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What Multinational Companies Can Do To Prepare for BEPS Pillar 2

This Q&A is based on a recent interview with Jason Yen, a principal in the international tax and transaction services practice of Ernst & Young LLP's National Tax Department in Washington, by Barbara Kirchheimer of EY US's Tax Technical Knowledge Group. Before joining EY, Yen was associate international tax counsel of the U.S. Treasury Department's Office of Tax Policy, where he was involved in the OECD's original base erosion and profit-shifting initiative and led Treasury's technical negotiations on the pillar 2 model rules and commentary.

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Question: There's been a lot of discussion about the OECD's BEPS 2.0 project and pillar 2 in particular. What can you tell us that taxpayers perhaps haven't heard much about but should be aware of?

Jason Yen: Pillar 2 is part of the OECD's initiative to address the challenges of the digital economy, but it has really broadened to address a larger scope of issues, including perceived concerns about tax competition. A main goal of pillar 2 is to have multinational companies pay a 15 percent minimum level tax rate in every country in which they operate.

The rules the OECD has issued provide a template for countries around the world to adopt this tax regime. What's unique is that it really is a global tax. The OECD has in the past put out recommendations or blueprints on specific areas of tax, such as transfer pricing or tax treaties or hybrids. But this is the first time they've put out a model for a new corporate tax regime intended to be adopted in nearly every country around the world. That's quite a monumental development.

Q: Broadly speaking, what are the tax implications for multinational enterprises?

Yen: MNEs that are within scope — those that generally earn over €750 million in revenue on an annual basis — will need to figure out, for every country in which they have operations, whether they are meeting this 15 percent tax threshold. For those computations, they will have to use a tax base and principles that are generally based on financial accounting.

This will be different than looking at the local countries' domestic tax law. Companies will have to follow the OECD rules to compute whether they're above or below the 15 percent threshold, and this may not always be obvious or intuitive.

The rules generally are meant to apply beginning in 2024, but some portions may be effective in 2025. The timing is all still to be determined as we wait and see which countries ultimately end up adopting them.

Q: What are the latest developments on pillar 2?

Yen: In late December 2022, the OECD released several documents that move the discussion forward and give businesses opportunities to share their perspectives with policymakers. One was a consultation document on tax certainty for pillar 2's global minimum tax rules, which seeks input from stakeholders to inform the OECD's ongoing work on dispute prevention and resolution mechanisms. As you can imagine, with something like a global tax with many, many countries applying it at the same time, there may be disputes and differences in interpretation, along with a risk of double taxation.

Another consultation document provides information on development of a standardized pillar 2 information return that companies can file and use to report their data. The information in the consultation document will help us determine how companies' data and compliance procedures need to be adapted.

The third document, intended to be used by governments when incorporating the global minimum tax rules into their domestic tax legislation, provides guidance on safe harbors and penalty relief. Its stated aim includes reducing complexity and compliance challenges for companies in the initial years the global minimum tax rules start to apply.

Q: How might the United States and global political environment affect the prospects for pillar 2?

Yen: Last year, the expectation was that the United States would adopt some elements of pillar 2. However, that ultimately did not happen. The Biden administration's Build Back Better Act (H.R. 5376) was not enacted, and instead, only some elements of that bill were included in the Inflation Reduction Act (IRA, P.L. 117-169) enacted in August 2022. That legislation did not contain the rules that we had expected would result in some conformity with pillar 2.

But pillar 2 was designed so that not every country has to adopt it. As long as some critical mass of countries do, then the rules can work, in theory. We have seen many countries, particularly many countries in the EU, saying that they plan to move ahead and adopt this legislation. In a major step forward, the EU announced on December 13, 2022, that its members had agreed to adopt the pillar 2 directive and that it would have to be transposed into member states' national laws by the end of 2023. Also significantly, U.K. Chancellor Jeremy Hunt confirmed in his November 17 autumn statement that he would implement the pillar 2 rules for accounting periods beginning on or after December 31, 2023. As more countries make similar commitments and adopt these rules, potentially in the next year, the United States will remain somewhat of a bystander but will still have to interact with these rules that are adopted in other countries.

Q: It sounds like many companies will need to pay attention to what individual countries are doing. So which types of businesses should be paying close attention to these developments? Which are likely to be most affected?

Yen: Certainly, any company with cross-border activities that are over the €750 million revenue threshold. Compare that to the new corporate alternative minimum tax that was enacted in the United States as part of the IRA. That rule applies to companies with $1 billion in profits. The pillar 2 tax focuses on revenue, not profits, so more companies are potentially impacted. The pillar 2 tax can apply to smaller companies, and even those that may not be profitable.

