Tax Control Framework & Pillar 2

Joint Seminar 2023

Grant Thornton Japan and Netherlands

Asian Desk

1 March 2023

Agenda

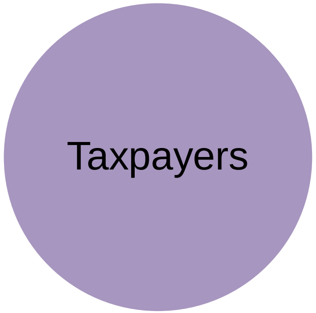
- Tax Control Framework
- Pillar 2

Background

Background

- Deficiencies in tax law
- Outdated texts in tax regulations
- Non-transparency and non-accessibility of the taxpayer's tax data

- Aggressive tax-saving structure
- Non-compliances



1) Horizontal Monitoring ("HM")
2) Enhanced cooperation
3) Enter into compliance agreement with Taxpayers and Qualified tax advisors

Cooperative Compliance

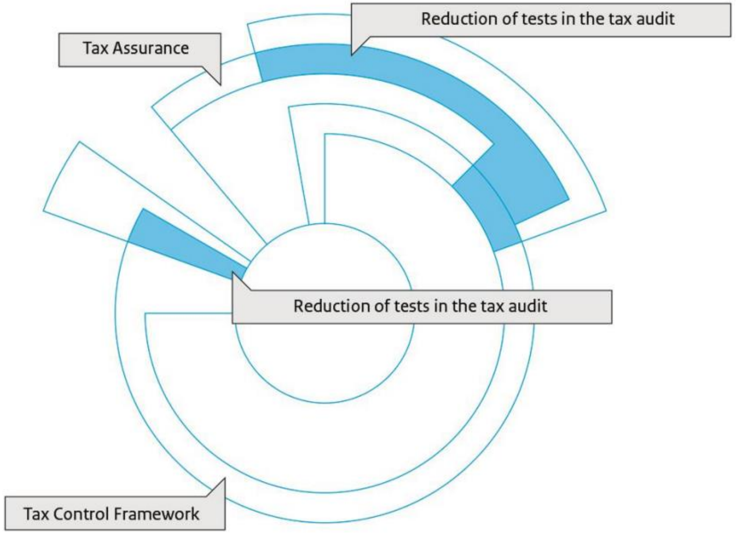
1) Tax Control Framework ("TCF");
2) Establish a cooperation with the tax authorities; and
3) Willing to work together with the tax authorities in a framework based on trust, understanding and transparency.

1) Monitoring strategies
2) Automated process
3) Testing & sampling
4) Disclosure and reporting

Grant Thornton

Layer Model / Onion System (1)

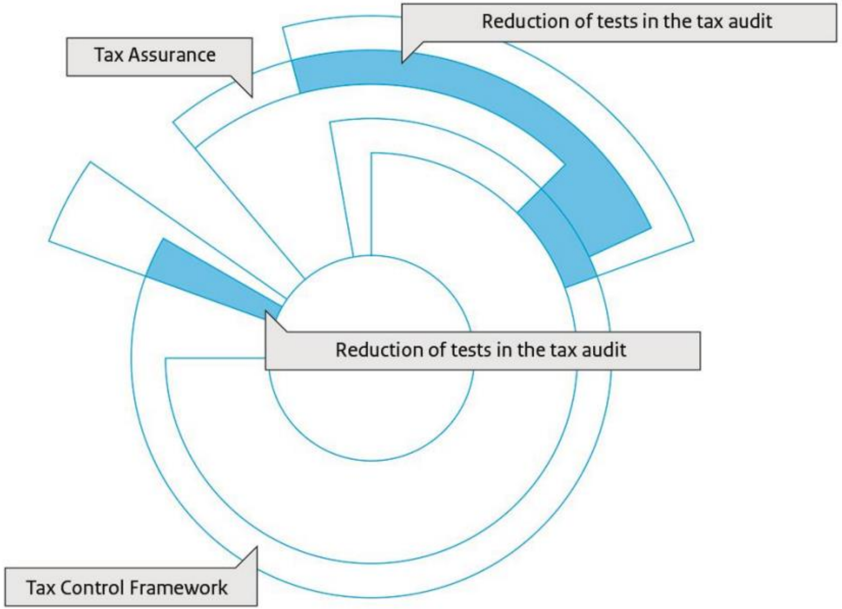
- **Tax Control Framework (“TCF”)**
  - Organizations to demonstrate “in control”
  - Expanding internal control with tax control measures and procedures
  - Automation
- **External specialists and tax assurance**
  - DTA trusted independent third party to enter into an upfront agreement (Covenant)
  - Qualified tax advisor role in the process
  - Larger Organizations can sign individual Covenant with the DTA through the support of external specialists
  - Smaller organizations can join the covenant of the qualified tax advisor,
  - Lower change to be audited,
  - Shorten the tax audit investigation process and time.



