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Increased Scrutiny of Taxpayer's Worldwide Taxation – Current Issues

2023 Financial Services Tax Conference

July 12, 2023
1:30 p.m. and 3:00 p.m.

Shaping the future:
convergence & collaboration
2023 Financial Services Tax Conference

Agenda

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Shaping the future:
convergence & collaboration
2023 Financial Services Tax Conference

01 Tax Transparency

- Tax Transparency standards
- Tax Transparency rules
- Common data model

02 Getting credit for your credits

- Tax credits as classified under Pillar 2

03 Pillar 2 in an uncertain world

Pillar 2 and the interactions with transfer pricing

Shaping the future:
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01
Tax Transparency

Anu Varadharajan

The road to tax transparency

Standards, Principles, Guidelines, and Regulations

2014

DJSI

Tax Strategy is included for the first time in its ESG ratings

2015

OECD BEPS

The OECD BEPS initiative was introduced as a way to stop MNCs from exploiting mismatches between different countries' tax systems.

Australia Audit Risk Assessment

Australia introduces its Annual Compliance Arrangement to promote cooperative tax compliance

2016

UK Requirement

The UK HMRC requires companies to publish a tax strategy

Australia TTC

Australia introduces its Tax Transparency Code for voluntary tax transparency

OECD

Calls for adoption of a Tax Controls Framework

2018

B Team

A group of leading companies met to generate a set of tax principles titled "Responsible Tax Principles"

2019

Global Reporting Initiative

GRI develops a new standard on tax, which includes tax strategy principles, tax governance principles, and public CbCR – effective from January 2021

2020

World Economic Forum IBC

WEF releases white paper on ESG metrics including Total Tax Impact (TTI)

2021

G20

Endorses a G7 communique on ESG reporting alignment

European Union

EU issues the public CbCR directive which requires member states to adopt domestic legislation on public CbCR

2023

FASB

Proposed enhanced income tax disclosures with retroactive application

Australia

Proposed public CbCR following GRI 207

Tax transparency disclosure – Current state summary

Voluntary

Various voluntary standards, principles and guidelines exist. Various initiatives exist to try and drive some commonality. In future, we may see convergence and the emergence of a recognized minimum standard.

- WEF – IBC Stakeholder Capitalism Metrics
- Global Reporting Initiative – 207
- Dow Jones Sustainability Index
- Future-Fit Business Benchmark
- B-Team responsible tax principles
- Tax Transparency Code
- Fair Tax Mark

Mandatory

Mandatory standards exist in various jurisdictions and may be public or private, or focused on particular industries. Multinational groups will need to stay abreast of changes and developments in mandatory regulations in multiple jurisdictions.

- CRD IV
- Country-by-country reporting
- EU Accounting Directive – EU CbCR
- Corporate Income Tax Act
- Proposed FASB Income Tax Disclosures
- Tax Strategy
- Dodd Frank
- The Extractive Industries Transparency Initiative
- Proposed Australian Public Country-by-country reporting

Global Reporting Standard 207

1 Approach to tax – Description of approach

- Public tax strategy
- Governance over tax strategy
- Approach to regulatory compliance
- How the strategy links to business & sustainability

2 Tax control framework – Governance & risk management

- Oversight of tax strategy
- How the approach is embedded within the organization
- Tax risk management
- How the framework is evaluated

3 Stakeholder engagement

- Stakeholder engagement
- Engagement with tax authorities
- Approach to public policy on tax
- The process for considering stakeholder views

4 Country-by-country reporting – all jurisdictions

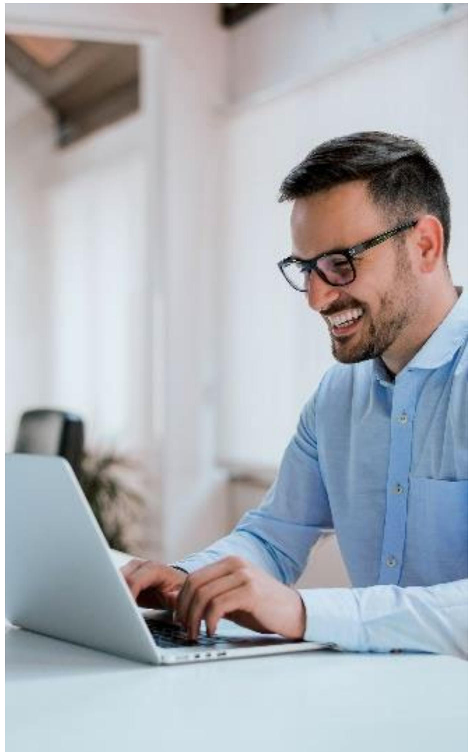
- Entity list
- Activities undertaken
- Number employees
- 3P and related party revenues
- PBIT
- Tangible assets
- Tax accrued
- Tax paid
- Explanations

Recommended: Total Tax Contributions & significant UTPs

Qualitative disclosures

The various standard setters and approaches to tax transparency emphasise different areas and details in their assessment of the appropriate approach to tax transparency disclosures. There is some commonality in the broad areas in scope, although the details required by each standard diverge.

Some approaches give significant weight to quantitative measures, which are not covered on this slide.



Scope of expected commentary	UK Tax Strategy	GRI 207	B-Team	Fair Tax	DJSI	Future Fit
Coverage	**UK**	**Whole group**				
Strategy/Policy publicly available	✓	✓	✓	✓	✓	✓
Link to broader business and/or ESG strategy	✗	✓	✗	✗	✓	✗
Governance & accountability	✓	✓	✓	✓	✓	✓
Compliance approach	✓	✓	✓	✗	✓	✗
Risk framework & management	✓	✓	✓	✗	✗	✗
Process for escalating concerns	✗	✓	✗	✗	✗	✗
Specific commitments on BEPS matters	✗	✗	✓	✓	✓	✓
Stakeholder engagement	✓ (HMRC only)	✓	✓	✗	✗	✗
Assurance/Accreditation required or recommended	✗	✓	✗	✓	✗	✓

Note: (a) This is not exhaustive. Various standards phrase requirements in different ways with different emphases. Some standards also consider qualitative measures such as tax paid, country-by-country reporting, or effective tax rates at a country level.
(b) The WEF 'Measuring stakeholder capitalism' report focuses solely on quantitative metrics so is not included here.

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Tax transparency rules

EU public country-by-country reporting (CbCR)

Disclosure framework

- UPE entity publishes the report on its website
- One EU group member files report with national commercial registry
- Auditor must confirm the report was published

Jurisdictional disclosures

- Separate disclosures for each EU member state where the group is active
- All “non-cooperative” and “grey listed” (2+ years) jurisdictions
- Rest of world aggregated

What to report

- Activities
- # of employees
- Total revenue
- PBIT
- Income tax accrued
- Income tax paid
- Accumulated earnings

Jurisdictional optionality

- Directive sets a “minimum standard” – Member state optionality
- “Safeguard clauses” deferring disclosures for commercially sensitive information
- Exemption from publishing on group website if already made publicly available
- Additional data points?

