

PILLAR TWO: Frequently Asked Questions

Pillar Two model rules will have a far-reaching effect on the taxation of multinational enterprises (MNE), which are companies with business operations in at least one country outside of their home countries. To date, more than 140 countries, including the majority of Europe and key Asian jurisdictions, have agreed to enact the Organization for Economic Development's (OECD) Pillar Two model rules in time for tax years beginning Jan. 1, 2024. The following Q&A highlights the essential aspects every affected MNE must understand to prepare for the looming deadline.

What is Pillar Two?

Pillar Two, commonly referred to as the “global minimum tax” or “GloBE,” establishes minimum tax rules to ensure large MNEs pay a minimum effective tax rate of at least 15%, calculated based on a specific rule set. MNEs with an effective tax rate below the minimum in any jurisdiction would be required to pay a top-up tax to their corporate headquarters location. The tax would be applied to groups with revenue of at least €750 million (currently roughly \$800 million) per year. Note: In addition to paying the tax, filing requirements for an information return apply regardless of whether an MNE owes taxes.

Why is a global minimum tax needed?

The OECD is implementing Pillar Two to reduce the benefit of multinational groups engaging in aggressive tax planning positions which reduce the tax burden by shifting profits from one jurisdiction to another. Additionally, by effectively implementing a global minimum tax on earnings, the OECD intends to create a more level playing field for countries seeking foreign business investment and economic growth, rather than investment being informed by the lowest income tax rate.

Which countries are part of Pillar Two?

More than 140 countries have agreed to enact Pillar Two tax reform, which comprise the majority of the OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting.

How do I know if this requirement applies to my company?

Pillar Two applies to multinational groups with consolidated revenue over €750 million according to the adopted accounting principles for the group. MNEs should consider various scenarios where Pillar Two may be applicable in an unexpected way. For example, companies funded through private equity which consolidate into the private equity group may trigger Pillar Two reporting requirements. This is due to the collective private equity company's investments exceeding the €750 million threshold, even if individual company operations would not reach the revenue threshold.

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Why does my company need to act if Congress has not yet approved Pillar Two legislation?

If your company operates in a jurisdiction outside the U.S., it will be subject to the top-up tax, regardless of congressional action. Further, the model rules are designed in a way which may require a foreign subsidiary or foreign parent to pay top-up tax on behalf of a U.S. affiliate if the effective tax rate is below 15% by GloBE standards. Effective tax planning may identify opportunities to align current profitability with a jurisdiction's functional profile, and limit overall top up tax owed.

What is the penalty if we don't comply?

In addition to the obligation to pay a top-up tax under Pillar Two, failure to comply with the filing requirements within 15 months after the fiscal year end of each constituent entity results in a penalty equal to 5% of revenue for the entity that does not meet the filing requirements.

What is the deadline for reporting and top-up payments?

Pillar Two is recommended to be implemented with an effective date for periods beginning on or after Dec. 31, 2023. However, each jurisdiction in which a company operates will need to choose to implement Pillar Two and may make modifications to the model rules, all of which will increase complexity. As various jurisdictions execute the rules, deviations from the model rules and the impact on a particular company's legal entity structure will be required. Further, the model rules are designed in a way that any country in which a multinational group operates will in effect trigger Pillar Two compliance for the collective group.

The due date for the top-up tax payments will be largely dependent on the jurisdictions in which you operate. For example, effective Jan. 1, 2024, U.K. entities must pay a top-up tax for any company it is responsible for to ensure an effective tax rate of 15%. These tax payments can be due at the same time traditional tax payments are due.

Is there a safe harbor?

MNEs will be pleased to know there is a transitional safe harbor to allow the time necessary for countries to enact Pillar Two. Under the proposed transitional safe harbor, the profit subject to additional top-up tax will be zero if the ultimate parent entities jurisdiction has a corporate tax rate of at least 20%.

The rules also present a transitional country-by-country reporting (CbCR) requirements safe harbor if a jurisdiction meets the following criteria:

- A simplified effective tax rate (ETR) is calculated by dividing covered income tax expense by profits reported on the CbCR for each jurisdiction.
- The transition rate meets the minimum defined for the year.
- The tested jurisdiction's profit or loss before income tax is equal to or less than the substance-based income exclusion.

The rules also lay out permanent safe harbors to help MNEs avoid the need to perform some more complex calculations when they would not impact the outcome.

Note, even if the safe harbors apply, they do not alleviate the requirement to file the information return, nor do they guarantee uniform adoption in the relevant jurisdiction.

What should we expect in terms of reporting requirements and data compilation?

Under the model rules, each constituent entity (defined by the OECD as a separate business unit to be included in the financial statements of a multinational group) is required to file an information return which includes the following information:

- Identification of the constituent entities including TIN numbers, domicile and status under the rules;
- Information on controlling interests held in other entities;
- Information necessary to compute:
 - » The effective tax rate for each jurisdiction and the top-up tax of each constituent entity;
 - » Top-up tax applicable to a member of a joint venture;
 - » The allocation of top-up tax under the income inclusion rule; and
 - » A record of any elections made.

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As detailed more extensively in the rules, the financial information required to provide the information identified above is more complex than traditional financial statement data. In our professional experience, the information required to make the requested adjustments to traditional financial statement information requires the compilation and manipulation of information from multiple sources and can have unexpected results.

What is my obligation if we are a subsidiary of a foreign-owned corporation?

Your obligations are largely dependent on your relationship with the foreign parent. Let's say you consolidate into the foreign parent and the group exceeds the revenue threshold. If the U.S. were to enact Pillar Two, you would be obligated to make the information return filing for the U.S. If the U.S. does not to enact Pillar Two, your foreign parent would likely be obligated to include the required information about your U.S. operations in its own information filing.

In other words, model rules specify that for jurisdictions which do not enact the rules, the Pillar Two obligations flow to the parent or subsidiary of the entity. Effectively, all entities must assess their ability to compile the required data and compute a Pillar Two effective tax rate.

Beyond meeting new regulatory requirements from the OECD, is there any hidden benefit to undertaking this assessment and compliance exercise?

Yes. Although the Pillar Two objective is to achieve a global minimum effective tax rate, it still allows for international tax and transfer pricing planning which can minimize these tax obligations to the Pillar Two minimum. The compliance exercise can help identify such opportunities to better align profitability with the functions, assets and risks associated with a company's operations.

What does CBIZ recommended as next steps?

Our suggested approach is to begin the process with an assessment. During an initial assessment CBIZ will work with you and your team to:

- Identify the applicability of Pillar Two to your organization;
- Conduct a high-level initial assessment of each jurisdiction's effective tax rate;
- Identify where data gaps exist; and
- Propose actionable next steps, including correcting Pillar Two data gaps and designing a tax optimized legal and transfer pricing structure.

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