Source: Audit Approach Netherlands Tax and Customs Administration

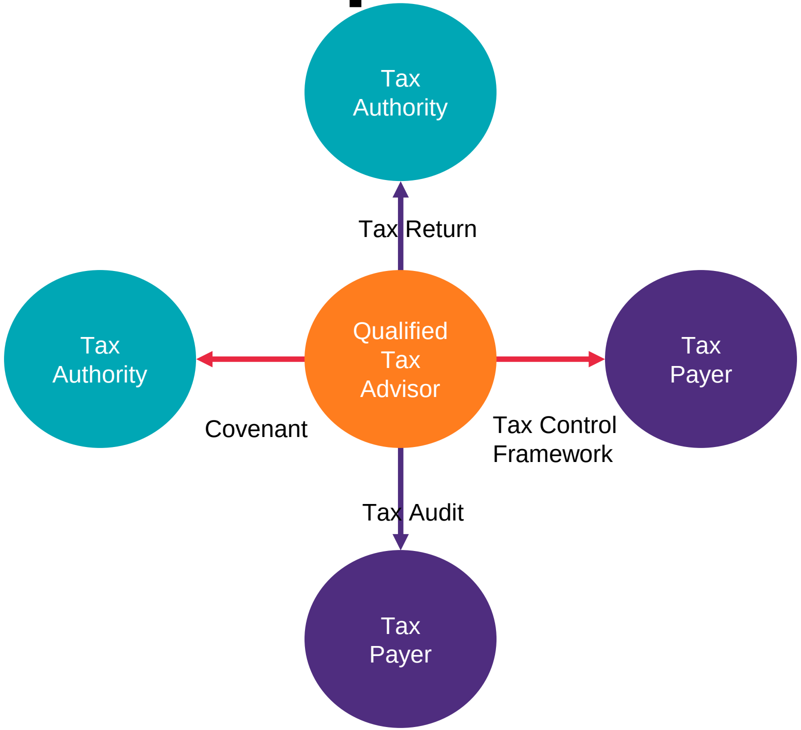
Layer Model / Onion System (2)

- **Horizontal Monitoring**
  - DTA reduce audit tests due to *trust* of the organization's internal control (TCF) and external control provided by qualified tax advisor
  - Periodic review to verify *trust* in the TCF by the qualified independent tax advisor



