation of the Pillar Two global minimum tax rules (“Pillar Two”). The package includes: guidance on safe harbors; a public consultation document on the GloBE information return (“information return”); and a public consultation document on tax certainty.

This follows the statement on the components of global tax reform, agreed by more than 135 members of the OECD/G20 Inclusive Framework on BEPS (“OECD inclusive framework”) in October 2021, and the publication by the OECD inclusive framework of model rules for Pillar Two in December 2021 and commentary in March 2022.

Background: The income inclusion rule and undertaxed profits rule

As a reminder, the OECD Pillar Two global minimum tax is set out in OECD model rules published in December 2021 and subsequent OECD commentary published in March 2022. The OECD model rules apply to large multinational groups with annual consolidated group revenue of at least EUR 750 million and have the following key components:

- An income inclusion rule (IIR) applies on a top-down basis such that in most cases any tax due is calculated and paid by the ultimate parent company to the tax authority in its country. The tax due is the "top-up" amount needed to bring the overall tax on the profits in each country where the group operates up to the minimum effective tax rate of 15%.

- The undertaxed profits rule (UTPR, sometimes referenced as the undertaxed payments rule) will apply as a secondary (backstop) rule in cases where the effective tax rate in a country is below the minimum rate of 15%, but the income inclusion rule has not been fully applied. The top-up tax is allocated to countries which have adopted the undertaxed profits rule based on a formula, and is to be implemented by countries either by denial of a deduction for payments or by making an equivalent adjustment.

- The OECD model rules also allow for countries to introduce a qualified domestic minimum top-up tax (QDMTT) aligned with Pillar Two. Top-up taxes in respect of any low-taxed profits of a group's entities in that country would then be paid to the local tax authority, rather than to other countries under the income inclusion or undertaxed profits rules.

Information return

The OECD are in the process of developing a standardized information return and it is recognized that a balance is needed between providing tax authorities with sufficiently comprehensive information and avoiding unnecessary compliance requirements for businesses. Work to date has focused on the identification of a comprehensive set of data points required for a group to calculate its top-up tax liability under the OECD model rules, including:

- General information about the group (determined by consolidated financial statements) and filing entity:
  - Group name and reporting fiscal year;
  - Identification of the filing entity; and
  - Group general accounting information.

- Corporate structure:
  - Ultimate parent entity details;
  - Group entities and members of joint ventures including information in respect of tax identification numbers (TINs), ownership structure, application of the income inclusion and undertaxed profits rules to the entity;
  - Excluded entities (such as pension funds and not-for-profit entities); and
  - Changes in the corporate structure that occurred during the reporting fiscal year.

- Effective tax rate (ETR) computation and top-up tax:
  - Identification of subgroups, e.g., a joint venture group;
  - Jurisdictional exceptions to reduce top-up tax to zero, e.g., use of safe harbors or de minimis exclusion. Jurisdictional information:
    - Effective tax rate and top-up tax, including the GloBE income or loss (Pillar Two tax base), covered taxes, and substance-based income exclusion;
    - Deferred tax adjustments, including recapture data and amounts brought in on transition; and

        - Jurisdictional elections (if any), e.g., stock based compensation.
    - Entity information:
        - GloBE income or loss (Pillar Two tax base);
        - Covered taxes;
        - Entity elections (or elections that apply to a joint venture group), e.g., to adjust for fair value accounting; and
        - International shipping income to be excluded.

- Top-up tax allocation and attribution:
    - Identification of the low-tax country;
    - Application of the income inclusion rule; and
    - Undertaxed profits rule top-up tax amount for the country.

The deadline for filing the information return is 15 months after the year end, extended to 18 months for the first year in which a group is in scope. Groups will also be subject to local tax filing and payment obligations, in domestic legislation.

The OECD inclusive framework will continue to work on the development of centralized filing requirements allowing for the information return to be filed with the tax authority of the ultimate parent entity (or another designated filing entity). The information return will be automatically exchanged with the tax authorities of countries in which other group entities are located. Consideration is being given to segmenting the information reported where not all tax authorities require all the group's information and tax calculations to assess any top-up tax liability.

Consideration is also being given to a coordinated framework for tax authority information requests and coordinated tax authority risk assessment in respect of information returns received.

