We just can’t get enough of Pillar Two

Status update and latest developments

Robin Hart, Principal – *Charles River Associates*

Chad Hungerford, Partner - *Deloitte*

David Wachutka, Principal – *EY*

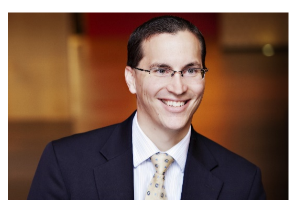
Mike Wittig, VP of Tax – *Instacart*

November 7, 2023

Speaking with you today

Introductions

Mike Wittig
- Vice President
- Tax
- Instacart



Chad Hungerford
- Partner
- International Tax
- Deloitte Tax LLP

Robin Hart
- Principal
- Global Transfer Pricing
- Charles River Associates

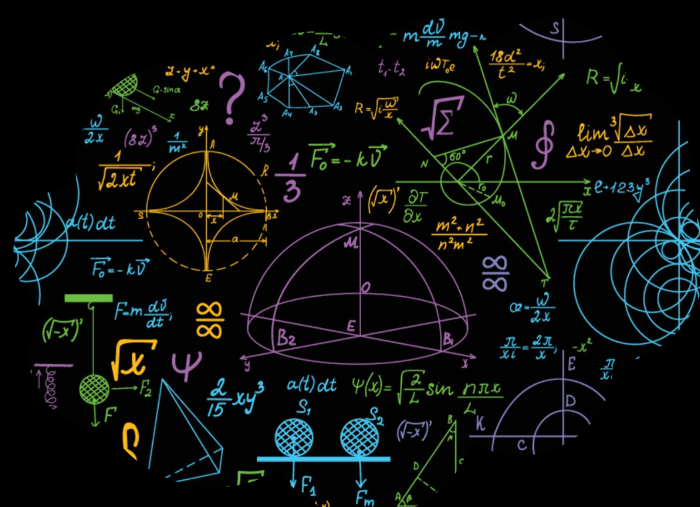
David Wachutka
- Principal
- International Tax
- EY

Welcome and Introduction

Agenda:

- Introduction (Mike)
- How did we get here? (Chad)
- Introduction to Pillar 1 with a focus on Amount B (Robin)
- What should US companies do for Pillar 2 now? (Chad)
- Key Pillar Two concepts for US MNEs (Dave)
- Practical considerations under Pillar Two for transactions (Dave)
- Conclusion and Q&A (Mike)

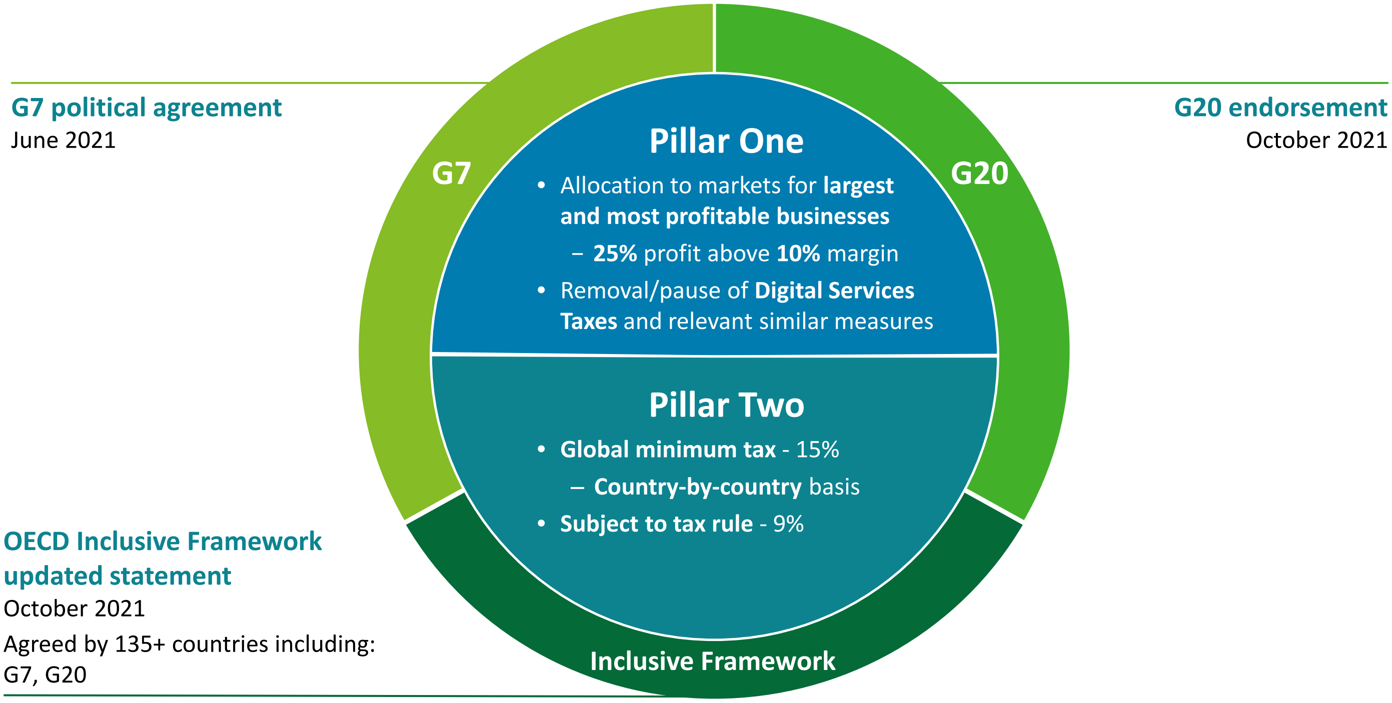
Deloitte.



