TAX IN MOTION

Understanding Pillar Two: Mechanics and financial operating model impact

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With you today

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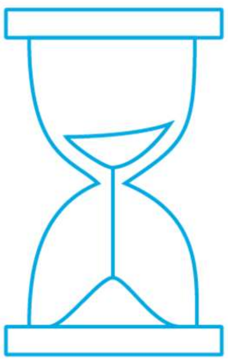
2023 ITAX FORUM

Agenda

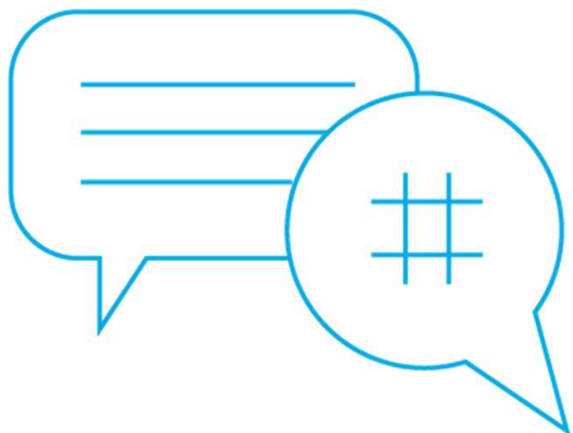


- Introduction to Pillar Two
- Pillar Two mechanics and details
- Implementation considerations
- Examples
- What’s next: Items to consider in your analysis

Learning objectives

By the end of this presentation, participants will be able to:

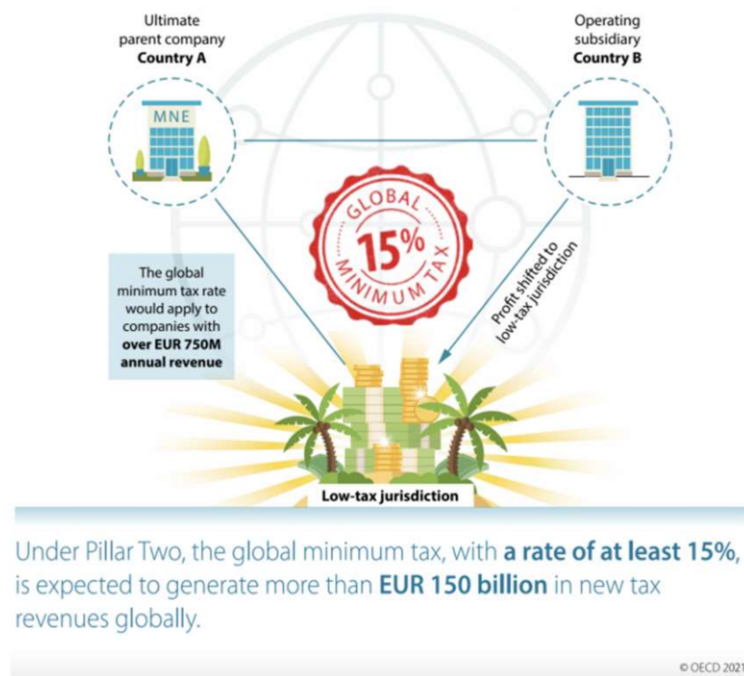
1. Describe the current legislative landscape surrounding Pillar Two
2. Explain the key technical components of Pillar Two
3. Identify the key concepts that will aid in assessing Pillar Two impact



Pillar Two introduction

Introduction

- Pillar Two addresses remaining Base Erosion and Profit Shifting (BEPS) challenges and is designed to ensure that large internationally operating businesses pay a minimum level of tax regardless of where they are headquartered or the jurisdictions where they operate in.
- Pillar Two consists of the Global Anti-Base Erosion (GloBE) rules and the Subject To Tax Rule (STTR).
    - The GloBE rules should ensure that MNE's are subject to a minimum tax rate of 15%.
    - The STTR provides developing countries with additional rights to levy withholding taxes on payments to low tax jurisdictions.
- Pillar Two is designed as a common approach, but it does not rely on all countries agreeing to a minimum tax, but simply enough countries agreeing to do so.
- Over 130 countries have signed up to follow the Organization for Economic Co-operation and Development (OECD) Pillar Two model rules if they implement a minimum tax.



What is Pillar Two?

