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International Tax ADVISORY ■

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Seeking Shelter in Your International Tax Safe Harbors, Even if They Are Temporary

Since the release of the Pillar 2 Model Rules in December 2021, the Organisation for Economic Cooperation and Development (OECD) has added two transitional safe harbors that temporarily relieve certain large multinational corporations from Pillar 2 compliance burdens. Companies should carefully evaluate the safe harbors and identify steps to take before year-end to avail themselves of the safe harbor benefits.

Background

Certain large multinational enterprises (MNEs) will be subject to Pillar 2 Global Anti-Base Erosion (GloBE) rules starting in 2024, marking a critical milestone in the OECD's decade-long effort to impose a 15% global minimum corporate tax rate. In particular, the European Union has unanimously adopted the Pillar 2 Model Rules and required its members to adopt certain Pillar 2 rules into domestic law by December 31, 2023. This development will soon subject MNEs to a new and complex tax regime.

Recognizing that the shift to Pillar 2 will generate significantly increased compliance burdens, the OECD developed two transitional safe harbors that relieve MNEs from certain taxes and compliance requirements in the initial period when Pillar 2 rules are being introduced in various countries: (1) Transitional Country-by-Country Report (CbCR) Safe Harbor; and (2) Transitional UTPR (formerly Undertaxed Payments Rule) Safe Harbor. These transitional safe harbors acknowledge the likelihood that the United States will not enact legislation adopting Pillar 2 until after 2024. MNEs should carefully evaluate any planning steps that should be taken before December 31, 2023 to take advantage of the safe harbors.

Transitional CbCR Safe Harbor

The Transitional CbCR Safe Harbor, introduced in December 2022, provides a short-term measure that excludes an MNE's operations in certain lower-risk jurisdictions from the scope of GloBE rules in the initial years. MNEs can undertake certain steps now to benefit from less onerous reporting obligations.

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The safe harbor applies when an MNE demonstrates, based on its qualifying CbCR and financial accounting data, that it meets any one of the three tests in the relevant jurisdiction: (1) de minimis test; (2) simplified effective tax rate (ETR) test; or (3) routine profits test. As a prerequisite, the MNE must "comply with the filing requirements in the GloBE Information Return that are specific to the Transitional CbCR Safe Harbour."

The de minimis test is satisfied when the average GloBE revenue for a jurisdiction is less than €10 million and the average GloBE income is less than €1 million (or there is an average GloBE loss in that jurisdiction). The test evaluates only total revenue and profit before income tax of the *current year* as reflected in the CbCR and extends the safe harbor's benefits to MNEs that have not prepared financial accounts based on standards set forth in the Model Rules but have switched to meet such standards.

The simplified ETR test allows the MNE to calculate a jurisdiction's ETR by dividing that jurisdiction's simplified covered taxes by its profit before income tax as reported on the MNE's qualified CbCR. The jurisdiction's simplified covered taxes are the aggregate simplified covered taxes of the constituent entities resident in that jurisdiction for CbCR purposes. If the ETR of the jurisdiction equals or exceeds the transition rate, then the tested jurisdiction qualifies for the safe harbor. If the ETR is below the transition rate, it would not qualify for the safe harbor, and the jurisdictional ETR is disregarded for the provisions of the GloBE rules.

Finally, the routine profits test compares a tested jurisdiction's substance-based income exclusion (SBIE) amount with that jurisdiction's profit before income tax per the MNE's qualified CbCR. If a jurisdiction's SBIE amount equals or exceeds its profit before income tax, then that jurisdiction would qualify for the safe harbor on the assumption that little (or no) excess profits likely arise in that jurisdiction.

Transitional UTPR Safe Harbor

The OECD's December 2022 guidance identified the need for another transitional safe harbor relating to the qualified domestic minimum top-up tax (QDMTT). If an MNE's ultimate parent entity (UPE) jurisdiction (e.g., the United States) does not have a QDMTT or an income inclusion rule (IIR), other countries can apply top-up taxes under the UTPR to reach the 15% minimum tax. Recognizing that certain countries, including the United States, will not enact tax legislation that complies with the QDMTT or IIR before 2025, the OECD released administrative guidance in July 2023 that established the second transitional safe harbor, referred to as the Transitional UTPR Safe Harbor.

Qualifying for the Transitional UTPR Safe Harbor is much simpler than the Transitional CbCR Safe Harbor. Under the Transitional UTPR Safe Harbor, the UTPR top-up tax amount calculated for the UPE jurisdiction shall be deemed to be zero for each fiscal year during the transition period if the UPE jurisdiction has a corporate income tax that applies at a rate of at least 20%. The nominal 20% rate test ensures that only an MNE with a UPE in a jurisdiction with a corporate income tax system and sufficiently high corporate income tax rate benefits from this safe harbor.

Transition Periods

The Transitional CbCR Safe Harbor will provide three fiscal years of compliance relief for fiscal years beginning on or before December 31, 2026 (but not including a fiscal year that ends after June 6, 2028). After that time, the safe harbor will expire.

The Transitional UTPR Safe Harbor offers transitional relief in the UPE jurisdiction during the first two years the GloBE rules are in effect. The transition period includes the fiscal years that run no longer than 12 months that begin on or before December 31, 2025 and end before December 31, 2026. For a calendar year taxpayer subject to Pillar 2, the safe harbor applies for years 2024 and 2025. This shorter transition period is intended to ensure that the safe harbor does

not disincentivize a jurisdiction from adopting the GloBE rules or incentivize an MNE to invert into a jurisdiction that has not yet adopted a QDMTT or shift profits into UPE jurisdictions with lower effective tax rates.

Conclusion

While MNEs prepare for a new regime of international tax rules and the absence of new U.S. tax legislation that conforms to Pillar 2, the two transitional safe harbors offer some temporary relief from the full extent of Pillar 2 compliance. To avail themselves of temporary relief from potential compliance and tax burdens associated with Pillar 2, MNEs should carefully evaluate the requirements of the safe harbors and implement necessary tax planning before December 31, 2023. After 2026, the safe harbors will expire, and MNEs will be fully immersed in the Pillar 2 regime for countries that have enacted their versions of the GloBE rules.

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