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Topic: Pillar Two and Its Ramifications

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Pillar Two and its ramifications

Global Considerations

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Content Outline

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    - *Permanent Establishment Definition under Globe Rules*
    - *Spotlight on Investment Entities*

3. Some Final (rather critical…) Remarks

1. Pillar Two: the US (S)aga…

None of the GloBE rules are currently in place

US domestic entity taxation – no QDMTT

- Taxation based on US tax principles, not financial accounting/GloBE
- 21% headline rate, but reduced by numerous tax incentives
- US corporate alternative minimum tax applies narrowly and does not align with GloBE rules

US outbound taxation – no Qualified IIR (currently)

- GILTI applies at a 10.5-13.125% rate – below 15% minimum
- Allows for global blending
- Computed based on US tax principles rather than GloBE
- Blended CFC Regime allocation rules expire in 2027

US will not adopt UTPR

- BEAT does not qualify
- UTPR safe harbor expires in 2026

1. Background on US Approach to P2

- P1 and P2 discussions began late in the first Trump Administration – mainly to address issues with DSTs
- Biden White House and Treasury Department proposed implementing some/all P2 rules
  - Implementation of a QDMTT
  - Modification of GILTI to increase rates and reduce global blending
  - Modification of BEAT to resemble original payment-based UTPR
- Certain proposals to further align US law with P2 passed US House of Representatives but failed in the Senate
- US did not further attempt to implement P2 – other than by issuing limited administrative guidance to reduce certain disagreements

1. Another Possible Retaliation coming from the US…

- **H.R. 591, *Defending American Jobs and Investment Act* (Jan. '25)**
  - Would enact new section 899
  - Identifies and addresses **extraterritorial taxes and discriminatory taxes** by foreign countries on U.S. businesses, like the UTPR and DSTs
  - Gradual U.S. tax rate increases on certain income earned by entities and individuals in countries implementing such taxes:
    - 5% annual increase for four years
    - Remains at 20% while taxes are in effect
  - Consideration of these taxes in U.S. negotiations – related to either tax or trade agreements
  - Presidential authority to prohibit government contracting and procurement agreements with such foreign countries.

- HR 591 has overwhelming support by House Republicans

- Possible revenue offset in budget reconciliation
- Treasury, House W&M are coordinating efforts to prepare for a possible Byrd Rule challenge

- Broader than section 891
- Provides for more targeted response
- Includes a detailed definition of an "extraterritorial" or "discriminatory" foreign tax

2. Lack of coordination: Scope, Mergers and Demergers between GloBE Rules and the EU Directive

Consolidated Revenue Threshold Definition:

- **OECD Model Rules** rely on a *multi-year* threshold concept (requiring €750 million consolidated revenue in at least 2 of the 4 preceding years) without separately defining an "annual" threshold.
- **Netherlands** explicitly defines the "consolidated revenue threshold" solely as an annual €750 million revenue, deviating from the OECD/EU's hybrid approach and creating a narrow, monetary-only interpretation.
- **Germany** avoids ambiguity by using distinct terms for the one-year monetary threshold (***Schwellenwert***) and the overall multi-year threshold (***Umsatzgrenze***), thereby aligning with the meaning in the OECD model rules

- **Interpretation of Article 6.1.1:** Technical drafting of the merger/demerger scope rules in each country has led to different interpretations of subparagraphs (i) and (ii) of GloBE Article 6.1.1 (**governing first-year vs. multi-year revenue tests for new groups**). **Germany** heads to the substance of the model rules but drops certain phrases like "tested Fiscal Year," enabling an **"extrapolation"** in the demerger test (i.e. treating first-year results as indicative for the four-year period).
- The **UK** explicitly inserted the word **"and"** between its equivalents of subparas., deviating from the OECD/EU text – this drafting choice makes the first-year and multi-year tests **cumulative** rather than alternative, imposing a stricter combined threshold condition. The **Netherlands** substantially restructured its demerger provision: it created a self-referential test for the first year (leading to a circular logic that had to be patched with an additional fiction), and it failed to extend that fiction to cover the multi-year test in subparagraph (ii).

