Is your company ready for Pillar Two's Global Minimum Tax?

Fit for Pillar Two series

The ***Fit for Pillar Two*** series aims to help tax teams of MNEs within the scope of Pillar Two prepare for the upcoming wave of international tax changes by putting theory into practice. **This first article is designed for those clients just beginning their journey or those that have taken steps forward but need to validate work completed to date**.

Many multinational enterprises (MNEs) need to prepare for new tax legislation around the world that will impose a minimum rate of tax in each jurisdiction where the MNE operates globally. Based on Pillar Two of the Organization for Economic Cooperation and Development's (OECD) base erosion and profit shifting (BEPS) project, these rules are complex and have taken effect in some countries as of January 1, 2024. As such, MNEs should act quickly to determine how they are affected.

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, as determined under the complex Pillar 2 rules, falls under 15 percent. If so, Top-Up Tax (TUT) will need to be calculated and paid based on timelines under domestic legislation. MNE groups will also be required to file a GloBE Information Return within 15 months after the last day of their fiscal year (18 months for the transitional year). MNE groups that do not comply with these rules may be subject to significant penalties.

Most MNEs must be ready by 2025

Keeping up with Pillar Two legislation will be one of the biggest challenges MNE tax teams will face in the next few years. Most of the OECD's member jurisdictions are moving steadily towards enacting Pillar Two rules, with close to 40 countries implementing the rules in 2024 and up to 60 countries expected to implement rules by the end of next year. As a result, 95 percent of in-scope MNEs will be affected in 2025 by Pillar Two Rules. Further, we've been observing jurisdictions working at different paces, applying different effective dates and deviating from the OECD's model rules. The rules will be new to tax authorities as well, so we can also expect to see rising volumes of tax controversy until consistent interpretations, policies, and precedents are established.

The GloBE Information Return, as well as the first set of local country tax returns prepared under the Pillar Two rules, are due in some jurisdictions as early as 30 June 2026. Registration requirements are already starting, for example, in Belgium, which requires a lot of information, such as the classification of entities within the MNE group. To comply with these rules, tax teams will require substantial new forms of financial data they may not currently have access to within their organizations. It's therefore advisable to get started as soon as possible and to keep the momentum once started.

Although many governments worldwide are at various stages of enacting Pillar Two rules, the MNEs that will have to comply with these complex rules are at vastly different levels of readiness. Only a few companies have fully investigated and prepared for all of the business elements that they will need to address based on what we know today — and with a regular stream of draft and enacted legislation frequently announced across the globe and continued guidance from the OECD — companies will have to continually re-assess the impact to their business.

So, let's ask the question, "Is your company ready for Pillar Two?" If not, you may want to begin with an impact assessment.

Impact assessment — the first step in the Pillar Two fitness journey

The first step in the Pillar Two fitness journey is to start with an "impact assessment", designed to evaluate the impact of Pillar Two legislation on your MNE.

Let's delve deeper into this topic and gather valuable insights from a Q&A discussion with three KPMG firm partners from across the globe: Janette Wilkinson, Partner, KPMG in the UK and Global BEPS Leader, KPMG International; Andy Baik, Tax Partner and BEPS Center of Excellence Leader, KPMG in Singapore; and Shawn Brade, National Service Line Leader, International Corporate Tax, KPMG in Canada, who combined to share their unique perspectives.

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Q&A Insights

Q1. What is typically included in an impact assessment?

The focus of an impact assessment should be to understand the effect Pillar Two will have on your organization's global effective tax rate, cash tax cost and compliance burden. In our experience, a thorough impact assessment will:

1. Identify the MNE Group's Ultimate Parent Entity (UPE) and the accounting standards applied to consolidate in-scope Constituent Entities of the MNE, as well as entities that are equity accounted for (with at least 50 percent ownership interest) as Pillar Two Joint Ventures (JV). While this is a straightforward exercise in many cases, there can be situations where the UPE is not readily apparent, for example, in the case of a Family Office. Identifying the UPE in such situations can require coordination among various tax teams to ensure proper information is available to make the determination.
2. Perform a Legal Entity Classification exercise for each in-scope Constituent Entity and Pillar Two Joint Venture. This is an important exercise for Groups to undertake because, for example, the charge to TUT might arise in a different entity than what has been perceived and blending will not be permitted where certain types of entities are involved, such as an investment entity, JV, or Minority-Owned Constituent Entities (MOCE).

