



## US International Tax Alert

New OECD guidance provides needed detail regarding Pillar Two implementation

On July 17, 2023, the OECD/G20 Inclusive Framework (IF) released a package of materials related to the 15% global minimum tax on multinational corporations and the Subject to Tax Rule that together form Pillar Two of the ongoing project relating to the tax challenges of the digitalization of the economy. The Pillar Two documents released were:

- Tax Challenges Arising from the Digitalization of the Economy—Administrative Guidance on the Global Anti-Base Erosion Model Rules (Pillar Two), July 2023 (hereafter the “July AG”)
- Tax Challenges Arising from the Digitalization of the Economy—GloBE Information Return (Pillar Two)
- Tax Challenges Arising from the Digitalization of the Economy—Subject to Tax Rule (Pillar Two)

The guidance with respect to the 15% minimum tax (the Global Anti-Base Erosion, or “GloBE,” Rules) forms part of the “common approach.” Under the common approach, countries are not required to adopt the GloBE Rules, but if they choose to do so, they agree to implement and administer the rules in a way that is consistent with the outcomes provided for under the Pillar Two Model Rules (“Model Rules”) released in December 2021 and any subsequent guidance agreed by the IF.

The publication of the July AG follows the release of the Model Rules in December 2021 and related Commentary in March 2022, rules for safe harbors and penalty relief released in December 2022, and Administrative Guidance released in February 2023 (the “February AG”). The newly released February AG and July AG will be incorporated into a revised version of the Commentary that is expected to be released in the future.

Pillar Two consists of two interlocking domestic rules that together make up the GloBE regime. The Income Inclusion Rule (IIR) imposes top-up tax on a parent entity with respect to the low-taxed income of a member of its multinational entity (MNE) group (a constituent entity or CE). The Undertaxed Profits Rule (UTPR) denies deductions or requires an equivalent adjustment to the extent the low-tax income of a constituent entity is not subject to tax under an IIR. Countries also have the option to adopt a “qualified domestic minimum top-up tax” (QDMTT) as defined in the Model Rules and further clarified in both the February AG and the July AG. The QDMTT is credited against liability otherwise owed under an IIR or the UTPR.

Pillar Two also contains the Subject to Tax Rule, a treaty-based rule that allows source jurisdictions to impose limited source-based taxation on certain related-party payments subject to tax below a minimum rate.

This alert sets forth the highlights of each document below.

## The July AG

The July AG consists of guidance with respect to each of the following:

- General Currency Conversion Rules for the GloBE Rules
- Tax Credits
- Substance-based Income Exclusion
- Qualified Domestic Minimum Top-up Tax
- Safe Harbors

**General Currency Conversion Rules for the GloBE Rules:** The July AG provides further direction (beyond what was provided in the February AG) on currency issues under GloBE. The following topics are specifically addressed in the July AG.

- The currency in which GloBE calculations must be made:** Under the July AG, GloBE calculations must be performed in the presentation currency of the MNE Group's consolidated financial statements.
- The method for converting amounts in the consolidated financial statements to those required for GloBE purposes:** Amounts not recorded in the presentation currency of the MNE Group's consolidated financial statement will need to be converted according to the "applicable foreign currency translation rules in the Authorised Financial Accounting Standard used to compute the Financial Accounting Net Income or Loss of Constituent Entities in the jurisdiction."
- Rules for translating the top-up tax amounts into the currency in which they will be paid:** Jurisdictions are provided with flexibility to adopt a "reasonable" basis for translating foreign currency.
- Translation rules for monetary thresholds that are listed in a currency other than that used for the GloBE calculations:** For purposes of determining whether a threshold under the GloBE Rules has been met, the MNE Group must translate the relevant amount from its presentation currency to the currency in which the relevant threshold is expressed in domestic law, based on the average foreign exchange rate for the December month of the previous Fiscal Year.

**Guidance on Tax Credits:** The July AG contains additional information related to the treatment of certain tax credits for purposes of the GloBE Rules. When a taxpayer computes each jurisdictional effective tax rate for purposes of Pillar Two, tax credits are generally treated as either a reduction to the amount of Covered Taxes taken into account, or an increase to the amount of GloBE Income, depending on the characteristics of the tax credit. The jurisdictional effective tax rate is generally computed by taking the amount of Adjusted Covered Taxes divided by the Net GloBE Income for a jurisdiction.

