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BEPS and Pillar 2 Are Here — Where in the GLOBE Are Your Employees?

by Christine Deveney and John DerOhanesian

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In this article, Deveney and DerOhanesian examine how correctly reporting employee numbers, locations, and costs will benefit multinational enterprises under pillar 2.

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The base erosion and profit-shifting project, initiated by the OECD and the G20, aims to create a fair and transparent international tax system. Pillar 2 of this initiative ensures that large multinational enterprises pay a minimum effective tax rate of 15 percent in every jurisdiction where they conduct business. If the ETR is less than 15 percent in any jurisdiction, the MNE is required to pay a top-up tax to meet the 15 percent minimum threshold. The ETR and any top-up tax is calculated and reported under newly developed global anti-base-erosion (GLOBE) rules.

A substantial number of jurisdictions have implemented the pillar 2 rules, with effect from January 1, 2024. While the United States has not implemented pillar 2 legislation, U.S. MNEs with operations in jurisdictions that have implemented pillar 2 legislation may nevertheless still be subject to some form of pillar 2 tax and information return reporting starting with this year. The pillar 2 rules require complicated and data-intensive calculations across multiple jurisdictions. Accurate data on employee numbers, employee locations, and employee costs are critical for compliance with pillar 2 and avoiding the risk of double taxation.

Since 2016, under the BEPS initiative, MNEs have been required to report the number of full-time equivalent employees in each jurisdiction where they operate on a country-by-country report that's shared with tax administrations in those jurisdictions. To date, CbC reports have been informational returns, used by tax administrations for high-level assessment of profit-shifting risks, with no direct link to the GLOBE tax calculation. With the commencement of the pillar 2 rules, correct CbC reporting takes on a new importance because this data will be used to determine whether an MNE qualifies for relief from additional tax or reporting in a specific jurisdiction under transitional safe harbor calculations provided for in the GLOBE rules.

If no safe harbor applies in a jurisdiction, a full GLOBE tax calculation must be performed and reported. The substance-based income exclusion (SBIE) is a carveout from the GLOBE tax calculation based on a markup on payroll expenses and tangible assets in each jurisdiction. The amount of payroll costs included in the SBIE directly reduces excess profits and hence the amount of any additional top-up tax an MNE may be required to pay. Finally, the pillar 2 rules provide for a special election for stock-based compensation that may beneficially affect an MNE's minimum tax calculation.

Collecting and compiling employee numbers and employee costs will therefore be vital to the process, and global mobility professionals can play an essential role. They can assist in determining the number of FTE employees to report in each country, where to report remote and mobile employees, whether to include independent contractors, the amount of eligible payroll costs in a jurisdiction, and how to prorate those costs when employees work outside the jurisdiction. They can also help identify and maintain consistent data sources across

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jurisdictions, agree on definitions for reporting, review policies, identify reporting anomalies, and assist in modeling GLOBE outcomes under different global workforce scenarios.

Background

In response to the growing concern that MNEs are not paying their fair share of taxes and existing international tax rules are not fit for the digital economy, the BEPS project is a global initiative aimed at creating a fairer and more transparent international tax system by preventing MNEs from exploiting gaps and mismatches in tax rules to artificially shift profits to low- or no-tax locations.

To address BEPS, in September 2013 the OECD and G20 countries adopted a 15-point action plan to tackle tax avoidance underpinned by three key pillars: coherence, substance, and transparency. Now informally referred to as BEPS 1.0, the action plan led to the BEPS package, which was announced jointly by the OECD and G20 countries in October 2015. The comprehensive package consolidated measures developed in response to the 15 actions designed to be implemented via changes in domestic law and practices and in tax treaties. While the OECD has no legislative power, once consensus is reached, its member countries usually agree to alter their own laws and treaties to reflect agreed OECD initiatives.

The OECD/G20 inclusive framework on BEPS, established in 2016, expanded participation beyond traditional OECD members to allow interested countries and jurisdictions to work with OECD and G20 members on developing standards on BEPS-related issues and to review and monitor the implementation of the BEPS package. To join the inclusive framework, countries and jurisdictions are required to commit to the consistent implementation of the comprehensive BEPS package and conform to certain minimum standards. As of January 2024, more than 140 countries and jurisdictions have joined the inclusive framework.[1]