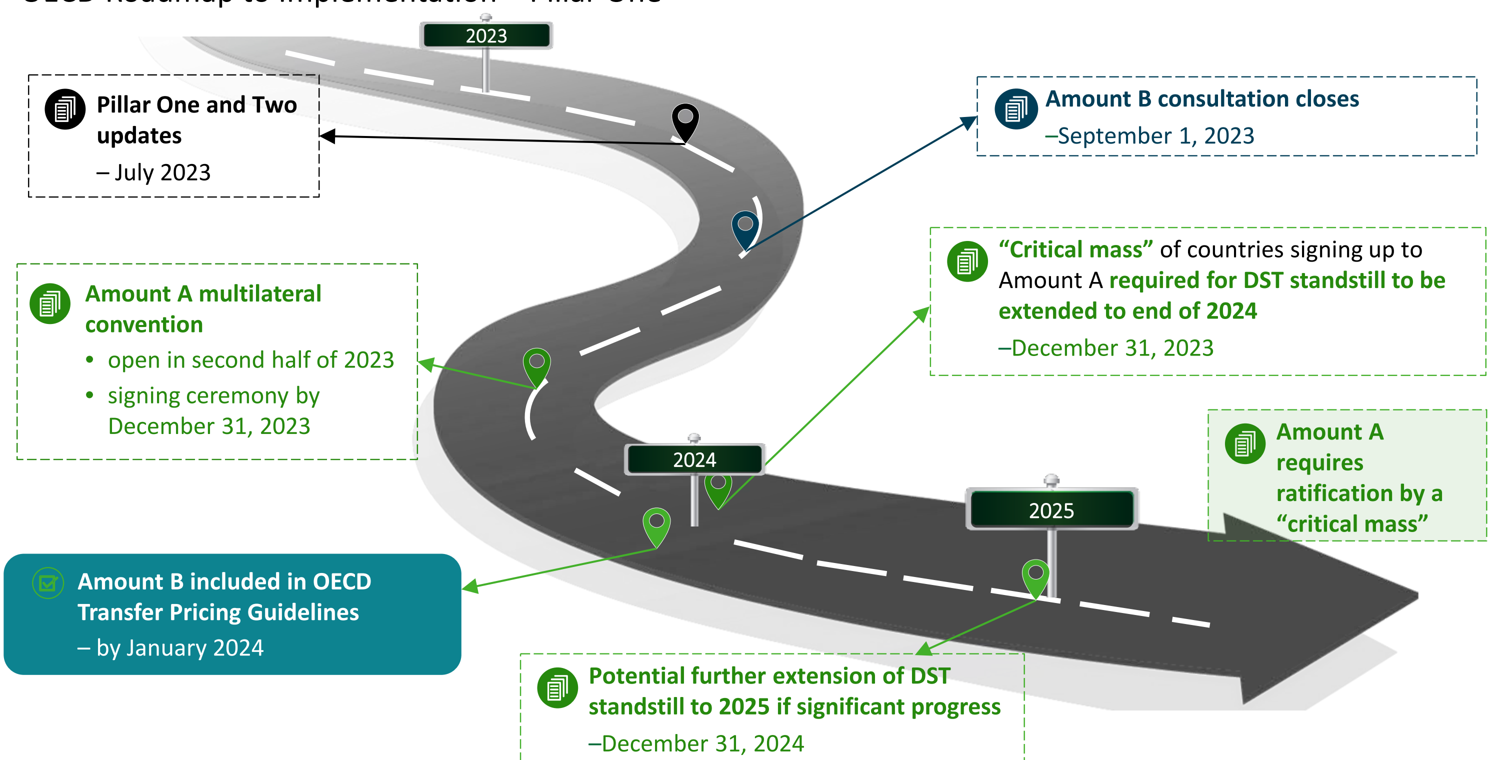
Pillar One and Pillar Two

How did we get here?

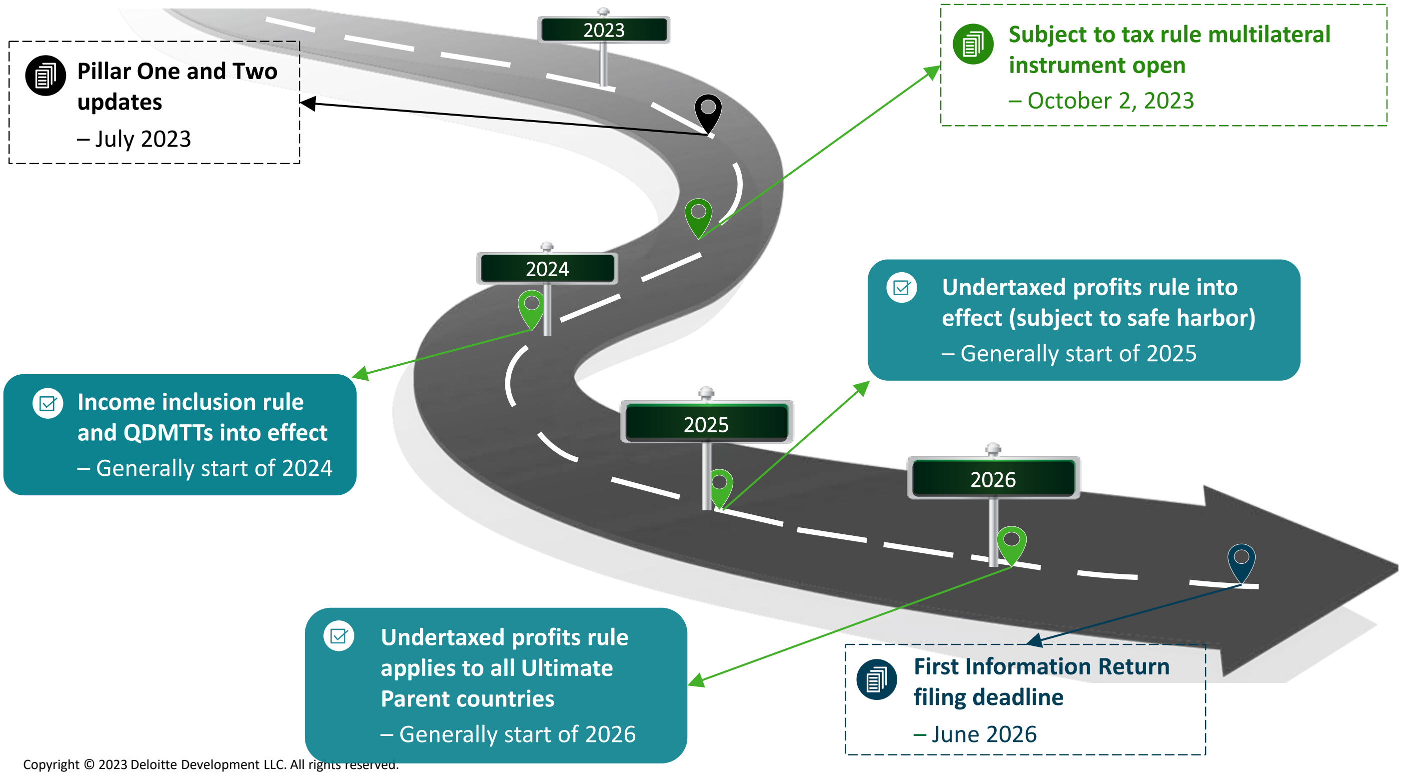
OECD proposals to address the tax challenges of the digitalization of the economy



