Tax Newsflash

OECD Pillar Two: Further guidance published 【Global Tax Reset II Series】

On 17 June 2024, the OECD/G20 Inclusive Framework on BEPS ("OECD inclusive framework") published further administrative guidance on the implementation of the Pillar Two global minimum tax rules ("Pillar Two"), together with details of the processes for determining that jurisdictions' local implementations of the Pillar Two rules are "qualified."

The Pillar Two global minimum tax rules have been agreed by more than 140 members of the OECD inclusive framework. Jurisdictions are in the process of implementing rules in domestic legislation, which began to apply from January 2024.

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 15% minimum effective tax rate. The key components 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.

New guidance

The guidance will be incorporated into the OECD's commentary to the model rules at a future date. There are also a number of additional examples which will be included in the OECD's published examples illustrating the application of the model rules.

The new guidance covers six distinct areas:

- recapture of deferred tax liabilities;
- divergences between Pillar Two basis and accounting carrying values;
- allocation of cross-border current taxes;
- allocation of cross-border deferred taxes;
- allocation of profits and taxes in groups including flow-through entities; and
- the treatment of securitization vehicles.

Recapture of deferred tax liabilities

The model rules include a deferred tax liability recapture rule, which requires the benefit of some deferred tax liabilities (e.g. in relation to intangible fixed assets) that are taken into account in the Pillar Two calculations, to be tracked and then recaptured if they do not reverse within five years.

Some businesses raised questions about whether it would be necessary to track deferred tax liabilities on an item-by-item basis. The latest guidance sets out approaches on how to apply the deferred tax recapture rule in practice. For example, group entities will be permitted to track deferred tax liabilities on a "general ledger account" basis. Simplified tracking approaches can also be permitted on a less detailed "aggregate DTL category" basis (i.e., two or more general ledger accounts within the same balance sheet or sub-balance sheet account) where the composition of the category does not include assets that are likely to be liable to deferred tax liability recapture. Specific general ledger accounts cannot be aggregated with other accounts, including: non-amortizable intangible assets, including goodwill; intangibles with an accounting life of more than five years; related party receivables and payables; and "swinging accounts" where net asset and net liability positions can arise at different points of the life of the relevant assets/liabilities. General ledger accounts, which would always only generate deferred tax assets, are also generally excluded from an aggregate DTL category.

Deferred tax liabilities that would otherwise be covered by an exception to the recapture (e.g., deferred tax liabilities in respect of tangible fixed assets) will become subject to recapture if tracked as part of a general ledger or aggregate DTL category.

The default method for calculating the amount of the recapture of liabilities within an aggregate DTL category is last-in, first-out (LIFO). In some circumstances groups may choose to use the first-in, first-out (FIFO) method. Where an aggregate DTL category contains only shortterm deferred tax liabilities that will reverse within five years, entities can benefit from a simplification to remove the need for tracking. Guidance is also provided on the methodology for determining whether any reversals are attributable to deferred tax liabilities that arose before the group came within the scope of Pillar Two.

The guidance also includes a clarification on the exceptions to the recapture rule: deferred tax liabilities associated with cost recovery allowances on leased property will be within the scope of the exception if the leased property is a tangible asset.

Divergences between Pillar Two basis and accounting carrying values

There are a number of areas in the model rules that require an entity to determine its Pillar Two income or loss by reference to values that may differ from the carrying values reflected in the financial accounts used in the preparation of the consolidated financial statements. Examples include: pension accruals; stock-based compensation; intra-group asset transfers accounted for at cost; elections to use the realisation method in lieu of fair value accounting; and adjustments following acquisitions or disposals of entities. The guidance provides clarifications on how the total deferred tax adjustment amount should be calculated using Pillar Two (global anti-base erosion or "GloBE") carrying values in these areas. The guidance also clarifies the limited extent to which such divergences are taken into account for the purposes of applying the transition rules, and how Pillar Two deferred tax amounts are calculated following intragroup transfers accounted for at cost and subsequently amortized/impaired. The substance-based income exclusion continues to be calculated using accounting carrying values.

Allocation of cross-border current taxes

Under the model rules, covered tax amounts included within the financial accounts of a "main entity" but relating to the profits of its permanent establishment, are generally allocated to the permanent establishment jurisdiction for effective tax rate calculation purposes. Some jurisdictions allow for "cross-crediting," i.e., foreign taxes paid on one source of income can give rise to foreign tax credits that can be used against income arising in a different jurisdiction. The existing guidance on 'cross-crediting' is significantly expanded and sets out a formulaic mechanism for determining the allocations of covered tax amounts to each permanent establishment where cross-crediting rules apply to the main entity. The mechanism uses a four-step process, together with allocation keys, to apportion amounts. Modifications apply where cross-crediting involves taxable distributions and/or is applied by reference to separate "baskets" of foreign income. The same principles also apply in respect of the cross-crediting of taxes on CFCs (other than taxes arising under a "blended CFC tax regime" such as US global intangible low-taxed income (GILTI), for which specific guidance issued in February 2023 remains applicable) and also hybrid and reverse hybrid entities.

