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ECOFIN Council and European Commission endorse progress made by the Inclusive Framework in respect of Pillar One and Pillar Two

Council of the EU – European Commission – BEPS 2.0 – Pillar One – Amount A – Amount B – Pillar Two – Administrative Guidance – Safe Harbours – GloBE Information Return – Country-by-Country Reporting – QDMTT – UTPR

On November 9, 2023, during the meeting of the Economic and Financial Affairs Council of the EU (ECOFIN Council), EU Member States approved a statement (Council statement) as well as an accompanying statement from the European Commission (EC statement) reconfirming their political support for Pillar One and Pillar Two.

In addition, the statements confirm the compatibility of the Safe Harbour rules and the Administrative Guidance that were agreed by the OECD/G20 Inclusive Framework (Inclusive Framework) with the EU Minimum Tax Directive.

Update on Pillar One

Background

As part of the adoption of the EU Minimum Tax Directive, a specific provision was added to the Directive text requiring the EC to submit a progress report to the Council on the implementation of Pillar One. A report was published on June 30, 2023 and outlined the progress achieved by the Inclusive Framework on Pillar One. The EC's commitment to ensuring a timely and consistent implementation of Pillar One at EU level was also confirmed.

Following the release of the June 30 report, further progress was made at the level of the Inclusive Framework in relation to Pillar One, including:

- Release of *Amount A Multilateral Convention*, which reflects the current consensus among the Inclusive Framework members. The release notes that work needs to continue to reach agreement on specific outstanding areas.

- Launch of a *public consultation on the design elements of Amount B* with a view to their implementation via an update to the OECD Transfer Pricing Guidelines with effect from January 2024 and a review of Amount B to be conducted after 3 years of implementation.

ECOFIN Council and EC statements on Pillar One

Key takeaways from the Council statement include:

- The Presidency introductory notes advise that it is of paramount importance to ensure that Pillar One is implemented.
- The Council statement welcomes the progress made by the Inclusive Framework on finalizing the Amount A Multilateral Convention and notes the progress made on Amount B.
- The Council statement further notes its continued support to the ongoing work in this area, taking into account the interests of all Member States in order to ensure that all enterprises pay their fair share of tax on profits generated by their activities in the EU.

In addition, the EC statement confirms the EC's intention to keep on working towards ensuring a successful delivery in the EU and calls on Member States to swiftly sign and ratify the Amount A Multilateral Convention. In addition, the EC statement underlines the importance of Amount B as a key component of the ongoing reform of international taxation, simplifying transfer pricing and enhancing legal certainty.

ETC Comment

It is important to consider that the EC has previously committed to putting forward, if appropriate, a proposal by the end of 2023 if agreement at international level on a Pillar One solution is not reached. The current EC work program does not indicate any upcoming releases in this respect. The Council and EC statements also seem to currently focus on finalizing and adopting the Amount A Multilateral Convention.

However, the Multilateral Convention on Amount A still needs to be finalized at Inclusive Framework level and it would enter into force only once it has been ratified by at least 30 countries accounting for at least 60 percent of the ultimate parent entities (UPEs) of businesses expected to be in scope for Amount A.

As such, it is important for taxpayers to monitor developments in relation to potential alternative solutions at both EU and EU Member State level. According to a recent public letter submitted to the Dutch Parliament, a Dutch tax official noted that the Amount A Multilateral Convention is unlikely to be signed this year in light of unresolved objections and some jurisdictions requiring additional time. The letter further advised that a multilateral digital services tax should be considered as an alternative, if countries are unlikely to reach a global agreement and the current moratorium on digital services taxes (agreed until end of 2023) would not be extended. Other alternative solutions may include a Digital Permanent Establishment or the introduction of an EU digital levy as a new own-resource for the EU as was previously proposed by the EC in 2018 and 2021.

Update on Pillar Two

Background

On December 15, 2022, the Council of the EU unanimously adopted the EU Minimum Tax Directive. The final text of the Directive was published in the Official Journal on December 22, 2023 and entered into force on the following day. Key elements include:

- *General:* The agreed Directive requires Member States to transpose the rules into domestic law by December 31, 2023 and to start applying the Income Inclusion Rule (IIR) for fiscal years beginning on or after this date. The Undertaxed Profits Rule (UTPR) will be applied for fiscal years beginning on or after December 31, 2024. In addition, the agreed text provides the option for Member States to implement a qualified domestic top-up tax (QDMTT) and to defer the application of the IIR and the UTPR up to December 31, 2029, where a maximum number of 12 UPEs are based in that EU Member State.
- *Reference to OECD materials:* The Directive text is closely aligned with the OECD GloBE Model Rules and seeks to implement the OECD rules in a manner which is compatible with the EU Treaties. In addition, the preamble of the Directive includes a recital indicating that Member States should rely on the Commentary to the GloBE Model Rules as well as the GloBE Implementation Framework, including its safe harbor rules, as a source of illustration or interpretation.
- *EU QDMTT Safe Harbour:* In addition, the EU Directive provides for a QDMTT safe harbor where the QDMTT is computed in accordance with the parent entity's acceptable accounting standard or IFRS. In that case, the parent entity is no longer required to compute the top-up tax for the respective low-taxed Constituent Entity (Article 11 para. 2 of the EU Directive).
- *EU Safe Harbour provisions:* The Directive also includes a specific article that deals with safe harbor provisions (other than the EU QDMTT safe harbor mentioned above), under which top-up tax shall be deemed to be zero in a jurisdiction where the effective level of taxation of the local constituent entities fulfils the conditions of an international set of rules and conditions which all Member States have consented to (Article 32 of the EU Directive). It is worth noting that Cyprus is the only EU Member State that is not a member of the OECD/G20 Inclusive Framework and has separately confirmed its consent to the transitional CbyC Safe Harbour (June 2023) and the transitional UTPR Safe Harbour and the permanent QDMTT Safe Harbour (October 2023).

