

Preparing Your Legal Department For Pillar 2 Compliance

By **Daniel Robyn** (September 27, 2023)

If you're a member of the legal department of a U.S. multinational entity, and particularly if you're part of your company's legal entity management team, you've likely heard about base erosion and profit shifting, or BEPS, 2.0.

BEPS 2.0 is shorthand for the Organization for Economic Cooperation and Development and G20 project addressing the tax challenges of the digitization of the economy and Pillar Two — part of said project that calls for a 15% global minimum tax for certain multinational entities, or MNEs.[1]



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To the extent your company meets the Pillar Two thresholds, it's imperative that your legal team be Pillar Two-ready as soon as possible, as these requirements may become effective as early as Jan. 1, 2024. So, if you've dismissed Pillar Two as just another tax development that doesn't fall in your wheelhouse, it's time to reconsider.

While Pillar Two is a global tax development, it will affect you and your legal team — specifically your legal entity management group — much sooner than you're anticipating. In fact, by the time you're reading this, you may have unknowingly become part of a cross-functional Pillar Two working-group.

Pillar Two calculations and reporting will require tax teams to work closely on a cross-functional basis with their legal departments, and with finance, accounting, human resources and IT teams, as well as business stakeholders.

Background

BEPS 2.0 has two elements: Pillar One on new nexus and profit allocation rules with the goal of assigning a greater share of taxing rights over global business income to market countries, and Pillar Two on a new 15% global minimum tax for MNEs with group revenue of €750 million (\$802 million) or more in at least two of the past four years.

The 143 jurisdictions participating in the BEPS 2.0 project approved the Pillar Two model rules in Oct. 2021.

Under Pillar Two, for jurisdictions where an MNE has an effective tax rate, or ETR, less than 15%, it will generally be required to make a top-up tax payment. In addition, an MNE subject to the global minimum tax rules will have to file a complex information return.

MNEs must implement the detailed Pillar Two reporting process regardless of whether their ETR is likely to fall below the 15% threshold because they will either need to calculate the additional tax liability or show that none is due. The reporting and top-up tax calculations required by Pillar Two are subject to complex rules that draw on multiple data points on an entity-by-entity basis and will require significant cross-functional collaboration.

Generally speaking, any group of entities that has at least one entity or permanent establishment located outside the ultimate parent company's jurisdiction may be subject to Pillar Two, if the group meets or exceeds the €750 million threshold. Thus, even companies

with a small global footprint — as little as one foreign entity or permanent establishment — can fall within the scope of Pillar Two.

Further, given that the scope of Pillar Two focuses on revenue, as opposed to profits, even companies that are not profitable may be affected.[2]

To implement Pillar Two, a country will need to pass its own local law. In December 2022, the European Union passed a directive requiring each EU member state to enact local Pillar Two laws by Dec. 31, 2023.[3] Several jurisdictions have already implemented Pillar Two in their local law, and more than two dozen others have prepared draft local legislation.[4]

Depending on the jurisdiction, local Pillar Two legislation may go into effect as early as 2024, but the effective dates vary. Also, even though Pillar Two establishes a common set of rules and principles, there will be differences in how countries ultimately implement the rules, so the actual local laws adopting the global minimum tax will vary.

Legal Departments Readiness

Several of the data points required for Pillar Two calculations will come from the legal function. The amount of data required from the legal function will vary depending on the group structure, specific entity and internal ownership of the data. Details such as involvement in intercompany transactions (e.g., dividend distributions, share ownership transfers), issuance of stock-based compensation, or third-party asset or share deals and similar transactions, may be additional relevant data points for Pillar Two.

Your legal team will need to be confident about the accuracy and comprehensiveness of its worldwide legal entity data, so it can timely and accurately report the data to the Pillar Two lead team within your company. The following are actions your legal team should consider taking to prepare.

Evaluate your ability to efficiently report accurate and comprehensive legal entity data.

The following types of legal entity data would typically come from the legal department.