Source: Audit Approach Netherlands Tax and Customs Administration

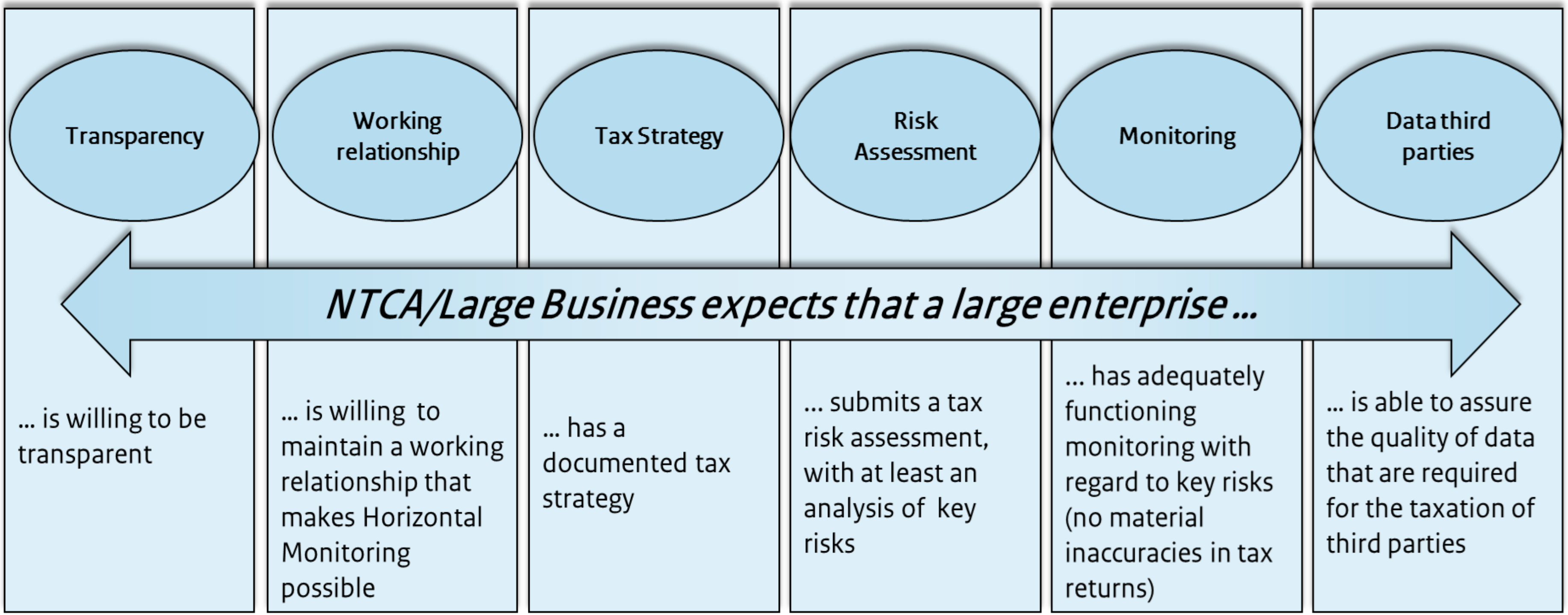
External specialists and tax assurance



Role Change between tax payer/tax inspector/advisor

Grant Thornton

Suitability criteria for individual covenant



Source: Dutch Tax Administration

Grant Thornton

Individual Covenant

Process participation HM individual	
Process towards covenant	**Process within covenant**
Organization expresses will to participate	Formal meeting, at least once a year
HM conversation between organization and NTA	Update of risk analysis by organization, at least once a year (and at least once in three years a reflection by the NTA)
Self-assessment by organization (incl. finalizing current problems where necessary)	Discussion on the results of internal monitoring by the organization (at least once a year)
Conclusion of covenant (for three years)	Evaluation and, where possible and desired by both parties, continuation of covenant

Source: Dutch Tax Administration

Covenant between DTA and the qualified tax advisor for smaller organizations


Belastingdienst

Grant Thornton

Convenant Horizontaal Toezicht

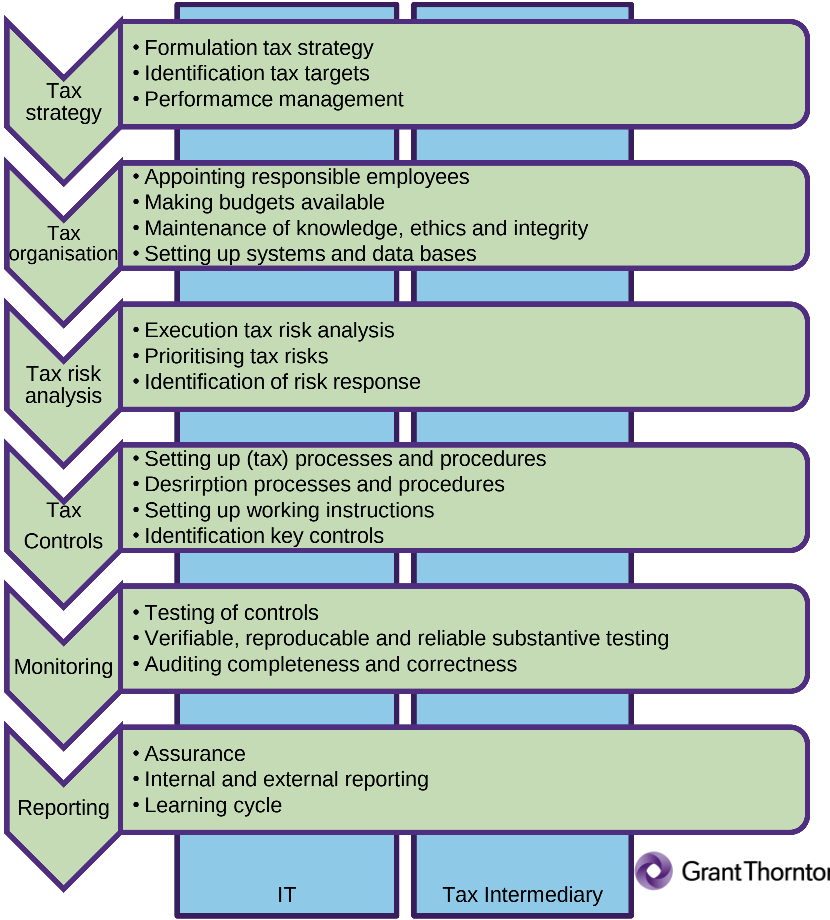
18 november 2022

- Tax advisor that meet the criteria of the DTA can enter into a Covenant with the DTA to be qualified to provide TCF and HM related tax services to enhance the level of assurance for their clients (taxpayers)
- Qualified tax advisor assist the organization to builds up TCF/TCF light which set the route of the road for the stakeholders
- TCF shows guarantee of acceptable tax return with transparency and automation of data
- Get rid of the taxpayer’s gambling mentality of aggressive tax planning
- DTA periodically investigate and verify the TCF approach of the tax advisor, not the taxpayer individually
- DTA can invest more time with the unable/unwilling taxpayers

Tax Control Framework Introduction

Tax control framework

1. A complete monitoring, control and reporting cycle.
2. Six basic principles that applies to TCF
3. The organization could increase their compliance level with the Dutch tax authorities and decrease the chance of being audited.
4. Characteristics:
   - Tailor-made
   - No blueprint
   - Good practices



Source: Dutch Tax Administration

Organisation *RACI-model*

People and responsibilities

What people have which responsibilities?

Responsible

The person carrying out a task is responsible for the execution.

Accountable

Someone makes sure the process is carried out correctly.

Consulted

Someone is asked for advise in advance.

Informed

Someone is informed of the progress made while the task was being carried out.