What?	• Framework for a global minimum tax for large multinational enterprises (MNEs)
	  • Annual consolidated book revenue > EUR 750M in at least two the last four years immediately preceding the tested year
	  • Limited exceptions for so-called “excluded entities” (e.g., governmental entities, pension funds)
	• 15% minimum tax paid with respect to EVERY country where income is earned

How?	• Top-up tax • Collected by the Global anti-Base Erosion Rules (GloBE) • Qualified Domestic Minimum Top-Up Tax (QDMTT) + Income Inclusion Rule (IIR) + Undertaxed Payment / Profits Rule (UTPR) • Treaty-based Subject to Tax Rule (STTR)
Impact?	• Additional tax revenue will be collected - but by which countries? • Significant costs - expected and unexpected (non-creditable foreign taxes) • Administration headaches • Heightened risk for tax controversy

Pillar two: tax filing overview

How?	The Pillar Two rules will require MNE's to prepare a GloBE Information Return. The GloBE Information Return shall include the following information including an overview of all the constituent entities of the MNE group, including their TIN, residence and status under the GloBE rules, a complete org chart, all information required to compute the effective tax rate and top up tax per jurisdiction and a record of elections made in accordance with the GloBE rules.
Where?	The GloBE information return needs to be filed for each group entity. Group entities can file on behalf of other group entities residing in the same jurisdiction. UPE's can file on behalf of other group entities insofar the jurisdiction of the UPE has a competent authority agreement with the jurisdiction of the group entity.
When?	Ultimately 15 months after the financial year has ended. For the first FY (2024), the deadline will be 18 months after the FY has ended. As such, the first Information return needs to be filed before July 1, 2026.

Scope and and exclusions

Multinational enterprises

Certain entities meeting certain revenue thresholders

Who is included in scope?	Who is excluded?
✓ Annual global revenues > €750M ✓ Two of the last four years preceding tested FY ✓ Transitional rules for single entities on becoming groups	✓ Government bodies and international organizations ✓ Non-profits ✓ Investment entities owned by ≥ 95% by excluded entities

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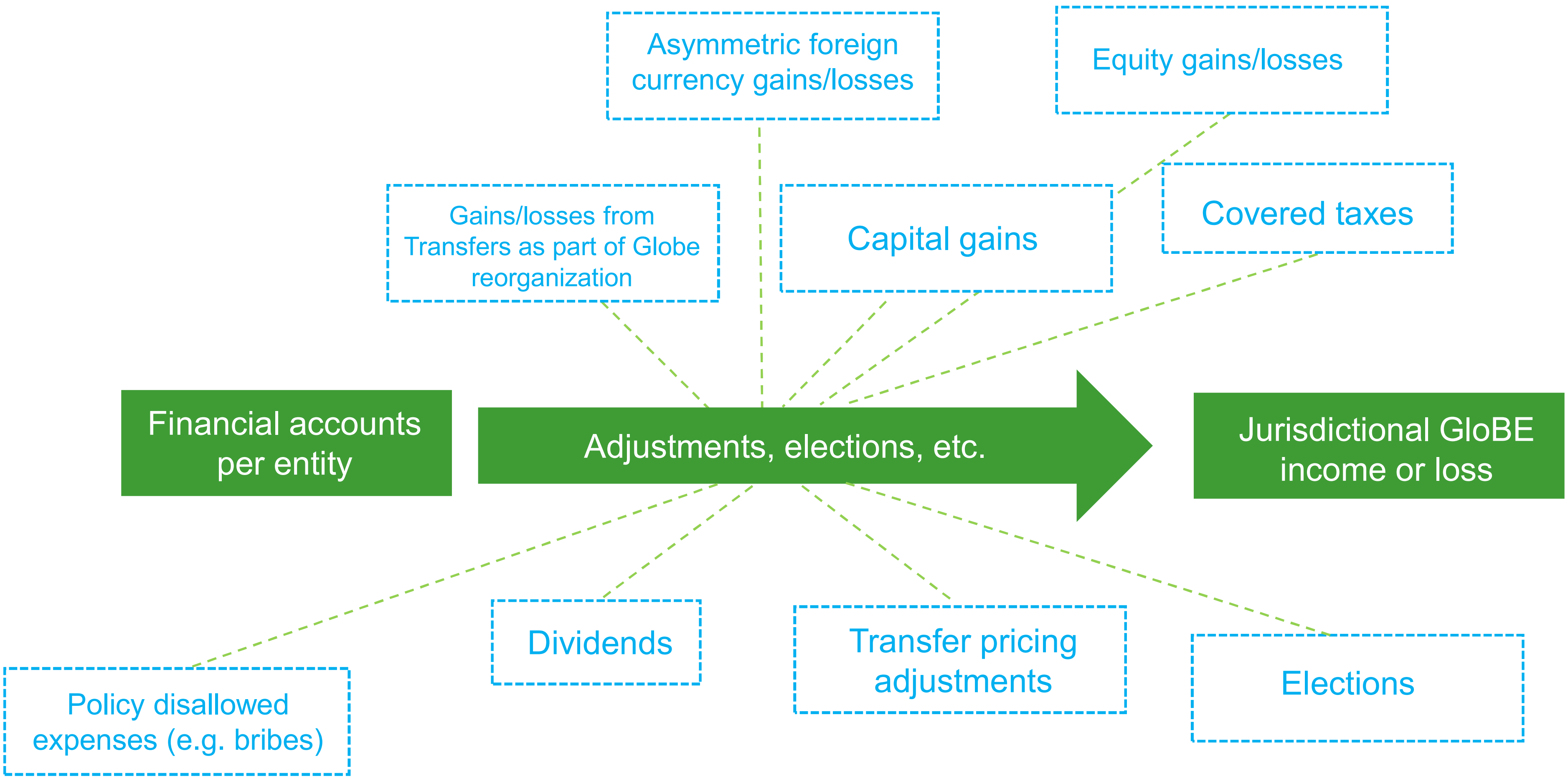
Pillar Two: top-up tax mechanics

