

All you need to know about Pillar Two 2/3/22



PwC tax director
Vita Sakne

Just before Christmas, the OECD published the long-awaited Global Anti-Base Erosion (GloBE) rules. This article highlights the main principles underlying the system and how the tax liability is computed.

The GloBE rules

The GloBE rules provide for a coordinated system of taxation intended to ensure large multinational enterprise (MNE) groups pay a minimum level of tax on the income arising in each of the jurisdictions they operate in. This will be achieved by imposing a top-up tax on profits arising in a jurisdiction whenever the effective tax rate, determined on a jurisdictional basis, is below the minimum rate.

Entities subject to GloBE

The GloBE rules apply to companies that are members of an MNE group with annual sales of EUR 750 million or more in the consolidated financial statements of the ultimate parent company in at least two of the four tax years immediately preceding the tax year tested.

Companies that are part of an MNE group may be permanent establishments and legal entities incorporated in countries that are not the country of the ultimate parent company. Government entities, pension funds and investment funds that are parents of an MNE group will be exempt entities to which the Pillar Two regime does not apply.

Computing taxable income or loss

The taxable income subject to GloBE or loss will be determined according to the financial accounting net income (before any consolidation adjustments eliminating intragroup transactions) of a particular entity within the MNE group and adjusted for:

- Net taxes expense
- Excluded dividends
- Excluded equity gain or loss
- Included revaluation method gain or loss
- Gain or loss from disposition of assets and liabilities excluded under article 6.3
- Asymmetric foreign currency gains or losses
- Policy disallowed expenses
- Prior period errors and changes in accounting principles
- Accrued pension expense

There will be a requirement for adjustment in respect of transactions between entities within the group that are not consistent with the transfer pricing principles and that are not recorded in the same amount in the financial accounts of both entities. Specific rules will apply to the assets subject to fair value or impairment accounting, flow-through entities, permanent establishments, and international shipping

income.

Computing covered taxes

The covered taxes computation includes:

- Taxes recorded in an entity's financial accounts with respect to its income or profits
- Taxes on distributed profits, deemed distributions, and non-business expenses imposed under national tax systems (such as Latvian corporate income tax)
- The effect of certain post-filing tax adjustments

Computing the effective tax rate and top-up tax

The effective tax rate of an MNE group for a jurisdiction equals the sum of the covered taxes (above) of each entity located in the jurisdiction divided by the net GloBE income of the jurisdiction for the fiscal year (if it is a positive figure).

If the effective tax rate is below the minimum rate, the difference results in a top-up tax percentage that is applied to the jurisdictional income to determine the total amount of top-up tax. The top-up tax is allocated proportionally between the entities located in that jurisdiction and then charged to each entity liable for any top-up tax.

The top-up tax percentage for a jurisdiction for a tax year will be the positive percentage point difference (if any) computed as follows:

$$\text{Top-up Tax Percentage} = \text{Minimum Rate} - \text{Effective Tax Rate}$$

On 22 December 2021, the European Commission proposed a directive to ensure a global minimum tax rate of 15% for large MNE groups operating in the EU.