UK Implementation of Pillar 2 Model Rules

A Global Minimum Tax

In October 2021, members of the Organisation for Economic Cooperation and Development ("OECD") agreed on a two-pillar solution to reform the international tax framework to address challenges related to the digitalisation of the economy. As part of the OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting ("BEPS"), members agreed to a co-ordinated system of Global Anti-Base Erosion ("GloBE") rules that are designed to ensure large multinational enterprises ("MNEs") pay a minimum level of tax in each jurisdiction in which they operate.

Developed through the collaboration of more than 130 countries, the OECD's Pillar 2 Model Rules[1] were released in December 2021, setting in motion the implementation of global minimum tax rules. In July 2023, the UK enacted the Finance (No. 2) Act 2023, which officially implements GloBE rules in the UK for accounting periods commencing on or after 31 December 2023. Most — if not all — large multinational and domestic businesses will need to take into account these far-reaching, complex rules.

FTI Consulting's expert-led team can help you navigate the complexities of the legislation, understand how the rules apply to your business, assess the impacts of the legislation in the different jurisdictions in which you operate, and assist you with meeting your filing obligations.

Key Points

- Pillar 1 and Pillar 2 follow on from the BEPS project, which commenced in 2013. The Pillar 2 rules[2] ensure that large multinational enterprises/groups ("MNEs") pay a global minimum tax through a combination of domestic and international tax mechanisms.
- Under the rules, an MNE with consolidated global revenues of more than €750 million may be required to pay a top-up tax if it has an effective tax rate of less than 15% (the minimum rate) in a jurisdiction in which it operates.

- In July 2023, the UK government enacted legislation (Finance (No. 2) Act 2023) that introduced a multinational top-up tax ("MTT"), by way of an Income Inclusion Rule ("IIR") and a domestic top-up tax ("DTT"). The DTT which is a qualified domestic minimum top-up tax ["QDMTT"] extends the scope of the Pillar 2 rules to UK operations. These rules apply to accounting periods commencing on or after 31 December 2023.
- In September 2023, the UK government published additional draft legislation that provides for an undertaxed profits rule ("UTPR") to be implemented no earlier than 31 December 2024. The UTPR is a protective measure that requires subsidiaries to collect top-up taxes in cases where a parent jurisdiction has not implemented the IIR.
- To reduce the compliance burden on companies, the legislation also includes various safe harbour provisions largely calculated using Country-by-Country Report ("CbCR") data. If a safe harbour applies, an election should be made annually in the information return.
- The rules introduce a number of compliance obligations, including the submission of an information return and the completion of a self-assessment return. For the first accounting period in which the rules apply, payment and filing dates have been extended to 18 months from the end of the period of account. For example, a company with a year end of 31 December 2024 will be subject to an initial filing deadline of 30 June 2026.

The Multinational Top-Up Tax

Pillar 2 introduces the multinational top-up tax ("MTT"), a new tax charged on the parent entities of large qualifying multinational enterprises/groups ("MNEs"). An MNE is broadly one with annual revenues in excess of €750 million in at least two of the previous four accounting periods as shown in the consolidated financial statements of the ultimate parent entity. This threshold is adjusted pro rata for different accounting periods.

The charge is applied through the Income Inclusion Rule ("IIR"), a mechanism which imposes a top-up tax on parent entities (including intermediate parents in cases where the ultimate parent's jurisdiction has not implemented the rules) in respect of the low-taxed income of a constituent entity. Permanent establishments are treated as distinct entities for the purposes of these rules. Another mechanism, the undertaxed profits rule ("UTPR"), will require subsidiaries to collect top-up taxes in cases where a parent entity is located in a jurisdiction that has not implemented the IIR. However, implementation of the UTPR has been delayed and is likely to become effective for accounting periods commencing on or after 31 December 2024.

