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Last Call for Global Minimum Tax Compliance: Considerations for Multinationals Operating in the EU

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Go-To Guide:

- The Organization for Economic Cooperation and Development (OECD)'s global minimum tax (GMT) covers multinational corporations with revenue of EUR 750 million or more.
- Under these rules, a minimum effective tax rate of 15% is required in all jurisdictions where the company operates. If a company's rate falls below 15%, additional "top-up tax" may be levied.
- More than 40 jurisdictions implemented the GMT in 2024. The European Union issued a directive requiring EU member states to apply the GMT rules on Jan. 1, 2024.
- The legislation carries compliance obligations for 2024, like filing notifications about where companies will supply required information. Late filing may result in significant penalties.

The GMT tax took effect in more than 40 jurisdictions in 2024. This GT Alert highlights elements to consider before year-end.

Global Minimum Tax (Pillar Two) Overview

The OECD's Pillar Two introduces a GMT framework designed to ensure large multinational corporations pay a minimum effective tax rate of 15% in each jurisdiction where they operate. Starting in 2024, the rules apply to multinational companies with consolidated revenues exceeding EUR 750 million. Various jurisdictions have already implemented legislation based on the OECD's initiative. The European Union issued a Directive on the topic that each EU member state must have implemented in 2024.

Safe Harbors

The OECD acknowledges that the Pillar Two legislation creates a significant compliance burden for multinationals. Therefore, a simplified, or “safe harbor,” calculation is available for 2024-2026. The safe harbor is based on the country-by-country reporting, already a requirement for companies with revenue of EUR 750 million or more. The safe harbor calculations are relatively simple and utilize a smaller dataset compared to the full GMT calculations. There are three bases on which a taxpayer can apply a safe harbor calculation. These are, from least to most complex:

1. *De minimis test:* According to the country-by-country report, (i) the total revenue in the jurisdiction is below EUR 10 million and (ii) the total profit before tax is below EUR one million (including losses).

2. *Effective tax rate test:* Based on the simplified “effective tax rate” calculation of tax due divided by profits, based on the country-by-country report, the effective tax rate in the jurisdiction is at least 15% for 2024 (16% for 2025, 17% for 2026).

3. *Routine profits test:* The profit before tax is less than or equal to the “substance-based income exclusion,” a set of rules designed to exclude certain income from the GMT calculation. The substance-based income exclusion applies to income derived from substantial economic activities, such as income linked to tangible assets or employees located in the jurisdiction.

To apply a safe harbor based on the country-by-country report, that report must meet a certain standard and be considered a qualifying report. Some late-stage adjustments, possibly relating to transfer pricing, may make the country-by-country report unsuitable for safe harbor calculations. In that case, companies must perform a full GMT calculation for that jurisdiction. The 2023 country-by-country report must be filed before the end of 2024. Therefore, companies should review this year’s country-by-country report eligibility and see if any adjustments are required.

The “safe harbor” has a “once out, always out” rule, whereby a jurisdiction that (i) does not meet any of the safe harbor provisions in a year or (ii) chooses not to apply the safe harbors for a jurisdiction in a year cannot benefit from any of the safe harbors in a subsequent year.

Exemptions for Specific Groups and Entities

Not every (company part of a) group with a revenue over EUR 750 million is in scope. For example, “investment entities” as defined under International Financial Reporting Standards (IFRS) are not in scope for the Pillar Two rules. The same goes for real estate investment vehicles and companies owned by sovereign wealth funds. The exemption may not apply automatically and may require local tax authority’s approval. Additionally, companies may seek to obtain a tax ruling on the exempt status. These rulings typically take a couple of months, so initiating those processes is key to obtain timely clarity, at least before the first GMT returns must be filed.

Compliance Obligations and Notification

Part of the GMT requirements is the information return, where taxpayers with a group revenue of EUR 750 million or more must provide various details on, amongst others, the effective tax rate of each jurisdiction they operate in. This allows tax authorities to determine whether “top-up tax” is due. The information return may only need to be filed in one jurisdiction if that jurisdiction properly exchanges information. However, if a jurisdiction does not properly exchange information, the return may have to be filed in multiple jurisdictions.