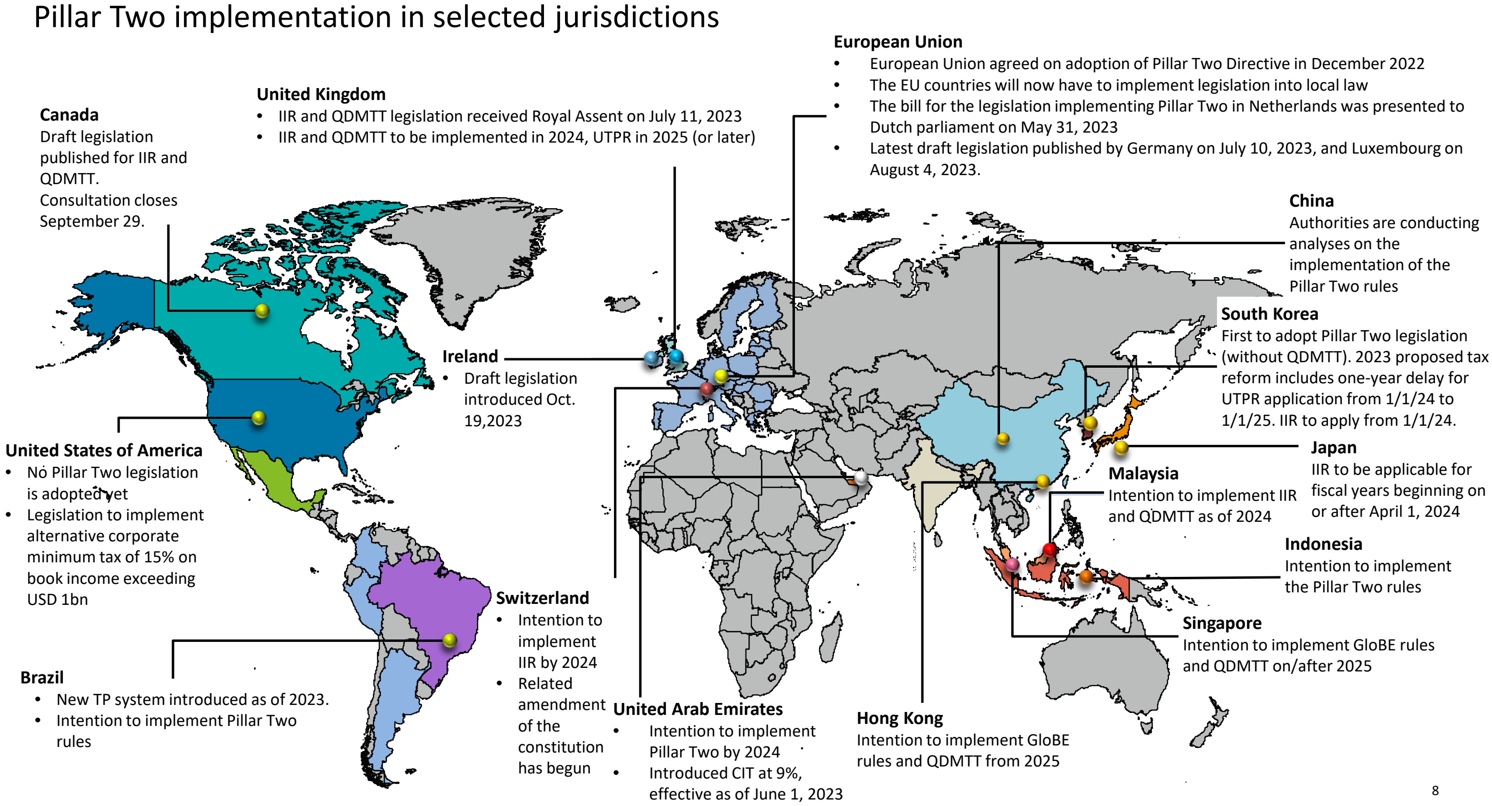
OECD Roadmap to Implementation – Pillar One



OECD Roadmap to Implementation – Pillar Two



Pillar Two implementation in selected jurisdictions



Pillar 1 – Amount B

Draft rules shed light on what might be in store in 2024

November 7, 2023

Charles River Associates

Amount B – Public Consultation Document

The aim of Amount B is to **streamline** and **simplify**

the application of the **arm’s length principle** (ALP)

for **baseline marketing and distribution** activities

to increase **tax certainty** and **reduce resources** by **multinational enterprises** (MNEs) and tax administrations, especially for **low-capacity jurisdictions** (LCJs).

Charles River Associates

Amount B – Public Consultation Document

The OECD Secretariat released a second public consultation draft (PCD 2023) relating to the design of Amount B on July 17, 2023.

- The PCD 2023 still does NOT represent a consensus view of the Inclusive Framework; however, it coalesces around an approach

- Amount B could potentially be effective as early as January 1, 2024 via the release of the 2024 OECD Transfer Pricing Guidelines which incorporate Amount B

There are no revenue or profit thresholds for Amount B

Amount B may apply to you!