The MTT applies where a group's profits arising in a subsidiary territory are taxed at an effective rate that is below 15% (the minimum rate). For the purposes of the Pillar 2 rules, the effective tax rate ("ETR") is calculated on a jurisdictional basis by reference to the covered taxes paid or attributed to local constituent entities and the GloBE-related income attributed to the local entities. These calculations are highly complex and require the analysis of detailed financial information — often the data used to prepare financial statements — in order to determine the amount of MTT payable by an entity. However, in cases where the blended ETR of a jurisdiction is above 15%, a top-up amount is not required.

The MTT may also have an impact on groups that take advantage of certain benefits, such as patent box relief, to reduce their tax liabilities; as a result of the rule changes, these benefits may be reduced or eliminated.

The Domestic Top-Up Tax

The Pillar 2 provisions also include a qualified domestic minimum top-up tax ("QDMTT") that enables territories to collect top-up taxes charged to untaxed subsidiaries operating within their jurisdiction and reduce any top-up taxes paid in the parent group's jurisdiction.

To support this provision, the Finance (No. 2) Act 2023 introduced a domestic top-up tax ("DTT") to ensure that top-up taxes charged to UK-based entities are paid in the UK rather than in a foreign jurisdiction where the parent entity is located. The rules apply to UK-based entities of MNEs, wholly domestic groups and UK standalone entities that meet applicable revenue thresholds. The provisions for the DTT largely mirror those for the MTT, with the revenue threshold and minimum tax rate operating in the same way.

Safe Harbour Provisions

In order to reduce the administrative burden of the Pillar 2 rules on groups, the UK (drawing from the OECD Model Rules) has introduced transitional safe harbour provisions. If a safe harbour applies, the top-up tax will be deemed to be £nil in the relevant jurisdiction. In practice, when assessing the applicability of the Pillar 2 rules to a

group, the potential use of safe harbour provisions should be considered near the start of any analysis performed (see summary diagram 1).

The transitional safe harbours apply to periods commencing on or before 31 December 2026 (and ending on or before 30 June 2028) and can be applied if one of the following three tests are met (based on CbCR data):

(a) The Threshold Test: The MNE must have both total revenues of less than €10 million and less than €1 million profit before tax in the jurisdiction on its Qualified CbCR.

(b) The Simplified ETR Test: The MNE must have a simplified ETR equal to or greater than the transition rate. The simplified ETR is calculated by dividing a jurisdiction's simplified covered taxes (in general, the income tax expense reported in the CbCR with adjustments for non-covered taxes and uncertain tax positions) by profit and loss amounts from the MNE's Qualified CbCR. The transition rate is 15% for fiscal years beginning in 2023 and 2024, 16% for fiscal years beginning in 2025, and 17% for fiscal years beginning in 2026.

(c) The Routine Profit Test: The MNE's profit before tax in a jurisdiction must be equal to or less than the substance-based income exclusion amount for constituent entities resident in that jurisdiction under the CbCR. The substance-based income exclusion provides a carve-out for expenditures on tangible fixed assets and payroll costs.

If a safe harbour applies, an election can be made that all members of an MNE group within the territory are treated as having no top-up amounts or additional top-up amounts for the relevant accounting period. The election is made annually in the information return. The transitional safe harbour election cannot be made in a subsequent period if the Pillar 2 rules applied to an earlier period commencing on or after 31 December 2023 and an election was not made.

If a group is subject to both DTT (where the DTT is a QDMTT) and MTT in a jurisdiction, they may also apply a **QDMTT safe harbour** election. The QDMTT safe harbour is similar to the transitional safe harbours described above in that it enables all standard members of an MNE group to be treated as having no top-up taxes or additional top-up amounts for MTT purposes. For the election to apply, the QDMTT must meet further conditions including similarity with the IIR and passing a peer review process. This is outlined in the legislation and an election cannot be made when the enforceability of a QDMTT is in question.