The information return should provide the necessary details to assess whether a top-up tax payment is required and serves as the foundation for preparing the actual tax return. The tax return must be submitted in jurisdictions where additional top-up tax is due. The deadline for filing and paying the tax return is 17 months after the reporting period. For the first year GMT applies, the deadline extends to 20 months.

The deadline for filing the first information return is 18 months after the end of the year. However, as with country-by-country reporting, countries often require a notification on where this information return will be filed. As the legislation is already in effect in various jurisdictions in 2024, notifications may have to be filed this year. For example, Belgium’s deadline for the notification was September 2024.

Tax Sharing

Top-up tax is levied at a company’s ultimate parent entity (UPE) based on the income inclusion rule (IIR). If the UPE’s jurisdiction does not apply the GMT rules, another group entity, an intermediate parent entity (IPE) may owe the tax. If a third party owns more than 20% of a company, that company is considered a “partially owned” parent entity (POPE). A POPE serves as a cut-off point for top-up tax and is treated as an UPE. Any top-up tax the POPE already paid can be credited pro rata by the UPE or IPE.

To avoid relinquishing the right to levy top-up tax to the UPE, IPE, or POPE’s jurisdiction, many jurisdictions have implemented their own “qualified domestic minimum top-up tax” (QDMTT). When the effective tax rate in a jurisdiction falls below 15%, this top-up tax brings it up to 15%. As the QDMTT has priority over the IIR, no top-up tax should be due under that rule regarding a jurisdiction that has implemented a QDMTT.

Without entering into specific agreements, the GMT burden may be allocated to an undesired entity or lead to liquidity issues. For example, an entity that is already taxed at a rate above 15% may also have to pay the QDMTT because another group company in the same jurisdiction is low-taxed and brings the total effective tax rate in the jurisdiction below 15%. When both high-taxed and low-taxed activities take place in the same jurisdiction, companies should consider implementing a policy on who will pay the top-up tax and to what extent. For example, does the high-taxed company get any compensation for reducing the top-up tax due for the low-taxed company? Can a high-taxed company deemed to be the taxpayer under the QDMTT lodge an objection to this status or reclaim any top-up tax due from its low-taxed sister company?

Without a recharge mechanism to compensate for top-up tax due under the IIR, a UPE or IPE may face liquidity issues when paying top-up tax. Therefore, a recharge mechanism is required to reclaim the amount from the companies in the low-taxed jurisdiction that triggers the top-up tax.

In joint venture structures, the top-up tax may be due at the POPE, rather than the UPE, level. In such structures, companies should determine whether and how and the POPE’s shareholders will reimburse each other for any top-up tax. This may require amending existing joint venture agreements. Similarly, when a group in the GMT’s scope acquires the shares in a group that does not meet the global revenue threshold, the shareholders of the acquired group may obtain shares in the top company of the acquiring entity in return. If the acquired group has low-taxed activities that result in top-up tax, parties may want to agree upon a compensation in the sale and purchase agreement and/or shareholder agreement.

Takeaways

- Pillar Two applies to multinational groups with consolidated revenues exceeding EUR 750 million. A minimum effective tax rate of 15% must be paid in every jurisdiction they operate, effective from 2024. A ruling may provide certainty about whether a group is in scope.

- Compliance includes an information return detailing the effective tax rate and other financial metrics to be filed in one or more jurisdictions, depending on information sharing agreements between governments. A notification on where this information return will be filed may have to be given before the end of 2024.

- Simplified compliance mechanisms, or “safe harbors,” are available from 2024-2026. These use a simplified dataset based on country-by-country reports, potentially reducing compliance burdens for qualifying jurisdictions. The country-by-country report must be eligible for these simplified calculations. If a company cannot apply safe harbors in the first year, it cannot use them in later years.

- Tax liabilities must be clearly allocated within corporations to avoid disputes, especially those that have both high-tax and low-tax operations in the same jurisdiction. This requires a review and potentially an update of current intercompany agreements. In the absence of such documentation, companies should consider drafting these immediately to avoid unintended leakage.

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