Existing guidance in the GloBE Rules covers the treatment of Qualified Refundable Tax Credits (QRTCs) and Non-Qualified Refundable Tax Credits (Non-QRTCs). But neither the GloBE Rules nor any prior administrative guidance addressed the treatment of transferable tax credits, and they are not clear on the treatment of certain other tax credits. Due to the large impact these credits may have on the jurisdictional effective tax rate calculation, especially since the enactment of the Inflation Reduction Act (IRA) in the United States, the July AG sets out mandatory GloBE treatment for these types of credits.

Marketable Transferable Tax Credits (MTTCs), consistent with the treatment of QRTCs, are *treated as income items* in the computation of GloBE Income or Loss for the Originator of the tax credit. A MTTC, in turn, is defined as a tax credit that can be used by the holder of the credit to reduce its liability for a Covered Tax in the jurisdiction that issued the tax credit and that meets two standards in the hands of the holder:

- **The legal transferability standard:** Generally met for the Originator of a tax credit if the tax credit regime is designed such that the Originator can transfer the credit to an unrelated party in the year in which it satisfies the eligibility criteria for the credit or within 15 months of the end of such year; and
- **The marketability standard:** Met for the Originator of a tax credit if it is transferred to an unrelated party within 15 months of the end of such year at a price that equals or exceeds 80% of the net present value of the credit determined under special rules.

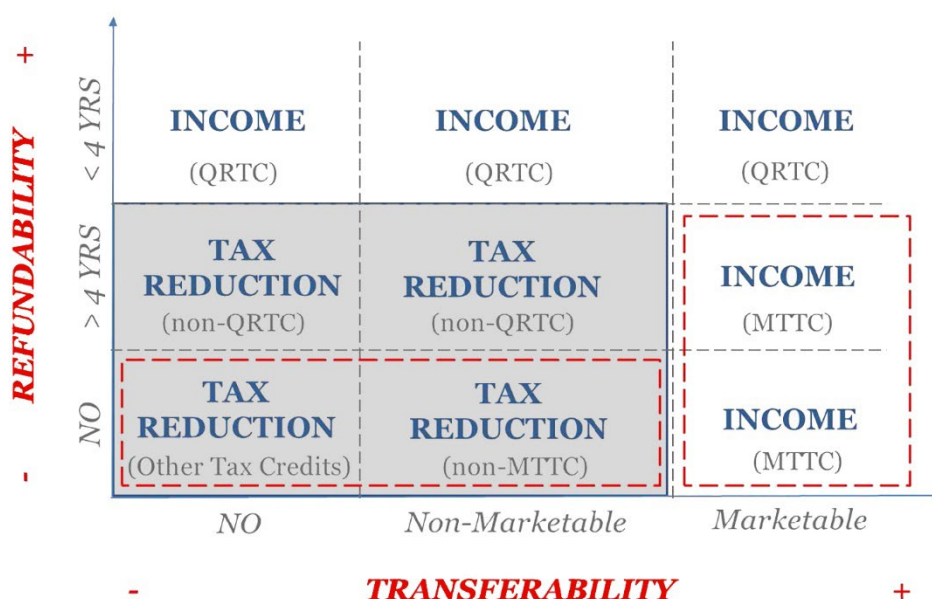
Generally, the Originator of a MTTC shall treat the face value of the tax credit as GloBE Income in the Origination Year. However, if the MTTC is related to the acquisition or construction of assets and the Originator has an accounting policy of reducing the carrying value of its assets with respect to such tax credits, or of recognizing the credit as deferred income, such that the income from the tax credit is recognized over the productive life of the asset, the Originator shall follow this same accounting policy for GloBE purposes. If all or part of a MTTC expires without use, the Originator treats the face value attributable to the expired portion of the credit as a loss (or increase to the carrying value of the asset) in the computation of GloBE Income or Loss in the Fiscal Year of the expiration. An Originator that transfers a MTTC within 15 months of the end of the Origination Year shall include the transfer price (in lieu of the face value of the credit) in its GloBE Income in the Origination Year.

Non-MTTCs and Other Tax Credits (OTCs) (*i.e.*, non-refundable and non-transferable tax credits) are *treated as reductions to Covered Taxes* under the GloBE Rules (regardless of how they are treated for financial accounting purposes).

Credits arising under the IRA that are transferred to a purchaser under Internal Revenue Code section 6418 are not MTTCs in the hands of the purchaser because they cannot be further transferred by the purchaser but are instead Non-MTTCs under the GloBE Rules. The July AG provides that in such cases a purchaser shall reduce its Covered Taxes for a fiscal year by any excess of the face value of the credit over its purchase price in proportion to the amount of

the credit used to satisfy its liability for a Covered Tax for a taxable period that ends during such fiscal year.