Draft legislation for the UTPR, released in September 2023, included a **UTPR safe harbour** election. The UTPR safe harbour provides that a filing member may elect that no entity in the group, located in the territory of the ultimate parent, has untaxed amounts. The UTPR safe harbour can be applied only (a) if the relevant territory has a minimum corporate tax rate of at least 20% and (b) to an accounting period of 12 months or less commencing on or before 31 December 2025 and ending before 31 December 2026.

The OECD have also introduced a framework for permanent safe harbours, but these are yet to be legislated on. In general, permanent safe harbours are expected to mirror the transitional safe harbours outlined above, although the calculation details may differ.

UK Filing Obligations

In terms of compliance responsibilities, various obligations are placed on a “filing member” (if an entity is part of a group) or a “qualifying entity” (if the entity is not part of a group), including the following:

- One-time registration with HM Revenue & Customs (“HMRC”)
- Submitting an information return or an overseas return notification to HMRC
- Completing a self-assessment return for HMRC and making any necessary elections (including transitional safe harbour elections)

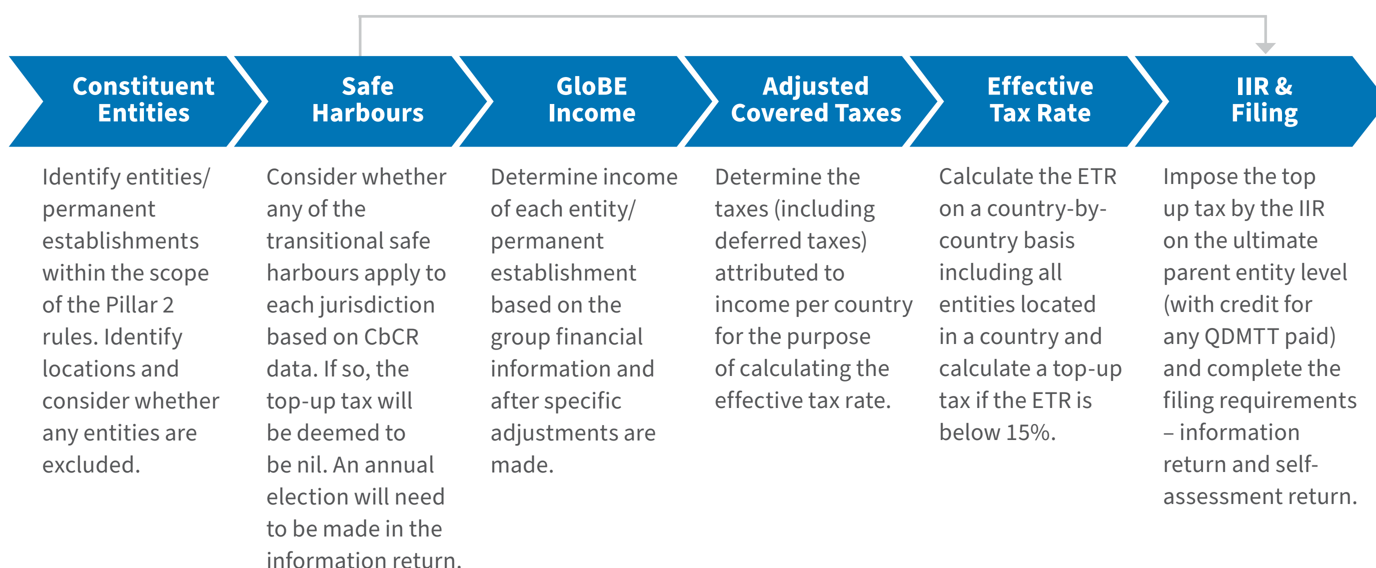
The filing and payment deadline is usually 15 months from the end of an accounting period, but this has been extended to 18 months for the first accounting period. For example, a company with a year end of 31 December 2024 should expect its first filing deadline to fall on 30 June 2026.

At the time of writing, details regarding the format and content of the information return and self-assessment return have not yet been finalised.