Australia draft legislation (public CbCR)

- CbC reporting parent with A$1billion or more global turnover
- Provide information to ATO in ‘approved form’, to be made **publicly available** on Australian government website

207-4 but extended Country-by-country reporting

Country-by-country reporting is the reporting of financial, economic, and tax-related information for each jurisdiction in which the organisation operates

1 **Name** of each entity in CbC reporting group

2 Description of the CbC reporting group’s **‘approach to tax’**

3 Certain **quantitative tax information** for the income year **for each jurisdiction** the CbC reporting group operates in

GRI 207-1 Approach to tax

- Tax Strategy
- Board approval
- Compliance approach
- How tax is linked to business and sustainable development strategies

- Note: GRI = Global Reporting Initiative, independent sustainability (ESG) reporting standards
- See appendix for information on GRI standard 207

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Australia – Key observations

New data points

- Related party cross-border payments
- List of intangible assets
- Book value of intangible assets
- Explanation for difference between expected tax and accrued tax

Foreign HQ parents

- Scope follows GRI 207-4
- Sensitivities in disclosing data, particularly for non-EU groups & intangibles listing
- Unlike EU equivalent, no size restrictions on Australian operations to fall in scope

Pillar 2 ETR

- Requirement to disclose Pillar 2 effective tax rates (calculated in accordance with Article 5.1 of the OECD Model Rules)
- Brings forward need to prepare global Pillar 2 ETRs by up to 6 months (otherwise due 18 months post year end in the first year, then 15 months)
- Unclear whether temporary CbC safe harbors can be used
- Doesn't include top up tax paid under the Pillar 2 rules or a Qualified Domestic Minimum Top-up Tax

FASB – Enhanced income tax disclosures

FASB Exposure Draft

On March 15, 2023, FASB issued an Exposure Draft – Improvement to Income Tax Disclosures (the 75-day comment period on the proposed ASU ends on May 30, 2023).

Rate reconciliation

Disclose 8 specific categories in the rate reconciliation

Additional information for items above specified quantitative thresholds

Taxes paid

Interim disclosures of taxes paid by federal, state & foreign

Annual disclosures by country where material (>5%)

Transition & effective date

Proposed to apply retroactively

Effective date TBD

Quantitative country-by-country reporting comparison

	Disclosure	GRI	OECD CbC	EU PCbC	FASB	AU PCbC	WEF
Economic activity	Total revenue	❌	✅	✅	❌	❌	✅
	Revenue from 3Ps	✅	✅	❌	❌	✅	❌
	Revenue from RPs	✅	✅	❌	❌	✅	❌
	RP X-border payments	❌	❌	❌	❌	✅	❌
	PBIT	✅	✅	✅	🟡 2	✅	✅
	Tangible assets (less cash & equivalents)	✅	✅	✅	❌	✅	❌
	Number of employees	✅	✅	✅	❌	✅	✅
	Employee compensation	🟡 1	❌	❌	❌	❌	✅
Financial data	Inventory and book value of intangibles	❌	❌	❌	❌	✅	❌
	Total accumulated earnings	❌	✅	✅	❌	❌	❌
	Stated capital	❌	✅	❌	❌	❌	❌
	Reconciliation to public financials	✅	❌	❌	✅	✅	❌
Corporate income tax	Cash tax paid	✅	✅	✅	🟡 2	✅	🟡 4
	Tax accrued	✅	✅	✅	❌	✅	❌
	Effective tax rate	❌	❌	❌	🟡 2	✅ 3	❌
	Explanation of difference between "expected tax" and tax accrued	✅	❌	🟡 1	❌	TBD	❌
	Explanation of permanent rate differences	❌	❌	❌	🟡 2	TBD	❌
Non-CIT	Non-income tax paid	🟡 1	❌	❌	❌	❌	🟡 4
	Non-income tax collected	🟡 1	❌	❌	❌	❌	🟡 4
	Grants & incentives received	🟡 2	❌	❌	🟡 2	TBD	✅

GRI = Global Reporting Initiative 207-4 (2019)

OECD CbC = Country-by-Country Reporting, Action 13 (October 15, 2015)

EU PCbC = Country-by-Country Reporting Directive (the Directive) (December 21, 2021)

FASB = Exposure Draft on Improvements to Income Tax Disclosures (March 15, 2023)

AU PCbC = Australian Treasury Exposure Draft on Public Country-by-country tax reporting (April 6, 2023)

WEF = Measuring Stakeholder Capitalism White Paper (September 2020)

✅ – Required

🟡 – Optional / Conditionally Required (see footnote)

❌ – Not Required

1 – Recommended, over and above base-line disclosures

2 – Disclosed where material

3 – OECD Pillar 2 ETR

4 – CbC recommended, over and above base-line global disclosures

CbCR – More important than ever

For many MNE groups, the CbC reporting process has been on autopilot for several years as the CbCR was just an informational report (i.e., used for risk assessment only). With Tax Transparency and BEPS Pillar Two, MNE groups are revisiting their processes.

Pillar Two Safe Harbors

- Wider use – **Pillar Two Safe Harbors**
- **Less flexibility** as to how the data is reported
- Practically speaking, taxpayers must be able to **reconcile** the data
- Is CbC data now potentially subject to **audit?**

Public CbCR & FASB

- Wider audience **– tax authorities** and the **public**
- Wider use – **public scrutiny**
- **Public disclosure**
- Practically speaking, taxpayers must be able to **reconcile** the data

Pillar 2: Transitional CbCR safe harbor

Safe harbor tests

01

De minimis test

CbCR Revenue of less than €10 million and Simplified GloBE Income of less than €1 million for the Fiscal Year (i.e., no 3-year average applies).

02

Simplified ETR test

Simplified ETR calculation for a jurisdiction by referring to the Simplified Covered Taxes divided by the Simplified GloBE Income. The applicable minimum rates are **15%** (2023 and 2024), **16%** (2025) and **17%** for fiscal years beginning in 2026.

03

Routine profits test

The amount of the Substance-based Income Exclusion is greater than the Simplified GloBE Income. No simplified determination of the substance factors (payroll and tangible assets) is applicable.

Definitions

Qualified CbC Report

CbC Report filed using the Consolidated Financial Statements of the UPE or separate financial statements of each Constituent Entity provided, in broad terms, they are prepared under an authorized accounting standard and are reliable (Qualified Financial Statement).

Simplified GloBE Income

Profit (Loss) before Income Tax from the MNE's Qualified CbC Report.

Simplified Covered Taxes

Income Tax Expense from the MNE's Qualified Financial Statements subject to certain adjustments to exclude taxes that are not Covered Taxes as defined in the Model Rules and uncertain tax positions.