Grant Thornton Approach

Our Approach

	STEP 1				STEP 2		STEP 3
	Phase I	Phase II	Phase III	Transition Phase	Phase IV	Phase V	Phase VI
Result	Formulating tax strategy and goals	Describing existing processes and training programs	KTR's are known and process description and risk response are ready	Verify orginisation's preference and risk appetite before roll out to next steps	Processes and key controls are formulated and coordinated with the tax authorities	The modules are implemented, and employees know how to use them. TCF goes live	Reporting and learning circle are complete
	Strategy	**Organisation**	**Risk analysis**	**Risk appetite**	**Control**	**Sampling & Monitoring**	**Reporting**

Example – Risk analysis

Risk analysis Report

#	Risk (subject)	Explanation	Likelihood	Explanation	Impact*	Final assessment
1	Events	Events such as acquisitions and mergers form a risk because they impact the structure of the organisation as a whole and pose specific challenges over different domains. Additionally they are not routine.	Likely	Without any control measures tax mistakes are likely to happen with big events such as mergers and acquisitions.	Severe	

Grant Thornton — Risk matrix

			Likelihood					
			1	2	3	4	5	6
			Farfetched	Highly improbable	Improbable	Possible	Very possible	Likely
Impact	6	Catastrophic						Severe
	5	Severe						
	4	Substantial				High		
	3	Present			Medium			
	2	Limited						
	1	Neglectable	Low					

Grant Thornton

Objective

Purpose of TCF/TCF - Light and several mutual advantages for both the taxpayer and the tax authority

- (Fully) Automated process
- Immediate communication based on transparency and mutual trust
- (Fully) functioning tax procedures
- Certainty of tax position
- Provide acceptable tax returns
- Effectively lower the aggressive tax planning, non-compliance and incorrectness in tax returns
- Effectively allocate tax audit resource of the tax authorities

Pillar 2

History

BEPS

- G20 addressed aggressive tax planning
- Where taxes should be paid based on "physical presence"
- BEPS Action Plans published in 2015 focusing on digitalization

Oct 2020

- Inclusive Framework releases Pillar One and Two Blueprint Reports

Jul 2021

- OECD/G20 Inclusive Framework Agreement on BEPS 2.0
- Set key terms of a two-pillar approach

Oct 2021

- 137 countries agrees to the Statement on a Two-Pillar Solution implementation plan

Dec 2021

- OECD released **Pillar Two model rules**, also referred to as the **"Anti Global Base Erosion" or "GloBE"** rules
- EC issued draft directive

Mar 2022

- OECD releases detailed technical guidance on the Pillar Two model rules for 15% global minimum tax

Dec 2022

- On December 12, 2022 the EU Council announced that EU Member States had reached an agreement to implement the minimum tax component (Pillar Two) of OECD's global international tax reform initiative.
- On 20 December 2022, the OECD released four guidance documents related to Pillars One and Two.

Grant Thornton

Development

In 2013, G20 addressed aggressive tax planning and aggressive / low effective tax rates of the multinational enterprises

Multinational enterprises operate in different countries to seek for and maximize the shareholder interests. The mismatch between different country's tax systems are what Pillar 2 meant to address

↓

Aggressive / low effective tax rates of large multinational enterprises (i.e. Apple 1%; Google: 3%)

↓

Distortion and tax competition

↓

Costs countries billions USD in lost of taxable income annually!

Grant Thornton

Pillar 2 Objectives

Large multinational enterprises (MNEs) are subject to a minimum level of tax

↓

The Pillar 2 Model Rules = “Anti Global Base Erosion” = “GloBE” Rules

↓

FAIR TAXATION
PREVENT LOSS OF TAXABLE INCOME

OECD Common Approach: GloBE. Inclusive Framework members are not required to adopt GloBE rules but OECD require members to meet certain conditions.

Pillar 2 – Building Blocks

Conditions

> 750 mil EUR

< 15% ETR

Right Place for Top-up Tax

Key Rules

Qualified Domestic Minimum Top-up Tax (QDMTT)

Income Inclusion Rule (IIR)

Undertaxed profit rule (UTPR)

Subject to tax rule (STTR)

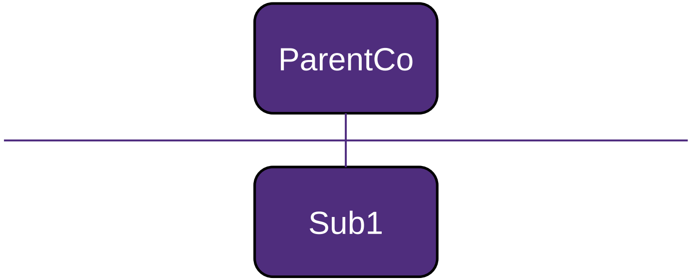
Pillar 2 Implementation Framework

GrantThornton

What does it mean to Multinationals?