Effective tax rate	• Calculated on a jurisdictional basis using standard definition of covered taxes and tax base ETR = Total covered taxes / Total GloBE Income
GloBE income	• Start with the financial accounting net income included in the ultimate parent entity's (UPE) consolidated accounts (e.g., IFRS, GAAP Equivalent) • Adjust for certain items
Covered taxes	• Basic rule – include taxes accrued (current + deferred) in UPE's consolidated accounts • Adjust for certain items
Substance-based carve out	• Carve-out from GloBE Income • 10% of payroll + 8% of carrying value of tangible fixed assets; declines to 5% in 10 years
Timing differences	• Adjust deferred tax at the lower of relevant domestic rate and 15% • Timing differences that reverse over a long period (greater than five years) are excluded and treated as permanent differences (certain exceptions apply)

Pillar Two: calculate GloBE income



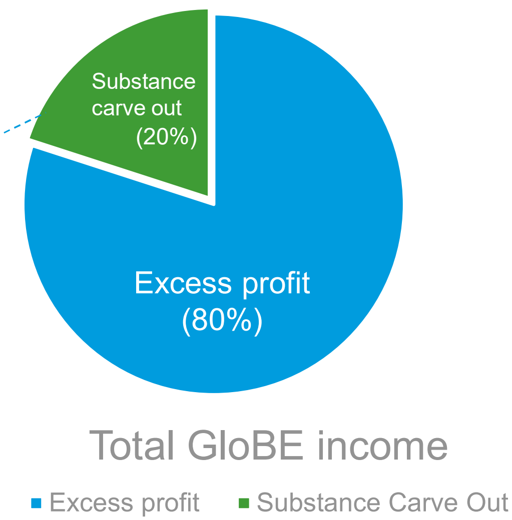
Pillar Two: calculate ETR and top-up tax

Maximum rate (15%)

Top-up tax % (e.g., 5%)

$$\frac{\text{Covered taxes}}{\text{GloBE income}} = \text{ETR (e.g. 10\%)}$$

5% of payroll costs and tangible assets



Top-up tax% (5%) x Excess profit (80) = Top-up tax (4)

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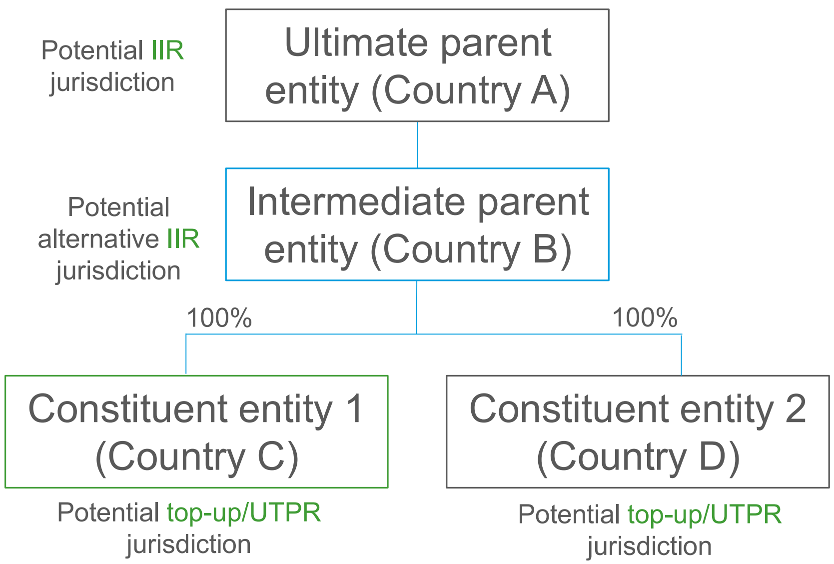
Pillar Two mechanics and details

Pillar Two terms



What do the terms mean?