Common data model

One data set – Multiple uses

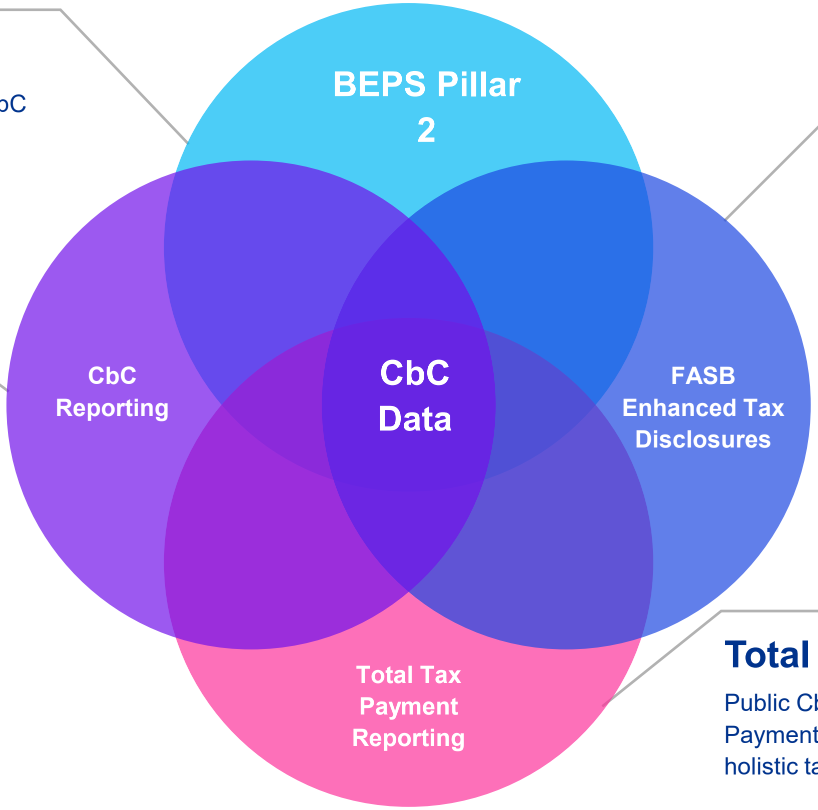
For many MNE groups, the country-by-country (CbC) reporting process has been on autopilot for several years with the CbC reporting being regarded as simply "another information return." BEPS Pillar Two and public CbC reporting have cast a renewed focus on CbC reporting and as a result, MNE groups are revisiting their data collection and reporting processes. Coordinating the data extraction and identifying different uses for this data increases the efficiency for resource constrained tax departments.

BEPS Pillar 2

Transitional safe harbor calculations will rely on CbC data and, going forward, country-level GAAP consolidations will be the starting point for Pillar 2 calculations and compliance obligations.

Public & Non-public CbC

CbC data will have to be publicly disclosed for fiscal years as early as 2023. This will form the basis for future Action 13 reporting.



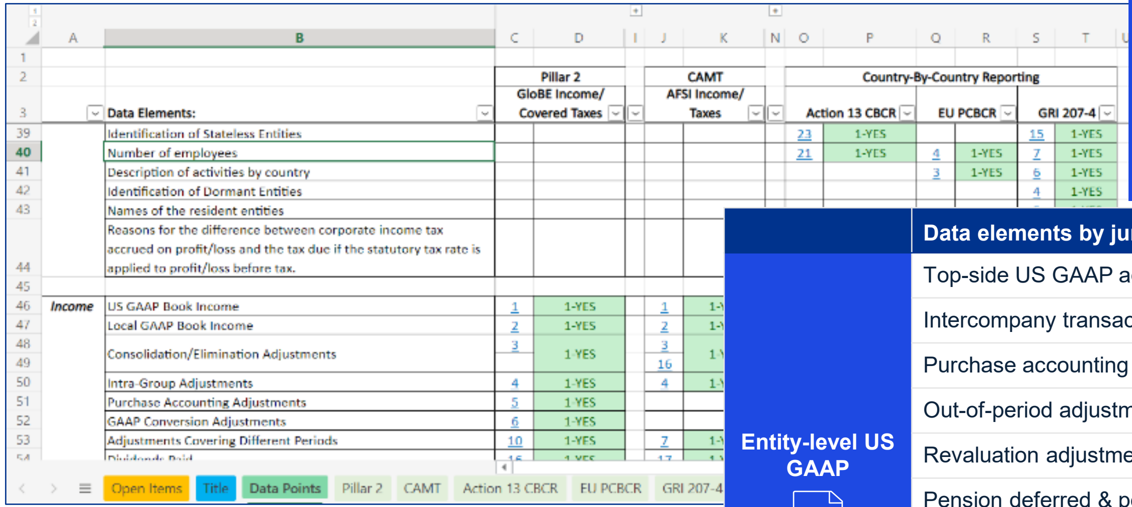
FASB Disaggregation

In 2023, FASB is expected to require companies to disclose, quarterly, the total income tax paid to federal, state, and foreign tax authorities and, annually, tax payments to countries or states. It is expected that FASB will also require rate reconciliation.

Total Tax Payment Reporting

Public CbC reporting will be a catalyst for Total Tax Payment Reporting to develop an accurate and holistic tax narrative around disclosed tax amounts.

Common data elements – Multiple use cases



Data Mapping

KPMG's tax data element matrix identifies data elements required for multiple use cases (with drill-down, citations & examples)

- Required
- Conditional
- Not Required

1 – Where material

Data hierarchy

Level 1 - Calculation Data Points (GLOBE INCOME, ADJ TAX, ETC.)
Level 2 - Return reporting data points that comprise GloBe Income (i.e., exclude
Level 3 - Data points that make up level 2 (i.e. definition of a level 2 item that is
Level 4 - Individual Data Points (answer of level 3 data and is a portion of what r
Level 5 - Containers of the Level 4 data (tax workpapers, financials, trial balance
Level 6 - Where would you find the containers of the Level 4 data? ERP system, (

Data Hierarchy

KPMG's data element matrix maps data elements from requirements to ultimate data source – building automated processes

	Data elements by jurisdiction	EU PCbC	FASB	GRI	Pillar 2	CAMT
Entity-level US GAAP	Top-side US GAAP adjustments	Conditional	Required	Required	Required	Conditional
	Intercompany transactions under US GAAP	Conditional	Required	Required	Required	Conditional
	Purchase accounting adjustments	Conditional	Required	Required	Required	Conditional
	Out-of-period adjustments	Conditional	Required	Required	Required	Conditional
	Revaluation adjustment gain/loss	Not Required	Conditional	Conditional	Required	Not Required
	Pension deferred & permanent items	Required 1	Required 1	Required 1	Required	Required
	Stock-based compensation permanent items	Required 1	Required 1	Required 1	Required	Required
	Reorgnization deferred gain/loss	Not Required	Not Required	Not Required	Required	Required
	All other book-tax differences	Required 1	Required 1	Required 1	Required	Conditional
Other	PP&E by jurisdiction	Required	Not Required	Required	Required	Not Required
	Employee compensation	Not Required	Not Required	Conditional	Required	Not Required
Corporate Income Tax	Current tax expense	Required	Required	Required	Required	Required
	Deferred tax expense	Required	Not Required	Required	Not Required	Not Required
	Change in uncertain tax positions/other tax expense	Required	Required	Required	Not Required	Not Required
	Refundable tax credits & other incentives	Required 1	Required 1	Required 1	Required	Not Required
	Deemed dividend inclusions (Sub F/GILTI)	Required	Required	Required	Required	Required
	Schedule of DTLs by expected/actual reversal date	Not Required	Not Required	Not Required	Required	Not Required

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Q&A

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02

Getting credit for your credits

Alistair Pepper

Getting credit for your credits

01 Pillar 2 has established a de facto international minimum tax standard

- The GloBE Rules establish a de facto internationally agreed approach to compute an in-scope MNE's tax base, with top-up tax potential due if the rate is below 15%.