Difference between with/without Pillar 2 law

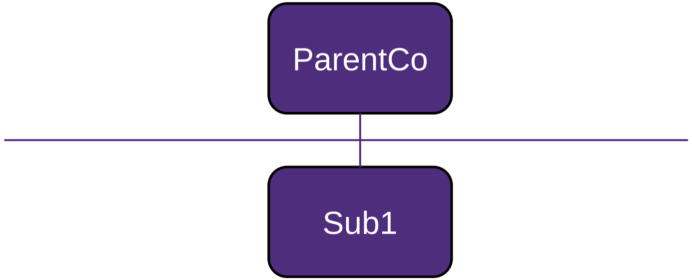
Example of the IIR



<u>In this case Sub1 country did not implement Pillar 2 law</u>

Jurisdiction of ParentCo can levy Top-up tax in IIR application

Example of the QDMTT



<u>In this case both countries implemented Pillar 2 law</u>

Both jurisdiction of ParentCo and Sub1 can levy Top-up tax

What would happen when there are 10 countries involved in the Top-up tax among jurisdictions

Pillar 2 and Update

Pillar 2 – four key rules (part 1)

Qualified Domestic Minimum Top-up Tax (QDMTT)

Income Inclusion Rule (IIR)

Qualified Domestic Minimum Top-up Tax (QDMTT)

- QDMTT as a minimum tax by domestic law.
- QDMTT is a minimum tax amount secured by jurisdiction.
- QDMTT is a deducted item in the Top-up Tax calculation (see Slide 34)

Income Inclusion Rule (IIR) – Primary and Main Rule

- Jurisdictional Top-up Tax levy on a Parent company.

If IIR does not apply, then the secondary rule UTPR applies

Pillar 2 – four key rules (part 2)

Undertaxed profit rule (UTPR)

Subject to tax rule (STTR)

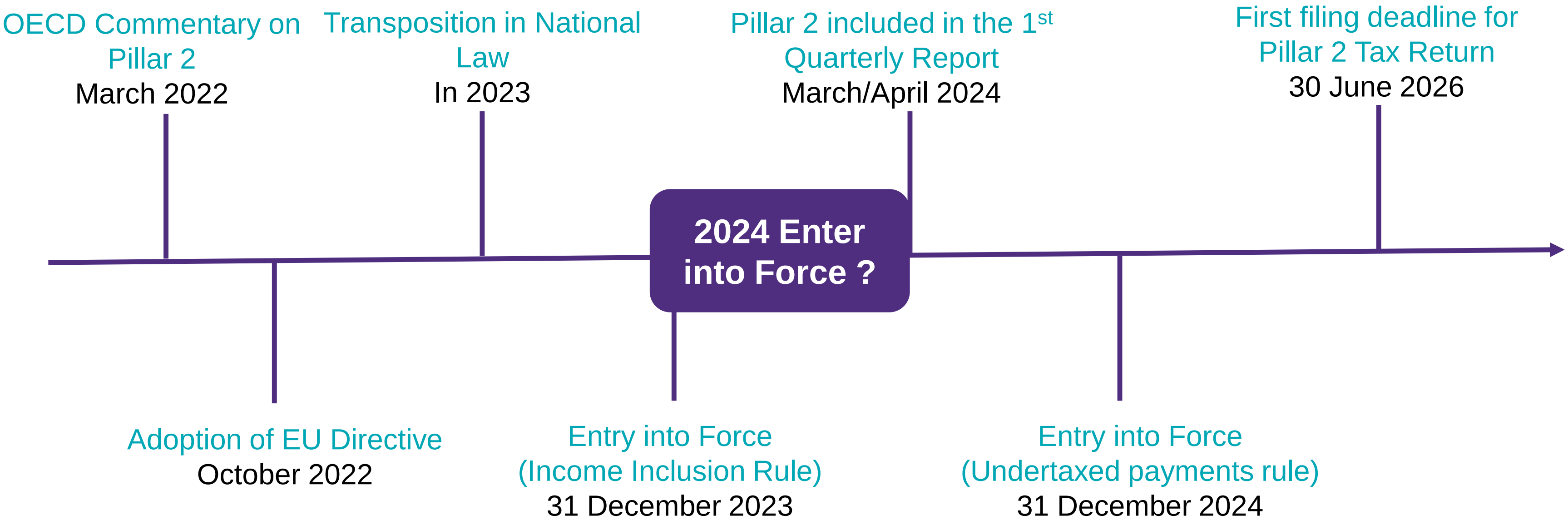
Undertaxed profit rule (UTPR)

- A “back stop” or a “secondary rule” to IIR.
- Top-up Tax can be imposed on a Constituent Entity (any separate business unit within the MNE group) when the Parent company is taxed lower than 15%.

Subject to tax rule (STTR)

- A treaty-based rule. Source jurisdiction is entitled to impose Top-up tax if ETR < 15%.
- Applicable to MNEs > 750 million
- Countries are free to elect STTR in domestic law.
- The Netherlands did not elect STTR.