Ultimate parent entity (UPE)

- Primary responsibility to apply IIR to collect the top-up tax ("top-down" approach)

Intermediate parent entity (IPE)

- Responsible for collecting top-up tax if:
- UPE does not apply IIR or another qualified income inclusion
  - Rule, UPE is excluded entity or IPE is a partially-owned parent entity (POPE)
- Needs controlling ownership interest

Constituent entity: Group entities subject to the GloBE rules (i.e., the IIR + UTPR)

- Any entity that is a member of a group (unless it is an excluded entity)
- A permanent establishment is treated as a separate constituent entity

Key concept: taxing rights

Income inclusion rule (IIR)	Undertaxed payment/profits rule (UTPR)
• Payable in the ultimate parent entity (UPE) jurisdiction or, if no IIR in UPE's jurisdiction, payable in intermediate parent entity (IPE) jurisdiction if IIR in such jurisdiction • Top-up tax with respect to entities in low-tax jurisdictions (i.e., less than 15% effective tax rate) Computed on a country-by-country basis • Priority over the UTPR rules • Effective for tax years beginning on or after December 31, 2023	• Backstop if income is not taxed by IIR in UPE or IPE jurisdiction • Payable by entities in UTPR jurisdictions • Increases tax on entities in a UTPR jurisdiction if they have low tax affiliates (below 15%) in other countries • Top-up tax by disallowing deductions or other adjustments • Allocated to the UTPR jurisdictions based on relative shares of total employees and tangible assets • Effective for tax years beginning on or after December 31, 2024

Subject to Tax Rules (STTR)
• Treaty based rule: Withholding tax on certain payments (e.g., royalties, interest) • Where the nominal tax rate is less than the STTR minimum rate of 9% • Restricted to tax treaties between developing and developed economies

Key concept: taxing rights (cont'd)

Qualified domestic minimum top-up taxes (QDMTT)

- Minimum tax rules passed at the local jurisdiction level
- Must be implemented and administered in a way consistent with the Model Framework
- QDMTT has prioritization over the IRR and UTPR from an ordering perspective
- Fully creditable against GloBE top-up tax
- Safe harbors must be available for QDMTT (further work needed in this area of the framework)
- Not required to have a substance carve-out. If it does, can't be broader than such factors in the framework.
- Allocation of GILTI and Subpart F taxes not allocated to local level for QDMTT purposes

Pillar Two: basic design

Subject to tax rule (STTR)
- Applies before GloBE rules
- Treaty based rule, allowing countries to impose source taxation on covered related party payments
- Minimum nominal rate: 9%

Stand-alone application

Income inclusion rule (IIR)
- Primary rule: Top-up Tax is imposed at the level of the UPE or intermediate parent entity for low-taxed constituent entities
- Top-up tax with respect to low-taxed entities computed on country-by-country basis
- Minimum ETR: 15%

2nd

IIR

Low tax

Ultimate parent entity
Country W

IIR

Intermediate parent
country X

STTR

UTPR

Subsidiary A
Country Y

Low tax

Subsidiary B
Country Z

Subsidiary C
Developing country

Interest payment
to Country W

QDMTT

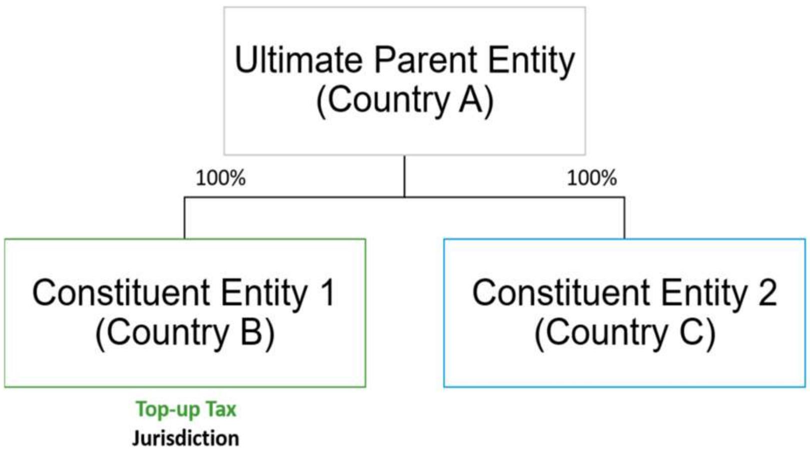
Undertaxed profits rule (UTPR)
- Backstop to IIR – applies if no IIR imposed
- Top-up Tax is allocated to countries with constituent entities based on tangible assets/employees
- Payable by entities in UTPR jurisdictions
- Minimum ETR: 15%