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Amount B – Scope

QUALIFYING TRANSACTIONS

Buy-sell marketing and distribution transactions* **(LRD)**

Sales Agency transactions **(SA)**

Commissionaire transactions **(C)**

* most appropriately tested with a one-sided method

EXEMPTIONS

- LRD/SA/C that sells commodities, services, or digital (services)
- Transactions tested via an internal Comparable Uncontrolled Price (CUP) method or via a two-sided method
- LRD/SA/C with operating expense-to-sales ratio below 3% or greater than 30% (or 50%)
- LRD/SA/C that performs non-baseline distribution activities that cannot be evaluated separately
- Multi-function entities where indirect operating expenses allocable between baseline distribution and other functions are greater than 30% of total costs
- LRD/SA/C with retail sales generate more than 20% of total revenue

POTENTIAL EXEMPTIONS

- LRD/SA/C that sells digital (goods) [TBD]
- LRD/SA/C that performs regulatory functions

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Amount B – Pricing

INDUSTRY GROUPS

Industry Group 1 (Perishable foods, animal feeds, agricultural supplies, Grocery, household consumables, alcohol and tobacco, pet foods, construction materials and supplies, plumbing supplies, metal, paper and packaging)

Industry Group 2 (Domestic vehicles, IT hardware, software and components, electrical components and consumables, clothing and apparel, textiles, hides, furs, jewelry, plastics and chemicals, lubricants, dyes, home appliances, consumer electronics, furniture, home and office consumables, printed matter, mixed, multiple, assorted & other)

Industry Group 3 (Medical machinery, pharmaceuticals, medical, health and wellbeing miscellaneous supplies, industrial machinery, industrial tools, industrial components and miscellaneous supplies, industrial, agricultural and used domestic vehicles, motorcycles, vehicle parts and supplies)

PRICING MATRICES

Intensity ratio	Low				High
Operating assets Op. expenses	X<15% Y<10%	X<15% Y>10%	15%<X<30% Any	30%<X<45% Any	X>45% Any
Target OM	1.50%	2.00%	2.75%	3.25%	3.50%
Target OM	1.75%	2.25%	3.25%	3.50%	5.25%
Target OM	2.25%	3.00%	4.25%	4.50%	5.50%

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Amount B – Pricing

PRICING MATRICES BY INDUSTRY GROUP

Intensity ratio	Low				High
Operating assets Op. expenses	X<15% Y<10%	X<15% Y>10%	15%<X<30% Any	30%<X<45% Any	X>45% Any
Industry Group 1					
Target OM	1.50%	2.00%	2.75%	3.25%	3.50%
Industry Group 2					
Target OM	1.75%	2.25%	3.25%	3.50%	5.25%
Industry Group 3					
Target OM	2.25%	3.00%	4.25%	4.50%	5.50%

COUNTRY FACTORS

Adjust for Country Risk when Sovereign Credit Rating is BBB or lower

Adjusted Target OM
=
Target OM
*
Net Risk Adjustment(%)
*
(Operating Assets / Sales)$^{\text{Tested Party}}$

CAP AND COLLAR

(Adjusted) Target OM subject to a secondary Berry ratio test

Amount B Profit$^{\textbf{Tested Party}}$

1.05 Berry ratio
=<
(Adjusted) Target Operating Profit$^{\text{Tested Party}}$
>=
1.50 Berry ratio

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Amount B – Issues

- Implementation
- Tax Certainty
- Safe Harbor
- Documentation
- Complexities
- Digital
- Arm’s Length

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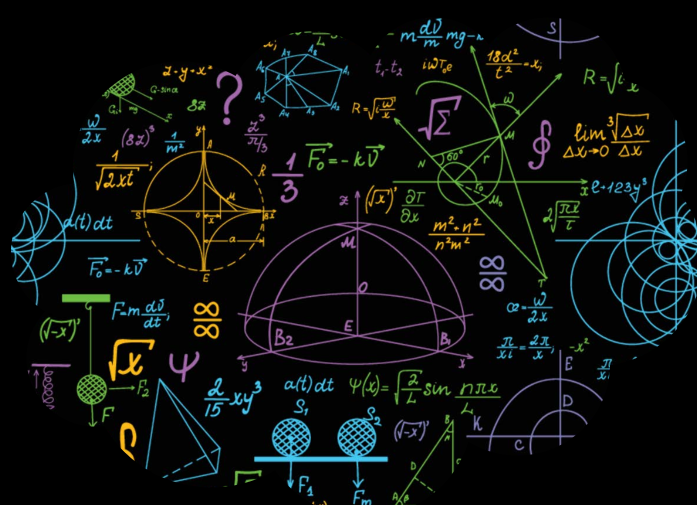
Deloitte.



Pillar Two

What should US companies do now?

Overview

A "global" Inclusive Framework to tax MNE Groups

At least € 750m Revenue

+

Minimum Tax: 15%!

The Global Minimum Tax applies to MNE with a consolidated revenue in excess of €750m with the aim to establish a minimum floor of taxation of 15% in every jurisdiction they operate.

MNEs in scope of Pillar Two must comply with the rules even if only one jurisdiction where they operate implements the rules in their domestic legislation.

The applicable rule-set to enforce global application

Priority	Qualified Domestic Minimum Top-up Tax (QDMTT)
Main	Income Inclusion Rule (IIR) In-scope MNE Groups pay a minimum level of tax for each country in which they operate at ultimate parent entity level
Backstop	Undertaxed Profit Rule (UTPR) In-scope MNE Groups pay a minimum level of tax for each country in which they operate at UTPR entity level, in case no IIR applies

OECD GloBE Rules have a direct impact to MNE & I/C transactions

Dec. 2021 — FY2022 — Dec. 2022 — FY2023 — Dec. 2023 — FY2024 — Dec. 2024 — FY2025 — Dec. 2025 — FY2026 — Dec. 2026

Model Rules → Commentary & GloBE Framework → OECD allows for IIR Rules to be introduced by jurisdictions

OECD allows for UTPR Rules to be introduced by jurisdictions

Multinational enterprise with global revenue of at least €750m? → Group entities in the European Union, United Kingdom, South Korea? → Global Minimum Tax from 2024!