Basic Legal Entity Data

- Entity name;
- Jurisdiction of incorporation;
- Tax jurisdiction;
- Ownership information, including minority ownership;
- Tax ID number; and
- Ultimate parent and ultimate beneficial ownership.

Additional Legal Entity Data

- Changes in ownership, along with historical ownership information;
- Changes in accounting principles;
- Changes in functional currency;
- Certain fines or penalties;
- Permanent establishment data; and

- Flow-through entity data.

Transaction-Related Data

- Third-party transfers, and intercompany transfers, of assets, liabilities or shares — e.g., merger, demerger, business transfer, asset sale, etc.;
- Dividend and profit distributions — along with details such as amounts, entities involved and dates;
- Other intercompany transactions between constituent entities; and
- Joint venture agreements and data.

Legal Effective Dates

- All relevant legal entity data points;
- All transactions or corporate changes; and
- Any required underlying corporate documentation

This data should be captured and kept updated to reflect the current entity status in as close to real time as possible, while at the same time keeping the ability to pull relevant data that may be needed for Pillar Two.

In addition to current entity data, historical legal entity data may be requested for Pillar Two calculations, so your legal team must be able to easily find and report the right entity data for the correct period.

Conduct an internal Pillar Two legal entity data-readiness assessment.

If there are doubts about whether your legal department is ready for Pillar Two, you may take this as an opportunity to conduct a legal entity data-readiness assessment.[5] Some key items to verify internally are, for instance, whether your legal team has a suitable legal entity management platform, efficient processes and procedures, and sufficient support staff in place to gather, verify, update, store and present the relevant legal entity data and, if needed, the relevant underlying entity documentation.[6]

While conducting your assessment you may come across some of the following challenges.

Ownership of Legal Entity Data

Even though control of legal entity data is traditionally assigned to the legal function, other

functions — e.g., tax, finance or human resources — may keep their own organizational chart or other legal entity data.

Also, legal entity updates resulting from transactions may not have been communicated across the various in-house functions, or may not have made it into the legal entity management system. This can lead to inconsistent entity data across functions, and make entity management software less reliable.

It may be necessary to reestablish clear rules regarding the ownership of legal entity data, real-time reporting of changes to the entity structure and the protocol for updating the entity management tool, so it becomes the only source for this data.

Changing of Legal Entity Management Approach

MNEs often adopt one of two approaches to legal entity management. Under a centralized approach, there is one central team within the legal department of the MNE that is tasked with managing all the entities and updating the entity management system, albeit different team members from the central team may be in charge of regions or specific countries.

Under a decentralized approach, the local legal teams in countries outside the MNE's headquarters handle the entity management of their respective local country entities largely independently, and report back to the MNE's headquarters on the entity's legal entity status and any changes.

While the decentralized model may work for some MNEs and may be driven by business, operational or local business relationship considerations, its general challenge is that the MNE's headquarters — and the legal entity database it uses — may not have the latest data and documents for its worldwide entities. As such, the headquarters' legal team may have to obtain the latest entity information from the local legal teams, which may present challenges.

To the extent this challenge exists in your organization today, it will likely be further amplified due to Pillar Two's data requirements. MNEs may wish to reevaluate their current processes and procedures within the decentralized model, or consider shifting to a centralized entity management model, to preemptively address some of these potential issues.

Suitability of Existing Legal Entity Management Database

Pillar Two represents a fundamental change in how multinationals are taxed. It will likely require companies to deploy new systems and technologies to manage myriad requirements.

These changes provide an opportunity to assess whether the legal entity management database currently in use is actually fit to allow you to be Pillar Two-ready. When undertaking this exercise, you may also discover that the technology your team is currently using may be subject to steep licensing fees or training costs, which may necessitate looking for a potentially more efficient technology solution.

Elements of a state-of-the art legal entity management platform that can accommodate Pillar Two include historical look-back capabilities, including point-in-time organizational charting functionality, and the ability to synchronize with a corresponding tax and Pillar Two technology platform.

