

ADIT PILLAR TWO AWARD

SAMPLE EXAM

PILLAR TWO EXAM

SUGGESTED SOLUTIONS

PART A

Question 1

Pillar 2's GloBE rules aim to ensure that large MNEs are subject to a global minimum corporate tax rate of 15% in each jurisdiction where they operate. The rules do this by calculating a jurisdictional effective tax rate (ETR) for each country where the group operates. The ETR is computed as the ratio of covered taxes to adjusted income for all constituent entities in that jurisdiction, based on the MNE's consolidated financial accounts (with adjustments). If a jurisdiction's ETR is below 15%, the group must pay a top-up tax to raise the total tax on profits in that jurisdiction up to the 15% minimum.

For example, if an MNE's subsidiary in Country A earned €100 of GloBE income and paid €5 of covered taxes (an ETR of 5%), the top-up tax would be €10 (which is the 10% shortfall from the 15% minimum, applied to the €100 profit).

To impose this top-up tax, Pillar 2 provides a hierarchy of interlocking rules. First, the rules allow the source country itself to impose a Qualified Domestic Minimum Top-up Tax (QDMTT) to capture the top up tax. This gives the source jurisdiction (Country A) the first opportunity to levy the top-up amount and retain taxing rights on income arising within its borders. In the example, if Country A has implemented a QDMTT aligned with the GloBE rules, the subsidiary would pay the €10 top-up tax locally, and no further Pillar 2 tax would be collected by other countries (since the effective tax rate in Country A would then be brought to 15%).

If the source country does not impose a QDMTT (or does not fully cover the top-up), the Pillar 2 framework then relies on the Income Inclusion Rule (IIR). Under the IIR, the Ultimate Parent Entity (UPE) of the group (or, if the UPE's country has not implemented Pillar 2, the next intermediate parent down the chain) must pay a top-up tax on its share of the low-taxed income of subsidiaries. In the example, if Country A had no QDMTT, and the parent company is in Country B which has implemented Pillar 2, Country B would apply the IIR. The parent in Country B would then be liable for the €10 top-up tax on the Country A subsidiary's income, ensuring the group's income in Country A is effectively taxed at 15%. The IIR is a residence-based rule – it operates by imposing an extra tax in the parent entity's home jurisdiction on low-taxed foreign income.

The Undertaxed Payments Rule (UTPR) acts as a backstop to the IIR. If some low-taxed income is not caught by a QDMTT or an IIR (for instance, if the ultimate parent's country has not implemented Pillar 2 and no other parent in the chain can apply an IIR), then countries where the MNE operates that have implemented Pillar 2 can apply the UTPR. The UTPR allocates the remaining top-up tax amount among those implementing jurisdictions, in proportion to factors such as the group's employees and tangible assets in each jurisdiction. Each such jurisdiction can then collect its portion of the top-up tax by denying deductions or via other mechanisms under its domestic law. In practical terms, the UTPR ensures that no low-taxed income goes untaxed in the Pillar 2 system: if the top-up tax was not collected by the parent's country, other countries get the right to collect it.

Question 2

Part 1

If a country implements rules that are not classified as 'qualifying', this impacts on how the GloBE rules apply to the MNE group. If an MNE has a low-taxed constituent entity (CE) in a country that has implemented a QDMTT, the CE would be subject to the QDMTT in that country. The top-up tax levied under the QDMTT would then be available as a credit against any top-up tax levied under an IIR in the country of the foreign parent company. (Articles 5.2.2. and 5.2.3. of the GloBE Model Rules)

However, if the domestic minimum tax that was levied was not 'qualifying' as a QDMTT under the GloBE rules, instead of a credit against the foreign IIR, the tax levied under the non-qualifying domestic minimum tax would just be another 'covered tax' for the purpose of calculating the ETR for the levying of the foreign IIR.

Part 2

The QDMTT Safe Harbour preempts the application of the IIR and UTPR in other jurisdictions by deeming the top-up tax payable under the GloBE Rules in the CE jurisdiction to be nil. where top-up tax is levied under a QDMTT. As a consequence, the MNE Group only needs to undertake one calculation, namely the QDMTT in the CE jurisdiction, which is a significant relief of the compliance burden.

Not all QDMTTs qualify for the Safe Harbour. Jurisdictions are given a certain flexibility over the design of their QDMTTs as compared to the design of a qualified IIR and UTPR. To qualify for the Safe Harbour, the QDMTT needs to satisfy the accountancy standard, consistency standard and administration standard. This implies that the QDMTT does not include any of the optional variations which trigger the switch-off rule, i.e. which makes the QDMTT not eligible for the Safe Harbour.

Part 3(a)

For IIR and UTPR purposes, tax paid under a CFC regime in CFC owner jurisdiction are generally allocated to the CFC entity (Model Rules, Article 4.3.2(c)). However, for QDMTT purposes, covered taxes in a QDMTT ETR calculation should not include taxes paid to another jurisdiction under a CFC regime that otherwise would be allocable under the GloBE rules to a constituent entity located in the jurisdiction. One of the reasons for excluding CFC taxes is to avoid a feedback loop between QDMTT and CFC tax.

