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Tax Newsflash

【Global Tax Reset II Series】 Pillar Two: OECD's further guidance

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On 18 December 2023, the OECD/G20 Inclusive Framework on BEPS ("OECD inclusive framework") published a third set of administrative guidance on the implementation of the Pillar Two global minimum tax rules ("Pillar Two").

This latest release follows the statement on the components of global tax reform, agreed by more than 135 members of the OECD inclusive framework in October 2021, and the subsequent publication of Pillar Two model rules, commentary, safe harbors, and guidance.

Components of the Pillar Two rules

The OECD inclusive framework 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 tax due is (in most cases) calculated and paid by the ultimate parent entity 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 will be 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 model rules also allow for countries to introduce a qualified domestic minimum top-up tax (QDMTT) aligned with Pillar Two. Under a QDMTT, top-up taxes in respect of any low-taxed profits of a group's entities in that country are payable domestically, rather than to other countries under the income inclusion or undertaxed profits rules.

Further administrative guidance

The third set of administrative guidance has been released to further clarify the interpretation and operation of the model rules.

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

The transitional CbC reporting safe harbor uses information taken from a business's CbC report and/or financial statements to exclude a group's operations in lower-risk countries from the compliance obligation of preparing full Pillar Two calculations, for up to three years.

Further guidance is provided on the requirement that the business's CbC report must be prepared and filed using qualified financial statements, including:

- Consistent use of data: All of the data used in the transitional CbC reporting safe harbor calculations for a country must come from the same qualified financial statements (i.e., consolidated financial statements of the ultimate parent entity *or* the separate financial statements of each group entity).

- Using different accounting standards: It is possible to use data from the consolidated financial statements of the ultimate parent entity for some countries and data from the separate financial statements of each group entity for other countries.

- Unless explicitly required, adjustments to qualified financial statement data are not permitted, even if the adjustments are intended to increase consistency with the Pillar Two rules.

- Groups in scope of the Pillar Two rules but not required to file CbC reports are eligible for the transitional CbC reporting safe harbor if they prepare calculations using data from qualified financial statements that would have been included in a CbC report.

The guidance also includes confirmation that the definition of "simplified covered taxes" for the safe harbor's simplified effective tax rate computation taken from qualified financial statements includes any adjustments for prior periods (but amounts in respect of any uncertain tax positions must be removed).

When calculating the routine profits test, the substance-based income exclusion amount should be calculated using the model rules' transitional rate applicable for the period, i.e., 9.8% for payroll and 7.8% for tangible assets in 2024.

An anti-avoidance rule will prevent the transitional CbC reporting safe harbor from applying if targeted "hybrid arbitrage arrangements" (e.g., deduction/non-inclusion arrangements, duplicate loss arrangements, or duplicate tax recognition arrangements), are entered into after 15 December 2022 (or 18 December 2023 in some circumstances).

Purchase price accounting adjustments

Additional guidance has been issued regarding purchase price accounting adjustments in the context of the transitional CbC reporting safe harbor. Adjustments to amounts reported in qualified financial statements are not generally permitted under the safe harbor. Specific rules will apply where purchase price accounting adjustments are allocated and incorporated into the financial accounts of an acquired group entity that are used in the preparation of the consolidated financial statements of the ultimate parent entity, or the separate financial statements of the group entity. In order to be considered "qualified financial statements," a goodwill impairment adjustment must be made to add back the impairment if it relates to transactions entered into after 30 November 2021 and a consistent CbC reporting condition must also be met.

Consolidated revenue threshold

Further guidance has been provided on the meaning of revenue for the EUR 750 million consolidated revenue threshold. Revenue includes the inflow of economic benefits from the group's ordinary activities reflected in the profit and loss statement of the ultimate parent entity's consolidated financial statements. Ancillary interest income outside of a group's ordinary activities is not included in revenues, whereas interest would be included if a business offers customer loans as part of its ordinary business and reports interest income in net revenues in the profit and loss statement.

Revenues are determined in line with the relevant accounting standard, which may allow for netting for discounts, returns, and allowances. If different types of revenue are separately presented, they must be aggregated. Revenue includes both realized and unrealized net gains from investments reflected in the profit and loss statement of the ultimate parent entity's consolidated financial statements, as well as income or net gains separately presented as extraordinary or non-recurring items. Adjustments can be made for investment losses if they are shown separately from investment gains in the consolidated financial statements to align with net treatment.

Where a financial entity does not record gross amounts from transactions in its financial statements, the items considered similar to revenue under the accounting standards of the ultimate parent entity should be used, e.g., "net banking product" or "net revenues." For example, for a financial entity, revenue includes the net amount of income/gains from a financial transaction such as an interest swap.

Mismatches between financial reporting years

Where there is a mismatch between the financial reporting year of the ultimate parent entity and another group entity, the Pillar Two rules follow the approach taken in the ultimate parent entity's consolidated financial statements. Similarly, where there is a mismatch between the taxable period of a group entity and the financial reporting year of the multinational group, the group entity should apply the approach used in the ultimate parent entity's consolidated financial statements to determine its adjusted covered taxes for the year.

