Unlocking global opportunities: Strategic tax responses and business restructurings in the era of Pillar Two

Fit for Pillar Two series

The ***Fit for Pillar Two*** series aims to help tax teams of multinational enterprises (MNEs) within the scope of Pillar Two prepare for the upcoming wave of international tax changes by putting theory into practice. In this series, Christian Athanasoulas, the Global Head of International Tax and M&A Tax at KPMG International and Tax Practice Leader — Services at KPMG in the US provides his insights and draws on experiences from professionals across KPMG member firms worldwide. Articles in the ***Fit for Pillar Two*** series will build upon each other and are designed to guide companies through the phases of Pillar Two readiness.

Multinational corporations must be ready to adapt to a new fiscal environment where traditional strategies that rely on low-tax jurisdictions may no longer yield the same benefits. This change is due to the introduction of a global minimum tax rate of 15 percent under Pillar Two of the Organisation for Economic Cooperation and Development's (OECD) base erosion and profit shifting (BEPS) project.

The new tax has spurred a wave of strategic restructuring, with companies seeking innovative approaches to align with the latest regulations while safeguarding their financial interests. This article explores how multinational enterprises can unlock global opportunities through strategic tax responses and business restructurings fit for the future global landscape in the era of Pillar Two.

Background

The OECD is working on the global implementation of tax proposals under two "pillars" as part of its BEPS project. Pillar Two focuses on ensuring that large MNEs pay a minimum rate of tax. Under these global anti-base erosion (GloBE) rules, MNEs with consolidated revenue above EUR750 million will be subject to a minimum 15 percent tax rate in each jurisdiction in which they operate. MNEs will need to look at their operations in each of these jurisdictions separately to see whether their effective tax rate falls under 15 percent. If so, a top-up tax (TUT) will need to be calculated and paid. MNE groups will be required to file a GloBE Information Return and generally make any required payments within 15 months after the last day of their fiscal year. MNE groups that do not comply with these rules may be subject to significant penalties.

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Challenges and opportunities

In response to the global implementation of Pillar Two, multinational corporations are reconsidering their global effective tax rate building blocks and business structures.

With the introduction of a global minimum tax rate of 15 percent, companies are compelled to navigate a drastically altered fiscal landscape, where traditional strategies that rely on low-tax jurisdictions may no longer yield the same benefits. This shift has spurred a wave of strategic restructuring, with firms seeking innovative approaches to align with the new regulations while safeguarding their financial interests.

The ongoing evolution of the OECD's administrative guidance on Pillar Two adds another layer of complexity to this already challenging scenario. Companies must remain agile, adapting their strategies in real-time to comply with the emerging details of the rules.

This need for adaptability underscores the importance of robust compliance frameworks that can quickly integrate new regulatory information and adjust operational and tax strategies accordingly. The dynamic nature of these changes demands that companies not only keep abreast of the regulatory environment but also maintain flexible operational structures that can swiftly respond to global tax changes.

Amidst these challenges, however, lie significant opportunities for tailored business restructuring that can optimize tax positions under the new global tax regime. Each company's approach will vary depending on its unique operational footprint, industry sector, and the jurisdictions in which it operates.

Strategic restructuring could involve realignment of intellectual property holdings, reconsideration of inter-company financing arrangements, or even relocation of certain business functions to jurisdictions with more favorable tax treaties or local incentives that align with Pillar Two's provisions. Business restructuring and planning provide a pathway for companies not only to comply with new tax laws but also to enhance their operational efficiency and global tax posture.

Companies that have completed comprehensive Pillar Two impact assessments and carried out significant data mapping exercises have an advantage. They can evaluate planning opportunities more effectively based on their unique facts and circumstances. These companies can make informed decisions that optimize their tax positions while complying with global standards.

How can multinational enterprises navigate the complexities of Pillar Two to optimize their response and seize business restructuring opportunities fit for the future global landscape?

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Q&A Insights

Let's delve deeper into the topic and gather valuable insights from a Q&A discussion with KPMG Partners from across the globe: Matthew Herrington, Partner, KPMG in the UK; Anthony Sileo, Principal and International Tax National Service Line Leader, KPMG in the US; Alia Lum, Partner and Tax Policy Leader, KPMG Australia; and Megha Menon, Partner, KPMG in the UK.

Q1. Are many companies undertaking business restructuring as a result of the Pillar Two rules?

We are seeing many companies consider business restructuring after identifying adverse outcomes from an initial Pillar Two impact assessment. The three key areas in which we assist clients are legal entity rationalization, retrofitting structures and tax attribute optimization.

1. Legal entity rationalization

Pillar Two introduces additional reporting requirements on MNE groups; the time and cost of complying with these requirements are expected to be significant. We are seeing many companies consider legal entity rationalization projects to lessen the administrative burden of Pillar Two on their organization. The GloBE Information Return is completed on a jurisdiction-by-jurisdiction basis; therefore, removing entities or whole jurisdictions from a group can alleviate some of the long-term compliance burdens, providing cost savings and reducing the tax risk for the group. In some cases, the upfront cost of unwinding or modifying a group structure will be less than the tax at risk or cost of complying with these new rules.