Any company with operations in any country that has talked about adopting pillar 2 needs to be paying attention. The effect may not be limited to income generated in the country adopting the rules. The pillar 2 rules may apply even outside of the jurisdiction in which they're imposed. Even profits generated in a country like the United States could be subject to these rules if other countries adopt them.

Q: That sounds like it might present some challenges. Can you give us some specific examples of what companies should be focusing on?

Yen: The key challenges here are going to be compliance and data. There are many companies that, when they actually do all the computations, will find out that they didn't have any top-up or additional tax liability. But to determine that really requires a whole lot of data; it involves managing and adjusting that data in ways that we really haven't had to do before because the pillar 2 rules require you to use financial accounting standards.

Beyond that, the rules require you to make a lot of specific types of adjustments to your financial accounting data. These adjustments may not be intuitive and may not be easily done; the information also may not be readily available to companies' tax departments. There will have to be communication across functions, including the finance and accounting departments, to find that data and to understand the background behind it and how to adjust it to conform with the pillar 2 rules. The key is going to be data and how to interpret and adapt it to be consistent with the rules' requirements.

Q: Looking ahead, what's next for pillar 2, given all these uncertainties?

Yen: In the coming months, we're expecting additional guidance and discussion, which will be based on business and other stakeholder feedback received during the OECD's public consultation process for pillar 2. There have been many technical questions raised about how the rules apply in various circumstances. I don't think we'll see all or most of those questions answered, but the OECD will likely address some of them that have been identified as priority issues.

Q: It sounds like there are many elements still in flux. What can companies start doing now?

Yen: Although the rules are still uncertain and many open questions remain, we do have a lot of information already. We have enough rules out there that companies can do big-picture scenario modeling and understand where there may be pressure points. There may be countries in which they have effective tax rates that might trigger a pillar 2 top-up tax, so they can try to determine why. Is it because of a glitch in the rules that may potentially be addressed? Or does it relate to their particular structure?

Understanding these issues and knowing where challenges may be present in determining the company's tax status in a particular country because the company does not have enough data will be important. Companies can then start trying to analyze what it might take to obtain that data and hopefully automate it so it's not something that has to be done manually every year. Once these taxes are up and running, you certainly want an automated process that will streamline compliance efforts.

Q: From what you are seeing in the field and your interactions with companies, what are some leading practices to consider for the changes that might be coming, whether it's pillar 2 globally or changes in individual countries?

Yen: The first step is certainly staying up to speed and monitoring and watching what is going on around the world. What are the countries in which your companies have operations doing now, and are they adopting these rules? How are they adopting the rules? Many countries have started consultation processes and are asking for industry input on implementation.

I think it's important to participate in this process and to keep an eye on any new guidance that comes out in the next few months to understand how those rules may either positively or negatively impact your company's particular situation.

Finally, companies may also want to consider examining the internal controls and processes they need to put in place to make sure they can gather this information. Typically, with a tax like this, I would expect that much of the process would be centralized and run out of the parent jurisdiction's tax headquarters, but it requires getting a lot of data from local jurisdictions. In the past, companies may have allowed the local tax teams to manage that. But with pillar 2, I think it's going to be difficult to do that because all the rules are so interconnected, and the interactions of this tax among the different countries is something that we really haven't seen before with typical income taxes. It's important to have those processes in place to get information from across the world wherever you have operations.

Q: In closing, if there were one key thought or idea you could leave us with, what is most important to keep in mind about pillar 2?

Yen: It goes back to what I mentioned in the beginning — what we have here now is truly a global tax, a tax that's based on a common set of rules and principles that's going to be adopted and applied by many, many different countries.

In some ways, that makes things easier because any adviser anywhere can advise on the same set of rules. But in reality, there are going to be a lot of differences in how countries ultimately implement the rules, even though they're starting from the same place. How it gets adapted and implemented in each jurisdiction is going to create some differences, and the coordination needed among all these jurisdictions will be significant. Until we see real procedures on how disputes will be resolved, I expect there may be hiccups in how this applies.

The key is recognizing that this is going to be a tax that requires you to work with people from all around the world. This means working with advisers and people in your company that are on the ground. It means understanding each country's local implementation and how it may interact with the implementation in other countries so that this all works seamlessly.

I don't think it will be seamless in the beginning. There are going to be bumps in the road. But hopefully, over time, as pillar 2 is implemented and companies and taxpayers and advisers gain some experience, we can see it work in a way that doesn't give rise to the kind of double taxation concerns that we've been worried about up until now. ■