Additional tax liability is possible!

Additional compliance obligation is certain!

Latest discussions with tax accounting standard setters

- **IFRS – International Accounting Standards Board (IASB)**
  - The IASB published an Exposure Draft on 9 January 2023. Their usual comment period is 120 days but given the urgency they requested comments by March 10, 2023. Therefore, final amendments to IAS 12 are expected in Q2 2023.
    - Introduces a temporary exception from accounting for deferred taxes arising from legislation enacted to implement the OECD's Pillar Two model rules (including any qualified domestic minimum top-up tax). The exception would apply until such time that the IASB decides to either remove it or make it permanent.
- **US GAAP – Financial Accounting Standards Board (FASB)**
  - At the FASB's February 1, 2023, meeting, the FASB staff announced the global minimum tax imposed under the Pillar Two rules (IIR and UTPR), as published by the OECD, is an AMT.
    - Deferred taxes will not be recognized or adjusted for the effect of global minimum taxes that conform to Pillar Two model rules (silent on QDMTT).
    - The incremental effects of such taxes will be accounted for as a period cost (i.e., the increase in tax payable will only be reflected in an entity's financial statements after a law is actually effective).

Safe Harbors

Overview

Overview - Top-up tax zero in a jurisdiction where **one** of three tests met

- Intention to simplify transition into GloBE taxation
- Utilization of CbCR to provide for actual simplification
- But: consideration of consolidated financial statements and deferred taxes

Applicable tests (per jurisdiction) to qualify for safe harbor

De minimis test

- Total revenue according to qualified CbCR is less than €10m
- Profit (Loss) before income tax (PBT) according to qualified CbCR is less than €1m

Simplified ETR test

$$\frac{\text{Simplified covered } tax}{\text{Profit } (Loss) \text{ before income tax}} > \text{Transition rate}$$

Where the transition rates:

Year	2023	2024	2025	2026
Rate	15%	15%	16%	17%

Routine profits test

- Substance-based income exclusion (SBIE) exceeds profit (loss) before income tax (PBT)

Once a jurisdiction fails the safe harbor, it can't use it in future years.

Sources of information

1. **Qualified CbCR**
   - Total revenue
   - Profit (Loss) before income tax
2. **Financial statements**
   - Income tax expense
3. **Group tax workings**
   - UTP recorded in income tax expense
4. **GloBE calculation**
   - Substance-based income exclusion

Safe Harbors

What starting with the safe harbors looks like

It's fair to ask, "**why now** and **why this way**?" In our experience many US MNEs have been slow to begin planning and preparing for Pillar Two. The data and computational complexities of Pillar Two have caused many to focus on other more straightforward tasks. The addition of the safe harbor enables MNEs to better focus their efforts and show immediate results.

Assess the safe harbor impact

The ETR and de minimis tests use information that should be readily available in the CbCR itself and in a company's tax provision workpapers. The routine profits test can be estimated as well.

You can quickly size up where your Pillar Two top-up taxes will likely land and where to focus resources.

Clean-up and solidify CbCR reporting

To be eligible to utilize the Transitional CbCR safe harbor your CbCR report must meet a number of requirements. Reduce the risk that an auditor may determine that you don't qualify by updating your CbCR processes now.

Start work on the exceptions

Most countries will likely meet the safe harbor tests. For countries that don't meet these tests, start gathering the information to do a GLOBE calculation for those specific countries.

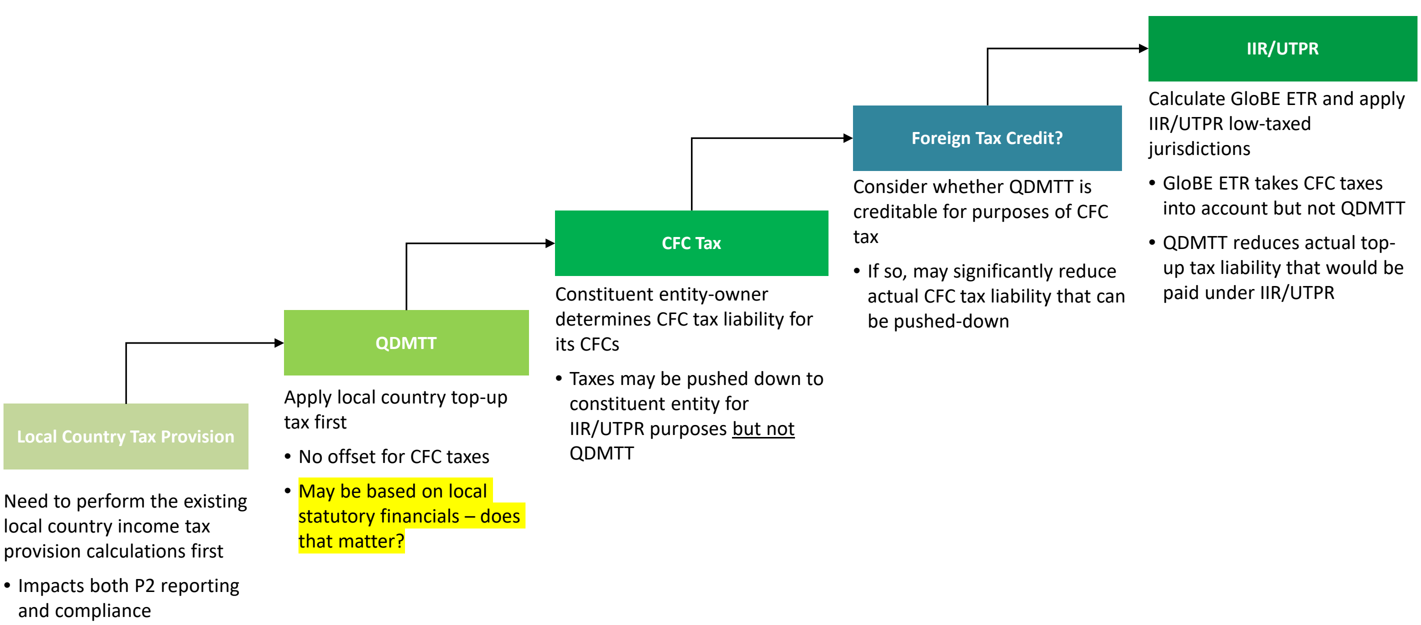
Use the safe harbor to launch planning and forecasting

With the safe harbor testing done and the likely top-up jurisdictions identified, an organization can advance Pillar Two forecasting.