2. Retrofitting structures

Clients are revisiting their existing structures to confirm they remain fit for purpose in a Pillar Two world. Whether that involves a review of the value chain, their financing arrangements or their intellectual property holdings, companies are conducting assessments to confirm that their structures continue to function as intended and to identify areas that need to change once viewed through a Pillar Two lens.

These activities can involve "retrofitting" the structure to ensure it remains fit for purpose or unwinding the structure if it no longer provides the previously intended tax outcomes. In some cases, specific exclusions are available under Pillar Two for certain types of transactions or certain industries; groups are considering restructuring to meet those exclusions.

For example, many groups have considered ensuring they are within the international shipping income exclusion as they typically rely on tonnage tax regimes with beneficial, effective tax rates. This step is generally easy, given that it relies on aligning tax with the nature of the business.

3. Tax attribute optimization

Some groups are looking at restructuring to optimize tax attributes and access to incentives, particularly where a change in structure is required commercially or as a result of an M&A deal.

The benefits of this restructuring include managing dilutive regimes such as Patent Box, optimizing losses and maximizing Research and Development credits. This restructuring is happening where changes to the tax operating model and distribution of system profits need to be made. As a result, companies are increasingly focusing on post-acquisition integration and restructuring efforts.

Q2. Are there other types of strategic responses that you are seeing companies undertake?

Many of the responses we see multinational groups consider are bespoke and fact specific. However, some common themes are starting to emerge across the largest and most sophisticated groups impacted by Pillar Two.

Using transitional safe harbors

Some groups are considering entering into transactions to preserve the benefit of existing structures in the short term while a transitional safe harbor is available. These arrangements may cease to be effective once the full Pillar 2 computation applies. However, it remains to be seen what impact the permanent safe harbors might have beyond that point.

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Focus areas here include accessing tax attributes such as losses, commercially bringing additional income into jurisdictions to blend out the effect of preferential regimes and exploring the application of alternative accounting bases (as permitted under Pillar Two) to particular fact patterns.

Developing longer-term strategies

Some groups are now considering longer-term strategies, in particular those that are now at the end of their first year in the safe harbor period and which are therefore starting to look ahead to activities that they need to take in the medium term to be ready to comply with the main rules in two years' time.

Here, it is harder to identify solid solutions, given that the Pillar Two rules are still being developed and updated administrative guidance from the OECD continues to change the landscape. However, many affected groups are starting to consider implementing "no-regrets" arrangements that can be incubated pending the outcome of the evolving landscape, implementing intra-group recharge and Pillar Two payment mechanisms to access the cash needed for payment of top-up tax exposures, and standing up resources to enable them to monitor and respond to changes in the international tax landscape such as the ramifications of the recent US election.

More sophisticated responses to managing Pillar Two impacts are also emerging in this group, focusing on the highest value-driving functions, such as financing and intellectual property. Structural responses are generally arrived at on a multijurisdictional basis using the interface between different domestic regimes. We see some parallels with groups within the transitional safe harbors, with deferred tax asset (DTA) grandfathering being a focus of discussion.

Such groups are also considering one-off transactions for particular occurrences. For example, to manage the impact of Pillar 2 on a third-party transaction or a group restructuring using existing group attributes.

Reviewing new incentives

Groups are also looking hard at incentives. Many jurisdictions are changing their tax credit and incentive regimes in response to Pillar Two to maintain competitiveness in the changing global tax environment. Companies are reviewing these new incentives to confirm whether and how to qualify and model the impact on their organization's Pillar Two profile. The availability of incentives in the post-Pillar Two world will remain one of the many important considerations that a group will look at when determining whether to set up in a new jurisdiction, expand in an existing one or exit a jurisdiction.

The availability of incentives can also impact how parent jurisdictions may react. We already see restrictions on foreign tax credits for domestic minimum top-up taxes for jurisdictions that "give back" the top-up tax through a grant or refundable credit. The OECD has indicated in recent materials that it assesses whether related benefit restrictions should be introduced into the rules. This uncertainty can make incentive access challenging, so groups are modelling a variety of outcomes.

Q3. How can the KPMG technology suite assist clients with tax planning opportunities?

Leveraging technology and modeling solutions like the KPMG BEPS 2.0 Automation Technology (KBAT) can be critical for groups wanting to get ahead of the curve and adopt best-in-class responses to Pillar Two.

Scenario modelling facilitates effective planning

KBAT provides extensive scenario modeling capabilities to facilitate the alignment of tax with business goals and objectives. Calculations can be "back-of-the-envelope" to provide a high-level overview of the anticipated impact of changes or in-depth to see the year-on-year impact. This modeling allows teams to create easy comparisons of opportunities and cost-benefit analyses for discussion with stakeholders. Given the complexity and evolving adoption of Pillar 2 by jurisdictions around the world, this analysis has become essential to validate a company's strategic planning initiatives, identify opportunities and reduce risk.