Action 1 of the BEPS action plan, "Tax Challenges Arising From Digitalisation," attempted to address the tax challenges of the digital economy, without answering any of the difficult questions or posing any solutions to the identified issues. The failure of action 1, and BEPS 1.0 in general, to deliver concrete solutions for the tax challenges posed by the digital economy was a key impetus for the start of the BEPS 2.0 project. BEPS 2.0 consists of two main pillars specifically aimed at addressing these challenges. Pillar 1 focuses on the allocation of taxing rights among countries and seeks to ensure that MNEs pay taxes where they generate revenue, even if they lack physical presence. Pillar 2 aims to ensure that MNEs pay a minimum level of tax regardless of the jurisdictions where they are headquartered or operate. The timing for the introduction of pillar 1 is still unknown, pending the issuance of further OECD guidance and adoption by key countries, such as the United States. However, pillar 2 is moving forward with about 50 jurisdictions that have implemented or are in the process of implementing pillar 2 legislation. The OECD estimates that by 2025 nearly 90 percent of MNEs with revenues of at least €750 million will be subject to the global minimum tax.[2]

The Role of Employee Data in BEPS and Pillar 2 Compliance

CbC Reporting

CbC reporting, a key element of the BEPS action 13 transparency initiative, requires MNEs with annual consolidated group revenue of €750 million or more to provide detailed financial and economic activity data for each tax jurisdiction in which they operate. A crucial aspect of this data is the number of FTE employees in each jurisdiction, which helps tax authorities assess the scale of an MNE's operations and its economic substance in a particular location. The CbC reporting requirement applies for fiscal years beginning on or after January 1, 2016, and is a BEPS minimum standard to be implemented by all the inclusive framework countries.

[1] OECD, "Members of the OECD/G20 Inclusive Framework on BEPS" (last updated May 28, 2024).

[2] OECD, "OECD/G20 Inclusive Framework on BEPS: Progress Report September 2022-September 2023" (Sept. 2023).

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CbC reports are scrutinized by tax authorities to identify potential profit-shifting strategies and to justify reported profits, tax liabilities, and transfer pricing for intragroup transactions. As an example, the OECD, in its 2023 analysis of aggregated CbC reporting data from more than 7,000 companies for fiscal 2019 and 2020, found evidence of a misalignment between the locations of reported profits and actual economic activities. This was inferred from the observation that reported revenues and profits per employee were typically higher in investment hubs,[3] suggesting potential BEPS activities.[4]

The OECD published guidelines and model legislation for reporting FTE employees of group entities resident in a relevant tax jurisdiction, allowing for reasonable rounding or approximation, provided that the basis for reporting applied by the MNE is consistent across tax jurisdictions and from year to year and doesn't result in material distortion of the distribution of employees across jurisdictions.[5] Independent contractors that participate in the ordinary operating activities of the entity may be reported as employees. Each inclusive framework country must implement its own CbC reporting rules in line with the OECD's model legislation.

The United States issued final regulations in 2016 to implement CbC reporting under domestic legislation.[6] In accordance with the regulations, reporting on Form 8975, "Country by Country Report," is required for fiscal years commencing on or after June 30, 2016, by the ultimate parent entity (UPE) of a U.S. MNE group with annual revenue of $850 million or more. The requirement to report the number of employees for each tax jurisdiction effectively mirrors the OECD guidance. However, as explained in the preamble to the final regulations, Treasury and the IRS declined to provide additional guidance on the meaning of FTE employee or whether to include independent contractors in the number of FTE employees. The reason given was that permitting flexibility in determining the number of FTE employees of each group entity appropriately balances the CbC reporting compliance burden with the tax administration benefits. U.S. MNE groups may determine the number of FTE employees of each group entity using any reasonable approach that is consistently applied. Treasury and the IRS also clarified that employees of a group entity are reflected in the tax jurisdiction of residence of such entity consistent with the BEPS final report. Special rules are provided for employees of partnerships.

Given the lack of detailed guidance on how to determine FTE employees for a particular jurisdiction, the allowed flexibility of approach, and the difficulty in gathering consistent data across multiple entities and jurisdictions, many MNEs have been left to develop data gathering and reporting procedures that balance practicality with accuracy. However, now that CbC reports will be used to qualify for the transitional safe harbors (discussed below), businesses can expect more scrutiny from their internal and external auditors as well as from tax authorities over their preparation, including how the information reconciles with financial reporting systems.

Pillar 2 and GLOBE Rules Overview

Pillar 2, whose key components are commonly referred to as the GLOBE rules, is a new international tax regime established under the BEPS project that partially came into effect January 1, 2024. Pillar 2 aims to ensure large multinational companies (those with annual turnover of at least €750 million) pay a global ETR of at least 15 percent in every jurisdiction in which they conduct business. If a minimum tax rate of 15 percent has not been paid in a particular jurisdiction, the MNE is required to pay a top-up tax to make up the shortfall. The top-up tax is collected under a three-tiered system:

(1) Qualified Domestic Minimum Top-Up Tax (QDMTT). This is a local country tax that permits the local jurisdiction to levy an additional tax if group entities of the MNE in that country are subject to an ETR of less than 15 percent.