Global Update — Key Jurisdictions

The ultimate parent entity of an MNE is usually responsible for collecting the top-up tax (where a QDMTT has not been implemented in a subsidiary’s jurisdiction) but only if the territory where the ultimate parent entity is located has implemented the relevant

Diagram 1
Summary: Steps required to calculate MTT due



Pillar 2 legislation. If it hasn't, the obligation is passed down to the next jurisdiction in the ownership chain that has implemented the rules and in which there is an intermediate parent entity. The intermediate parent entity becomes the responsible member for all members of the group that it has a direct or indirect interest in and that are not located in a territory in which it is located. It is therefore necessary to consider the implementation status of various jurisdictions in order to understand the impact that this legislation may have on UK intermediate entities.

FTI Consulting is a UK member of WTS Global, a leading independent tax network with representation in more than 100 countries that is uniquely positioned to track the implementation status of Pillar 2 in a number of jurisdictions. WTS Global is currently monitoring the implementation of Pillar 2 in 72 countries; more information can be found here.[3]

A summary of activity in key jurisdictions is provided below.

Europe

EU member states unanimously approved an EU directive on the Pillar 2 rules in December 2022. The directive required EU countries to introduce domestic legislation implementing the rules by 31 December 2023. The implementation date aligns with the UK implementation date and means that EU member states are one of the first groups of countries globally to implement the Pillar 2 rules.

However, a few countries — Estonia, Latvia, Lithuania, Malta and Slovakia — are using a delayed implementation time frame, as permitted by the EU directive.

United States

The United States has not yet initiated the implementation of an IIR under Pillar 2 rules, and there is currently no indication of whether and when this will occur. A minimum tax was implemented for taxable years starting after 31 December 2022; however, the tax applies only to U.S. operations and therefore is not considered an IIR.

However, the Biden administration's Green Book for the 2024 fiscal year includes a proposal to align the U.S. global intangible low-taxed income rules with the Pillar 2 rules. The proposal aims to increase the ETR and switch to a jurisdiction-by-jurisdiction calculation format, which may qualify the U.S. minimum tax as an IIR under Pillar 2. The proposal also suggests replacing the U.S. base erosion and anti-abuse tax with the UTPR, which would apply to financial reporting groups that had global annual revenues of at least €750 million in at least two of the last four years.

Until legislation is implemented, the administrative burden of performing Pillar 2 calculations and meeting compliance obligations may fall to UK subsidiaries of U.S.-headed MNEs in cases where such subsidiaries are considered the intermediate parent entity. However, the UTPR safe harbour election outlined above is likely to be of particular importance to U.S.-headed groups.

Asia-Pacific Region

- **Australia** has initiated implementation of the Pillar 2 rules and draft legislation is expected shortly; the IIR and QDMTT are expected to apply for the first time from 1 January 2024 with retrospective legislation expected in early 2024.
- At the time of writing, **China** has not initiated its implementation of the Pillar 2 rules, and it is unclear when draft legislation can be expected. The Chinese government has actively participated in and collaborated on the design and development of the BEPS programmes, including Pillar 2. However, it might take some time for domestic lawmakers to analyse the full implications of Pillar 2 and make necessary realignments to current legislation.
- **Japan** has initiated implementation of the Pillar 2 rules, with a view that the IIR will apply for the first time to fiscal years beginning on or after 1 April 2024. Japan's National Tax Agency has emphasised its commitment to aligning Japanese global minimum tax laws with the OECD Model Rules.
- **Singapore** has initiated implementation of the Pillar 2 rules and expects the IIR and QDMTT to first apply from 1 January 2025.
- **South Korea** has implemented legislation introducing both the IIR and the UTPR. The IIR applies from 1 January 2024; the UTPR has been deferred until 1 January 2025.

The variation in time frames for implementation of the Pillar 2 rules means that many UK intermediate parent entities are likely to become responsible for meeting the Pillar 2 compliance obligations. FTI Consulting can work with you to understand the implications of this legislation for your group and help you assess which entity will be the responsible member for the purposes of these rules.