Modeling outputs can provide both summary comparisons and detailed analyses of year-on-year global tax impacts associated with one or more planning initiatives. This information can be particularly useful to facilitate discussions with key business stakeholders and support organizations to effectively manage their global tax profile, effective tax rate and cash tax position over a multi-year period.

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As a best practice, organizations are using KBAT to take a multi-faceted approach to the modeling that underpins their strategic planning initiatives and objectives. For example, an organization may first seek to establish its baseline global tax position as impacted by Pillar Two over a multi-year period. Again, this information is crucial given the evolving adoption of Pillar Two legislation by jurisdictions around the globe. Organizations may then consider ways to optimize their baseline by assessing various elections available and the differences in the Pillar Two rules between jurisdictions.

Once a refined baseline is established, appropriate scenario modeling for one or more strategic planning initiatives can then be accomplished. Leading organizations do not view this planning as static, but as a regularly evaluated and updated process as financial results, Pillar Two guidance, and business objectives evolve.

Consider differences in jurisdictions' Pillar Two rules

Organizations must also consider the differences in the Pillar Two rules from jurisdiction to jurisdiction. The July 2023 guidance issued by the OECD/G20 Inclusive Framework (July 2023 OECD Guidance) allows for 16 adjustments a jurisdiction may consider when implementing Pillar Two, one of which relates to the starting point for the Global Anti-Base Erosion (GloBE) computation. For example, in Ireland, the local accounting standard is used as a starting point for Qualified Domestic Minimum Top-Up Tax (QDMTT), with Ultimate Parent Entity (UPE) GAAP financials as an alternative if certain conditions are not met. The Pillar 2 rules in other jurisdictions may defer to the financial accounting standard of the UPE.

Several elections are also available that companies should consider in their modeling framework. One of these elections is the stock-based compensation expense election under Article 3.2.2 of the 2021 guidance issued by the OECD/G20 Inclusive Framework (the Model Rules). This five-year jurisdictional election allows a taxpayer to use the amount of a constituent entity's stock-based compensation deductible for tax purposes in the local jurisdiction instead of its book stock-based compensation expense when computing GloBE income.

The importance of modeling may be even more important in Pillar Two planning based upon the tax regime in the jurisdiction where a multinational is headquartered, including whether that jurisdiction has adopted Pillar Two into its local laws.

For example, US multinationals are faced with the daunting task of modeling the complex relationship between US tax provisions like the Global Intangible Low-Taxed Income (GILTI) regime and the US foreign tax credit rules, with the impacts of Pillar Two in each of the jurisdictions where they operate. For this purpose, the GILTI regime is considered a "Blended CFC Tax Regime" within Article 4.3.2 of the Model Rules.

Under current guidance, for calendar years 2024 and 2025, the US residual tax on GILTI may be allocated to jurisdictions with an effective tax rate below 13.125 percent that have not enacted a QDMTT. This allocation may serve to reduce the Pillar Two top-up tax that could arise under an income inclusion rule (IRR) or Undertaxed Profit Rule (UTPR).

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KPMG observation

1. Multinational corporations must be ready to navigate a drastically altered fiscal landscape where traditional strategies that rely on low-tax jurisdictions may no longer yield the same benefits.
2. Significant opportunities exist for tailored business restructuring that can optimize tax positions under the new global tax regime.
3. Comprehensive Pillar Two impact assessments allow companies to evaluate planning opportunities more effectively.
4. Many companies' business restructuring focuses on legal entity rationalization, retrofitting structures and tax attribute optimization.
5. Other strategic responses include using transitional safe harbors, developing longer-term strategies and reviewing new incentives.
6. Leveraging technology and modeling solutions like the KPMG BEPS 2.0 Automation Technology (KBAT) are critical for groups wanting to get ahead of the curve and adopt best-in-class responses to Pillar Two.

Stay tuned for the next article in our next Fit for Pillar Two series that will delve deeper into data, transformation and technology.

Enabling technology

KPMG Digital Gateway — Powered by Microsoft Azure, KPMG Digital Gateway, is a single platform cloud-based solution that gives you access to the full suite of KPMG Tax technologies.

KPMG' BEPS 2.0 Automation Technology (KBAT) is a cloud-based tool designed to help to evaluate, monitor, compile, track, calculate, analyze, report and comply with Pillar Two obligations, through integration with the KPMG Digital Gateway platform.

KPMG BEPS 2.0 tracker — Hosted on Digital Gateway, BEPS Pillar Two content providing access to announcements, justification status information and jurisdiction contacts.

If you haven't completed an impact assessment, click here to find out how to get started.

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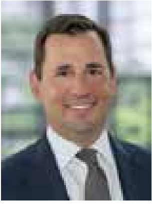

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Designed by Evalueserve.

Publication name: Unlocking global opportunities: Strategic tax responses and business restructurings in the era of Pillar Two
Publication number: 139813-G
Publication date: January 2025