[3] The OECD defines investment hubs as jurisdictions with a total inward foreign direct investment above 150 percent of GDP and includes 21 countries commonly considered tax havens, such as Bermuda, the British Virgin Islands, Guernsey, Ireland, Jersey, Luxembourg, the Netherlands, Singapore, and Switzerland.

[4] OECD, "Corporate Tax Statistics" (2023).

[5] OECD, "Transfer Pricing Documentation and Country-by-Country Reporting, Action 13 — 2015 Final Report" (2015).

[6] T.D. 9773.

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(2) Income Inclusion Rule. This is a parent country tax that allows the UPE's jurisdiction, or an intermediate parent company's jurisdiction in certain cases, to collect the top-up tax if there are foreign subsidiaries within the group that on a jurisdictional level do not meet the 15 percent ETR and the foreign jurisdiction has not implemented a QDMTT.

(3) Undertaxed Profits Rule (formerly known as the undertaxed payments rule). This is a backstop tax. If a foreign jurisdiction has not implemented a QDMTT and there is no UPE or intermediate parent company's country that can collect the top-up tax via an IIR, the right to impose the top-up tax is allocated to other jurisdictions in which group subsidiaries are located and that have adopted a UTPR. Allocation is based on the "substance" of a company in a particular jurisdiction, which is determined by the number of employees and tangible assets of the group in those jurisdictions. The amount allocated to a jurisdiction is collected through a denial of a deduction for certain intragroup payments (or an equivalent adjustment under domestic law that results in the taxpayer having an incremental tax liability equal to the allocated top-up tax amount).

The computation of any top-up tax due is reported by the MNE on the GLOBE information return, which is due 18 months after the last day of the reporting period for the first year of pillar 2, and 15 months after the last day of the reporting period for years 2 and later.

Safe Harbors

The GLOBE rules provide safe harbors that allow MNEs to reduce the compliance burden by following a simpler set of rules rather than the more complex general rules. This is achieved by deeming the top-up tax to be zero for businesses and jurisdictions with low levels of foreign-source income or that have a low risk of profit shifting.

Safe harbors are divided into a transitional period and a permanent period. The transitional CbC reporting safe harbor period is a short-term measure to help ease transition to the GLOBE rules. It applies for years beginning on or before December 31, 2026, and uses certain information from the company's CbC reports to determine whether activities in a country meet any of three safe harbor tests.

In addition, the BEPS final report sets out a framework for the development of future permanent safe harbors that, if agreed, would reduce the number of calculations a company is required to make. The permanent safe harbor test would rely on information calculated under the GLOBE rules (rather than CbC reporting data) to determine eligibility.[7]

A company can apply for safe harbor relief under the transitional CbC reporting safe harbor if it meets one of the three tests in a jurisdiction:

(1) De Minimis Test. Applies if total revenues are less than €10 million and pretax income or loss is less than €1 million in the jurisdiction.

(2) Simplified ETR Test. Applies if the company has an ETR for the jurisdiction equal to or greater than 15 percent in 2024. (The threshold ETR increases to 16 percent in 2025 and 17 percent in 2026.)

(3) Routine Profits Test. Applies if the pretax income in a jurisdiction is less than the SBIE (discussed in more detail below), which is calculated as a percentage of the jurisdiction's payroll costs and tangible assets. This test uses labor and/or tangible assets to identify group entities that have substance in a jurisdiction when compared with profit.

An additional transitional UTPR safe harbor provides transitional relief during the first two years in which the GLOBE rules come into effect. This safe harbor deems the UTPR top-up tax to be zero for parent entities located in a jurisdiction that has a corporate income tax rate of at least 20 percent, which includes the United States.[8]

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[7] OECD, "Safe Harbours and Penalty Relief: Global Anti-Base Erosion Rules (Pillar Two)" (2022).

[8] OECD, "Tax Challenges Arising From the Digitalisation of the Economy — Consolidated Commentary to the Global Anti-Base Erosion Model Rules (2023)" (Apr. 2024).

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Even if an MNE is eligible for a transitional safe harbor on a jurisdictional level, it must still adhere to the GLOBE rules. The safe harbor does not exempt the MNE group from meeting the GLOBE requirements that apply across the group. For instance, an MNE group is still obligated to compile and submit the relevant parts of its GLOBE information return, which includes details about the application of the transitional CbC reporting safe harbor in any relevant jurisdiction.