Safe harbors

Transitional country-by-country (CbC) reporting safe harbor

The transitional safe harbor is a short-term measure to exclude a group's operations in lower-risk countries from the compliance obligation of preparing full Pillar Two calculations. It applies for years beginning on or before 31 December 2026 (i.e., three years for most groups).

The transitional safe harbor uses information taken from a business's CbC report and/or financial statements to determine whether its operations in a country meet any of three tests:

- **De minimis test**: The business reports total revenues of less than EUR 10 million and profit before income tax of less than EUR 1 million on its CbC report for a country.
- **Effective tax rate test**: The business has a "simplified ETR" for a country that is equal to or greater than the "transition rate" for the year.
    - The transition rate is 15% for years beginning in 2023 and 2024, increasing to 16% and then 17% for years beginning in 2025 and 2026 respectively.

- **Routine profits test**: The business's profit before income tax in a country is equal to or less than the "substance-based income exclusion amount" (as calculated under the OECD model rules).

Where the transitional safe harbor applies, and any of these tests are satisfied, the top-up tax for that country will be zero.

The business's CbC report is required to be prepared and filed using qualified financial statements. Qualified financial statements include both the consolidated financial statements of the ultimate parent entity, and the separate financial statements of each group entity (provided these are prepared in accordance with an acceptable or authorized financial accounting standard and are reliable).

The simplified ETR for the purposes of the effective tax rate test is calculated by dividing the country's "simplified covered taxes" by its profit before income tax as reported on the CbC report. Simplified covered taxes are based on financial statements data, not CbC data. They comprise a country's income tax expense as reported on the business's financial statements (excluding taxes that are not Pillar Two covered taxes and eliminating any uncertain tax positions).

A "once out, always out" approach will apply: if a business has not applied the transitional safe harbor to a country in one year, it cannot use the safe harbor for that country in a subsequent year.

A number of special rules may apply to exclude certain entities in specific circumstances such as: where there are joint ventures or joint venture subsidiaries; where there are entities held for sale; where the ultimate parent entity is a flow-through entity or is subject to a deductible dividend regime; where a business is "multi-parented"; or where a business includes investment entities or insurance investment entities, stateless entities, or entities subject to eligible distribution tax systems. There is also a special rule that requires "net unrealized fair value losses" arising from changes in fair value of shareholdings (ownership interests) to be excluded if the loss exceeds EUR 50 million in a country.

Potential permanent safe harbors: Simplified calculations

The report sets out a framework for the future development of permanent safe harbors—"simplified calculations safe harbors"—that, if agreed, would reduce the number of computations and adjustments a business is required to make.

The framework envisages that future guidance would set out simplified calculation rules to enable businesses to demonstrate for a country that:

- The GloBE income is equal or less than the amount of the substance-based income exclusion;
- Revenue is less than EUR 10 million, and income (profits) are less than EUR 1 million (i.e., that the country qualifies for the de minimis exclusion within the OECD model rules); or
- The effective tax rate is at least 15%.

For example, the simplified calculations safe harbor will apply for non-material constituent entities excluded from consolidated financial statements solely on size or materiality grounds. Simplified source of information rules, and calculations of revenue, income, and tax amounts, will apply to these entities, using CbC reporting data.

The OECD inclusive framework are also considering a safe harbor for businesses which prepare a qualified domestic minimum top-up tax calculation under local rules.

Transitional penalty relief

Transitional penalty relief will require tax authorities to give "careful consideration" before applying penalties where a group has taken reasonable measures to apply the global minimum tax rules. Relief will apply for years beginning on or before 31 December 2026 (i.e., three years for most groups).

Tax certainty

The global minimum tax rules include a number of mechanisms to facilitate consistent and coordination adoption, but differences could still arise in the interpretation or application of domestic rules among different tax authorities. The OECD inclusive framework is exploring mechanisms to provide increased tax certainty, including dispute prevention mechanisms such as:

- Reliance on the OECD model rules, commentary, and guidance to support consistency in the application of the rules, noting there may be interpretative questions that have not been considered or resolved.
- A multilateral review process to determine whether a country has implemented a "qualified" income inclusion rule, undertaxed profits rules, and/or domestic minimum top-up tax.
- Tax authority referral to the OECD inclusive framework for clarification of questions of general interpretation through the release of guidance.
- Common risk assessment and coordinated compliance programs, e.g., similar to the OECD International Compliance Assurance Programme (ICAP).
- Binding certainty mechanisms, including bilateral and multilateral advance pricing arrangements (APAs).