3rd

Qualified domestic minimum top up tax (QDMTT)
- Applies before IIR and UTPR
- Assessed by low tax jurisdiction itself, under computation consistent with Pillar Two top-up tax calculation
- Fully creditable against GloBE top-up tax
- Minimum ETR: 15%

1st

Pillar Two: top-up tax example



Reference	High–level definition	Entity 1 Country B	Entity 2 Country C
a	GloBe income	$2,000	$1,000
b	Covered taxes	$100	$250
C=b/a	Jurisdiction level ETR	5%	25%
d = 15% (-) c	Top-up tax percentage	10%	0%
e	Tangible assets plus payroll	$500	$2,000
f = e * 5%^	Substance based carve-out	$25	$100
g = a (-) f	Excess profit	$1,975	$900
h = d * g	Top-up tax	198	-

Currency represented in USD for example

A QDMTT could reduce or eliminate the amount of top-up taxes paid under the IIR or UTPR

Implementation considerations

Pillar Two technical overview - steps

1. Identification of constituent entities

1. Identify whether the MNE is within scope.
2. Identify the constituent entities.
3. Identify where each of the constituent entities is resident.
4. Identify the UPE.
5. Identify excluded entities.

2. ETR calculation

1. Calculate GloBE income. GloBE income is financial accounting net income adjusted for certain permanent book to tax differences.
2. Calculate covered taxes.
3. ETR = covered taxes / GloBE income.
4. Make this calculation for each jurisdiction in which MNE is active.
5. Verify whether the MNE Group is relying on any simplifications or safe harbours in calculating its GloBE tax liability

3. Top-up tax calculation

1. The top up tax rate equal 15% - ETR if the ETR is below 15%.
2. Apply the GloBE substance based carve out.
3. Apply GloBE loss carry forwards.
4. Top up tax = (GloBE income – substance based carve out – carry forward losses) * top up tax rate.

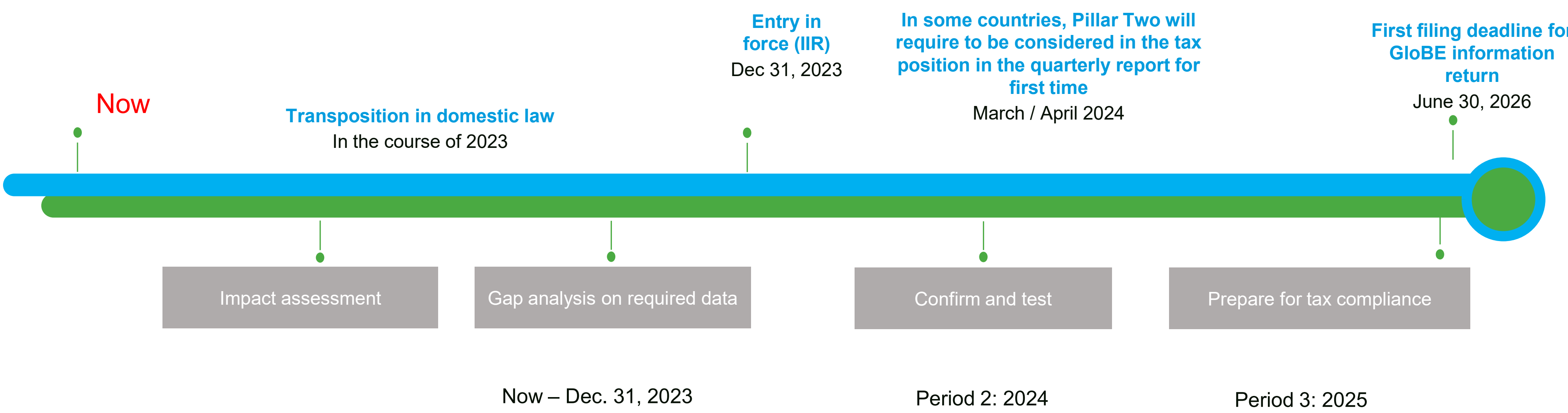
4. Top-up tax allocation

1. Determine top up tax due for the UPE under the IIR.
2. Determine top up tax due for any intermediate parents under the IIR.
3. Allocate remaining top up tax under the UTPR.
4. Determine whether or not any top up tax is rolled over to next year.

