



Tax Newsflash

【Global Tax Reset II Series】

Pillar Two: Consolidated commentary published



On 25 April 2024, the [OECD/G20 Inclusive Framework on BEPS](#) (“OECD inclusive framework”) published its [consolidated commentary](#) to the Pillar Two global minimum tax rules (“Pillar Two”). The consolidated commentary incorporates guidance that had been approved and published by the OECD inclusive framework before the end of December 2023.

The components of the Pillar Two global tax reform rules have been agreed by 140 members of the OECD inclusive framework. Jurisdictions are in the process of implementing the Pillar Two model rules in their domestic legislation, and the rules will begin to apply as from January 2024.

Overview

The OECD inclusive framework has published, as promised, an updated consolidated version of the commentary on the Pillar Two rules. The updated commentary puts in one document the original commentary (first published in March 2022) with subsequent further releases including on the country-by-country (CbC) reporting safe harbor (first published in December 2022) and the three sets of agreed administrative guidance on Pillar Two (originally published in February, July, and December 2023). There is also an accompanying set of

examples (first published in March 2022) which have also been updated for examples subsequently included in published guidance. As such, there is no “new” technical guidance included in this update.

The consolidated commentary runs to some 330 pages, which is notably shorter than the sum of the pages in the original commentary and all the published guidance to date. The reason for this is that the agreed administrative guidance sets out issues to be considered, and then concludes with amendments or additions to be made. The consolidated commentary only includes those amendments or additions, and not the explanation of the issues. In some cases, especially those which remain in any way unclear, it may in future still be helpful to refer to the agreed administrative guidance to give context.

Implementation of the consolidated commentary and matters covered by guidance may vary depending on how jurisdictions have introduced Pillar Two into their domestic law (some will have a flexible approach to automatically bring in new guidance from the OECD inclusive framework, others will require law changes). In some cases, where the commentary is providing a better or clearer explanation of the model rules and their local implementation, no law changes will be needed.

The consolidated commentary includes all Pillar Two technical guidance published through the end of 2023. As the OECD inclusive framework plans to issue more guidance on specific areas of Pillar Two, it is expected that the commentary will be further updated and consolidated in future.

Components of the Pillar Two rules

The OECD inclusive framework’s Pillar Two model rules, applicable to large multinational groups with annual consolidated group revenue of at least EUR 750 million, will result in “top-up” tax amounts to bring the overall tax on profits in each jurisdiction where a group operates up to a minimum effective tax rate of 15%. The key components of the model rules are: qualified domestic minimum top-up taxes (QDMTT) which allow jurisdictions to charge any top-up taxes due in respect of local profits; the income inclusion rule (IIR) under which parent company jurisdictions apply the top-up tax rules on a top-down basis; and the undertaxed profits rule (UTPR) which will apply as a secondary (backstop) rule where the other rules have not been fully applied.

Consolidated commentary

The introduction to the consolidated commentary provides an overview of each of its chapters. It now incorporates guidance on currency conversion, and on rebasing monetary thresholds in local currencies.

Scope

Chapter 1 of the consolidated commentary sets out the scope of the model rules.

Guidance has been incorporated on the definition of “excluded entity,” the application of the ultimate parent entity definition to sovereign wealth funds, and the meaning of “ancillary” for subsidiaries of non-profit organizations. Further detail has also been added on the meaning of revenue for the purposes of the EUR 750 million consolidated revenue threshold, and how to address mismatches between the financial year of the ultimate parent entity and other group entities.

Charging provisions

Chapter 2 contains the operating mechanics for the IIR and UTPR. Updates include commentary on the exclusion of insurance investment entities from the definitions of “intermediate parent entity” and “partially-owned parent entity.”

Computation of Pillar Two income or loss

Chapter 3 sets out the rules for calculating each group entity’s income or loss for Pillar Two effective tax rate computation purposes.

The commentary has been updated to incorporate guidance on topics including how the excluded equity gains/loss rules apply to hedges of investments, the treatment of debt releases, the scope of the accrued pension expense adjustment, the equity investment inclusion election, and the election to include all dividends from portfolio shareholdings in the computation of Pillar Two income or loss.

Other additions include guidance on the treatment of “qualified refundable tax credits,” “marketable transferable tax credits,” and “qualified flow through tax benefits,” and the requirement that Pillar Two calculations should generally be prepared using the presentational currency of the ultimate parent entity’s consolidated financial statements.

Computation of adjusted covered taxes

Chapter 4 sets out the mechanics for determining the amount of “covered taxes” for each group entity. Updates to the chapter include guidance on consolidated deferred tax amounts, the carry forward of “excess negative tax expense,” loss-making parent entities of controlled foreign companies (CFCs), and the allocation of taxes arising under blended CFC tax regimes such as US global intangible low-taxed income (GILTI).