The table below summarizes the GloBE treatment of QRTCs, MTTCs, non-QRTCs, non-MTTCs, and OTCs:



Source: OECD (2023), *Tax Challenges Arising from the Digitalisation of the Economy – Administrative Guidance on the Global Anti-Base Erosion Model Rules (Pillar Two)*, July 2023, <https://www.oecd.org/tax/beps/administrative-guidance-global-anti-base-erosion-rules-pillar-two-july-2023.pdf>

The July AG also provides an alternative timing rule for Qualified Flow-through Tax Benefits (QFTBs) by the investor in a Qualified Ownership Interest (QOI). The February AG provided that QFTBs are first treated as a reduction to the QOI investment until it is reduced to zero, and then as a reduction to the investor’s Adjusted Covered Taxes. The July AG provides an alternative timing rule. As an administrative simplification, an MNE Group that uses the proportional amortization method of accounting for a QOI shall apply the same methodology to determine whether and to what extent benefits flowing through a QOI are treated as a reduction to the investment or a reduction to Adjusted Covered Taxes. An MNE Group that does not use the proportional amortization method of a QOI may elect to apply this methodology for GloBE purposes.

**Substance-based Income Exclusion:** Further guidance has been provided with respect to the substance-based income exclusion, including with respect to “eligible employees” and “eligible tangible assets” who/that spend time outside of the country of the constituent entity that is the employer/asset owner. A threshold test will apply such that the full payroll/tangible asset carve-out can be claimed if the employee/asset spends more than 50% of the time in the location of the constituent entity. Where 50% or less of the time is spent in the location, the constituent entity will only be entitled to claim a share of the carve-out amount in proportion to the time spent in the location. Additional guidance has been provided in several other areas, including confirmation that businesses do not have to claim the maximum allowable

amount, *e.g.*, if substantial compliance work would be needed, and clarification of the treatment of assets held for short-term operating leases, such as rental cars and hotel rooms.

**Qualified Domestic Minimum Top-up Taxes:** Jurisdictions that adopt the Pillar Two rules may, but are not required to, adopt a QDMTT. A QDMTT is credited against top-up tax liability otherwise due under an IIR or UTPR. The February AG provided some guidelines on aspects of the design and operation of a QDMTT to be used to assess whether a minimum tax meets the requirements for qualified status. Specifically, it set out two guiding principles for evaluating QDMTTs: (a) the minimum tax must be consistent with the design of the GloBE Rules, and (b) the minimum tax must provide for outcomes that are consistent with the GloBE Rules and Commentary (together, functional equivalence). In light of these guiding principles, there are respects in which a QDMTT can vary from the IIR and UTPR and still not run afoul of these guiding principles.

The February AG, however, did not cover certain aspects of a QDMTT and anticipated that some further guidance would be produced by the IF at a later stage. The July AG provides that future guidance with respect to some specific issues identified in the February AG as well as some other aspects of a QDMTT that required tailored solutions or additional clarifications.

Among the items considered in the July AG are those that consider the application of the QDMTT in the following circumstances:

- Where entities located in the QDMTT jurisdiction are not wholly owned by the UPE or a partially owned parent entity, as well as where there are Joint Ventures, subsidiaries of Joint Ventures and Minority Owned Constituent Entities located in the jurisdiction imposing the QDMTT
- Application of the QDMTT when taxes are imposed at a sub-national level, or when jurisdictional blending is not permitted under domestic law
- The allocation of QDMTT liability among CEs
- Treatment of Stateless CEs
- Treatment of Flow-through UPEs
- Treatment of Flow-through Entities required to apply the IIR
- The ETR calculation for Investment Entities
- Treatment of taxes allocable to Hybrid Entities and distributing constituent entities
- Application of the transition rules when a QDMTT is in effect
- Currency for QDMTT computations
- Application of the QDMTT in the case of multi-parented MNE groups
- Filing obligations under the QDMTT

#### **Safe Harbors:**

**QDMTT Safe Harbor:** The July AG added a permanent QDMTT Safe Harbor that will allow businesses to elect to *prepare a single QDMTT computation* for a country. Where the safe harbor applies, no additional top-up tax will arise under the IIR or UTPR. In order for the QDMTT Safe Harbor to apply, the domestic minimum tax must not only be “qualified,” but the domestic legislation must also meet an *additional set of safe harbor standards*.

In order for a QDMTT to qualify for the QDMTT Safe Harbor, the QDMTT must meet three standards: the QDMTT Accounting Standard, the Consistency Standard, and the Administration Standard.