This is a mandatory variation of the QDMTT. A DMTT that omits a mandatory variation cannot qualify as a QDMTT (Commentary, para 30-32). An unqualified DMTT does not give eligibility to the QDMTT safe harbour.

Part 3(b)

A QDMTT is not required to have a substance-based income exclusion. However, if it does have one it cannot have a wider scope than under the GloBE rules. This is not to say it couldn't have a narrower scope and, for instance, the carve-out rate could be lower than under the GloBE rules. Country A's SBIE does not exclude QDMTT status or QDMTT Safe Harbour status.

Part 3(c)

The inclusion of the UTPR exclusion for MNEs in their initial phase of international activity does not make the DMTT ineligible for QDMTT status. It does trigger the switch-off rule which means that the QDMTT Safe Harbour cannot be applied.

PART B

Question 3

Part 1

The Substance Based Income Exclusion (SBIE) is a carve-out for expenditure on tangible fixed assets and payroll costs.

SBIE excludes from the GloBE tax base a certain amount of income calculated by reference to a fixed return on assets and payroll expenses in each jurisdiction.

The amount of this SBIE is equal to the sum of (i) 5% of the carrying value of tangible assets located in the jurisdiction and (ii) 5% of the payroll costs for employees that perform activities in the jurisdiction.

The GloBE rules also provide for a 10-year transition period in recognition of the potential impact of the GloBE rules on existing incentives and existing investment. The Transition Period starts with a 10% carve-out for payroll costs and 8% carve-out for tangible assets, with these carve-out percentages declining to 5% over time.

Part 2

A substance carve-out based on assets and payroll costs allows a jurisdiction to continue to offer tax incentives that reduce taxes on routine returns from investment in substantive activities, without triggering additional GloBE top-up tax. Given the carve-out covers investment in both tangible assets and payroll it may have different effects on the manufacturing and software industries.

Manufacturing involves both tangible assets in the form of machines and payroll in the form of workers, thus will benefit from both factors of the SBIE.

Software is less likely to involve significant tangible assets, thus may not benefit from the first element exclusion of the value of tangible assets. However, software programmers may be more sought after and highly paid compared to average workers. Consequently, the payroll costs exclusion will play a larger role in Software MNEs' SBIE.

Part 3

The relevant carrying value of an asset for SBIE calculation purposes shall be based on the average of the carrying value (net of accumulated depreciation, amortisation, or depletion and including any amount attributable to capitalisation of payroll expense) at the beginning and ending of the Reporting Fiscal Year as recorded for the purposes of preparing the Consolidated Financial Statements of the Ultimate Parent Entity.

Any adjustment to the carrying value of an asset for GloBE purposes under the Administrative Guidance (4) is for the purposes of determining the GloBE Income or Loss and Covered Taxes of a Constituent Entity and therefore does not affect the carrying value for SBIE purposes.

Part 4

Countries are not obliged to include the SBIE in their QDMTT. They can also opt to include a SBIE that is less generous than the model SBIE. Countries are also not obliged to include additional transitional relief for the SBIE during a 10-year transition period. Omitting the SBIE or the SBIE transitional relief leads to higher top-up tax collection which is outcome 'consistent with the GloBE rules'. (See article 118.50 of the GloBE Commentary). It also does not affect the country's QDMTT's ability to be eligible to the QDMTT safe harbour (GloBE Commentary, QDMTT Safe Harbour, para 34.)

Question 4

Part 1

The GloBE Rules apply to Constituent Entities that are members of an MNE Group that has annual revenue of €750 million or more in the Consolidated Financial Statements of the Ultimate Parent Entity in at least two of the four fiscal years immediately preceding the tested fiscal year.

If one or more of the fiscal years of the MNE Group taken into account for purposes of GloBE rules is of a period other than 12 months, for each of those fiscal years the €750 million threshold is adjusted proportionally to correspond with the length of the relevant fiscal year.

Not met because even though two of the four preceding years are met, 2028 is not met.

- 2024 = included
- 2025 = excluded
- 2026 = included
- 2027 = excluded
- 2028 = excluded

Part 2

Under Rule 6.1.1(a), if two or more Groups merge to form a single Group in any of the four fiscal years prior to the tested fiscal year, then the consolidated revenue threshold of the MNE Group for any fiscal year prior to the merger is deemed to be met for that year if the sum of the revenue included in each of their Consolidated Financial Statements for that year is equal to or greater than €750 million.

2028 is not met because:

- in 2024, Group B €600 million is less than €750 million;
- in 2025, Group B €700 million is less than €750 million; and
- in 2027, Group C €700 million is less than €750 million.

PART C

Question 5

This question tests the candidate's understanding of how to adjust Financial Accounting Net Income or Loss to arrive at that the GloBE Income or Loss.

