THE EU FINALLY AGREES ON PILLAR 2 (GLOBAL MINIMUM TAX) RULES, WHICH CALLS FOR ACTION.

On December 15, 2022, the EU Member States unanimously agreed to implement the minimum taxation component of the OECD's reform of international taxation, known as Pillar 2. The instrument to implement the Pillar 2 rules at the EU level is to be achieved by means of an EU Directive. The text of the EU Pillar 2 Directive has been published by the European Commission on December 22, 2022. The EU Directive to implement Pillar 2 must be transposed into EU Member States' national law by the end of 2023. This will result in the EU being a front-runner in applying the G20/ OECD global agreement on Pillar 2.

Under Pillar 2, the profit of large multinational and domestic groups or companies with a (consolidated) annual turnover of at least €750 million must be taxed at a minimum rate of 15%. To achieve a global minimum tax, the OECD developed a new standardized approach to calculate taxable income based on accounting standards (Global Anti-Base Erosion Rules, hereafter "GloBE rules"). If the effective tax rate in a jurisdiction based on that calculation is below 15%, such jurisdiction is considered as low taxed and additional tax will typically be due at the level of the (ultimate) shareholder(s).

KEY FEATURES PILLAR 2

In short, the key features of Pillar 2 are as follows:

- **Scope** – Cross border and domestic groups are in scope of Pillar 2 in a tax year if the consolidated turnover of the group is at least €750 million in at least two of the preceding four fiscal years. Certain type of entities are exempt from Pillar 2, e.g. governmental entities, international organizations, non-profit organizations, pension funds, an investment/real estate fund that is an ultimate parent entity.
- **Top up tax calculation** – Groups will have to calculate their effective tax rates ("ETR") for each jurisdiction in which they are active. If the ETR in a jurisdiction is below 15% based on the GloBE rules calculation, top up tax must be paid to ensure a minimum level of taxation.
  - The GloBE rules incorporate a primary rule, an Income Inclusion Rule ("IIR"), whereby the ultimate parent of the group that is located in a EU Member State should pay the top-up tax. If the ultimate parent entity is not established in the EU country and does not apply the IIR (e.g. because it is an excluded entity), the Member States of the EU intermediate entity should apply the IIR.
  - In addition to the primary rule, the Undertaxed Profit Rule ("UTPR") will act as a backstop and will apply where the IIR has not captured the entire top-up tax, including the jurisdiction of the ultimate parent. The UTPR ensures the payment of the minimum tax through either (i) a denial of deduction against the taxable income or similar mechanism, or through (ii) a top-up tax due in all countries where there is a presence. As the EU Member States may elect for the form of this UTPR-based adjustment, (as to date) the Dutch government opted for the latter; i.e. the "top-up tax due"-option (based on the latest Dutch Draft Bill Minimum Tax Act 2024).
  - The interlocking nature of these rules therefore ensures that top-up tax will be collected in jurisdictions that have introduced the GloBE rules even in the case where other jurisdictions are involved that have not implemented the rules.
- **Top up tax allocation**
  - Under the IIR, the top up tax will be payable by the (ultimate) parent entity in proportion to ownership. Generally, the IIR is applied at the top, at the level of the ultimate parent entity, and works its way down the ownership chain if required.
  - The UTPR acts as a backstop insofar the IIR does not apply. Under the UTPR, top up tax will not be allocated based on ownership but based on relative share of assets and head count.
  - In addition to the IIR and UTPR, EU Member States have the option to implement a Qualified Domestic Minimum Top-up Tax ("QDMTT") in order to allow EU Member States to benefit from the top-up tax revenues collected from low taxed entities established in their respective jurisdictions.

- **Carve-outs** – Pillar 2 contains a 'substance based carve-out' and a 'de minimis'-exclusion.
  - » The 'substance based carve-out' allows 5% of eligible payroll costs and 5% of eligible tangible assets per entity, to be deducted from the Pillar 2 income when calculating the ETR.
  - » The 'de minimis exclusion' allows a reduction of the top up tax for a jurisdiction to zero if:
    - – the average annual qualifying revenue of all entities in such jurisdiction is below €10 million, and
    - – the average annual qualifying income or loss of all entities in such jurisdiction is below €1 million.

    The average is based on the current tax year and the two previous tax years.
- **Enter into effect** – The IIR will be applied for fiscal years starting on or after December 31, 2023. The UTPR will be applied for fiscal years starting on or after December 31, 2024.

PILLAR 2 COMPLIANCE

Pillar 2 will trigger a new set of tax transparency compliance requirements. Among others an obligation to file top-up tax information return(s) is introduced. Furthermore, compliance with Pillar 2 rules will require strong tax data management that could be ensured through implementing a set of operating procedures (with controls). To implement such procedures successfully, it will be key to first determine the different Pillar 2 calculation process steps for ensuring compliance, including determining the roles and responsibilities between all stakeholders involved in that process. The implementation of these procedures will be key, particularly to ensure that reconciliations from the financial accounting net income to GloBE Income and from income taxes are adequately performed.

NEED FOR ACTION

For tax departments of internationally active companies, it will be essential to understand these rules quickly and thoroughly, preparing their tax compliance processes for the new global review required and making sure they have access to all relevant data.

Our Pillar 2 support team is available to support internationally active companies in analyzing and modelling the impact of the Pillar 2 rules, setting up internal and governance processes and exploring ways to address increased taxation and complexity. At RSM, we have developed a clear process to understand the potential impact for internationally active companies followed by a practical approach to implement.

Should you want to know more, please do not hesitate to contact us to schedule a meeting to discuss your possible needs.