- **The QDMTT Accounting Standard:** Requires a QDMTT to be computed based on the UPE's Financial Accounting Standard (provisions equivalent to Articles 3.1.2 and 3.1.3 of the GloBE Rules) or a "Local Financial Accounting Standard," subject to certain conditions. QDMTTs are expected to be drafted in a manner that requires the use of particular Financial Accounting Standards if certain requirements are met (thereby prohibiting an MNE Group from choosing the Financial Accounting Standard that provides a better outcome under the QDMTT).
- **The Consistency Standard:** Requires the QDMTT computations to be the same as the computations required under the GloBE Rules, except as required or allowed in the Commentary. Mandatory variations (deviations from the GloBE Rules explicitly required in the Commentary such as those that relate to the allocation of cross-border taxes and the requirement that the QDMTT be calculated using local currency under certain circumstances) are required for a QDMTT to meet the Consistency Standard. In the case of optional variations (certain deviations from the GloBE Rules permitted in the Commentary), the Consistency Standard will generally "only be met where the QDMTT jurisdiction chooses the option that aligns with the outcomes provided for under the Model Rules and Commentary for the IIR and UTPR," unless the IF has agreed otherwise.

In certain circumstances, a QDMTT jurisdiction might be subject to certain domestic law restrictions that prevent the application of the QDMTT to a particular CE or corporate structure. Consequently, the July AG provides a list of scenarios that will not prevent a QDMTT jurisdiction from meeting the Consistency Standard (*e.g.*, a QDMTT jurisdiction does not impose a QDMTT on Flow-through Entities created in its jurisdiction). Rather, in cases in which an MNE Group has entities that are described in such scenarios, the MNE Group may be subject to a "Switch-off Rule." The Switch-off Rule (a) prevents an MNE Group from applying the QDMTT Safe Harbor with respect to all or a subset of certain Constituent Entities located or created in the QDMTT jurisdiction, and (b) requires the MNE Group to use instead the credit method for the QDMTT in Article 5.2.3 of the GloBE Rules.

- **The Administration Standard:** Requires that the QDMTT jurisdiction be subject to the same ongoing monitoring process as the GloBE Rules.

Whether a QDMTT meets the above standards and qualifies for the QDMTT Safe Harbor is determined by a "Peer Review Process" based on the jurisdiction's QDMTT legislation and administration of such legislation (rather than based on how the QDMTT legislation applies to a particular MNE Group).

**UTPR Safe Harbor:** Under a transitional UTPR safe harbor, no top-up tax will be payable under the UTPR with respect to any undertaxed profits of a business in its ultimate parent entity (UPE) country if that country applies a nominal

statutory corporate income tax rate of at least 20%. This is a temporary safe harbor and will defer the application of the UTPR to such profits until 2026 (*i.e.*, for years beginning on or before December 31, 2025).

While this is likely to be viewed as welcome relief for US-parented MNEs, it should be noted that the July AG provides that “[w]hen an MNE qualifies for both a transitional CbCR and UTPR safe harbour in a jurisdiction in a Fiscal Year, the MNE may elect to apply the Transitional CbCR Safe Harbour, rather than the UTPR safe harbour, in order to avoid losing the benefit of the Transitional CbCR Safe Harbour in a subsequent Fiscal Year under the ‘once out, always out’ approach.” In light of this, US MNEs that would hope to rely on the CbCR safe harbor in 2026 will also need to satisfy the CbCR safe harbor in 2025 with respect to the potential application of the UTPR to the US operations of the US-parented MNE.

### **Pillar Two Tax Challenges Arising from the Digitalization of the Economy— GloBE Information Return**

Following an earlier public consultation launched in December 2022, the OECD IF has developed the standardized [Information Return](#) to be filed by businesses within the scope of the Model Rules. The Information Return will include a *comprehensive set of data points* required for a tax authority to evaluate the correctness of a business’s calculation of its top-up tax liabilities in each country. The Information Return includes sections on: the business in general, including a summary table with a high-level overview of the application of the rules in each country, *e.g.*, stating the range in which the effective tax rate and amount of top-up tax payable falls; the corporate structure; application of jurisdictional safe harbors and exclusions; detailed calculations of amounts of Pillar Two income and losses, adjusted covered taxes, and effective tax rates; and the allocation of top-up tax liabilities.