2. Selected Issues: Permanent Establishment Definition

- **Overview of PE Definitions in GloBE Rules**

• Four different permanent establishment (PE) definitions:

- **Treaty PE**: Exists when there's an applicable tax treaty between the head office jurisdiction and PE jurisdiction, and the PE jurisdiction taxes income under a provis similar to Article 7 of the OECD Model
- **Domestic CIT PE**: Applies when no applicable tax treaty exists, but the PE jurisdiction taxes income on a net basis similar to its own tax residents
- **Deemed PE**: Applies when no applicable tax treaty exists and the PE jurisdiction has no CIT system, but would have taxing rights under OECD Model provisions
- **Stateless PE**: Applies when none of the above definitions are met, there's a foreign place of business, and the head office jurisdiction exempts that income

- **Hierarchical Relationship Between PE Definitions**

•The rules should be applied in a step analysis (hierarchical approach):

- First determine if there's an applicable tax treaty in force
- Then check if the PE jurisdiction has a CIT system
- Then analyze if the PE would exist under OECD Model provisions
- Finally, consider if the Stateless PE definition applies

- **Interpretation Issues with Treaty PE Definition**

•Ambiguity in the term "taxes the income" - should this be interpreted as:

- Actual taxation requirement, or
- Merely having the right to tax under the treaty?

• It seems it should mean "may tax" (having the right to tax) based on:

- Article 3.4.2(a) of GloBE Rules and related Commentary
- Domestic exemptions shouldn't affect Treaty PE status, only its ETR

- **Challenges with Treaty Provisions and Exclusive Taxing Rights**

•When a tax treaty gives exclusive taxing rights to the residence state (e.g., international traffic income):

- The Commentary indicates no Treaty PE exists under GloBE Rules
- This transfers potential top-up tax risk from the PE jurisdiction to the head office state - This may undermine domestic branch exemption systems

2. Selected Issues: Spotlight on Investment Entities

◆ **GloBE's Broad Scope vs. IFRS Limits: A Hidden Compliance Trap**

GloBE recognizes investment entities even when **IFRS 10 would not**—especially those measuring assets at cost.
Italy aligns with this broader scope, forcing consolidation for entities otherwise exempt under accounting rules.

➤ *Result:* Unexpected GloBE exposure for Italian funds and holding vehicles.

◆ **Standalone ETR in Italy: Neutrality Principle Under Pressure**

OECD GloBE isolates investment entity ETRs to **shield minority investors** from group-level top-up taxes.
But Italy allows QDMTT collection at the fund level if no local CE exists, risking a breach of neutrality.

➤ *Result:* Policy clash between administrative simplicity and global tax design principles.

◆ **Optional Regimes: Flexibility Meets Ambiguity in Cross-Border Chains**

GloBE elections (transparency / taxable distribution) shift tax to **investor-level jurisdictions**.
Italy adopts both options but offers **little clarity on layered cross-border structures** (e.g., fund-of-funds).

➤ *Result:* Risk of mismatches in timing, location, and compliance obligations.

◆ **Example Deemed Consolidation in Italy: From Passive Vehicle to Group Entity**

GloBE applies a **"deemed" group test** even without actual consolidated accounts.
Italy enforces this rigorously—**capturing PE platforms and "for-sale" holdings** long excluded under GAAP.

➤ *Result:* Substantial reporting and tax implications for funds never considered part of an MNE group.

3.Some Final (rather Critical….) Remarks

- **Pillar Two is Not (Yet) a "Global" Minimum Tax**

Divergences in implementation (e.g., US non-adoption, EU inconsistencies, local QDMTTs) show this is **not one cohesive system**—but a patchwork of overlapping, sometimes conflicting, rules. Policymakers must stop pretending GloBE has achieved global consensus.

- **Complex Rules Create Asymmetric Burdens—Especially for Funds**

Investment entities and passive holding vehicles are **over-exposed** under current interpretations. The interplay between consolidation rules, standalone ETR, and optional regimes creates **uncertain outcomes for minority investors** and unaligned tax liabilities.

- **Neutrality is at Risk—More Than Policymakers Admit**

What was meant to be a minimum floor is now shaping into a **de facto global tax base definition**, often overriding domestic and treaty policies. The original neutrality principle—especially in investment contexts—is **increasingly compromised**.

- **Without Real Coordination, Pillar Two May Trigger Retaliation, Not Harmonization**

The threat of retaliatory moves like **US H.R. 591** highlights the geopolitical fragility of Pillar Two. Unless jurisdictions align technically and politically, the system risks becoming a **trigger for trade and tax wars**, not a platform for cooperation.

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PANEL DISCUSSION

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Subject 2. Improper use of tax treaties and source taxation: policy, practice and beyond

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