02 When evaluating the economic benefits of tax credits – you need to keep Pillar 2 in mind

- When estimating the benefit of tax credits it is important to take into account the impact of Pillar 2, which will vary by MNE.
- The specific Pillar 2 profile of your group will affect the economic benefit you can expect to derive from tax credits.
- This limits the ability of MNE to benefit from certain forms of tax credits – notably non-refundable credits, as these credits reduce an MNE's Covered Taxes and hence increase the likelihood its Pillar 2 ETR drops below 15%.

03 This isn't easy – the rules are still moving

- Since the OECD issued Model Rules and Commentary in December 2021 and March 2022, it has issued further clarificatory guidance that materially impacts how certain provisions are interpretated.
- This includes how certain tax credits and flow-through losses are treated.
- We are expecting further guidance imminently on the treatment of transferable credits, as well as refinements to the treatment of tax equity structures.

How likely is it that U.S. GloBE ETR will be below 15%?

Despite a 21% corporate income tax rate (+ state), experience shows that U.S.-headquartered MNEs may nevertheless have a GloBE ETR on their U.S. income that is less than 15 percent.

Why? The most common ingredients include material:

- R&D credit
- Energy credits
- Evolving treatment of transferable credits, tax equity structures and other niche incentives
- Foreign Derived Intangible Income (FDII) deduction
- FTC carryforwards, particularly in combination with overall domestic losses (ODLs) or separate limitation loss (SLLs)
- M&A related adjustments
- Deferred tax liabilities and assets capped at 15 percent at booking and reversal
- Other technical gaps, e.g., the impact of a loss making DRE/hybrid entity in allocating USFIT to relevant MNE Group jurisdictions

Potential for a short-term UTPR safe harbor for the UPE jurisdiction, which could benefit US MNEs

Treatment of tax credits as classified under the GloBE Rules

Treatment of tax credits under GloBE Model Rules

The GloBE Model Rules (released on 20 December 2021) and Commentary (released on 14 March 2022) established the treatment for (i) qualified refundable tax credits, (ii) non-qualified refundable tax credits, and (iii) non-refundable tax credits.

01 Qualified Refundable Tax Credit (QRTC)

- QRTC to the extent that paid as cash / cash equivalents within 4 years of eligibility for credit
- Treated as an increase to GloBE income but not as a reduction to Covered Taxes. *See Article 3.2.4 and 4.1.2(d).*

02 Non-Qualified Refundable Tax Credits

- Partially / wholly refundable tax credit that is not a QRTC.
- Treated as a reduction to Covered Taxes. *See Article 3.2.4 and 4.1.3(b).*

03 Non-Refundable Tax Credits

- Not refundable
- Treated as a reduction to Covered Taxes. *See 4.1.3(c).*
- E.g.: U.S. R&D credit.

Why does it matter? As a practical matter, this difference in treatment means that credits that fall in Category 2 and 3 are more likely to result in top-up tax than credits in Category 1. The following slide provides quantitative examples for each category.

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Treatment of tax credits under GloBE Model Rules (cont'd)

USP (UPE)

UK (CE) | Germany (CE)

Pre-credit PTBI:	100
Credit (Category 1):	10
Post-credit PTBI:	110
Book Tax Expense:	21
After Tax Profit:	89

Qualified Refundable Tax Credit (QRTC)

U.S. Jurisdictional ETR:

GloBE Income = 110
Adjusted Covered Taxes = 21
ETR = 19%
Top-up tax = 0

01

USP (UPE)

UK (CE) | Germany (CE)

Pre-credit PTBI:	100
Credit (Category 2):	10
Post-credit PTBI:	110
Book Tax Expense:	21
After Tax Profit:	89

Non-Qualified Refundable Tax Credits

U.S. Jurisdictional ETR:

GloBE Income = 100
Adjusted Covered Taxes = 11
ETR = 11%
Top-up tax = 4
Collected by the UK and Germany (based on allocation key) pursuant to UTPR (when effective)

02

USP (UPE)

UK (CE) | Germany (CE)

PTBI:	100
Pre-credit BTE:	21
Credit (Category 3):	10
Post-credit BTE:	11
After Tax Profit:	89

Non-Refundable Tax Credits

U.S. Jurisdictional ETR:

GloBE Income = 100
Adjusted Covered Taxes = 11
ETR = 11%
Top-up tax = 4
Collected by the UK and Germany (based on allocation key) pursuant to UTPR (when effective)

03

Administrative Guidance ("AG") released in Feb 2023 introduced Qualified Flow-through Benefits

Two problems, one solution:

- Losses related to equity method accounted entities, including tax transparent entities, are excluded from GloBE Income (Article 3.2.1(c)). However, Adjusted Covered Taxes are reduced by "the amount of current tax expense with respect to <u>income</u> excluded from the computation of GloBE Income or Loss under Chapter 3", with no ability to "gross-up" Adjusted Covered Taxes for the impact of an excluded loss. (Article 4.1.3(a)).
- Separately, U.S. tax equity arrangements (for example, low-income housing credits and some renewable energy credits / projects) structured via partnerships could also result in low jurisdictional ETRs absent qualification for relief provided by the AG.
- The AG (as released on February 2, 2023) attempts to address both issues through an **"Equity Investment Inclusion Election"** (**"EIIE"**). Where the EIIE is made in respect of a jurisdiction, Qualified Ownership Interests create a new Category 4 for **"Qualified Flow-through Tax Benefits"** (**"QFTBs"**):
  - QFTBs are tax credits (other than QRTCs) and tax benefits of losses that flow through to an investor as a return of (rather than a return on) the investor's investment.
  - Only available where: (i) at the time of investment, investor's expected return on ownership interest would not be positive in the absence of expected non-refundable credits; and (ii) to the extent the QFTBs constitute a return of all or part of the investor's investment.

01	02	03	04
Qualified Refundable Tax Credit (QRTC)	Non-Qualified Refundable Tax Credit	Non-Refundable Tax Credit	Qualified Flow-through Tax Benefits for Qualified Ownership Interest

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Benefit of EIIE where partnership interest does not constitute a Qualified Ownership Interest

Facts

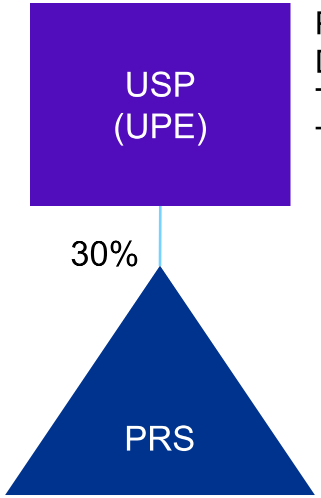
- USP holds a 30% interest in PRS which it accounts for under the equity method.
- PRS does NOT constitute a "Qualified Ownership Interest" because USP will recover its investment without relying on credits that are not QRTCs.