Computation of effective tax rate and top-up tax

Chapter 5 sets out the steps to be taken in determining whether any jurisdictions’ effective tax rates are less than 15%, and any amounts of top-up tax due.

Updates include additional guidance on the substance-based income exclusion (SBIE) rules, including in respect of “eligible employees” and

“eligible tangible assets” that spend time outside of the jurisdiction of the relevant group entity.

Corporate restructurings and holding structures

Chapter 6 includes guidance dealing with corporate restructurings, such as mergers, acquisitions, and demergers. The updated commentary now incorporates guidance on intragroup transactions accounted for at cost.

Tax neutrality and distribution regimes

Chapter 7 provides specific rules where groups are subject to tax neutrality or distribution-based regimes. Updates include guidance in relation to the application of the taxable distribution method election to insurance investment entities, and the application of the investment entity tax transparency election to mutual insurance companies.

Administration

Chapter 8 sets out commentary on the administration of the model rules. Minor changes have been made to the commentary to refer to the four Pillar Two safe harbors that have been agreed by the OECD inclusive framework.

Transition rules

Chapter 9 provides guidance on transition rules, including rules for taking into account losses and tax attributes that arose prior to the application of Pillar Two, and for the treatment of intragroup asset transfers occurring before Pillar Two applies to a transferor.

Updates include more detailed commentary on transactions similar to intragroup asset transfers, the use of asset carrying value and deferred taxes, and transitional filing deadlines for groups with short reporting fiscal years.

Definitions

Chapter 10 sets out commentary on terms used in the Pillar Two model rules. Guidance on the definitions of “consolidated financial statements” and “ownership interest” have now been included.

The commentary also now incorporates guidance on QDMTTs, including in respect of how QDMTTs should apply to specific types of entities (e.g., joint ventures, minority-owned constituent entities, stateless entities, flow through entities).

Annex A—safe harbors

A new annex has been added to the consolidated commentary, comprising four chapters collecting together guidance on each of the four safe harbors agreed by the OECD inclusive framework to date.

Transitional 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 jurisdictions from the compliance obligation of preparing full Pillar Two calculations for up to three years.

The chapter includes the guidance from the original December 2022 safe harbors document, as updated by the December 2023 agreed administrative guidance, such as on the requirement that the business's CbC report must be prepared and filed using qualified financial statements and the inclusion of the "hybrid arbitrage arrangements" anti-avoidance rule.

Permanent safe harbor

Chapter 2 of annex A incorporates guidance in the December 2022 safe harbor document which set out a framework for the development of future permanent "simplified calculations safe harbors" to reduce the number of computations and adjustments a business is required to make. It also includes the December 2023 guidance on a permanent simplified calculation safe harbor for non-material constituent entities (NMCEs).

QDMTT safe harbor

Guidance on the permanent QDMTT safe harbor has been included as chapter 3 of annex A to allow businesses to elect to prepare a single QDMTT computation for a jurisdiction. Where the safe harbor applies, no additional top-up tax will arise under the IIR or UTPR.

Transitional UTPR safe harbor

Under this temporary safe harbor, no top-up tax will be payable under the UTPR in respect of any undertaxed profits of a business in its ultimate parent entity jurisdiction if that jurisdiction applies a nominal statutory corporate income tax rate of at least 20%. The safe harbor will defer the application of the UTPR to such profits until 2026.

Examples

The OECD has also released an updated version of its document of [examples illustrating the application of the model rules](#). The new version incorporates the 30 additional examples that had previously been included within the agreed administrative guidance documents. One new example—a further example of the application of the special rules for flow-through ultimate parent entities—has also been included.

Next steps

The OECD inclusive framework will continue to release further agreed guidance on an ongoing basis. More guidance is expected to be released in the next few weeks, before summer 2024. It is expected that the

consolidated commentary will be further updated for any new guidance published in due course.

Content provided by Deloitte United Kingdom.

If you have any questions, please contact our professionals:

International Tax and M&A Services

National Leader

Vicky Wang

Tax Partner

+86 21 6141 1035

vicwang@deloitte.com.cn

Northern China

Nina Zhou

Tax Partner

+86 10 8512 5477

nzhou@deloitte.com.cn

Eastern China

Hong Ye

Partner

+86 21 6141 1171

hoye@deloitte.com.cn

Western China

Tony Zhang

Tax Partner

+86 28 6789 8008

tonzhang@deloitte.com.cn

Southern China

Anthony Lau

Tax Partner

+852 2852 1082

antlau@deloitte.com.hk

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