Allocation of cross-border deferred taxes

Expanded guidance is provided on the principles relevant to allocating deferred taxes between group entities where a deferred tax balance in the financial accounts of one entity arises due to the income of a different Pillar Two entity. The guidance focuses on deferred tax associated with CFC rules and sets out a formulaic five-step approach for calculating the Pillar Two reallocation of associated deferred tax amounts of a parent to its CFC. Several numerical examples are given that illustrate the interaction with deferred tax from credits for the underlying tax of the CFC itself, requirements to recast deferred tax amounts to 15% and/or the passive income limitation. The guidance states that the same principles will also apply to allocation of similar deferred taxes from a main entity to permanent establishments, and from parent entities to hybrid and reverse hybrid entities.

The new guidance also expands existing commentary that sets out a "substitute loss carry-forward DTA" mechanism to address situations where a parent entity has a current year domestic tax loss that is used against current year foreign CFC income with a corresponding carry forward of excess foreign tax credits. This mechanism is extended to situations involving permanent establishments, hybrid entities and reverse hybrid entities, and also to similar situations involving the interaction of domestic tax losses brought forward and foreign tax credits.

Allocation of profits and taxes in groups including flow-through entities

Additional guidance has been released in respect of the allocation of profits and taxes to and from "flow-through entities" (i.e., broadly, entities which are treated as transparent in their jurisdiction of creation). The guidance addresses situations where a flow-through entity is itself held directly by another flow-through entity. In such cases, classification of entities as "tax transparent" or "reverse hybrids," and reallocations of profits and taxes, will generally be determined by the tax law of the entity closest in the ownership chain which is itself not a flow-through entity (the "reference entity"). The guidance includes situations where the ultimate parent of a group is a flow-through entity, or where there is a minority interest in a flow-through entity. The guidance also confirms how CFC taxes, initially attributable to a flow-through entity, should be treated under the general reallocation rules for flow-through entities.

The definition of a hybrid entity has been expanded such that an entity can be treated as a hybrid entity by reference to its tax treatment in the jurisdiction of an *indirect* owner, enabling in some circumstances for taxes paid by the indirect owner to be allocated to the hybrid entity. An entity can also be treated as a hybrid entity where its local tax jurisdiction does not have a corporate income tax regime. The guidance also sets out circumstances where taxes paid by an *indirect* owner in respect of a reverse hybrid entity are allocated to the reverse hybrid.

Treatment of securitization vehicles

Additional guidance has been issued on the treatment of groups with special purpose vehicles used for the purposes of securitization transactions. The guidance notes the importance for the sector that securitization entities remain "bankruptcy remote." Where a special purpose vehicle meets the guidance’s definition of a securitization entity (including having non-group investors), jurisdictions can exclude these entities from the scope of their QDMTTs. However, the "switch-off rule" would apply such that a group with an excluded securitization entity would not benefit from the QDMTT safe harbor for that jurisdiction. Alternatively, jurisdictions may choose to design their QDMTTs so that any QDMTT top-up tax liabilities in respect of securitization entities are imposed on other group entities located in the same jurisdiction, in which case the QDMTT safe harbor would remain available for that jurisdiction.

The OECD inclusive framework will consider issuing further administrative guidance to address issues associated with securitization entities, e.g., in respect of hedging arrangements.

Qualified status under Pillar Two

The Pillar Two global minimum tax rules incorporate an agreed rule order, which prevents a jurisdiction from levying top-up tax in respect of low tax profits where those profits have already been subject to top-up tax under "qualified" rules in another jurisdiction. A separate questions and answers document published by the OECD inclusive framework describes agreed processes for common assessment of the "qualified" rules status of jurisdictions' implementations of domestic minimum top-up tax rules, IIRs, and UTPRs; as well as assessing whether a jurisdiction's QDMTT satisfies the additional criteria for the QDMTT safe harbor to apply.