U.S. jurisdictional ETR computation without EIIE:

- \$(50) loss from PRS excluded from USP's GloBE Income (Article 3.2.1(c))
- But USP's tax benefit from PRS loss is NOT excluded from Covered Taxes (Article 4.1.3(a)).
- Jurisdictional ETR = 10.5%

U.S. jurisdictional ETR computation with EIIE:

- Further to EIIE, USP may include \$(50) loss from PRS in its GloBE Income.
- ETR = \$10.5 / \$50 = 21%



Pre-tax Income (excluding PRS):	100
Distributive Share from PRS (Loss):	(50)
Taxable income:	50
Tax paid @21%:	10.5

Important notes regarding EIIE:

- Jurisdictional election; binding for 5 years once made. Irrevocable during the 5-year period w.r.t. an ownership interest if a loss w.r.t that ownership interest was taken into account in GloBE income / loss computation while EIIE was in effect.
- For the 5 years during which the EIIE is binding, all equity method income or loss arising from flow-through entities as well as gains or losses upon disposition (plus fair value gains or losses) of ownership interests in CEs are required to be included in GloBE Income or Loss (if such disposition or fair value amounts are included in the relevant taxable income determination in the jurisdiction where the election is made).
- EIIE does not apply to Qualified Ownership Interests or for purposes of the Transitional CbCR Safe Harbor.

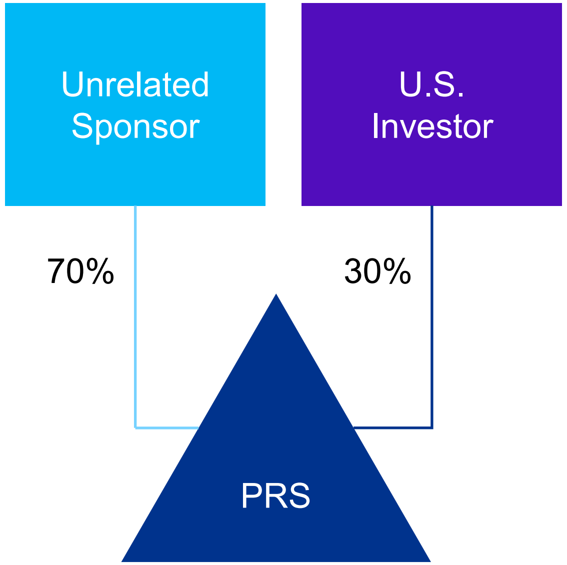
Benefit of EIIE where partnership interest constitutes a Qualified Ownership Interest

Facts

- U.S. Investor holds a 30% interest in PRS which it accounts for under the equity method. Its interest in PRS is a "Qualified Ownership Interest" because U.S. Investor does not expect to recover its investment in PRS without relying on incentive credits that are not QRTCs.
- In Year 1, U.S. Investor invests $100 in PRS and receives a distributive share of $(100) depreciation from PRS.
- Year 2 onwards, U.S. Investor receives $25 of non-refundable incentive credits.

U.S. jurisdictional ETR computation without EIIE / QFTB:

- $(100) depreciation loss from PRS excluded from US. Investor's GloBE Income (Article 3.2.1(c))
- U.S. Investor's tax benefits (depreciation loss and credits) from PRS loss are NOT excluded from Covered Taxes (Article 4.1.3(a)).
- Jurisdictional ETR in Year 1 = 14% (42 / 300)
- Jurisdictional ETR in Year 2 =12.6% (38 / 300)



Year 1 U.S. Investor -	
Pre-tax Income (excluding PRS):	300
Depreciation Loss from PRS:	(100)
Taxable income:	200
Tax paid @21%:	42
Credit from PRS (Category 3):	0
Tax after credit:	42

Year 2 U.S. Investor -	
Pre-tax Income (excluding PRS):	300
Depreciation Loss from PRS:	0
Taxable income:	300
Tax paid @21%:	63
Credit from PRS (Category 3):	25
Tax after credit:	38

Important notes regarding treatment of QFTBs:

- No guidance under February 2023 AAG for Sponsor. Such guidance is expected in July 2023.
- What if the "ownership interest" is accounted for as debt rather than equity?
- Timing of positive adjustments under proportional amortization.

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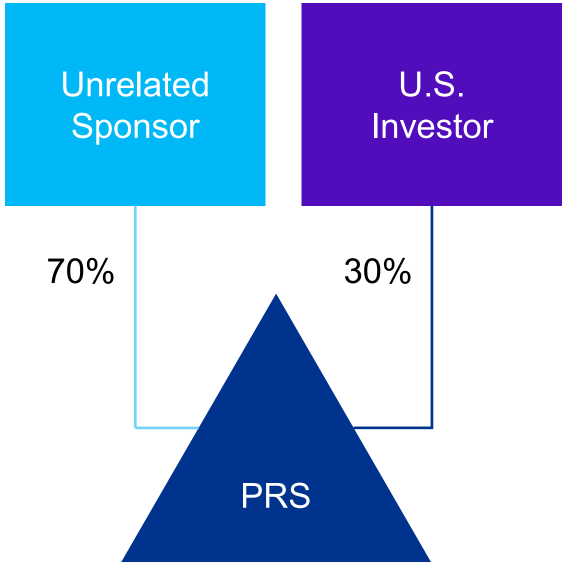
Benefit of EIIE where partnership interest constitutes a Qualified Ownership Interest (cont'd)

U.S. jurisdictional ETR computation with EIIE for QFTB (contd.):

- Where EIIE is made, in lieu of the rules described in the previous example, U.S. Investor will reduce its investment for the amount of distributions, credits, proceeds on sale / disposition and the tax benefit of losses because PRS is a Qualified Ownership Interest
- Until its investment is reduced to 0, U.S. Investor gets a positive adjustment to Covered Taxes for the amount of credits and tax-effected losses
- Year 1: Positive Adjustment of $21 to Covered Taxes
  - Jurisdictional ETR in Year 1 = 21% (63 / 300)
  - Remaining investment of U.S. Investor = $79
- Year 2: Positive Adjustment of $25 to Covered Taxes
  - Jurisdictional ETR in Year 2 = 21% (63 / 300)
  - Remaining investment of U.S. Investor = 54



Year 1 U.S. Investor -

Pre-tax Income (excluding PRS):	300
Depreciation Loss from PRS:	(100)
Taxable income:	200
Tax paid @21%:	42
Credit from PRS (Category 3):	0
Tax after credit:	42

Year 2 U.S. Investor -

Pre-tax Income (excluding PRS):	300
Depreciation Loss from PRS:	0
Taxable income:	300
Tax paid @21%:	63
Credit from PRS (Category 3):	25
Tax after credit:	38

Important notes regarding treatment of QFTBs:

- No guidance under February 2023 AAG for Sponsor. Such guidance is expected in July 2023.
- What if the "ownership interest" is accounted for as debt rather than equity?
- Timing of positive adjustments under proportional amortization.