The Legal Entity Classification exercise requires the following inputs for each entity of the MNE:

a. Entity name;

b. Legal form;

c. Country of incorporation;

d. Country of tax residence;

e. Tax Identification Number;

f. Whether it is consolidated by the UPE, and if so, the effective ownership interest from UPE;

g. If not consolidated by the UPE, whether it is due to (i) size, (ii) materiality, or (iii) entity held for sale);

h. The direct shareholder of the entity;

i. Whether the entity is held directly by third parties outside of the MNE Group and, if so, the effective ownership interest by third parties;

j. Whether the entity holds other entities, and if so, names of the entities held; and

k. If the entity is a Branch or Permanent Establishment (PE), which type of PE it falls under (Type A, B, C, or D) and its Head Office (or Main Entity).

3. Assess eligibility for the Transitional Country-by-Country Reporting (CbCR) Safe Harbor (TCSH) to reduce compliance cost and burden for at least the first three years (FYs 2024, 2025 and 2026). These safe harbors, if satisfied for a jurisdiction, allow taxpayers to simplify certain calculations and not be subject to GloBE TUTs in that jurisdiction for the first three years the rules apply. To qualify for the safe harbors, MNE groups must ensure their CbCR is prepared according to OECD guidelines using qualified financial statements. If the CbCR meets these requirements, MNE entities may be entitled to use the simplified tests available under these rules (i.e., a de minimis test, a simplified effective tax rate (ETR) test, or a routine profit test).

    a. To assess safe harbor eligibility, the first step is to understand the current source of data used to complete the CbCR — whether "revenue" and "profit/(loss) before income tax" are extracted from consolidated financial statements or separate entity local statutory accounts, and whether these are considered "Qualified Financial Statements." The same set of Qualified Financial Statements must be used to extract Simplified Covered Taxes (for the Simplified ETR test) as well as Payroll Expense and Net Book Value of Qualifying Tangible Assets (for the Routine Profits Test).

    b. Confirm the type of entities within the scope of the MNE Group, as the following entities will still require a full effective tax rate (ETR) calculation, notwithstanding that the jurisdiction in which they are located meets one of the three TCSH tests:

        - Stateless Entities (i.e., tax transparent and reverse hybrid entities)

        - Investment Entities (where the Constituent Entity Owners are within the same country, or an election has been made under Articles 7.5 and 7.6 of the GloBE rules.)

    c. As Pillar Two Joint Ventures, are not included in the current CbCR, the information for TCSH will be extracted directly from their Qualified Financial Statements. In addition, they will be regarded as a separate jurisdiction for TCSH.

    d. There are also specific scenarios where TCSH cannot be applied: e.g., UPE jurisdictions where the UPE is a flow-through entity (and not all Ownership Interests are held by owners subject to tax at a rate of at least 15 percent), multi-parented MNE Groups where a single Qualified CbCR does not include information on the combined groups, and jurisdictions where Constituent Entities have elected for the Article 7.3 Eligible Distribution Tax Systems.

4. For jurisdictions that do not qualify for TCSH, the full ETR calculation is required. It is also important to understand which TCSH test is met and whether the jurisdiction continues meeting the tests for FYs 2025 and 2026 (bearing in mind that TCSH is a once out-always out approach — i.e., if a jurisdiction fails in FY 2025, TCSH will not apply for that jurisdiction in FY 2026 as well).

5. Model preliminary cash tax impacts and determine "at-risk" jurisdictions through high-level ETR and TUT calculations, including the impact on future forecasts.

6. Include scenario planning to consider the estimated impact of any future planned M&A activity.

7. Prepare for new financial statement disclosures — which can leverage the work done under TCSH. Only jurisdictions that do not meet the TCSH need to assess for potential TUT impact.

Given the significant data required to complete a Pillar Two calculation, an impact assessment is also a fantastic way to identify data gaps that may exist in an organization. Identifying these gaps allows time for the organization to understand the data requirements and associated data structure and systems to comply with Pillar Two.