Dispute resolution mechanisms are also being explored, including:

- How existing mutual agreement procedure (MAP) rules in double tax treaties could be adapted as the basis for dispute resolution;
- The scope of disputes covered, e.g., where the dispute has resulted in double taxation;
- The basis for resolving disputes, e.g., the use of the OECD model rules, commentary, and guidance as the common standard for competent authorities to reach an agreement; and
- Possible instruments available for a dispute resolution mechanism, including: a new multilateral convention; under the Convention for Mutual Administrative Assistance in Tax Matters; under existing tax

treaties; or a common dispute resolution mechanism in domestic law.

Next steps

Comments on both the information return and tax certainty document are invited by 3 February 2023. The OECD inclusive framework expects to release further guidance on the interpretation and administration of the global minimum tax rules on a rolling basis, with the first installment expected to be released in early 2023. Work will also continue on the treaty-based subject to tax rule, to apply to selected intragroup payments from developing countries.

Deloitte comments

The documents released cover the compliance and administration aspects of the global minimum tax rules, an area that is a significant concern for businesses. The work on the Pillar Two information return has focused to date on the information and data that may (subject to the design of the final information return) need to be collected and reported. The OECD inclusive framework is looking for businesses' input on a range of questions, including the data requested, potential simplifications, and input on the potential interaction with local qualified domestic minimum top-up tax regimes. The data list is in table form and, as an approximate guide, includes four pages of "group" data, 10 pages of data that will be required by country, six pages of data that is required by entity, and two pages of calculation of top-up tax by country.

The income inclusion rule will apply in some countries, including the UK and the 27 member states of the EU, for years beginning on or after 31 December 2023. Businesses will want to understand the data needed on a real-time basis when the rules take effect in 2024, even though returns will not, except in rare circumstances, need to be filed until 30 June 2026. The intention is that the information return will be filed centrally with one tax authority (usually the parent or intermediate parent country tax authority) and exchanged with other tax authorities. This will require an XML schema to facilitate exchange, and suitable competent authority exchange agreements to be in place between countries. Experience from the introduction of CbC reporting is that early finalization of such exchange agreements, on a multilateral or bilateral basis, will be important to prevent local filing requirements and last minute compliance process changes.

The OECD inclusive framework's work on safe harbors will be essential to minimizing the compliance burden for businesses, at least in the transitional years. Such simplifications, particularly using CbC reporting data for income and financial statements data for tax to calculate a simplified effective tax rate, will be very helpful for many groups for, broadly, the first three years of the rules. Businesses will be pleased that CbC reports prepared using either group financial statements data or local financial statements data (under an appropriate GAAP) are acceptable, allowing existing "top-down" or "bottom-up" approaches to CbC reporting to be maintained. It is important that safe harbors, whether transitional or longer term, are mirrored in all countries' local rules for a qualified domestic minimum top-up tax. The African Tax Administration Forum (ATAF) recently released a Suggested Approach to

Drafting Domestic Minimum Top-Up Tax Legislation which includes scope for adding safe harbors to reduce the compliance burden. Longer term, it remains to be seen if the OECD inclusive framework can agree simplifications that will be meaningful for a wide range of groups.

Further work is needed by the OECD inclusive framework to finalize approaches to dispute prevention and resolution. Any such processes will need to be legally binding on countries via an internationally agreed legal instrument to have effect. One approach would be via a double tax treaty "wrapper" for Pillar Two to support the rules implemented domestically by countries.

There remains ongoing work on the subject to tax rule, a type of withholding tax on selected intragroup payments from developing countries to low-tax jurisdictions, and also on further clarification of technical aspects of the global minimum tax rules. This will be achieved via updates to the commentary originally published in March 2022, with the first update expected in early 2023.

Content provided by Deloitte United States.

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P354/2022 - 2022 年 5 月 24 日
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[Simplified Chinese] [English] [Japanese]

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[Simplified Chinese]

P322/2020 – 2020 年 10 月 7 日
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[Simplified Chinese]

P317/2020 – 27 July 2020
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OECD's public consultation document: Secretariat Proposal for a "Unified Approach" under Pillar One
[Simplified Chinese] [English] [Japanese]

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Hong Kong Tax Analysis
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