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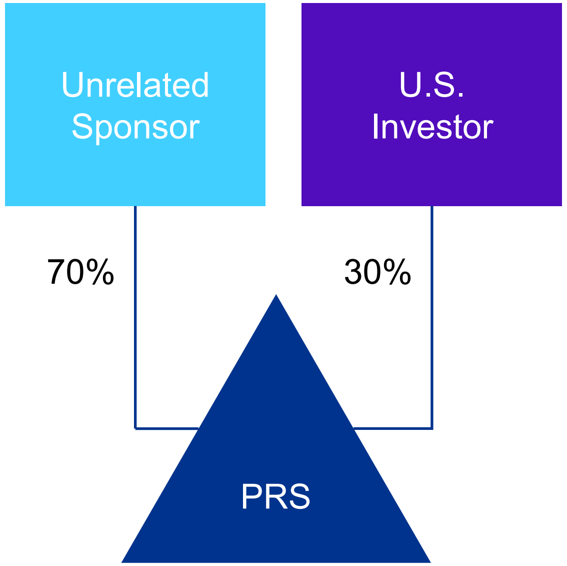
Benefit of EIIE where partnership interest constitutes a Qualified Ownership Interest (contd.)

U.S. jurisdictional ETR computation with EIIE for QFTB (contd.):

- Once investment has been reduced to 0, subsequent amounts of tax-effected losses and credits will be treated as a reduction to Covered Taxes, as will sale proceeds and distributions (to the extent of prior positive adjustments for tax-effected losses and credits).
- Therefore, U.S. Investor may experience low jurisdictional ETRs in future years.
- The EIIE applies in respect of all equity method investments (not just flow-through entities) of the U.S. Investor (and other CEs in such jurisdiction).
  - However, the treatment in the current example applies only to those that are Qualified Ownership Interests, whereas the treatment in the previous example applies only to those that are NOT Qualified Ownership Interests.
  - When not a Qualified Ownership Interest, the election protects against flow-through losses, but not credits



Year 1 U.S. Investor -

Pre-tax Income (excluding PRS):	300
Depreciation Loss from PRS:	(100)
Taxable income:	200
Tax paid @21%:	42
Credit from PRS (Category 3):	0
Tax after credit:	42

Year 2 U.S. Investor -

Pre-tax Income (excluding PRS):	300
Depreciation Loss from PRS:	0
Taxable income:	300
Tax paid @21%:	63
Credit from PRS (Category 3):	25
Tax after credit:	38

Important notes regarding treatment of QFTBs:

- No guidance under February 2023 AAG for Sponsor. Such guidance is expected in July 2023.
- What if the “ownership interest” is accounted for as debt rather than equity?
- Timing of positive adjustments under proportional amortization.

GloBE Treatment of transferable credits

- **Not addressed in the AAG:** Treatment of transferable credits as included in the Inflation Reduction Act ("IRA").
- **The U.S. Treasury Department has stated:** *"the economics of a transferable credit are equivalent to refundability… But that is something that is somewhat controversial in the multilateral discussions, and so we are working to provide additional clarity to taxpayers on credits more generally as well."*
- **Guidance expected imminently.**

01 Qualified Refundable Tax Credit (QRTC)

02 Non-Qualified Refundable Tax Credit

03 Non-Refundable Tax Credit

04 Qualified Flow-through Tax Benefits for Qualified Ownership Interest

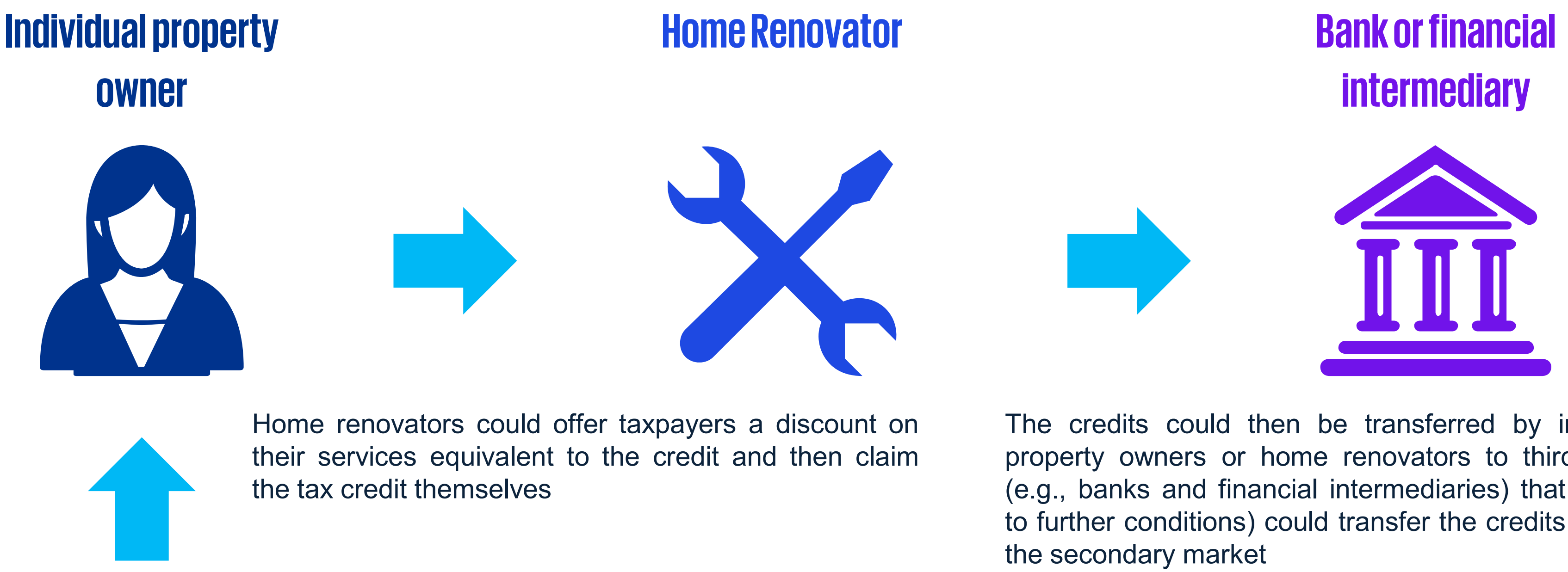
05 Transferable credits introduced through the IRA

- **Originator:** Treated the same as Category 1 (limited to market value)?
- **Transferee:** Treated similar to Category 4, except discount treated as a reduction to tax expense? Is partner in tax equity treated as transferee or originator?