Transitional CbCR Safe Harbours – Audit Considerations

Key Source of Information	Audit Considerations
Qualified CbC Report (CbC Report) • Revenue – De minimis test • Profit (loss) before Income Tax – Simplified ETR test, Routine profits test	• Validate that CbC Report is prepared using "Qualified FS" and understand how both are reconciled. • Understand management's plan to estimate/ accelerate preparation of CbC Report – as it is usually due within 12 months after the fiscal year-end. • Understand management's process to perform the calculations used for the CbC Report – any applications, tools that may be relevant for the audit.
Qualified Financial Statements • Income tax expense – Simplified ETR test [adjustments needed to remove (1) not covered taxes (2) UTT/UTPs]	• Validate that income tax expense at the CE level reflects adjustments that may have historically been made at a higher level (e.g., top-side tax entries). • Understand management's plan to identify and track adjustments for items not included as covered taxes and UTT/UTPs – generally same process used for full GloBE calculation.
Substance Based Income Exclusion (SBIE) • Eligible Payroll Costs – Routine profits test • Eligible Tangible Assets – Routine profits test	• Understand management's process in verifying that eligible payroll costs and tangible assets used are in line with the July 2023 Administrative Guidance and how they reconcile to the amounts in the consolidated financial statements – generally same process used for full GloBE calculation. • Understand whether the financial statement accounts are currently subject to testing and whether additional testing attributes are needed (e.g., eligible employee, location)?

Computational Ordering – Provision Process Implications



Simplified Top-Up Tax Calculation: illustration

Net GloBE income
calculated on jurisdictional basis
1,000

Adjusted covered taxes
calculated on jurisdictional basis
100

Jurisdictional ETR = 10%
Adjusted Covered Taxes **100**
Net GloBE Income **1,000**

Top-up tax percentage = 5%
15 % – jurisdictional ETR
(15% Minimum Rate — **10%** Jurisdictional ETR)

X

Excess profit = 800
Net GloBE Income **1,000** — Substance-based Income Exclusion **(200)**

-

QDMTT

Jurisdictional Top-Up Tax amount

Constituent entity Top-Up Tax amount

$$\text{Jurisdictional Top-Up Tax} \times \frac{\text{Net GloBE Income of CE}}{\text{Jurisdictional Net GloBE Income}}$$

EY

GloBE income or loss: examples of adjustments and elections

- Starting point is **net income or loss** as reported in **financial accounts** used in preparing the consolidated financial statements of the UPE
  - Before consolidation adjustments
  - Determined based on the accounting standard used by the UPE in such statements

Adjustments to financial accounting net income or loss

- Excluded dividends
- Excluded equity gain/loss
- Certain revaluation method gains/losses
- Certain gains/losses on disposition of assets/liabilities
- Asymmetric foreign currency gains/losses
- Policy disallowed expenses
- Prior period errors/changes in accounting principles
- Accrued pension expense **(**Article 3.2.1 (i))
- Allocation of income/loss to permanent establishments and from flow-through entities
- Business combination accounting and related amortization/impairment (pre/post December 1, 2021)

Special rules and available elections

- Intercompany transactions adjusted to arm's length
- Qualified refundable tax credits treated as income
- Exclusion of certain expenses attributable to Intercompany financing arrangements between low-taxed and high-taxed entities
- Elections:
  - Stock-based compensation tax expense
  - Exclusion of gains/losses attributable to fair value accounting or impairment accounting
  - Look back for aggregate asset gain
  - Consolidated accounting treatment of entities in the same jurisdiction

Adjusted covered taxes: examples of current and deferred tax adjustments

Current tax expense

- Starting point is **current tax expense accrued** in the financial accounting net income or loss
- Taxes on actual/deemed distributions (i.e., controlled foreign corporation (CFC) regimes)
- Taxes "in lieu of" corporate income tax
- Taxes levied on retained earnings/corporate equity
- Any covered taxes accrued as an expense "above the line"

Exclusions and adjustments:

- Uncertain tax positions — current tax expense vs. taxes paid
- Refundable tax credits — credits and refunds
- Excludes current tax expense that is not expected to be paid within three years
- Provision-to-return adjustments

Deferred tax expense

- **Deferred taxes** accrued in the financial accounts recast to the lower of 15% or actual income tax rate

Exclusions and adjustments:

- Deferred tax expense relating to disallowed accruals and unclaimed accruals
- Valuation allowances/accounting recognition adjustments to deferred tax assets
- Deferred tax expense relating to rate changes
- Deferred tax expense relating to tax credits
- Recaptured deferred tax liability (DTL)
- GloBE loss election in lieu of temporary adjustments, if applicable
- Deferred taxes relating to intercompany asset transfers post-November 30, 2021, (transition rule)

Allocation of GILTI tax under Administrative Guidance

Allocation mechanism: AG considers the US GILTI a 'Blended CFC Tax,' allocated by using an ETR weighted income allocation:

Step 1: Blended CFC Allocation Key

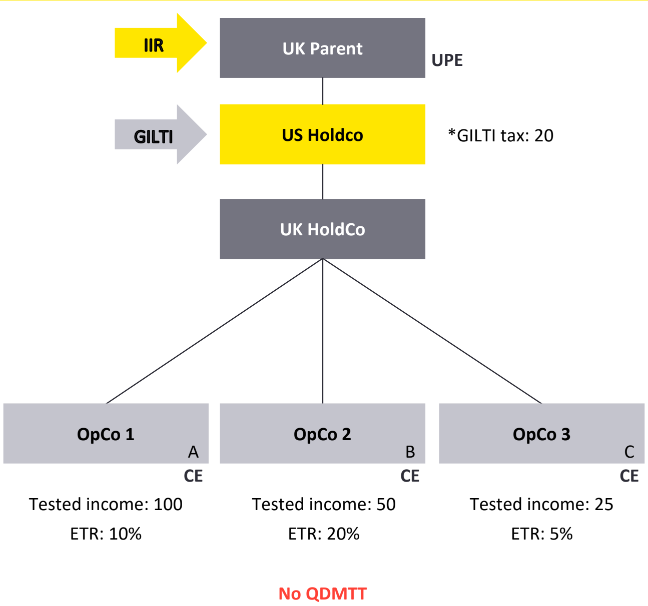
Blended CFC Allocation Key = [Applicable Rate − Globe Jurisdictional ETR] × Attributable Income of CE