5. Compliance

1. Collect the reportable data.
2. Prepare the GloBE information return within 15 months after year end.
3. Make sure Pillar Two consequences are properly incorporated in financial statements and tax returns.
4. Identify the filing entities.

Pillar Two timeline – SEC filer

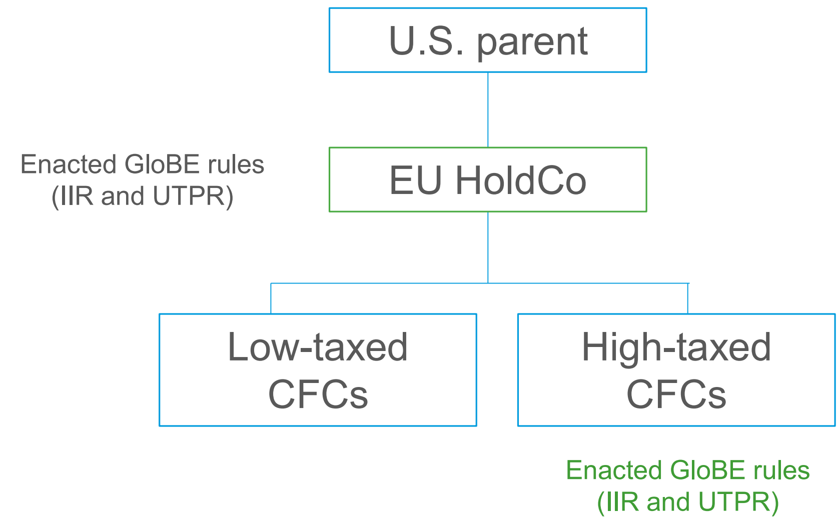


Throughout: Ongoing tracking of local country legislation in relevant operational countries

Examples

U.S. multinationals: IIR and UTPR

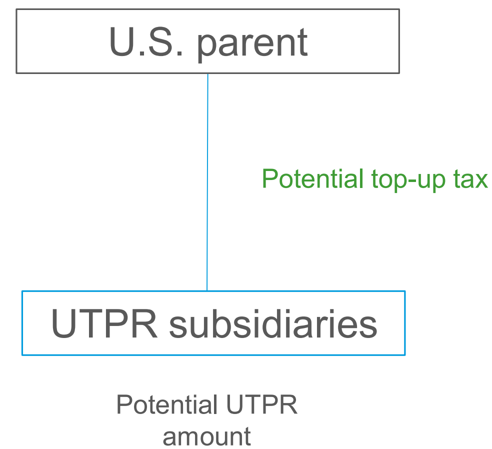
Example 1: EU Intermediate HoldCo and IIR	
Overview	• U.S. parent has several low-taxed CFCs and high-taxed CFCs held by a holding company in the EU (EU HoldCo). • The EU enacted the GloBE rules via a minimum tax directive, including an IIR and UTPR. • The jurisdictions of the high-taxed CFCs have enacted the GloBE rules (both IIR and UTPR). • The U.S. has not adopted an IIR (e.g., no adjustments to GILTI regime to make country-by-country and apply higher tax rate).
Considerations and impact:	EU HoldCo is expected to be viewed as an Intermediate parent entity (IPE) of the MNE group. • Because U.S. does not have an IIR, IPE must apply the IIR for any low-taxed constituent entities that are lower-tier subsidiaries. Consequently, the entire top-up tax is expected to be due at the level of EU HoldCo. • Turns off the potential application of a UTPR at the level of the high-taxed CFCs (except with respect to U.S. earnings). Consider impact of U.S. GILTI and Subpart F along with foreign tax credits.



U.S. multinationals: IIR and UTPR

Example 2: U.S. Parent and UTPR Subsidiaries	
Overview	• U.S. parent holds several foreign subsidiaries, all of which are high-taxed. • Some/all of the foreign subsidiaries have enacted the GloBE rules, including a UTPR. • U.S. parent has certain permanent book differences and general business credits that reduce its ETR on its U.S. income.