GLOBE Calculation

An MNE must complete a GLOBE ETR calculation for every jurisdiction that does not qualify for the safe harbor. The ETR is the ratio of covered taxes to GLOBE income, which starts with the pretax profit or loss from financial accounts, with certain adjustments, to arrive at the GLOBE tax base.[9]

One such adjustment relates to stock-based compensation. The default rule is that the book deduction attributable to stock-based compensation is used to calculate the MNE's GLOBE income in a jurisdiction. Alternatively, the rules allow the MNE to make an election, for a five-year period, on a jurisdiction-by-jurisdiction basis, to take an actual deduction for tax purposes regarding the stock-based compensation when calculating the GLOBE income. In most cases, assuming the stock price has appreciated over time, there would be a higher deduction for tax purposes (versus the default book deduction), which would be beneficial in calculating the ETR.[10]

If the ETR is less than 15 percent in any jurisdiction, a top-up tax is applied. This tax is calculated by multiplying the shortfall from the 15 percent minimum tax by the excess profit, which is the GLOBE income minus the SBIE.

The SBIE is a carveout from the GLOBE tax base, calculated based on a fixed return on assets and payroll expenses in each jurisdiction. A carveout in the form of a markup on those costs focuses the top-up tax on "excess income," such as intangible-related income that is most susceptible to BEPS risks. During a transition period, the carveout starts at 10 percent for payroll costs and 8 percent for tangible assets, both declining to 5 percent by 2033.[11]

The payroll carveout is based on the eligible payroll costs of eligible employees performing activities in the employer's jurisdiction. Eligible employees include part-time employees and independent contractors participating in the ordinary operating activities and under the direction and control of the MNE. To address remote work, secondment, and business travel arrangements, the OECD provides guidance for situations when an employee works outside the employer's jurisdiction. If an eligible employee spends more than 50 percent of their working time within the employer's jurisdiction, the employer can claim the full payroll carveout for that employee. If an eligible employee spends less than 50 percent of their working time within the employer's jurisdiction, the employer can claim only the payroll carveout proportionate to the working time spent within the jurisdiction. For example, if the eligible employee spent 30 percent of their working time in the employer's jurisdiction, the employer would be able to claim 30 percent of the payroll carveout for that eligible employee.[12]

Eligible payroll costs are broadly defined and include salaries, wages, benefits, bonuses, allowances, stock-based compensation, payroll taxes, and employer social security contributions.

The SBIE applies automatically unless an MNE elects on a jurisdictional basis for it not to apply.

For instance, an MNE might opt out of the SBIE if the costs of compiling information to determine the exclusion are higher than any possible savings in top-up tax that would result from the exclusion.

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[9] OECD, "Tax Challenges Arising From Digitalisation — Report on Pillar Two Blueprint" (2020) (Chapter 3: "Calculating the ETR Under the GloBE Rules").

[10] *See* KPMG, "Stronger Case for Stock-Based Compensation Recharges Under OECD Pillar Two" (2023).

[11] OECD, "Tax Challenges Arising From the Digitalisation of the Economy — Global Anti-Base Erosion Model Rules (Pillar Two)" (2021).

[12] OECD, pillar 2 consolidated commentary, *supra* note 8.

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Key Takeaways

The BEPS pillar 2 initiative marks a significant shift in the international tax landscape, and global mobility professionals have a key role to play. MNEs, which operate in multiple countries and have diverse business models, legal frameworks, and accounting practices, face many challenges compiling and maintaining accurate and consistent global employee data for CbC and GLOBE reporting. Collecting accurate data across various subsidiaries, branches, and affiliates can be complicated by decentralized operations and discrepancies arising from different accounting systems, differences in financial reporting standards, and varying interpretations of reporting guidelines. Global mobility professionals are encouraged to familiarize themselves with the BEPS pillar 2 rules, stay informed about the ongoing developments, and engage with members of their organization's human resources, finance, and tax departments to support the development of data collection protocols and identify relevant planning opportunities related to the organization's global workforce.[13] ■

[13]The foregoing information is not intended to be "written advice concerning one or more Federal tax matters" subject to the requirements of section 10.37(a)(2) of Treasury Department Circular 230. The information contained herein is of a general nature and based on authorities that are subject to change. Applicability of the information to specific situations should be determined through consultation with your tax adviser. This article represents the views of the author(s) only, and does not necessarily represent the views or professional advice of KPMG LLP.

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