Pillar 2 - OECD timeline



OECD released 4 consultation documents on December 2022

OECD released 4 consultation documents

1. Guidance on Safe Harbour and Penalty Relief
2. Tax Certainty for the GloBE Rules
3. GloBE Information Return
4. Pillar 1 - Multilateral Convention (MLC) Provisions on Digital Services Taxes (DSTs) and Measures

GloBE Implementation Framework

Safe Harbour		
Transitional Safe Harbour	Permanent Safe Harbour	QDMTT Safe Harbour
Administrative Guidance		
Dispute Resolution & Rule Coordination		
GloBE Information Return		

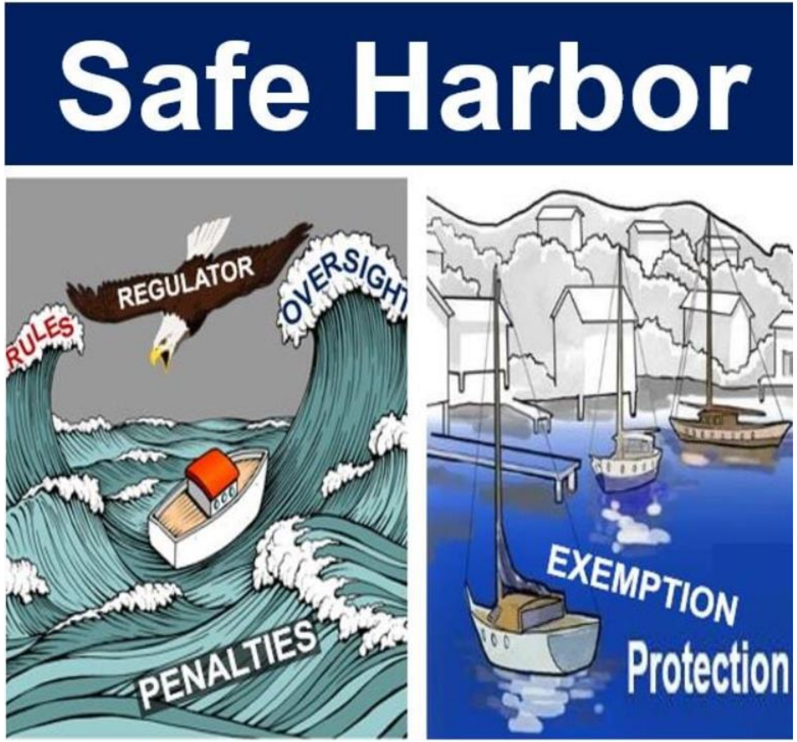
STTR

Grant Thornton

Doc. 1 Safe Habours

What is Safe Harbour Rule?

Safe harbour is a qualification of tax exempt and compliance-free position provided the conditions are met.



Needs of Safe Harbours in Pillar 2:

During public consultations, stakeholders addressed the need for safe harbour rules to reduce the complexity and compliance burden of Pillar 2 rules.

Guidance on Safe Harbours and Penalty Relief

Transitional Safe Harbour

Permanent Safe Harbour

QDMTT Safe Harbour

- Not subject to public consultation process
- An exchange of information network for transparency and data accessibility
- CbCR safe harbour would for the development from a transitional CbCR to permanent safe harbour
- Transitional penalty relief regime - measures in applying the GloBE rules

Grant Thornton

Transitional Safe Harbour

Transitional Safe Harbour

Permanent Safe Harbour

QDMTT Safe Harbour

Transitional CbCR Safe Harbour

- A transitional period – between 2026 and June 2028.
- The first and temporary safe harbour to exempt MNEs Top-up tax in particular jurisdictions where it satisfied one of the three tests
    1. The minimum Test ("De minimis test"); **Or**
    2. Simplified ETR test; **Or**
    3. Routine profits test.
- The data used to determine the tests are originated from FR and CbCR.

Grant Thornton

Transitional Penalty Relief

Transitional Safe Harbour

Permanent Safe Harbour

QDMTT Safe Harbour

Transitional Penalty Relief

- Applicable from 2026 to June 2028
- Filing GloBE return related penalty relief in the years of subject.
- Possibility of relief from sanctions and penalties if MNE –
    - has taken reasonable measures;
    - demonstrate acted in good faith;
    - understand and comply with the GloBE rule.

Grant Thornton

Permanent Safe Harbour

Transitional Safe Harbour

Permanent Safe Harbour

QDMTT Safe Harbour

A framework for permanent safe harbours

- Qualified for transitional CbCR safe harbour.
- After June 2028, entities are allowed to perform simplified GloBE calculations as an alternative.
- If entity qualifies in a jurisdiction for safe harbours, MNE group does not necessarily exempt from Pillar 2 requirements.
- Available in jurisdictions where it satisfied one of the three tests
    1. Routine profits test; **Or**
    2. De minimis test; **Or**
    3. Effective tax rate test.
- The permanent safe harbour tests are applied by using the GloBE rules and applied information other than using CbCR and qualified financial statement data.

Grant Thornton

QDMTT Safe Harbour – Reducing the admin burden

Transitional Safe Harbour | Permanent Safe Harbour | QDMTT Safe Harbour

QDMTT safe harbour

- In development for future work.
- The inclusive framework has committed to consider it as part of the administrative guidance on the QDMTT.
- QDMTT safe harbour eliminates additional GloBE calculation.
- QDMTT safe harbour applies only in a jurisdiction with QDMTT law.