Following the entry into force of the EU Minimum Tax Directive, the Inclusive Framework published a number of additional rules and clarifications that supplement the OECD GloBE Model Rules, including:

- Release of *GloBE Implementation Framework* including the agreed design of the transitional Country-by-Country (CbyC) Reporting Safe Harbour.
- Release of *February Administrative Guidance* including guidance on the QDMTT design, election to exclude income attributable to debt releases under certain conditions, election to include portfolio shareholding income, application of an Excess Negative Tax Expense carry forward, special methodology to allocate taxes arising under blended CFC tax regimes.
- Release of the standardized template of the *GloBE Information Return* with accompanying explanatory notes and certain administrative relief provisions.
- Release of *July Administrative Guidance* including the agreed design of the permanent QDMTT Safe Harbour and the transitional UTPR Safe Harbour as well as guidance on the QDMTT design, treatment of transferrable tax credits, general currency conversion rules and the Substance-based Income Exclusion.
- Agreement on the *Multilateral Convention for the Subject to Tax Rule*.

ECOFIN Council and EC statements on Pillar Two

The EC statement expresses the view that the Administrative Guidance endorsed by the Inclusive Framework is compatible with the EU Directive. In addition, the EC encourages all Member States to proceed swiftly with the transposition of the EU Minimum Tax Directive and notes that it will continue to support the efforts of Member States in this regard.

The Council statement welcomes and supports the agreement on the Administrative Guidance at the level of the Inclusive Framework, including the transitional UTPR Safe Harbour, the permanent QDMTT Safe Harbour, the new guidance on Transferable Tax Credits, as well as the transitional CbyC Reporting Safe Harbour and the GloBE Information Return.

In addition, the Council statement endorses the view (as expressed in the EC statement) that the Administrative Guidance agreed and released by the Inclusive Framework in December 2022, February 2023 and July 2023 is considered to be compatible with the EU Minimum Tax Directive. In this context, the Council statement further recognizes the need to ensure consistency and notes the intention of the EU Member States to follow the Administrative Guidance when transposing the EU Minimum Tax Directive into their national law in order to avoid divergences and inconsistencies in interpretation.

Finally, the Council statement recalls that the recitals of the EU Minimum Tax Directive refer to the use of the guidance developed by the Inclusive Framework as a source of illustration or interpretation.

ETC Comment

In recent weeks, the implementation of Pillar Two in EU countries has significantly picked up speed as the implementation deadline (December 31, 2023) approaches.

With an increasing number of EU Member States taking steps to transpose the EU Minimum Tax Directive, a recurring question has emerged on how EU Member States would apply the supplementary rules and clarifications agreed by the Inclusive Framework as part of the GloBE Implementation Framework, Administrative Guidance and GloBE Information Return, which were released after the adoption of the Directive. The general expectation is that the text of the EU Directive will not be updated in the short term to reflect any specific items of additional guidance.

In particular, questions were raised on the interaction between the existing EU QDMTT Safe Harbour and the OECD QDMTT Safe Harbour released in July 2023. Similarly, it has not been clear whether the reference to the OECD materials in the Directive recital, together with Article 32 serve as sufficient legal basis for EU Member States to introduce and apply the transitional CbyC Safe Harbour and the transitional UTPR Safe Harbour.

The Council and EC statements provide welcome assurance in this context with a view to enable EU countries to finalize their transposition laws by end of 2023. It may nevertheless be the case that Member States are not able to specifically include e.g. the Safe Harbours as part of the initial version of their implementing legislation or guidance, which may need to be amended subsequently. It is therefore important for taxpayers to monitor closely how EU Member States implement and apply the Safe Harbor provisions and elements of the Administrative Guidance. Some jurisdictions may be able to include an interpretive clause in the legislative text which provides that the domestic rules are to be interpreted in light of the most recent version of the Commentary. Other jurisdictions may be required to incorporate certain elements of the Commentary, Administrative Guidance and Safe Harbours directly into the jurisdiction's domestic law due to constitutional requirements.

Additional relevant links

- KPMG’s Pillar Two implementation tracker
- KPMG’s GloBE Implementation Framework observations
- KPMG’s Administrative Guidance observations (February 2023)
- KPMG’s Administrative Guidance observations (July 2023)
- KPMG’s GloBE Information Return observations (July 2023)
- KPMG’s Subject-To-Tax Rule observations (July 2023)
- KPMG’s Pillar One Amount A observations (October 2023)
- Euro Tax Flash 500: Council adopts EU Minimum Tax Directive
- E-News Issue 180: EC progress report on Pillar One

Should you have any queries, please do not hesitate to contact KPMG’s EU Tax Centre, or, as appropriate, your local KPMG tax advisor.

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