- Profit or loss: €20 million
- Other comprehensive income: not relevant
- Income tax expense (for both Covered Taxes and Qualified Domestic Minimum Top-up Tax): add-back of €5 million
- Current and deferred taxes shown as contra to particular revenue items (Covered Taxes only): add-back of €2 million
- "Excluded Dividends" (on all 11%, 8% and 1% shareholdings): deduction of €1 million
- Loss on disposition of 12% shareholding: add-back of €1 million
- Prior period error: deduction of €5 million
- Accrued Pension Expense: add-back of €1 million
- Service fees expense (Transfer pricing adjustment): add-back of €1 million
- Tangible assets and payroll: not relevant
- Result: Adjusted profit or loss = €20 million + €5 million + €2 million - €1 million + €1 million - €5 million + €1 million + €1 million = €24 million

Question 6

Part 1

MNE with consolidated revenue of more than €750 million

In scope for GloBE.

Has a branch, a subsidiary and a pension fund in another country

Branch, being a PE is treated separately from its UPE or any other branch of the UPE.
So branch will be resident in that country.

Pension fund is an excluded entity.

The revenue for each of the entities is less than €10 million, i.e. €5 million, 4 million and less than €1 million respectively, and has been that way for the past three years.

No *de minimis*, because the €10 million applies to country not entity (testing whether they know that it's per country and not entity).

Revenue of excluded entities is not subject to GloBE rules but taken into account to determine the consolidated revenue of the MNE.

Part 2

Then branch will be separate entity, the €10 million and the €1 million will be determined separately and *de minimis* would not apply.

Same as subsidiary.

Part 3

The pension fund ceases to be an excluded entity because it does not meet the 95% threshold AND it is a Pension Services Entity.

Question 7

Part 1

First, we calculate Country A's effective tax rate (ETR) under the GloBE rules. The subsidiary in Country A has €100 million of GloBE profit and paid €5 million of covered taxes. This results in a jurisdictional ETR of 5% ($€5m/€100m$). This is below the 15% minimum rate set by Pillar 2.

We determine the top-up rate as the shortfall to 15%. In Country A, the shortfall is $15\% - 5\% = 10\%$. This top-up rate is then applied to the profit. Thus, the top-up tax amount for Country A's income is €10 million (which is 10% of the €100 million profit).

Next, we consider who collects this €10 million top-up tax under the Pillar 2 rule order. Country A itself has not implemented a Qualified Domestic Minimum Top-up Tax, so it will not levy any additional tax on the subsidiary's income. The responsibility therefore shifts to Country B, where the ultimate parent is located and which has implemented an Income Inclusion Rule. Under the IIR, the parent entity in Country B will be required to pay a top-up tax equal to €10m, attributable to the low-taxed income of its Country A subsidiary.

Part 2

If Country B had not implemented Pillar 2, the Pillar 2 framework would invoke the Undertaxed Payments Rule in other jurisdictions where XYZ Corp operates. Under the UTPR, other Pillar 2 implementing countries in which XYZ Corp has a presence would be allocated a portion of the €10m top-up, based on a formula that takes into account the proportion of XYZ's employees and tangible assets in each UTPR country. Those countries would then impose an equivalent additional tax on XYZ Corp's local subsidiaries or deny deductions to yield the extra tax.

Question 8

Part 1

Step 1: assess whether group is in-scope and constituent entities in Country A and in Country B.

Step 2: determine GloBE income of Company B:

Shipping Income Exclusion (article 3.3.) not applicable: maritime activity not qualifying as international shipping income (article 3.3.2), hiring out of engineers may qualify as Qualified Ancillary International Shipping Activity if portion is below 50% but only if ancillary to transport, quod non (article 3.3.3. and 3.3.4.).

Step 3: covered taxed (tonnage tax).

Step 4: effective tax rate.

Step 5: application of IIR, because priority over UTPR.

Part 2

Step 1: assess in-scope constituent entities in Country B and in Country C.

Crux: does Group A have a constituent entity in Country C -Depends on the question whether Company B has a constituent entity in Country C in the form of a 'permanent establishment' (article 1.3.1.(b)) -In line with the definition of 'permanent establishment' in Article 10.1.1., the rule under (a) applies which says that a 'permanent establishment' exists if the relevant tax treaty says so and if the profit attribution rule is similar to article 7 of the OECD Model.

Because the tax treaty in place between Country B and C is modelled to the OECD model, it can be concluded that Company B does not have a permanent establishment in Country C. As such, there is no constituent entity and the UTPR cannot be applied (article 2.4.1.).

If the tax treaty were to follow the UN Model (2025), this would imply Company B could be seen as having a permanent establishment in Country C in certain circumstances in the form of a services PE (article 5(3)(b) or potentially under new article 5C (services related to offshore extractives).

The question then arises whether article 7 of the UN Model can be deemed 'similar to article 7 of the OECD Model'. Para. 102 of the GloBE Commentary does not settle this issue as it suggests, as an example, that both AOA or pre-AOA are allowed and deemed similar, but it does not mention fractional apportionment (article 7(4) of the UN Model) to be 'similar'.