Considerations and impact:	• The U.S. has not enacted a compliant IIR regime. Significantly, even if it had, the IIR at U.S. Parent level would not turn off the potential application of the UTPR with respect to the U.S. earnings at the level of the UTPR subsidiaries.
	• U.S. parent's GloBE income and covered taxes are calculated to determine its U.S. jurisdictional-level ETR.
	• Consider impact of U.S. GILTI and Subpart F along with foreign tax credits.
	• Certain facts are expected to result in potential top-up tax (non-exhaustive list):
	    ◦ Book/tax differences: Deferreds must be booked at 15% instead of U.S. rate (21%)
	    ◦ Significant stock option expense w/o election
	    ◦ General business credits and other tax incentives reducing U.S. ETR.
	    ◦ Article 9.1 IP transfers in transition period
	• State income taxes are expected to be considered U.S. covered taxes taken into account in the U.S. jurisdictional-level ETR.



Determining GloBE income and covered taxes

Example 1: Temporary differences

	20X3
Corporate Income Tax Rate	25%
Tax Computation	
Pre-Tax Income	10,000,000
Deduct Temporary Short term differeneces	(4,000,000)
Taxable Income	6,000,000
Tax Provision	
Current Tax Expense	150,000
Ttotal current Tax Expense	150,000
Deferred Tax on short term temporary differences	100,000
Total Tax Expense / (Benefit)	**250,000**
Total Tax Reconcoiliation	
Pretax Income	1,000,000
Expected Tax Expense	250,000
Rate reconciling items	-
Total Tax Expense	**250,000**
Effective Rate under US GAAP	**25.0%**

GloBE	20X3
Calculation of GloBE income	
GAAP Pre-tax Income	1,000,000
GloBE Income*	**1,000,000**
**for purposes of this example, assumed no adjustments are required to pre-tax income.*	
Calculation of adjusted covered taxes	
Covered Tax	250,000
Adjustments	
- Remove deferred tax at 25% rate	(100,000)
- Recompute at 15% minimum tax rate	60,000
Adjusted covered tax	**210,000**
GloBE Effective Tax Rate	**21.0%**

Determining GloBE income and covered taxes

Example 2: Permanent and temporary differences

	20X3
Corporate Income Tax Rate	25%
Tax computation	
Pre-Tax Income	1,000,000
Disallowed expenses (fines and penalties)	70,000
Deduct: Local tax incentives (FDII / R&D / Patent Box)	(250,000)
Deduct: short term temporary differences	(400,000)
Taxable Income	420,000

Tax Provision	
Current tax expense before credit	105,000
Tax credits	(50,000)
Total current tax expense	55,000
Deferred tax on short term temporary differences	100,000
Total tax expense / (benefit)	**155,000**

Total Tax Reconciliation	
Pre-tax income	1,000,000
Expected Tax Expense	250,000
Rate reconciling item	
- Disallowed expenses	17,500
- Local tax incentives	(62,500)
- Tax credits	(50,000)
Total Tax Expense	**155,000**
Effective Rate under US GAAP	**15.5%**

GloBE	**20X3**
Calculation of GloBE income	
GAAP Pre-tax Income	1,000,000
	70,000
GloBE Income*	**1,070,000**

**for purposes of this example, assumed no other adjustments are required to pre-tax income.*

Calculation of adjusted covered taxes	
Covered Tax	155,000
Adjustments	
- Remove deferred tax at 25% rate	(100,000)
- Recompute at 15% minimum tax rate	60,000
Adjusted covered tax	**115,000**

GloBE Effective Tax Rate	**10.7%**

Determining GloBE income and covered taxes

RSM

Example 3: CFC taxes	
Facts	• U.S. ultimate parent entity (U.S. UPE) with two lower-tier foreign subsidiaries (CFCs). One subsidiary. • Generates only subpart F income and the other only GILTI. • Assume that both subpart F and GILTI are "qualified CFC" regimes for Pillar Two. • Assume that the subpart F activities are not considered "passive" under the Model Rules. • Assume the CFCs have no local tax base permanent or temporary differences. • Assume U.S. UPE has no temporary differences; only permanent differences.

Determining GloBE income and covered taxes

Example 3: CFC taxes (cont.)

