The European Union reaches an agreement on global minimum taxation (Pillar 2)

Tax Alert

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The Council of the European Union has **announced** that the member states have formally adopted an agreement to implement the **"Pillar 2" Directive at European Union level**. The Directive sets out to introduce a global minimum effective tax rate of 15% for large multinational groups, wherever they may operate.

The Directive to implement Pillar 2 within the European Union was finally approved on 14 December 2022 and published on 22 December 2022.

Council Directive (EU) 2022/2523 on ensuring a global minimum level of taxation for multinational enterprise groups and large-scale domestic groups in the Union.

Large multinational and EU national groups are analysis Pillar 2 implications.

Member states will have until the end of 2023 to incorporate the provisions of the Directive into their domestic laws.

Context

In recent years, the OECD has been developing a set of international tax rules to address the challenges arising from the digitalisation of the economy and put an end to tax practices that allow multinationals to shift profits to jurisdictions where they are subject to no or very low taxation.

It was against this background that it published its "Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy" on 8 October 2021, thus implementing the multilateral policy agreement reached a few months previously, on 1 July 2021.

OECD discussions in this connection have centred around two broad topics, namely:

- Pillar 1, proposing rules on profit allocation in a global, digitalised economy; and

- Pillar 2, which seeks to introduce a global minimum effective tax rate of 15% for large multinational groups, wherever they may operate.

As regards Pillar 2, on 20 December 2021 the OECD released a set of rules collectively dubbed the "GloBE - Global Anti-Base Erosion- Rules", aimed at setting in place a global minimum taxation system. These rules were supported by 137 of the 140 OECD Inclusive Framework member countries.

Pillar 2 comprises three rules, the first two of which are together referred to as the GloBE rules, as noted above, and consist of: (i) the "Income Inclusion Rule" (IIR); and (ii) the "Undertaxed Payments Rule" or Undertaxed Profit Rule, according to the EU Directive (UTPR). The IIR will be implemented first and is set to apply to years commencing as of 31 December 2023, while the UTPR will apply to fiscal years commencing as of 31 December 2024.

These GloBE rules are expected to be supplemented by a third rule known as the "Subject to Tax Rule" (STTR). The STTR has yet to be developed by the OECD.

The EU Commission responded by putting forward a proposal for a Community Directive setting out rules to ensure minimum effective taxation of multinational groups mere days following the publication of the GloBE rules. Although the proposed Community Directive is consistent with the OECD's GloBE rules of the OECD, it also extends to strictly domestic large-scale groups.

The wording of the Directive reflects the OECD's global agreement, albeit with certain necessary adjustments to ensure conformity with EU law.

The Directive to implement Pillar 2 at European Union level was finally approved on 14 December 2022 and published on the Official Journal of the European Union on 22 December 2022.

Most salient aspects of Pillar 2

As noted above, Pillar 2 aims to ensure a global minimum effective tax rate of 15% in each jurisdiction in which large multinational groups operate. This may imply that Pillar 2 will apply in scenarios where a group's global effective taxation exceeds 15% despite not reaching that threshold in a given jurisdiction. Moreover, in jurisdictions such as Spain, with an effective taxation level exceeding 15% (calculated pursuant to domestic tax provisions), the minimum taxation threshold might not be reached under the Pillar 2 computation rules.

An overview of the main aspects of Pillar 2 is provided below:

- **Scope**

  Pillar 2 is set to apply to multinational enterprise groups and domestic groups that meet the annual threshold of at least Euros 750 million of consolidated revenue in two of the four years prior to the “tested” year.

- **Effective tax rate (ETR) and top-up tax**

  The ETR must be calculated in each of the jurisdictions in which the group operates. The ETR will be calculated on the basis of adjusted covered taxes and qualifying income or loss (in accordance with specific rules).

  If the ETR in a given jurisdiction is less than 15%, a top-up tax must be paid to bring the rate up to the minimum 15% threshold, subject to certain deductions based on the costs associated with employees and the value of assets.

  A *de minimis* exclusion rule is established, whereby a multinational group may consider the top-up tax due in a certain jurisdiction to be equal to zero (i.e. no minimum taxation will be due in such jurisdiction). For this to apply, certain thresholds must not be exceeded in the relevant jurisdiction: average revenue of less than Euros 10 million; and average qualifying income or loss of less than Euros 1 million, calculated under GloBE rules (average of the mentioned values for the fiscal year under consideration and the two preceding fiscal years).

- **Charging rules**

  The IIR and UTPR provided for under Pillar 2 are conceived as two interlocking rules used to identify the group enterprise or enterprises incurring the primary tax obligation and the jurisdiction in which the top-up tax for the year will be collected in the event that the minimum ETR of 15% is not reached in a given jurisdiction.