Allocation of blended controlled foreign company (CFC) taxes

Administrative guidance was released in February 2023 on allocating blended CFC taxes (such as US GILTI (global intangible low-taxed income)) to group entities for the purposes of the Pillar Two calculations using a formulaic approach based on "blended CFC allocation keys." Further guidance has now been released, including clarification that where multiple jurisdictional effective tax rates are computed for a country (e.g., because a separate effective tax rate calculation has been required for an investment entity) the allocation key for an entity is calculated using the jurisdictional effective tax rate applicable to the blending group to which that entity belongs. Guidance is also provided on how to calculate the blended CFC allocation key if there is no other requirement to calculate an effective tax rate for the country, e.g., the simplified effective tax rate calculation should be used where an election has been made to use the transitional CbC reporting safe harbor. Guidance is also provided in respect of the allocation of blended CFC taxes to entities that are not group members (or joint ventures) for Pillar Two purposes.

Administrative relief for groups with short reporting years

For groups with a short reporting year the due date for compliance and filing obligations will not be before 30 June 2026 (the earliest filing date for groups with full reporting years).

Simplified calculation safe harbor for non-material constituent entities

The guidance includes a permanent simplified calculation safe harbor for non-material constituent entities (NMCEs). Broadly, an NMCE is an entity that is not consolidated in the ultimate parent entity's consolidated financial statements solely on size or materiality grounds but is still considered a "constituent entity" for Pillar Two purposes. A number of conditions must be met in relation to the NMCE, including that the ultimate parent entity's consolidated financial statements have been externally audited. An annual election is required for each individual NMCE.

Under the safe harbor, groups can use CbC reporting information for an NMCE to determine whether the country where the NMCE is located meets one or more of the routine profits, de minimis, or effective tax rate tests such that the top-up tax for the country is deemed to be zero. The safe harbor uses "total revenue" and "accrued income tax (current

year)" (with no deferred tax) as used for CbC reports as a proxy for the NMCE's profit and covered taxes, respectively.

Next steps

The OECD inclusive framework will continue to release further agreed guidance on an ongoing basis. Guidance is expected to be released in the first half of 2024, including on the application of deferred tax liability recapture rules and the allocation of deferred taxes to other constituent entities (e.g., in relation to CFC regimes or permanent establishments). A government peer review process will also be implemented to monitor countries' implementation of the Pillar Two rules, and work will continue on the Pillar Two administrative framework and dispute resolution mechanisms.

The administrative guidance will be incorporated into a revised version of the commentary to the Pillar Two model rules to be released in 2024.

Countries are in the process of implementing the Pillar Two model rules in their domestic legislation. IIRs and QDMTTs will begin to apply from 2024 in some countries, with UTPRs starting to apply from 2025.

Deloitte comments

The OECD inclusive framework continues to publish guidance on the interpretation and application of aspects of the Pillar Two global minimum tax rules, with a view to enabling their consistent application and to provide simplifications where possible.

The third tranche of administrative guidance focuses in particular on the CbC reporting safe harbor as one of the areas that in-scope groups will want to consider first in applying the rules. The new guidance clarifies some aspects of the existing safe harbor, including how much variation in sources of data (consolidated financial statements, local financial statements, management accounts, etc.) can be used in different circumstances. The most notable update is the inclusion of new guidance for groups that do not have to prepare CbC reports but are nevertheless in the scope of the Pillar Two rules, e.g., because of currency translation differences in the EUR 750 million threshold or because the group is wholly domestic. Such groups will be able to take advantage of the Pillar Two CbC safe harbor by using the information that would have been included in a CbC report if one had been required. The new guidance also includes anti-avoidance rules, focused on hybrid arbitrage arrangements (deduction/non-inclusion arrangements, duplicate loss arrangements, and duplicate tax recognition arrangements).

There is also a new simplification framework for non-material constituent entities that may help some groups with data requirements for very small entities that are not included in consolidated financial statements. The simplification uses data taken from CbC reports and focuses on revenue as a proxy for profit and current tax accrued (with no deferred tax) as a proxy for tax.

The OECD inclusive framework also sets out further guidance on temporary blended CFC taxes, which allows in particular US GILTI to be pushed down to entities/countries. These rules illustrate the complexity of taking into account tax computed on a blended basis, and the interaction of the Pillar Two rules with countries' individual existing tax regimes. Recently, the US published information on how Pillar Two top-up taxes would be treated in the US. Broadly, US groups might be able to take credit for qualified domestic minimum top-up taxes (QDMTTs), but most IIR top-up taxes will not be creditable where they take into account US federal income taxes in their calculations.