Grant Thornton

Doc. 2 Tax Certainty

Tax Certainty for the GloBE rules

OECD Common Approach:

Ensures that the rules are implemented consistently across the relevant territories.

Pillar 2 rules must be enacted through domestic legislation in each jurisdiction separately, there remains a risk that interpretations could vary, leading to divergent outcomes.

Two Mechanisms:

1. Dispute prevention mechanisms
2. Dispute resolution mechanisms

Tax Certainty for the GloBE rules

Mechanism 1: Prevention

- Application of the OECD Commentary and Guidance to the GloBE Model Rules
- Binding Certainty Mechanisms
- Development of a Multilateral Review process to determine which jurisdiction's domestic legislation is qualified for Pillar 2 purposes
- Development of a coordinated compliance for GloBE purposes

Mechanism 2: Resolution

- Utilizing existing double tax treaty mechanisms
- Develop a Multilateral Convention (MLC)
- Rely on Competent Authority Agreements under the Mutual Administrative Assistance in Tax Matters (MAAC)

Doc. 3 GloBE Information Return

GloBE Information Return

- **Similar to CbCR**, a standard template for MNEs to file. Generally, in the jurisdiction of the ultimate parent entity (UPE).
- Submission deadline: 15 months.
- Transition deadline: can be extended to 18 months.
- Ensure transparency and standardized administration.

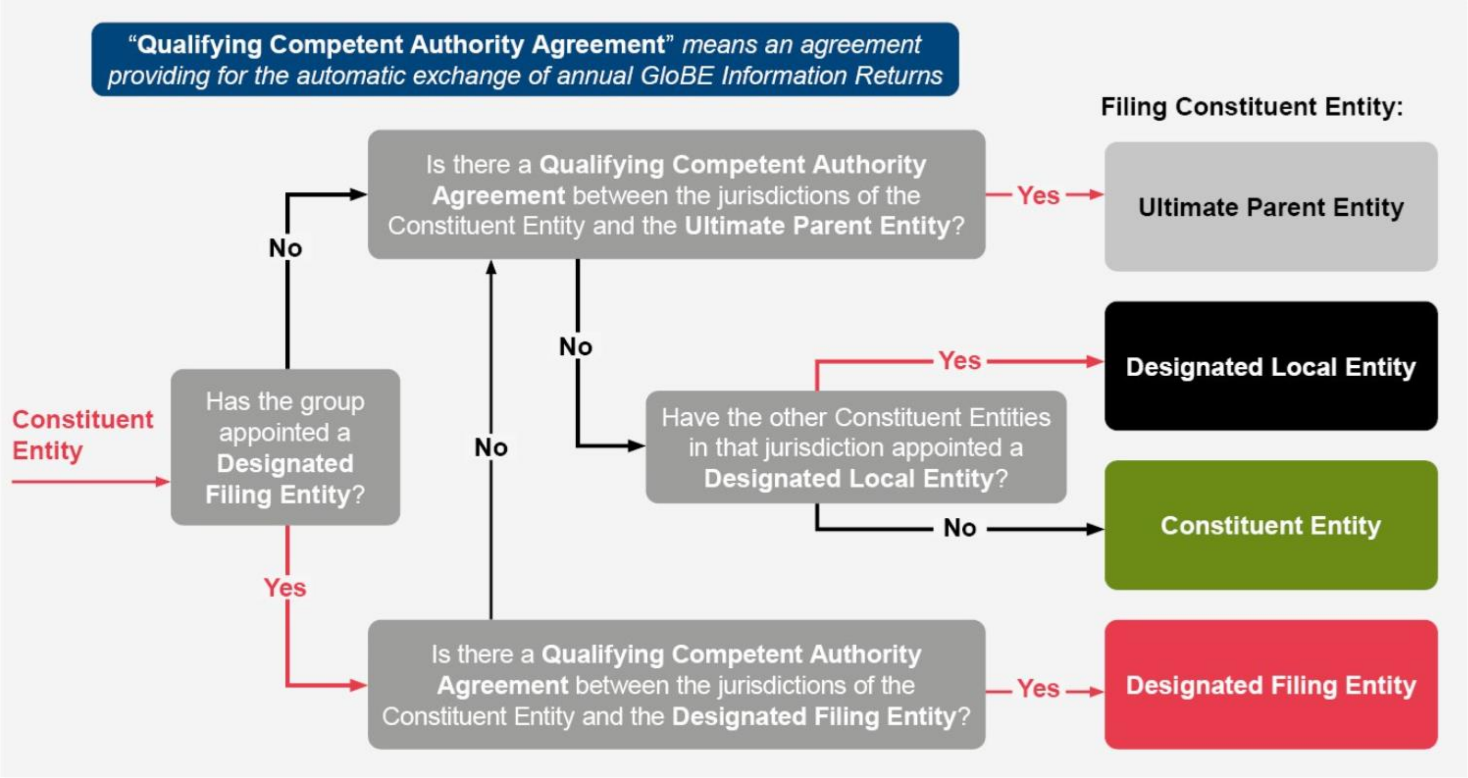
1. General Infomration

2. Corporate Structure

3. Effective Tax Rate and Top-up Tax calculation

4. Top-up Tax allocation and attribution

Who should file GloBE Information Return?