Transfer elections available in respect of the following credits

- Sections 45, 45Y Clean electricity production tax credit
- Sections 48, 48E Clean electricity investment tax credit
- Section 45U Zero-emission nuclear power production credit
- **Section 45Q Credit for carbon oxide sequestration (also eligible for Direct Pay)**
- **Section 45Z Clean fuel production credit**
- **Section 45V Clean hydrogen production tax credit (also eligible for Direct Pay)**
- Section 30C Alternative fuel vehicle refueling property credit
- Section 48C Advanced energy project credit
- Section 45X Advanced manufacturing production credit

Italy's Superbonus 110 Initiative



Home renovators could offer taxpayers a discount on their services equivalent to the credit and then claim the tax credit themselves

The credits could then be transferred by individual property owners or home renovators to third parties (e.g., banks and financial intermediaries) that (subject to further conditions) could transfer the credits again in the secondary market

The 110% Superbonus is a **tax credit** recognized to qualifying taxpayers (mainly individuals) **equal to 110% of qualifying expenses incurred for**

- **refurbishing immovable properties**,
- **improving energy efficiency** and
- **reducing the seismic risk** and others.

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03

Pillar 2 in an uncertain world

Lucia Barone

Pillar 2 in an uncertain world

01 Pillar 2 assumes groups have perfect entity-level accounts

- Pillar 2 relies on the FANIL and Covered Taxes determined for a Constituent Entity in preparing the Consolidated Financial Statements of the UPE.
- There are a variety of reasons why an entity's FANIL or Covered Taxes may change after the Consolidated Financial Statements of the UPE have been finalized, including transfer pricing adjustments or return to provision (RTP) adjustments.
- Few groups will have perfect entity-level accounts.

02 If entity-level accounts are less then perfect, there are post-filing adjustments

- Article 4.6 provides for adjustments to be made to a group's Pillar 2 calculation where it makes post-filing adjustments.
- Article 4.6 applies in respect of adjustments made after the GloBE Information Return (GIR) is filed.
- Article 4.6 does not apply in respect of adjustments made between the finalization of a UPE's Consolidated Financial Statements and the filing of the GIR (which could be a 12 month period).

03 Group's Pillar 2 tax liability can go up, but not down

- Article 4.6 requires groups to recalculate their ETR when there is a decrease in Covered Taxes, potentially exposing groups to additional top-up tax.
- But any additional tax paid in a jurisdiction is taken into account in the Fiscal Year the adjustment was made.
- This means that post-year end adjustments can result in an increase, but not a reduction, in a group's Pillar 2 tax liability.

Common transfer pricing adjustments in the FS sector

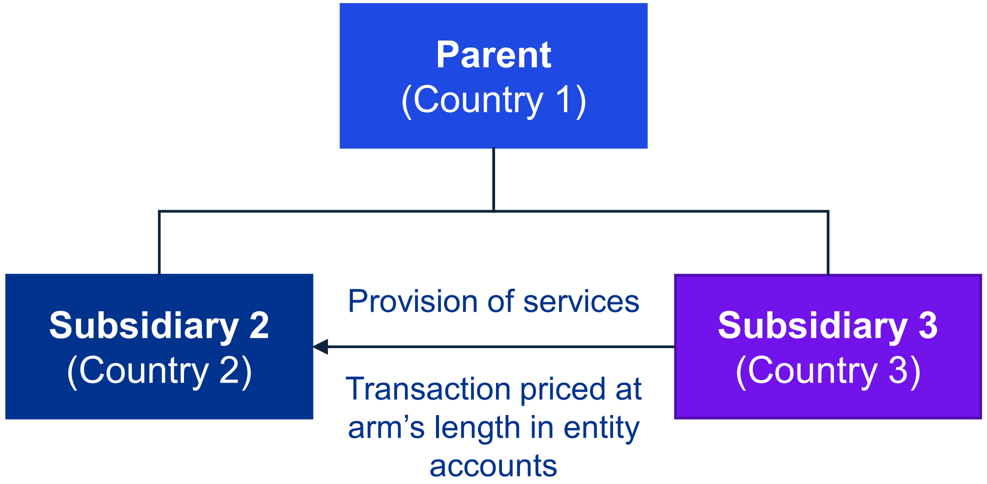
Common transfer pricing adjustments

- **Management fees** — Management fee and other IC Charges for services (including low value adding)
- **Marketing and promotion** — Marketing and promotion activity remunerated at cost plus
- **Attribution of profit to PEs** — Attribution of profit to PE (Attribution of free capital/Determining the investment income for Insurance PE)
- **Hidden PE** — Hidden PE challenge
- **IP** — Remuneration of shared IPs (i.e. charge of royalty on Trademark)
- **Reinsurance** — Remuneration of Reinsurance

Example 1: The setup

Explanation

- Country 1 implements the IIR, which applies to Country 2 and Country 3, where Parent has two subsidiaries (Subsidiary 2 and 3).
- Country 2 has a tax rate of 17% and Country 3 has a tax rate of 10%.
- There is an intragroup transaction between Subsidiary 2 and 3 (the provision of services) that is priced correctly in the accounts of both entities.
- The group has a top-up tax liability in respect of Country 3, but no additional liability in Country 2.
- The Pillar 2 rules have worked as anticipated.



	$m
FANIL	100
GloBE Income	100
Tax ($100m @ 17%)	17
GloBE ETR	17%
Top-up tax due	0

	$m
FANIL	100
GloBE Income	100
Tax ($100m @ 10%)	10
GloBE ETR	10%
Top-up tax due ($100m x 5%)	5

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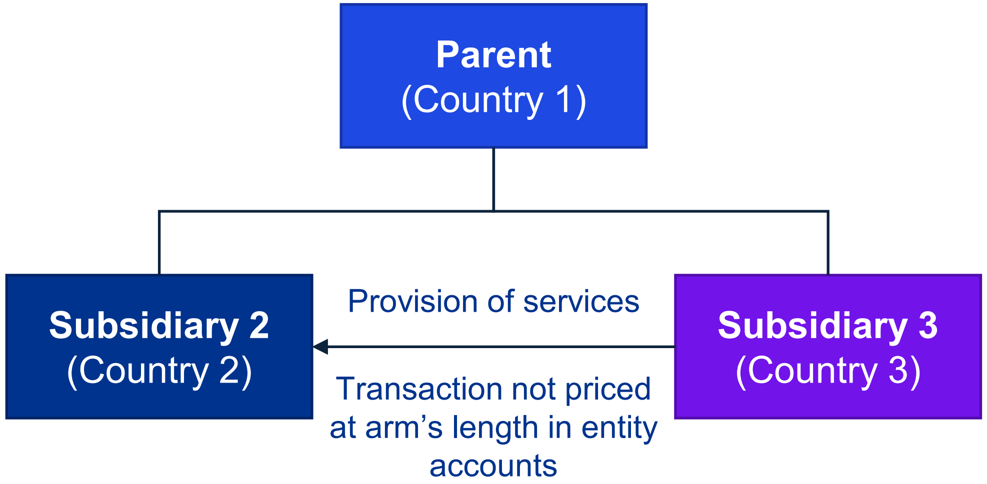
Example 2: Post-year end transfer pricing adjustment

Explanation

- The intragroup transaction between Subsidiary 2 and 3 was initially mispriced.
- Following the closure of the UPE's Consolidated Financial Statements, a post-year end adjustment was made to increase Subsidiary 2's income by $35m and reduce Subsidiary 3's income by a corresponding amount.
- Article 3.2.3 states that transactions between Constituent Entities should be adjusted to be consistent with the ALP, so this adjustment should be reflected when calculating GloBE Income.
- There is not equivalent provision to adjusted Covered Taxes and Article 4.6 does not apply because the GIR has not yet been filed.
- This means Subsidiary 2 would be deemed low-tax and Subsidiary 3 high-tax.