Q2. What are some of the top best practices/lessons learned, and what actions should companies take when conducting impact assessments?

An impact assessment can lead to early identification of adverse outcomes from the implementation of Pillar Two and enhance business planning by:

- *Identifying issues to raise in OECD and local consultations, which can help lead to real change:* As an example, for in-scope MNE Groups within the property developer sector, variances between accounting recognition of revenue and local tax treatment could inadvertently lead to additional tax costs under the five-year deferred tax liability (DTL) recapture rule. To the extent future OECD AGs do not address this issue, feedback is provided to local tax authorities via a consultation process to ensure alignment to GloBE Rules and mitigate the impact on in-scope MNE Groups.

- *Identifying material data gaps for resolution and understanding how your organization's current infrastructure may be utilized to maximize the efficiency of complying with Pillar Two:* It is important to understand the sources of data (which ERP it is extracted from, how many data sources are manual, how the data reconciles), which stakeholders are involved in the process, and what the technical and technology requirements are. This understanding is especially important if the MNE Group intends to invest in technology or automation tools for Pillar Two compliance as Phase 2 (i.e., after impact assessment). For companies investing in technology and automation, the data extracted for CbCR can be used for many tax processes, including Pillar Two TCSH, EU Public CbCR, and Australian Public CbCR and other such initiatives. Specific to Joint Ventures (JV), we note that many in-scope MNE groups face practical challenges in obtaining information from JV partners (especially where JVs are managed by JV partners), so it is critical to start the data gathering process early and educate the relevant stakeholders.
- *Informing the outcomes of a multi-year project plan to identify resource needs and project budgets:* TCSH is the critical key to budgeting for compliance as multiple returns (e.g., Qualified Domestic Minimum Top-up Taxes (QDMTT), Income Inclusion Rule (IIR) returns) are required once TCSH is not met (vs. a notification for TCSH). Companies that have performed impact assessments have a much better grasp of the expected downstream compliance costs associated with Pillar Two.
- *Understanding how TUT is allocated:* For countries where TUT is payable, MNE Groups need to understand how the TUT will be allocated among the entities (Note: MNE Groups have different business units which may not agree with the existing allocation methodology under the GloBE Rules). In addition, to the extent that countries assign one entity as the paying entity, a recharge arrangement is needed within the group to reimburse the TUTs paid on behalf of other entities.
- *Identifying tax planning opportunities:* Approaches to impact assessments range from "light-touch" to extremely detailed. The benefit of taking a detailed approach is that it allows for the identification of tax planning opportunities that can mitigate TUT exposure and reduce compliance costs. By undertaking a comprehensive analysis, companies can pinpoint specific opportunities such as the utilization of tax credits, re-evaluating the tax impact of operational restructuring or simplifying corporate structures to reduce the number of entities. This detailed assessment facilitates strategic decision-making to optimize tax positions and align them with global tax compliance requirements, helping mitigate the financial impact of the GloBE rules. Conversely, a "light-touch" approach can often fail to identify such opportunities early in the process, which can result in further assessments being required later and tax planning opportunities being missed.

Q3. Anything else on this topic that is critical or impactful to MNEs?

- As Pillar Two starts from accounting, understanding the accounting treatment of every transaction is critical — so involve accounting and financial reporting teams as early as possible. This is especially the case as a QDMTT could be based on UPE GAAP or local statutory accounts (depending on the country). We observe that, from a systems perspective, the consolidated books and local statutory accounts are often stored on different ERPs (e.g., consolidated books on BPC, local statutory accounts on SAP).
- MNEs should review the existing CbCR process as soon as possible. Many companies are forced to scrutinize CbCR and answer questions that they never had to before (e.g., how should tax transparent entities be reflected for CbCR, should there be any adjustments, whether adjustments result in Non-Qualified CbCR), especially now given that CbCR is not just used for Pillar Two TCSH, but also EU Public CbCR and Australian Public CbCR and other such initiatives. Such data at a country level will be transparent to the public. How the information will be interpreted (e.g., by investors, analysts) will impact Tax Governance.
- Early engagement with the financial statement auditors is important to understand the financial statement disclosures they expect a group to make in relation to the impact of Pillar Two and what information they will require to audit a Group's assessment of the impact of Pillar Two. It is likely that auditors will request information that has not previously been reviewed for audit purposes, such as details of CbCR processes and outputs.