A simplified transitional qualification mechanism will apply initially based on self-certification by an implementing jurisdiction. An implementing jurisdiction will provide the OECD inclusive framework with information on the main features of their (draft or enacted) legislation. If the rules contain some minor inconsistencies, a jurisdiction can still make a self-certification where these are expected to be addressed within an agreed timeframe. If no questions are received from other OECD inclusive framework jurisdictions, or if any such questions are resolved, the rules will be recorded on the OECD website as having transitional qualified status. If questions cannot be resolved and a required level of opposition is reached ('consensus minus one' - i.e. all or all but one of the reviewing jurisdictions have agreed that the self-certification should be rejected) then the jurisdiction's rules will not have transitional qualified status. If the rejection requirements are not reached, the jurisdiction's rules will have transitional qualified status, but they will also be prioritized for early full legislative review under the peer review process. All implementing jurisdictions will be required to respect any transitional qualified status.

A full peer review process will be introduced, involving both a full legislative review of whether domestic legislation achieves outcomes consistent with the model rules, and ongoing monitoring to ensure that a jurisdiction's rules are in practice applied and administered consistently with the model rules. Any loss of transitional qualified status as a result of a peer review will not be retrospective but will only apply for accounting periods that begin on or after the date that the status changes.

Next steps

The OECD inclusive framework will continue to release further agreed guidance on an ongoing basis. It is expected that future guidance will include the treatment of hybrid arbitrage arrangements in the main Pillar Two rules.

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 provide simplifications where possible.

This is the fourth set of administrative guidance and covers a range of areas such as the practical application of the deferred tax liability recapture rule, how to deal with divergences between Pillar Two and accounting carrying values, the allocation of cross-border current and deferred taxes, the allocation of profits and taxes in groups including flow-through entities, and the treatment of securitization vehicles.

Businesses will need to work through the new guidance with reference to their facts and group entities to ensure that the effect of the new guidance is understood and reflected in calculations. Of particular note is the requirement for additional deferred tax to be calculated on differences between Pillar Two carrying values and corporate income tax carrying values, solely for the purposes of the Pillar Two calculations.

A large part of the guidance relates to situations affecting US multinationals where the model rules and existing commentary did not sit comfortably with either GAAP accounting treatment or the specialisms of the US corporate income tax regime (including the check-the-box rules). For example, the application of the Pillar Two rules to flow-through entities has been challenging from the start. The latest guidance deals with some concerns regarding mismatches arising in relation to reverse hybrids.

The guidance sets out that further work will be undertaken in some areas, including situations where there are losses in a main entity with permanent establishments or parent entities of controlled foreign companies (CFCs) and hybrid entities, and also in relation to securitization vehicles. Further guidance on hybrid arbitrage arrangements in the main Pillar Two rules is also expected.

The OECD inclusive framework continues its work on mechanisms for dispute resolution in relation to differences of interpretation (including between tax authorities) of the Pillar Two rules.

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Tax Analysis / Tax Newsflash

26 April 2024
OECD 发布支柱二综合注释
Pillar Two: Consolidated commentary published

P386/2024 – 26 February 2024
OECD 发布《支柱一金额 B》报告
[Simplified Chinese]

21 December 2023
Pillar Two: OECD's further guidance

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

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]

3 February 2023
OECD released administrative guidance on global minimum tax

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

21 December 2022

OECD Pillar Two: Information return and safe harbors published

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》
[Simplified Chinese] [Japanese]

P352/2022 - 13 April 2022
OECD 发布支柱一金额 A 立法模板系列之《税基确定立法模板草案》
[Simplified Chinese] [Japanese]

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

P350/2022 – 9 March 2022
OECD 发布支柱一金额 A 立法模板系列之《联结度与收入来源规则立法模板草案》
[Simplified Chinese]

P347/2021 – 22 December 2021
支柱二 – G20/OECD 包容性框架发布全球最低税立法模板
[Simplified Chinese] [Japanese]

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

P343/2021 – 12 July 2021
Global Minimum Tax Frequently Asked Questions (FAQ)
[Simplified Chinese] [English] [Japanese]

7 July 2021
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

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
[Simplified Chinese] [Japanese]

P323/2020 – 22 October 2020
变革与经济复苏下的全球税收政策导向
[Simplified Chinese]

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

P322/2020 – 7 October 2020
澳大利亚发布 2020-21 年预算：政策利好复苏
[Simplified Chinese]

P317/2020 – 27 July 2020
European Union - Mandatory Tax Reporting for certain cross-border arrangements
[Simplified Chinese] [English]

P311/2020 – 14 February 2020
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
[Simplified Chinese]

P309/2019 – 20 December 2019
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]

Hong Kong Tax Analysis / Tax Newsflash

21 December 2023
Hong Kong Pillar 2 QDMTT / HKMTT and GloBE Rules consultation

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

18 August 2022
Hong Kong defers the implementation of Pillar Two

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

H99/2020 – 27 November 2020
Pillar Two – Impact on Hong Kong
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