Pillar 2 OECD Calculation Example

Top-up Tax Mechanism

Step 1
Constituent Entity within Scope

Step 2
GloBE Income

Step 3
Covered Taxes

Step 4
Effective Tax Rate and Top-up Tax

Step 5
IIR and UTPR

Jurisdictional Top-up Tax Calculation (Theory)

Step 2 — Jurisdictional Adjusted Covered Taxes

Step 1 — Net Jurisdictional GloBE Income

=

Jurisdictional ETR — Step 3

Step 5 — Adjusted minimum tax minus Substance-based Income Exclusion = Jurisdictional Excess Profit

×

15% - effective tax rate = Top-up tax % — Step 4

Step 6 — Jurisdictional Excess Profit x Top-up tax% + additional current top-up tax – QDMTT(optional) = Jurisdictional Top-up tax

Step 7 — Primary: IIR: charge Top-up tax to the Parent Company
Secondary: UTPR: Top-up tax to other group entities within the jurisdiction

Development by Countries and NL

Development – European Union

European Union

- 15 December 2022, EU Council adopted Pillar 2
- EU member states -before
- France, Germany, Italy and Spain – est. the same as EU

Netherlands

- 24 October 2022 government published Implementation-est. 2024
- Does not include STTR

Japan

- December 2022 released draft for IIR
- Implementation will be April 2024

South Korea

- Proposed- 12 /2022
- IIR and UTPR est. elected
- **Timeline-2024**
- QDMTT-excluded

Switzerland

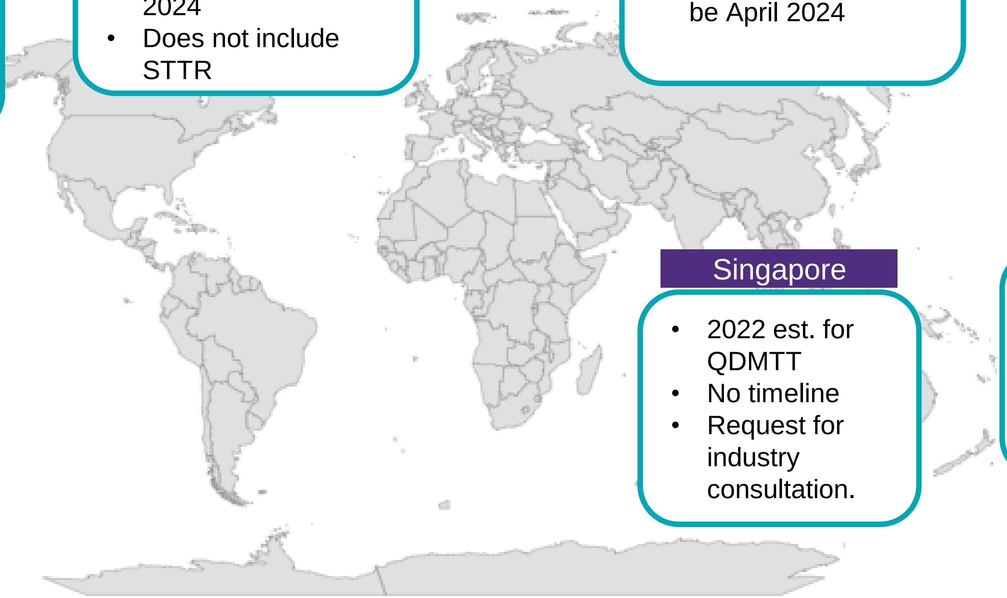
- **August 2022** released draft
- IIR and UTPR expected
- **Est. 2024**

Singapore

- 2022 est. for QDMTT
- No timeline
- Request for industry consultation.

Hong Kong

- **Est. April 2024**
- IIR deferred to 2024
- Legislative proposals 2023



Powered by Bing
© Australian Bureau of Statistics, GeoNames, Microsoft, Navinfo, OpenStreetMap, TomTom

Grant Thornton

Our Approach

Grant Thornton approach

Impact analysis

Analysis of data availability

Tool

Implementation and Monitoring

Reporting and compliance

Outlook to MNE

Pillar 2 challenges

Determination of Constituent Entities

- Calculate Globe Income
- Definition differences
- Substance over form

Deferred Taxes as "cover taxes"

- Deferred taxe = Covered Tax ?
- Temporary Differences?
- Article 4.4 OECD MR Adjustment of deferred tax

Assets transfer in the transition period

- Double Taxation
- Legal admissibility of retroactivity?
- Latency differences GloBE value vs actual value?

Data collection

- Data Availability
- System Accessibility
- More Data?

Grant Thornton

What does it mean to MNEs?
Be prepared /Be compliant

Contact Grant Thornton

Jacob Mook
Partner & Head of Tax
T 088 676 91 11
E jacob.mook@nl.gt.com

Christina Cheng
Director Asian Desk
T 088 676 92 79
E christina.cheng@nl.gt.com

Thank you!