Key takeaways

Multinational enterprises (MNEs) need to act quickly to prepare for the OECD's Pillar Two Global Minimum Tax, which will be enacted in countries around the world as early as 2024.

MNEs with consolidated revenue above EUR 750 million are affected. Pillar Two imposes a 15 percent minimum tax rate in each jurisdiction in which an MNE operates.

To comply with these rules, tax teams will require substantial new forms of financial data they may not currently have access to within their organizations.

To prepare for Pillar Two, companies should begin with an impact assessment. This assessment will:

- Identify the MNE group's Ultimate Parent Entity (UPE) and the accounting standards applied to consolidate the constituent entities of the MNE
- Perform a legal entity classification for each constituent entity of the MNE
- Assess eligibility for safe harbor rules that apply for the first three years that Pillar Two rules apply
- Model preliminary cash tax impacts
- Consider the impact of any planned M&A activity
- Prepare for new financial statement disclosures.

An impact assessment can lead to early identification of adverse outcomes from Pillar Two and enhance business planning.

These rules are complex and will be in effect soon — MNEs should begin their assessment of Pillar Two's effect on their organization right away.

Conclusion

Given the complexity of these rules and the timeline for implementation, MNEs should begin their assessment of Pillar Two's effect on their organization right away. Once an impact assessment is complete, multinational enterprises will then need to understand how to navigate the complexities of Pillar Two to optimize tax planning. Stay tuned for the next article in our next Fit for Pillar Two series that will delve deeper into tax planning and business restructuring.

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.

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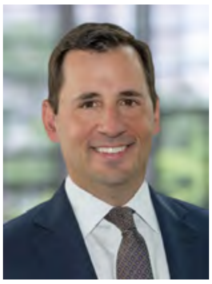

Christian Athanasoulas

Tax Practice Leader – Services, KPMG in the US, and Global Head of International Tax and Mergers–Acquisition Tax
E: cathanasoulas@kpmg.com

Christian is the Tax Practice Leader — Services at KPMG in the US and the Global Head of International Tax and M&A Tax at KPMG International with over 30 years of extensive experience in international tax, mergers and acquisitions (M&A) tax, and BEPS (Base Erosion and Profit Shifting). He is currently responsible for overseeing the development and delivery of U.S. Tax Services to KPMG clients around the globe and in his role as Global Head of International Tax and M&A Tax, KPMG International, he oversees the International Tax and M&A Tax member firm teams across the global network.

Janette Wilkinson

Lead Tax and M&A Partner, KPMG in the UK, and Global BEPS leader
KPMG International
E: janette.wilkinson@kpmg.co.uk

Janette is a Lead Tax and M&A partner of KPMG in the UK and Global BEPS leader at KPMG International. Her global responsibilities include managing KPMG International's response to BEPS. Janette has more than 25 years of experience in International Tax and M&A Tax, serving FTSE 100 international groups and Fortune 500 companies.

Andy Baik

Partner, KPMG in Singapore, Co-Head of BEPS Center of Excellence, and Head of US Tax Desk
E: andybaik1@kpmg.com.sg

Andy is a Partner and co-Leader of BEPS COE group at KPMG in Singapore. He also leads the US Tax Desk in Singapore/Asia. Andy has advised various private funds, sovereigns/pension funds, asset managers, family offices and MNCs on BEPS Pillar 2 related technical tax, planning and implementation issues. His practice focuses on the asset management sector and works closely with private equity, real estate and sovereign/pension funds on all aspects of their tax matters, including cross border structuring, tax controversy and policy issues.

Shawn Brade

International Corporate Tax Leader
KPMG in Canada
E: sbrade@kpmg.ca

Shawn is an International Corporate Tax Leader of KPMG in Canada based in Calgary. He has over 20+ years of experience specializing in international corporate income tax advisory and compliance services to Canadian clients operating outside of Canada and to non-Canadian multinationals operating within Canadian borders. He has over 15 years' experience assisting clients in this regard.

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