Gaps in Legal Entity Data and Remedial Actions

To the extent your internal assessment identifies existing governance issues, or if you otherwise have doubts regarding entity data readiness for certain entities, the time to act would be now, before Pillar Two becomes effective.

Typical steps would include conducting health checks of relevant entities, identifying and implementing remedial actions and updating the legal entity management database — or switching to a more suitable platform — such that it can be relied on by all cross-functional teams.

Staffing Challenges

Both preparation for Pillar Two and the actual amount of work required from your team on Pillar Two are likely to be time-consuming. When evaluating your current staffing needs, some questions to consider include:

- Does your current team have the bandwidth to take on Pillar Two tasks?
- Are more legal team members needed?
- How can internal resources be freed up to focus on more strategic work streams, mergers and acquisitions, transaction support, etc.?

Prepare for potential intercompany restructuring.

Your tax team may want to revisit your current entity structure in response to Pillar Two. This may result in an intercompany restructuring, which would likely involve your legal team — e.g., share transfers, mergers, redomiciliations, continuations, etc. Under this scenario, your legal team will, for instance, want to be ready for a legal entity rationalization project.

If an intercompany restructuring is being considered, you and your tax, finance, HR and other cross-functional teams may also want to assess whether a legal entity rationalization of some of the entities in your organizational structure may be warranted, either as a direct result of the intercompany reorganization or as its by-product — e.g., to get rid of dormant entities in an effort to save recurring annual corporate, tax and audit compliance, and other operational costs.

Be ready to implement corporate changes. Depending on your cross-functional teams' assessment of Pillar Two's impact, and the design of a potential intercompany restructuring, corporate changes may be required that could affect local entity management and control.

These changes would likely require your legal team's involvement and may mean reevaluating items such as the current slates of directors, who has signing authority and current practices regarding the issuance of corporate approvals.

Learn a new language.

Several new terms have entered the tax lexicon as a result of the BEPS 2.0 project.[7] Some common terms your legal team will want to be familiar with include:

- CbCR — country-by-country reporting;
- Constituent entity — (a) any entity that is included in a group; and (b) any permanent establishment of a main entity that is within (a);
- GloBE rules — set of model global anti-base erosion rules;
- IIR — income inclusion rule;
- OECD — Organization for Economic Cooperation and Development;
- QDMTT — qualified domestic minimum top-up tax, and
- UTPR — under-taxed profits rule.

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[1] For more details on the BEPS project history, see: https://www.ey.com/en_us/tax/multinationals-face-complex-data-challenges-from-global-tax-deal.

[2] What multinational companies can do to prepare for BEPS Pillar 2, https://www.ey.com/en_us/tax/what-multinational-companies-can-do-to-prepare-for-beps-pillar-2.

[3] EU Member States unanimously adopt Directive implementing Pillar Two Global

Minimum Tax rules, https://www.ey.com/en_gl/tax-alerts/eu-member-states-unanimously-adopt-directive-implementing-pillar.

[4] Navigating BEPS 2.0: Pillar Two, https://www.ey.com/en_us/tax/base-erosion-profit-shifting-beps.

[5] The importance of accurate and accessible legal entity data, <https://www.linkedin.com/pulse/importance-accurate-accessible-legal-entity-data-seth-mcnary%3FtrackingId=iGXR3M6DRGejQL1DNijqDg%253D%253D/?trackingId=iGXR3M6DRGejQL1DNijqDg%3D%3D>.

[6] Leading entity management practices, <https://www.linkedin.com/pulse/leading-entity-management-practices-seth-mcnary%3FtrackingId=lqcqW0bESgyEtxVyQJ8jqQ%253D%253D/?trackingId=lqcqW0bESgyEtxVyQJ8jqQ%3D%3D>.

[7] Tax Challenges Arising from Digitalisation of the Economy – Global Anti-Base Erosion Model Rules (Pillar Two), https://www.oecd-ilibrary.org/taxation/tax-challenges-arising-from-digitalisation-of-the-economy-global-anti-base-erosion-model-rules-pillar-two_782bac33-en.