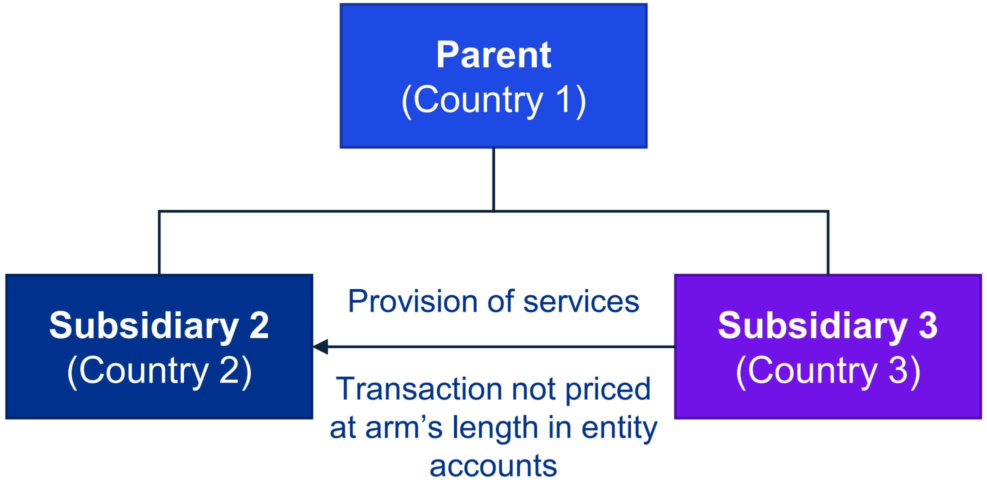
	$m
FANIL	100
TP adjustment	35
GloBE Income	135
Tax ($100m @ 17%)	17
GloBE ETR	12.6%
Top-up tax due ($135m x 2.4%)	3

	$m
FANIL	100
TP adjustment	(35)
GloBE Income	65
Tax ($100m @ 10%)	10
GloBE ETR	15.4%
Top-up tax due	0

Example 3: Transfer pricing adjustment agreed in MAP

Explanation

- Following an audit and MAP, Country 2 and 3's tax administrations agree that Subsidiary 2's income has been understated by $75m and Subsidiary 3's income overstated by $75 in Year X.
- This adjustment is agreed after the GIR has been filled.
- In Country 2, the increase in income and increase in taxes paid is likely to be accounted for in the year the adjustment is made (pursuant to Article 3.2.1(h) and Article 4.6).
- In Country 3, the decrease in income and reduction in taxes paid is likely to require a re-computation of jurisdiction's GloBE ETR (under Article 4.6.1).
- There is no mechanism for the group to be repaid the top-up tax no longer due in respect of Country 3.



	Year X	Year X Adj.
FANIL	100	100
TP adjustment	-	75
GloBE Income	100	175
Tax (@ 17%)	17	30
GloBE ETR	17	17
Top-up tax due	0	0

	Year X	Year X Adj.
FANIL	100	100
TP adjustment	-	(75)
GloBE Income	100	25
Tax (@ 10%)	10	2.5
GloBE ETR (%)	10	10
Top-up tax due	5	1.25

Responding to uncertainty

01

Transfer pricing policy

Groups should review their current transfer pricing policy, as part of their broader response to Pillar 2. Are you still comfortable with your approach to risk?

02

Operational transfer pricing

Improving operational transfer pricing can address some of the challenges – particularly around post-year end transfer pricing adjustments. If these are a material issue for your group, they may be worth revisiting.

03

APAs / ICAP

Bilateral or multilateral APAs remain the best way to guarantee certainty. You may also want to consider whether the OECD's ICAP has any benefits.

04

Additional Pillar 2 guidance

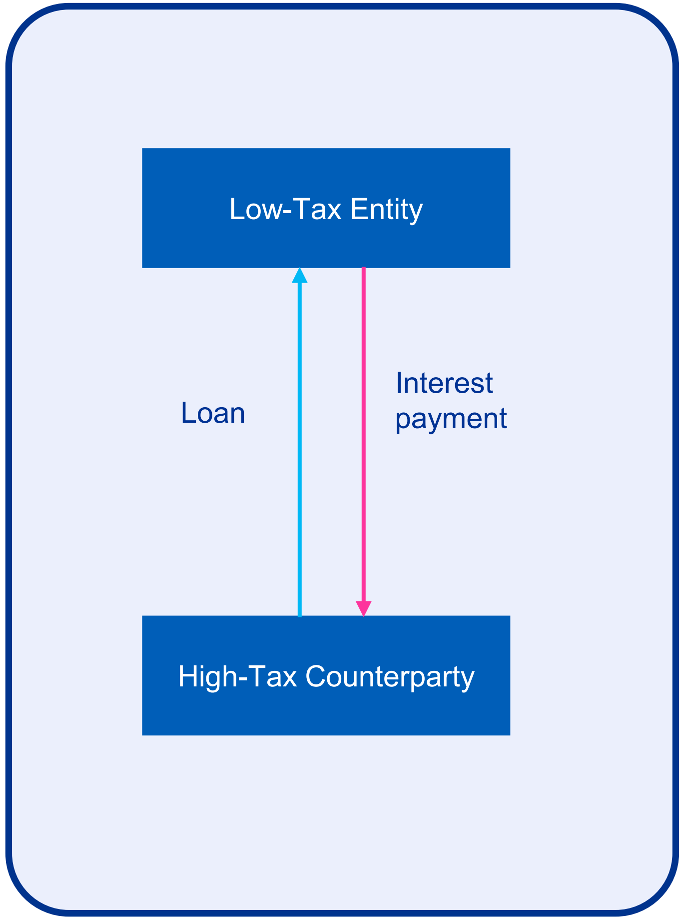
Some of these issues have obvious fixes – particularly the post-year end adjustments to covered taxes – watch out for more OECD guidance that might address these issues.

05

Pillar 2 dispute resolution mechanism

We're still waiting for more details on the Pillar 2 dispute resolution mechanism, which might provide some relief for these problems.

Pillar 2 rules – Intragroup Financing Arrangements (Art 3.2.7)



Intragroup Financing Arrangement

- Direct and indirect financing
- Interest paid from Low-tax CE to High-tax CE
- Pre-regime arrangements covered
- Series of transactions treated as single arrangement
- Role of excess interest capacity that is eligible to be carried forward and set-off against interest income in a subsequent year

High-tax vs. Low-tax

Hypothetical ETR to be calculated without regard to the financing income or expense accrued.

For example: HK SAR Parent: 100 interest income (no tax) and 100 other profit (tax at 16.5%)

- ETR if including the interest income: 8.25% (16.5/200)
- ETR if excluding the interest income: 16.5% (16.5/100)

HK is a High-tax Counterparty for the purpose Art 3.2.7

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Q&A

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Thank you!