	US GAAP US (UPE)	US GAAP CFC (Sub F)	US GAAP CFC (GILTI)	US GAAP Consol	Pillar II US (UPE)	Pillar II CFC (Sub F)	Pillar II CFC (GILTI)	Pillar II Consol
GloBE / pre-tax income	1000	100	400	1500	1000	100	400	1500
Statuatory rate	21.00%	13.00%	10.00%		21.00%	13.00%	10.00%	
Tax at statuatory rate	**210**	**13**	**40**	**263**	**210**	**13**	**40**	**263**
CFC tax on Subpart F, pre-credit	21	-	-	21	-	21	-	21
Total FTC generated, Subpart F	(13)	-	-	(13)	-	(13)	-	(13)
Lost FTC's, US expense apportionment	-	-	-	-	-	-	-	-
Net cost of Subpart F, after credits	**8**	-	-	**8**	-	**8**	-	**8**
CFC tax on GILTI, pre-credit (post 250 deductior	42	-	-	42	0	-	42	42
Total FTC generated, GILTI	(40)	-	-	(40)	0	-	(40)	(40)
Lost FTC's, 20% haircut on GILTI FTC's	8	-	-	8	0	-	8	8
Lost FTC's, US expense apportionment	6	-	-	6	6	-	-	-
Net cost of GILTI, after credits	**16**	-	-	**16**	**6**	-	**10**	**10**
FDII	(84)	-	-	(84)	(84)	-	-	(84)
Total taxes	**150**	**13**	**40**	**203**	**132**	**21**	**50**	**203**
ETR	**15.00%**	**13.00%**	**10.00%**		**13.20%**	**21.00%**	**12.50%**	

Statuatory rate - US 21%

Statuatory rate - US 21% X 50% (250 deduction) X 10.5% + (20% FTC haircut impact) = 12.5%

	A, D	B, C	
Covered taxes at local level	40	40	
Covered taxes, pushdown of CFC taxes from UP	10	10	C, D
Total taxes at consolidated level	**21**	**50**	

There is uncertainty concerning whether the impacts of US expense apportionment (or other limitations under US federal tax law) which serve to further increase the CFC tax cost (net of FTC) can also be pushed down. In this example, it is assumed that such costs cannot be pushed down, such tht the only CFC tax allocated to lower tier CE is actual "top-up" tax. Further guidance will be needed.

Model Rules. However, to the extent that the activities are not considered "Passive" (e.g. sales or commission activities considered as Foreign Base Company sales Income under Subpart F), this limitation would not apply, as shown in the example above.

What's next: items to consider in your analysis

GloBE transitional safe harbor rules

- Covers all fiscal years beginning on or before Dec. 31, 2026, but not including a fiscal year ending after June 30, 2023 (calendar years 2024 – 2026)
- Not dependent on first year that GloBE rules become applicable to a group
- Once transitional safe harbor not applied for a year for a jurisdiction, no application for subsequent years
- Still required to comply with group-wide GloBE requirements including filing GloBE information return
- Intended to reduce initial compliance burden based upon tests applied against CbC data.

GloBE transitional safe harbor rules: specific tests

- To qualify, jurisdictions must meet one of the following tests:
  - De minimis test
    - Revenue less than EUR 10 million **and** profit (loss) before income tax is less than EUR 1 million; Based on revenue and profit (loss) before income tax as reported in CbC report
  - Simplified ETR test
    - Simplified ETR test uses income tax expense from financial statements adjusted for uncertain tax positions and non-covered taxes compared to profit (loss) before income tax as reported in CbC report
    - ETR >= 15% (2023-2024), 16% (2025) and 17% (2026)
  - Routine profits test
    - Profits before income tax <= Substance-based carve-out amount under GloBE based on payroll and tangible assets
- Permanent safe harbors still being assessed by OECD

Pillar Two impacts to U.S. multinational groups

- U.S. global intangible low-taxed income (GILTI) does not currently qualify as an IIR.
- Administrative guidance allows U.S. MNEs to claim credit for tax paid under GILTI against Pillar Two liabilities, but only for two years and not against QDMTT regimes. Other similar taxes not addressed.
- IRS is currently reviewing whether U.S. MNEs can claim foreign tax credit for taxes paid under QDMTT liabilities incurred in source countries. IIR and UTPR can qualify as credits in certain circumstances.
- Certain U.S. non-refundable tax incentives could reduce ETR below the minimum 15%, resulting tax elsewhere under UTPR.
- FASB staff view GloBE model rules as an alternative minimum tax which would be accounted for as a period cost in the year the GloBE liability arises.

Key considerations for multinational groups

- Administration and compliance burden with GloBE rules is not necessarily proportional to the amount of tax due.
- Need detailed analysis of entity structures to determine scope and applicability of GloBE rules.
- Organizations will need to identify resources and develop workplans to assist in information gathering from multiple data sources to assess impact and remain compliant.
- GloBE developments across jurisdictions will be fluid and require continual monitoring.
- Media attention on Pillar Two is driving interest from various stakeholders – internal and external to organizations.
- Financial statement impacts and appropriate disclosures will need to be assessed perhaps sooner than later.

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