Step 2: Blended CFC Tax Allocated to CE

Blended CFC Tax Allocated to a CE = Allocable Blended CFC Tax × (Blended CFC Allocation Key / Sum of all Blended CFC Allocation Key)

Interaction with QDMTTs	Result of allocation	Limited time
Primary taxing rights attributed to the QDMTT jurisdiction; QDMTT excludes CFC taxes. Expected that GILTI will provide an FTC for the QDMTT, although clarity from US Treasury is needed.	GILTI allocated to CFCs with an ETR less than Applicable GILTI Rate at 13.125% (low tax non-QDMTT CFCs) using an above ETR-weighted income allocation	Allocation mechanism is applicable for Fiscal Years beginning on or before 31 December 2025, but not including Fiscal Years that end after 30 June 2027

Example: GILTI Tax Allocation among CEs

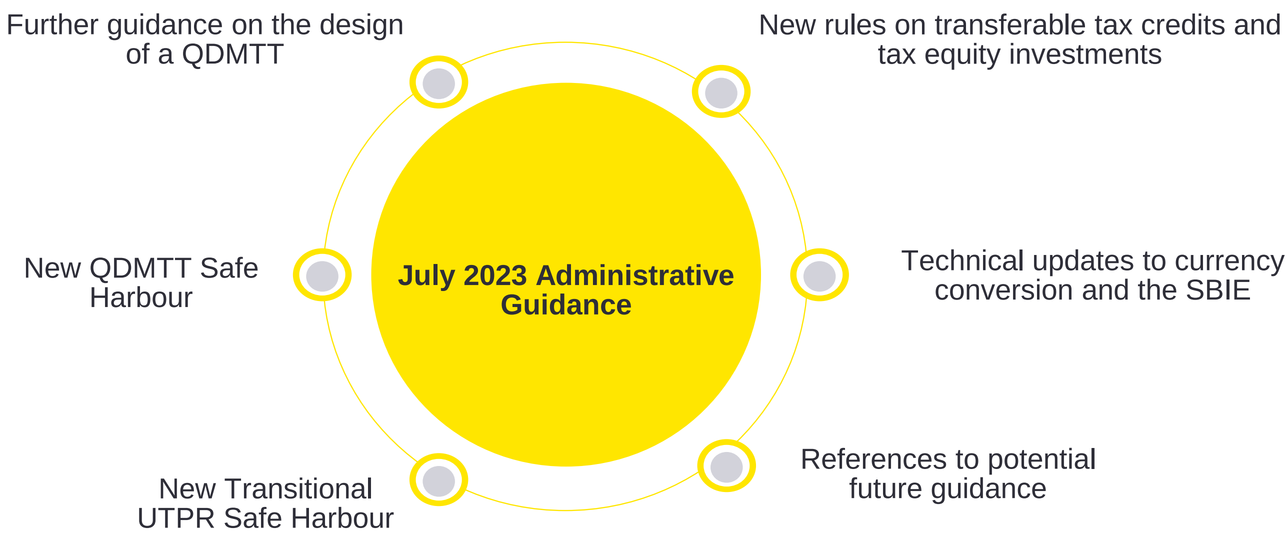


Computation of GILTI Allocation

	Key	OpCo 1	OpCo 2	OpCo 3	Total
Attributable income	A	100	50	25	175
Applicable rate	B	13.125%	13.125%	13.125%	-
GloBE Jurisdictional ETR	C	10%	20%	5%	-
Rate differential	D=B-C	3.125%	(-) 6.875%	8.125%	-
Blended allocation key	**E=A*D**	**3.125**	**No allocation**	**2.031**	**5.156**
Blended allocation key (%)	F= E/Total E	60.61%	-	39.39%	100%
GILTI allocation	**G=F*GILTI Tax**	**12.12**	**-**	**7.88**	**20**

*Assumed amount — can not be computed from the information available on this slide

July 2023 Administrative Guidance - Snapshot



July 2023 Administrative Guidance

New Transitional UTPR Safe Harbour

- The UTPR Top-up Tax for the UPE Jurisdiction will be deemed to be zero during the Transition Period (up through Fiscal Years ending before Dec. 31, 2026) if the UPE Jurisdiction has a CIT rate of at least 20%
  - E.g., the United States, but not applicable to CFCs of US MNEs and foreign-parented US subsidiaries
- When an MNE qualifies for both the Transitional CbCR Safe Harbour (TCSH) and Transitional UTPR Safe Harbour in a Fiscal Year, the MNE may choose which safe harbour to apply; in which case, it may apply TCSH to avoid losing the benefit of TCSH under the “once out, always out” approach

QDMTT

Further guidance on the design of a QDMTT including: blending of income and taxes, allocation of QDMTT liability among CEs, treatment of certain entities (e.g., stateless CEs, Flow-through UPEs, JVs), Transition Years, QDMTT payable, currency, and filing obligations

New QDMTT Safe Harbour

A QDMTT that meets *three additional standards* (i.e., QDMTT Accounting Standard, Consistency Standard, and Administration Standard) will qualify for the QDMTT Safe Harbour, and the Jurisdictional Top-Up Tax will be deemed to be zero

Stock purchase: example

Facts

- During a year in which the GloBE rules are in effect (a "**GloBE Year**"), US Acquirer purchases US Target from US Seller
- The book basis of the Target's assets is increased to fair value on US Acquirer's consolidated financial statements under purchase accounting

Does US Seller recognize gain or loss from the sale for GloBE purposes?

