

Minimum Global Tax on Multinational Businesses

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By **Lionel de Freitas**, 19th February 2024

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In the digital age and face of globalisation, the global economy has transformed – with countries facing pressure to lower their corporate income tax rates to offer incentives to compete for capital and investment. Building on BEPS actions and placing a floor under tax competition, the OECD, together with member countries, have addressed the collective action problem for the so-called race to the bottom.

A series of interlocking rules apply to companies taxed below the 15% rate in one country (with the possibility of other countries being able to apply a top-up tax), which is summarised below in six steps:

Step 1: Determination of Multinational Groups in Scope

The following steps apply in determining which multinational groups are in scope:

- i. Internationally active groups – determination as to whether the group has entities or permanent establishments in more than one jurisdiction, is required;

- ii. Groups with annual revenue of €750 million or more, in at least two out of the four prior years immediately preceding the fiscal year being tested; and
 - iii. Identify excluded entities from the application of the Pillar II rules (but note that these are not excluded from the revenue threshold calculation above).
4. Public interest entities, such as governmental and non-profit organisations, tax-neutral entities (such as pension and investment funds), and certain asset-holding companies are excluded.

Step 2: Allocation of Income to Constituent Entities on a Jurisdictional Basis

The multinational group needs to determine the income (abbreviated as FANIL for Financial Accounting Net Income or Loss – determined by accounting standards for financial reporting) and the location of each constituent entity, to identify the respective local tax treatment.

Step 3: Calculation of GloBE Income

Global Anti-Base Erosion (GloBE) income is calculated by making adjustments to FANIL to align the tax base for the global minimum tax with those that are typically applied for local tax purposes. Types of adjustments include:

- i. Adjustments to financial accounting income to better align with taxable income – net taxes, dividends (avoid double counting profits within a group), equity gains and losses (unrealized – no impact for GloBE; realized – may need adjustments for timing differences between accounting and tax), asymmetric forex gains and losses (differences in treatment between accounting and tax require reconciliation to align with taxable income), pension expenses (use of tax accounting principles), stock-based compensation (portion deductible for tax added to GloBE income);
- ii. Correct allocation of income between jurisdictions is adjusted for – such as transfer pricing adjustments and intra-group financing;
- iii. Policy-based adjustments – such as the disallowance of illegal payments such as bribes, or payments of fines and penalties (only allowed to a maximum of €50,000).

Step 4: Determination of Adjusted Covered Taxes

For each constituent entity, the GloBE income or loss is calculated. The tax associated with the income must then be calculated using the following steps:

- i. Determination of covered taxes – the current tax expense as shown in the financial accounts (includes income taxes, but does not include non-income-based taxes such as indirect taxes, payroll and property taxes);
- ii. Adjustment to covered taxes – to consider taxes that are not recorded in the tax line of the profit or loss statement and exclude taxes not related to GloBE Income or Loss, addressing of temporary differences as well as tax credits;
- iii. Cross-border allocation – adjustment to allocate certain cross-border taxes to the proper constituent entity (like taxes imposed under a CFC regime, distribution taxes, withholding tax on dividends paid, or other taxes paid);
- iv. Post-filing adjustments – in the case of post-filing adjustments, generally an ETR recalculation is required for the relevant fiscal year (examples include audit or transfer pricing adjustments).

Step 5: Computation of ETR and Calculation of Top-Up Tax

GloBE income or loss and covered taxes (steps 3 and 4 above) from the same jurisdictions must be added together to determine the jurisdictional effective tax rate (ETR).

Note an exemption applies for multinationals that have limited operations, namely, below the de minimis thresholds of €10m for revenue and €1m for income.

From GloBE, a substance-based income exclusion is deducted to reduce the potential burden on multinationals with genuine operations and investments in a jurisdiction. A percentage of tangible assets and payroll expenses is applied for the purpose of the substance-based income exclusion.

The top-up tax percentage is due on the difference between the 15% minimum rate and the ETR in the jurisdiction – the delta which is applied to the GloBE income or loss in the jurisdiction, after deducting a substance-based income exclusion.

Each constituent entity, with GloBE income, is subsequently allocated top-up tax.

Step 6: Charge the Top Up Tax under QDMTT, IRR, or UTPR

A member jurisdiction has a liability towards a top-up tax for a multinational group under three types of provisions, in the following agreed rule of order:

- i. If your domestic tax already hits the global minimum, you won't be hit with extra "top-up" taxes from other countries – referred to as the Qualified Domestic Minimum Top-Up (QDMTT);
- ii. If the jurisdiction where the low-taxed constituent entity is located does not have a domestic minimum top-up tax, the ultimate parent entity, in proportion to its ownership interest, might collect the top-up tax under IRR (Income Inclusion Rule);
- iii. If the ultimate parent entity is in a jurisdiction that has not implemented a domestic minimum top-up tax, then the top-up tax will be levied on the next entity in the ownership chain that is located in a jurisdiction with an IRR following a top-down approach;
- iv. Where IRR does not apply, the Under-Taxed Payment Rule (UTPR) becomes applicable. UTPR acts as a back-up to the IRR, ensuring a top-up tax payment within jurisdictions applying this rule.

Specific Rules for Each Jurisdiction

Members will need to implement the GloBE rules in a way that is consistent with the outcomes provided in the agreed rule order, to ensure transparent and predictable outcomes across jurisdictions. Note that the legislative draft GloBE rules accommodate a wide range of multinational groups and tax systems. The OECD have recommended Pillar 2 rules to become effective in 2024.

Conclusion

The implementation of Pillar 2 marks a significant step towards creating a more level playing field and addressing tax challenges arising from the digital economy. Ultimately, Pillar 2 represents a critical step towards a more equitable and sustainable global tax system. Its impact will depend on effective implementation, addressing potential concerns, and continuous evaluation to ensure it meets its intended goals.

Additional Information

If you would like to discuss any of the matters raised in this Article, please contact Lionel de Freitas, a director of our Dixcart office in Portugal:
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