The Information Return framework includes a “*transitional simplified jurisdictional reporting framework*” that will apply to the first five reporting years of the regime (*i.e.*, returns for fiscal years beginning on or before December 31, 2028). Where the conditions are met, a business can elect to report the majority of the required data for a country on a net/aggregated basis, rather than for each constituent entity. This transitional simplification is available for countries where no top-up tax liability arises, or where a top-up tax liability does arise but does not need to be allocated to individual constituent entities (*e.g.*, because all top-up tax arising with respect to that country would be payable under the IIR of the UPE country). Businesses that elect to report jurisdictional data are expected to have an accounting system that facilitates a jurisdictional approach. Tax authorities will be able to make follow-up information requests, including requesting constituent entity data. Countries have the option in certain circumstances not to apply simplified jurisdictional reporting in their QDMTTs. The IF will consider whether any such simplifications could apply on a permanent basis.

The deadline for filing an Information Return is 15 months after the fiscal year end, extended to 18 months for the first year in which a group is in scope. An Information Return typically will be *filed centrally* with the tax authority of the business’s UPE. Sections of the Information Return will then be *shared* with tax authorities of countries in which the business has constituent entities.

Countries with top-up taxing rights, including under a QDMTT, will be provided with the parts of the Information Return that relate to the detailed computation of the relevant top-up tax amounts. Other countries will receive the Information Return's general information and corporate structure sections. In situations where the centralized filing mechanism does not apply, *e.g.*, in the absence of a qualified information exchange agreement between two tax authorities, any resulting local filing obligations will be limited to the same information the local tax authority would have received through the centralized filing mechanism.

The IF is exploring the possibility of developing other administrative mechanisms to facilitate further coordination and consistent application of the global minimum tax rules, *e.g.*, a coordinated framework for further information requests and coordinated risk assessment activities.

### Subject to Tax Rule

The OECD Inclusive Framework has released [the model articles and commentary](#) for the treaty-based Subject to Tax Rule (STTR) for some intra-group payments.

Where the STTR is included in a double tax treaty, the payment country will be permitted to charge *tax on gross amounts of payments* if the income is subject to tax in the recipient's country at a *nominal tax rate below 9%*. (The nominal rate is the statutory tax rate applicable to the type of income received, as amended by any "preferential adjustments" such as a full or partial exemption or exclusion from income.) This additional taxing right will be limited to the difference between the 9% STTR minimum rate and the nominal tax rate, less any existing taxing rights of the source country, *e.g.*, withholding taxes.

IF countries that apply nominal corporate income tax rates below 9% have made a political commitment to implement the STTR into their double tax treaties with *developing country* members *when requested to do so*. Developing countries are defined as those with a Gross National Income per capita in 2019 of \$12,535 or less.

The STTR applies to the following types of payments: interest, royalties, payments for distribution rights, insurance or reinsurance premiums, financing fees, rent for the use of equipment, payments for services. Other than with respect to interest and royalties, the STTR does not apply if the income in the hands of the recipient does not exceed costs incurred plus an *8.5% mark-up threshold*. The rules do not apply where the income is paid by an individual or is received by an individual or certain defined classes of entities such as pension funds or non-profit organizations.

The STTR applies to payments between connected parties (defined based on whether there is common control, or alternatively common direct or indirect participation of more than 50%). A *targeted anti-avoidance rule* will prevent the use of *intermediaries* to avoid the STTR.

Tax will be *assessed annually following the end of each fiscal year* (an "ex-post annualised charge") and will apply if the aggregate amount of payments made by the group from one country to the group in the other country exceeds a



materiality threshold (€250,000 per annum for countries with a GDP of less than €40 billion, and €1 million otherwise).

## Contacts

[Bob Stack](#), Washington, DC

[Ryan Bowen](#), Washington, DC

[Drew Moss](#), Washington, DC

[Carrie Walker](#), Washington, DC



[Deloitte.com](#) | [Legal](#) | [Privacy](#)

30 Rockefeller Plaza  
New York, NY 10112-0015  
United States

This alert contains general information only and Deloitte is not, by means of this alert, rendering accounting, business, financial, investment, legal, tax, or other professional advice or services. This alert is not a substitute for such professional advice or services, nor should it be used as a basis for any decision or action that may affect your business. Before making any decision or taking any action that may affect your business, you should consult a qualified professional advisor. Deloitte shall not be responsible for any loss sustained by any person who relies on this alert.

As used in this document, "Deloitte" means Deloitte Tax LLP, a subsidiary of Deloitte LLP. Please see [www.deloitte.com/us/about](http://www.deloitte.com/us/about) for a detailed description of our legal structure. Certain services may not be available to attest clients under the rules and regulations of public accounting.

Copyright © 2023 Deloitte Development LLC. All rights reserved.