- Gain or loss from the sale of equity interests (other than <10% portfolio shareholdings) is excluded from the GloBE tax base
- However, under OECD administrative guidance, the seller may elect to include such gain or loss in the GloBE tax base if the gain or loss is included in the seller's domestic taxable income
- Taxes imposed on income excluded from the GloBE tax base are not reflected in the GloBE ETR

Does US Acquirer increase the basis of US Target's asset for GloBE purposes?

- No, for transactions occurring after November 30, 2021, purchase accounting adjustments are not taken into account
- However, for transactions occurring prior to December 1, 2021, purchase accounting adjustments can be taken into account if:
  - The acquirer's financial accounting standard permits the pushdown of purchase accounting adjustments, and
  - The acquirer does not have sufficient records to determine the historical book basis of the Target's asset

Note: The diagram is for illustrative purposes only and for ease of explanation. Please note that the facts and circumstances for any taxpayer will vary, and it is essential that business purposes and company-specific facts and circumstances are independently assessed.

Asset purchase: example

Facts

- US Acquirer purchases asset from US Seller for cash
- The transaction is treated as an asset acquisition for book purposes, resulting in an increase to the book basis of the acquired asset

Does Seller recognize gain for GloBE purposes?

- Yes

Does US Acquirer get a basis increase in the purchased asset for GloBE purposes?

- Yes, but the resulting benefit depends on the type of asset acquired
- Deferred tax liabilities (DTLs) are generally taken into account in the computation of GloBE ETR, so that temporary book to tax differences do not result in top-up tax
- But a recapture rule requires certain DTLs to be reversed to the extent not paid within five years
- The recapture rule does not apply to DTLs from cost recovery deductions for tangible property (e.g., accelerated depreciation)
- But it does apply to DTLs from cost recovery deductions for intangible property (e.g., amortization of goodwill for tax but not book purposes)
- **The recapture rule can reduce the value of a GloBE basis increase with respect to long-lived intangible assets that are not amortizable for book purposes (e.g., goodwill)**

Note: The diagram is for illustrative purposes only and for ease of explanation. Please note that the facts and circumstances for any taxpayer will vary, and it is essential that business purposes and company-specific facts and circumstances are independently assessed.

GloBE treatment of deemed asset purchases

Article 6.2.2: A stock acquisition is treated as an asset acquisition for GloBE purposes if the jurisdiction in which the target is located—

- Treats the transaction as an asset acquisition and
- Imposes tax on the seller based on the gain in the target's assets

Article 6.3.4: When the tax basis of an entity is stepped up in the jurisdiction in which it is located (e.g., upon an ownership change), the MNE group may elect to—

- Step up the basis of the assets for GloBE purposes, and
- Include the gain in the assets in the calculation of its GloBE income

Stock purchase with Section 338(g) election: example

Facts

- In a GloBE Year, US Acquirer purchases all the stock of Foreign Target from Foreign Seller and makes a Section 338(g) election
- The book basis of the Target's assets is increased to fair market value on US Acquirer's consolidated financial statements under purchase accounting

What are the potential GloBE consequences to US Acquirer?

- For GloBE purposes, pushdown accounting adjustments from transactions occurring on or after December 1, 2021, are disregarded
- The exception in Article 6.2.2 does not apply because the jurisdiction in which Foreign Target is located does not impose tax on Foreign Seller by reason of the Section 338(g) election

Note: The diagram is for illustrative purposes only and for ease of explanation. Please note that the facts and circumstances for any taxpayer will vary, and it is essential that business purposes and company-specific facts and circumstances are independently assessed.

Stock purchase with Section 338(h)(10) election: example

Facts

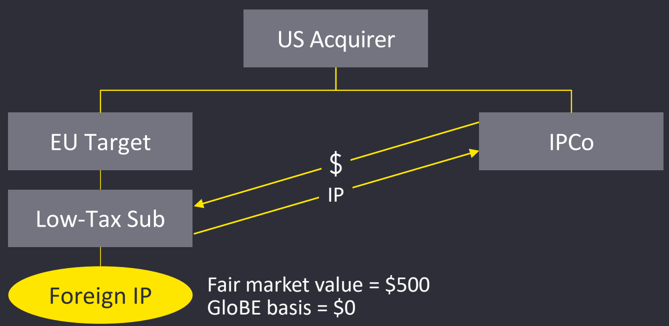
- In a GloBE Year, US Acquirer purchases all the stock of US Target from US Seller and the parties join in making a Section 338(h)(10) election

What are the potential GloBE consequences to US Acquirer?

- Under Article 6.3.4, US Acquirer may elect to step up the basis of the assets for GloBE purposes and include the asset gain in GloBE Income
- Same result if the transaction occurs in a pre-GlobE Year?

Note: The diagram is for illustrative purposes only and for ease of explanation. Please note that the facts and circumstances for any taxpayer will vary, and it is essential that business purposes and company-specific facts and circumstances are independently assessed.

Post-acquisition integration – centralizing foreign IP: example



Facts

- In 2024, US Acquirer purchases all the stock of EU Target and makes a Section 338(g) election
- The book basis of the assets of EU Target and Low-Tax Sub is increased to fair value on US Acquirer's consolidated financial statements under purchase accounting
- Later in 2024, Low-Tax Sub sells the Foreign IP to IPCo for $500
- Low-Tax Sub is located in a jurisdiction that has not adopted a QDMTT

What are the potential GloBE implications of the sale?

- Low-Tax's GloBE basis in the IP equal to its historical book basis ($0), Low-Tax Sub recognizes $500 of gain for GloBE purposes
- Unless Low-Tax Sub comes under a CbCR transition safe harbor, that gain may give rise to Top-up Tax
- Since there is no income for US tax purposes at Low-Tax Sub due to the Section 338(g) election, there is no US GILTI or Subpart F tax to push down to Low-Tax Sub

Creditability of IIR/UTPR?

Availability of GloBE reorganization?

Note: The diagram is for illustrative purposes only and for ease of explanation. Please note that the facts and circumstances for any taxpayer will vary, and it is essential that business purposes and company-specific facts and circumstances are independently assessed.