  While the IIR stands as the primary rule, the UTPR will serve as a backstop or protective mechanism, only applying in the event that minimum taxation of 15% is not achieved in each jurisdiction under the IIR.

  ✓ The IIR provides that the relevant top-up tax corresponding to constituent entities in low-tax jurisdictions is levied on the group’s ultimate parent entity (UPE) which, as a general rule, takes precedence over other second- or lower-level parent entities, albeit with certain significant exceptions.

  ✓ The backstop rule, or UTPR, provides that it will take effect where the entire amount of the top-up tax cannot be collected under the IIR.

  It is worth noting that the Directive offers countries the option of introducing a qualified minimum domestic top-up tax, which would prevail over the implementation of the aforementioned primary and backstop rules and potentially become the first line of defence when the GloBE framework is triggered in respect of a given jurisdiction. In other words, countries may establish legislation whereby groups that do not reach a minimum ETR of 15% in the jurisdiction concerned will pay top-up tax in their own countries in order to bring the tax rate up to the 15% level stipulated under Pillar 2, rather than paying such tax in the parent’s jurisdiction.

Next steps

Member states will have until 31 December 2023 to transpose the Directive into their domestic legislation once it has been published in the Official Journal of the European Union.

The OECD has published certain guidance on implementing regulations on administrative, coordination and compliance aspects of Pillar 2 (including initial safe harbours rules, still under discussion). Additional guidance is still expected.

However, bearing in mind the manner in which the charging rules laid down in Pillar 2 operate, it will be necessary to monitor the pace of its implementation in other jurisdictions, in case the tax liability is triggered earlier in other jurisdictions in which the group operates. For instance, countries such as South Korea, the Netherlands, Switzerland and the United Kingdom have already released draft GloBE legislation, while others such as Australia, Canada, Hong Kong, Malaysia, Mexico, New Zealand and Singapore have formally announced the inclusion of Pillar 2 in their respective legislation.

Remarks

The major technical complexity of the GloBE rules is a widely accepted fact, and the implementation of these rules will no doubt raise a number of questions to be addressed by the groups concerned over the course of 2023, given that the new rules are expected to apply as of 2024. The numerous technical aspects include, among others:

(i) Analysis of the group's corporate structure to identify the entities forming part of the group concerned (perimeter), identifying which of them are constituent entities and which are not and may therefore be excluded (for instance, non-profit organisations, pension funds, investment funds, etc.);

(ii) Classification of the entities required to incur the primary tax obligation, drawing a distinction between UPEs, IPEs (intermediate parent entities) and POPEs (partially-owned parent entities);

(iii) Determination, in each jurisdiction, of which taxes must be taken into account for the purpose of calculating whether or not the minimum taxation threshold is reached (for example, withholdings on cross-border payments and direct taxes potentially classifiable as covered taxes);

(iv) Computation of the GloBE tax base by jurisdiction, having regard to accounting aspects which may be particularly relevant for the purposes of Pillar 2, by identifying the possibility of applying specific adjustments and various options provided for in the GloBE rules, and considering how such aspects interact with the tax credits and adjustments provided for in the relevant corporate income tax rules;

(v) Review of the safe harbour rules and the extent to which they will be capable of easing the administrative burden associated with the implementation of the legislation;

(vi) The interplay between Pillar 2 and the measurement of related-party transactions or the analysis of special situations such as business restructuring and special or transitional regimes;

(vii) The interaction of the regulatory accounting framework applicable to the UPE with the relevant local GAAPs in each jurisdiction, and with international accounting standards (the IASB is currently discussing the implications of the potential recognition of deferred taxes, among other aspects).

The legislation also presents significant challenges in the management and administration phase, such as:

(i) Understanding the potential difficulties that may come to light at each organisation as regards gathering the accounting and tax information necessary to perform the relevant calculations under GloBE;

(ii) Adapting systems to support subsequent tax reporting (automation);

(iii) Setting in place a suitable tax control framework, which will include defining the approach to be adopted -whether central, regional or hybrid- when interacting with Pillar 2;

(iv) The interrelation between Pillar 2 and the information reported in the country-by-country (CbC) report. Note, in this connection, that final provision six of the Law to Promote the Start-up Ecosystem (widely known as the "Start-ups Law") provides for amendments to Audit Law 22/2015 of 20 July 2015 and requires large multinational groups to report on the corporate income tax, or taxes of a similar or identical nature, that they have paid.

At KPMG we are aware of the ever increasing need to adopt a global approach to all of these matters, by providing the groups concerned with comprehensive support rendered by a multidisciplinary team acting in coordination with KPMG's network of professionals across various jurisdictions, who can offer advice on the practical application of this new international taxation landscape.

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