IFRS/FRS 101 Reporting Requirements

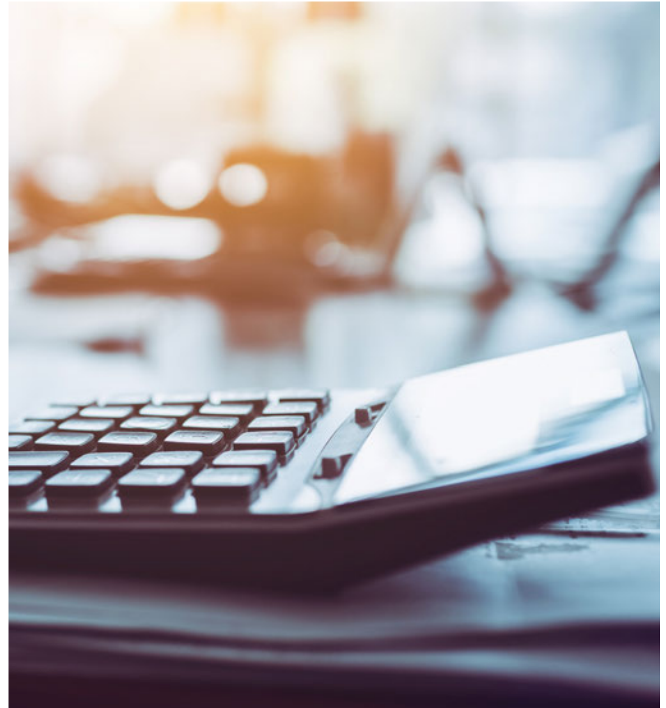
IAS 12 Income Taxes requires companies accounting under IFRS or FRS 101 to account for income taxes in relation to Pillar 2. The International Accounting Standards Board introduced amendments to IAS 12 in May 2023, although these were fairly narrow in scope given the complexity of the new rules and the uncertainty among stakeholders regarding how the rules would impact current and deferred taxes.

The changes include the following:

(a) Deferred tax: a temporary exception to the requirements to recognise and disclose information about deferred tax assets and liabilities related to Pillar 2 income taxes. Entities are still required to disclose that they have applied the temporary exception (at present, it is unclear how long the temporary exception will remain in place). The exception applies immediately and retrospectively from the date the amendments were issued.

(b) Current tax: the requirement that an entity disclose separately its current tax income expense related to the Pillar 2 rules. This applies to accounting periods beginning on or after 1 January 2023, although entities are not required to disclose information for any interim period ending on or before 31 December 2023.

Additional reporting requirements apply in cases where Pillar 2 has been enacted or substantively enacted but is not yet in effect. As the UK legislation came into effect in July 2023 and applies to accounting periods commencing on or after 31 December 2023, we expect these requirements to apply in a limited number of cases.



How Can We Help

FTI Consulting can help you prepare for the implementation of the Pillar 2 rules and meet your compliance obligations. Pillar 2 will change the way tax operates on a global scale, and businesses need to prepare now.

If you have any questions about the information presented in this report or would like to discuss how these changes will affect your business, please contact the authors listed below.

All information found in this article can be sourced from the below references. If you have any questions on the information found in this piece, please reach out to FTI.Tax@fticonsulting.com

Endnotes

[1] OECD (2021), T*ax Challenges Arising from Digitalisation of the Economy – Global Anti-Base Erosion Model Rules (Pillar Two): Inclusive Framework on BEPS*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, https://www.oecd-ilibrary.org/taxation/tax-challenges-arising-from-digitalisation-of-the-economy-global-anti-base-erosion-model-rules-pillar-two_782bac33-en

[2] Legislation.gov.uk (2023), Finance (No. 2) Act 2023, Part 3, Part 4, Schedules 14 to 18 https://www.legislation.gov.uk/ukpga/2023/30/contents

[3] WTS (2024), *Pillar Two - Implementation Status Worldwide*, WTS Global https://wts.com/global/hot-topics/pillar-two/pillar-two-implementation-status-worldwide

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