The OECD inclusive framework will continue to publish administrative guidance on further Pillar Two topics, including, for example, the deferred tax liability recapture rules and deferred tax arising in relation to the profits of other constituent entities such as CFCs or permanent establishments. More guidance is expected in the first half of 2024. Where necessary, the OECD inclusive framework will also publish further anti-avoidance rules. There remain a number of uncertainties around technical areas, and groups that are coming into the scope of the Pillar Two rules from 1 January 2024 will be keen for as many of these as possible to be resolved quickly. The OECD inclusive framework is also continuing to work on mechanisms for dispute resolution should there be differences of view (including between tax authorities) on interpretation of the rules.

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P374/2023 - 16 March 2023
支柱一金额 A 下撤销数字服务税和相关类似措施的多边公约条款草案
[Simplified Chinese][Japanese]

P373/2023 - 6 March 2023
全球税制重塑 2.0 系列：OECD 发布支柱二征管指南
[Simplified Chinese] [Japanese]

P372/2023 - 2 March 2023
全球税制重塑 2.0 系列：支柱二下的信息报告表和安全港规则
[Simplified Chinese][Japanese]

P368/2022 - 30 December 2022
OECD 发布《支柱一金额 B 公众意见征询文件》
[Simplified Chinese]

P356/2022 - 16 June 2022
OECD 发布支柱一金额 A 立法模板系列之《支柱一金额 A 下的受监管金融服务业排除》
[Simplified Chinese] [Japanese]

P354/2022 - 24 May 2022
OECD 发布支柱一金额 A 立法模板系列之《金额 A 的适用范围立法模板草案》以及《支柱一金额 A 下的采掘业排除》
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支柱二 – G20/OECD 包容性框架发布全球最低税立法模板
[Simplified Chinese] [Japanese]

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Global Minimum Tax Frequently Asked Questions (FAQ)
[Simplified Chinese] [English] [Japanese]

P338/2021 - 20 May 2021
在不断变化的国际环境中管理和规划知识产权的注意要点
[Simplified Chinese] [Japanese]

P332/2021 – 22 January 2021
在不确定性中寻找机会——有关 OECD/G20 税基侵蚀和利润转移(BEPS) 计划以及全球税制重塑 2.0 的第七次年度全球调查
[Simplified Chinese] [Japanese]

P330/2021 – 11 January 2021
European Union – Mandatory Tax Reporting (DAC6) implemented
[Simplified Chinese] [English]

P327/2020 – 19 November 2020
OECD 就应对数字经济带来的税收挑战发布蓝图报告：支柱二之详细解读
[Simplified Chinese] [Japanese]

P325/2020 – 4 November 2020
OECD 就应对数字经济带来的税收挑战发布蓝图报告：支柱一之详细解读
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[Simplified Chinese]

P322/2020 – 7 October 2020
澳大利亚发布 2020-21 年预算：政策利好复苏
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P317/2020 – 27 July 2020
European Union - Mandatory Tax Reporting for certain cross-border arrangements
[Simplified Chinese] [English]

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包容性框架成员国再次承诺将致力于解决数字化经济带来的税收挑战
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数字经济征税方案下“统一方法”与现行转让定价规则碰撞之初探
[Simplified Chinese]

P304/2019 – 15 November 2019
OECD 发布最新意见征询文件：全球防止税基侵蚀提案（支柱二）
[Simplified Chinese] [Japanese]

P302/2019 – 5 November 2019
OECD's public consultation document: Secretariat Proposal for a "Unified Approach" under Pillar One
[Simplified Chinese] [English] [Japanese]

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18 July 2023
支柱二 – OECD/G20 合格国内最低补足税规则（QDMTT），低税支付规则（UTPR）和 GloBE 信息报告表（GIR）的最新进展 – 对中国香港、新加坡和中国内地的影响
Pillar 2 – QDMTT, UTPR & GIR developments relevant to Hong Kong, Singapore and Mainland China

3 February 2023
OECD released administrative guidance on global minimum tax

21 December 2022
OECD Pillar Two: Information return and safe harbors published

18 August 2022
Hong Kong defers the implementation of Pillar Two

15 March 2022
OECD 发布支柱二下全球最低税的注释
OECD announces release of commentary on Pillar Two model rules for global minimum tax

21 December 2021
Pillar Two – OECD Inclusive Framework global minimum tax model rules

11 October 2021
关于应对经济数字化税收挑战“双支柱”方案最新进展
OECD inclusive framework updates political agreement on Pillar One and Pillar Two

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OECD Inclusive Framework reaches political agreement on taxing the digitalised economy and a global minimum rate

3 July 2021

双支柱方案得到全球性支持
Global Endorsement on Pillar One and Pillar Two

13 October 2020
2020 年美国大选对美国企业所得税政策的影响

Hong Kong Tax Analysis

H113/2023 – 8 March 2023
How Global Minimum Tax implementation timelines could affect top-up tax liabilities
[English]

H107/2022 – 31 May 2022
The Impact of Pillar 2 on Hong Kong's Real Estate Sector
[English]

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Pillar Two – Impact on Hong Kong
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