Pillar Two applies where, even after the effect of Pillar One (if any), multinationals are regarded as undertaxed by reference to an agreed minimum level of taxation.

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Levelling the playing field

- Pillar Two has four new rules granting jurisdictions additional taxing rights where other jurisdictions have not exercised their primary taxing rights or income is subject to low rates of tax.
- An Income Inclusion Rule (IIR) that would subject foreign income of branches and controlled entities to an agreed minimum tax in the parent jurisdiction.
- An Undertaxed Payments Rule (UTPR) that acts as a backstop to the IIR denying deductions or introducing source-based taxation under certain conditions.
- A Subject to Tax Rule which complements the UTPR in certain cases.
- A Switch-over Rule that applies where a PE is "undertaxed" switching off a treaty based exemption in the head office jurisdiction and replacing it with a credit based method of taxation.

Exclusions and simplifications

- The intention for most practical purposes is that these rules should only apply to MNE Groups with a total consolidated group revenue above €750 million or equivalent.
- The rules are designed to focus on "excess income", particularly intangible-related income, which is regarded as most susceptible to diversion.
- The proposals therefore include a “carve-out” and simple fixed return for payroll and certain tangible asset costs.
- A further in-principle exclusion may be to recognise tax already imposed under the US GILTI regime (still to be agreed).
- To limit the compliance burden on low-risk businesses, simplification options are proposed which may be based on some or all of CbC data, de minimis profits, or low local tax risk.

What businesses need to know

- Work on Pillar Two has greatly advanced towards consensus, the main areas which still need to be resolved are around simplification measures.
- Pillar Two could have a significant impact on the effective tax rates of MNE Groups by itself or in combination with Pillar One.
- Implementation of the rules will involve a combination of changes to domestic tax laws and bilateral tax treaties (expected to be via a Multilateral Instrument).
- A period of open consultation on the proposals will now follow until 14 December 2020. The OECD has published its global impact analysis; potentially affected businesses should consider what these changes could mean for their ETRs.