Navigating the new realities of Pillar Two compliance

As new global tax regulations take effect, here's a closer look at the emerging challenges—and the leading practices to address them.

After years of extensive international debate, Pillar Two has arrived. Now, the work to manage the most significant international tax change in decades has begun in earnest.

“Pillar Two” is a component of the Base Erosion and Profit Shifting (BEPS) project developed by the Organization for Economic Co-operation and Development (OECD). Pillar Two consists of a set of interlocking and coordinated rules designed to ensure that multinational operating businesses pay a minimum rate of tax of 15 percent in every jurisdiction in which the group does business. Some of the key elements of the rules take effect in 2024.

Pillar Two casts a relatively wide net: The new rules affect any company, public or private, that is operating in more than one jurisdiction and has at least €750 million in total annual revenue in at least two of the last four years. Those two qualifiers cover several thousand groups, many of which are based in the United States.

As many companies expected—and are now quickly confirming with their initial on-the-ground execution—Pillar Two is a complex challenge with far-reaching implications: financial, operational, risk and controls, along with significantly increased demands on staff and technology needed to meet these complicated new reporting requirements.

The following are some of our latest insights on the key challenges, considerations, and emerging best practices as we close out the first months of the Pillar Two era.

What are the biggest challenges?

Since some aspects of Pillar Two are effective for the 2024 tax year across many major jurisdictions, public companies on a calendar-year fiscal cycle have already completed the first quarter tax provision and experienced some of the pain points firsthand.

While private companies and public entities with later fiscal-year starts have a little more time, some of the principal challenges anticipated by many organizations are now fully formed problems to solve. Here are three key challenges for organizations to consider:

01 Increased reporting—and a third set of books

Pillar Two creates a higher volume of tax reporting overall. And these new reports are truly net-new across the board: additional inputs, expanded details, and new templates for filing in each jurisdiction. Crucially, this applies to both the no- or low-tax jurisdictions where top-up taxes will be due, but also to higher-tax countries—even when no additional taxes are due. That's because Pillar Two also requires organizations to demonstrate that no top-up tax is due in each relevant jurisdiction. But, here again, this requires a new reporting format with additional details that obviate previous reporting templates. For many companies, these new reporting outputs mean they need to create and maintain a third set of books: one for annual reporting and filings; one for established tax work; and now one for Pillar Two reporting.

02 Data capture, quality, and consistency

Collecting and verifying all the data required for Pillar Two compliance is another critical problem to solve. The need for new types of tax calculations means that organizations must reset at least a few existing data feeds, and then verify they are tracking correctly. But the net-new reporting requirements will likely obligate most organizations to identify and source additional new data into their enterprise reporting systems—and then track and verify that as well. Multiply that data complexity across the nuances of each individual tax jurisdiction and that leads to a need for close coordination with the IT team.

03 The bottom line

For many organizations, the most tangible effect of Pillar Two will be the impact on their financials. The top-up taxes now due in previously low-tax countries will drag down net income. And the extra bandwidth needed to comply with the added reporting and filing requirements may mean additional operating costs for some companies, especially in the first year as the organization gets up to speed.

For some organizations, an additional consideration to their response to Pillar Two is the framework's Safe Harbor provision. Under the Safe Harbor, companies may be able to defer the detailed calculations for up to three years in some jurisdictions, as we outlined in more detail in a recent KPMG report, BEPS 2.0: Pillar One and Pillar Two.

What are the long-term considerations?

In many ways, Pillar Two is like any other major tax reform in its immediate implications: Company tax teams need to lead the one-time adjustments and updates that will establish an operating foundation for compliance going forward.

That said, the Pillar Two "adjustments" are quite extensive, and there are still some moving parts that must be monitored over the next few years before any organization's Pillar Two infrastructure will truly be replicable from year to year. Here are some considerations to keep in mind:

- **Additional regulations:** One provision of Pillar Two, the Undertaxed Profits Rule (UTPR), was delayed until 2025. Organizations will need to add additional processes to meet that provision in 2025, unless they plan on incorporating that as part of their heavy lifting on the setup this year.

- **Jurisdictional legislation:** Pillar Two itself is not a legal obligation, but a set of guidelines that jurisdictions have agreed on to inform actual tax law in each jurisdiction. Some countries are not making any changes to their laws, others have rushed new legislation forward, and a few more have not finalized their approach.

- **Data and technology needs:** Given Pillar Two's significant impact on data and reporting volumes, many companies will be hard-pressed to get a fully formed Pillar Two technology infrastructure in place this year. Additionally, the data complexity and the need to add additional inputs down the line as the legislation requirements in each jurisdiction become clearer will also require ongoing monitoring. Companies should expect that the sheer complexity of standing up an operation to support Pillar Two overall will require hands-on oversight for at least a few years to ensure the new calculations, data, and supporting technologies are tracking correctly.

How are leading companies adapting?

One of the best practices we have observed is that leading companies are meeting this challenge head-on, rather than deferring key decisions in areas like resourcing and technology, or otherwise kicking the can down the road.

Safe Harbor, for example, might seem a tempting option at first glance—simplifying your obligations for another three years may sound attractive. But given the likelihood that an organization will not be eligible for Safe Harbor in at least one of its operating jurisdictions, it may not make sense to patch together an operation for one location this year while deferring on the rest.

Instead, many companies are now actively building out a comprehensive approach that will ensure alignment, reduce compliance risks, and manage Pillar Two for the long term. Some of the best practices we have seen so far include:

- **Aligning the organization:** A fulsome Pillar Two approach will extend well beyond the tax team. While the tax department will be lead for most organizations, the controllership team must be closely involved as well, along with accounting, finance, IT, and legal. The internal audit team will play an additional key role as well. Leadership must ensure that every relevant player in the organization understands the urgency and priority of Pillar Two.

- **Shoring up support:** Pillar Two includes lots of "new" for companies: requirements, tasks, data, calculations, reports, reviews, systems, and onward. Simply throwing more staff at this is not an answer on its own—and not a realistic option for many companies anyway. Instead, leading companies are looking at a combined approach of staff, third-party support, and technology to deliver the additional bandwidth that Pillar Two compliance will need.

- **Exploring new tech solutions:** Much of the complexity of Pillar Two may ultimately be managed through technology solutions. Leading finance technology providers are already offering new Pillar Two-specific modules that can handle some of the complexities, although these applications will likely require significant customization and testing before they can work seamlessly with the other required enterprise systems and streamline the data and reporting operations. Many companies that have been considering larger finance transformation initiatives are looking at Pillar Two as the final push they've needed to prompt a broader reimagination of their people, processes, and technologies.

- **Working ahead with auditors:** The "we're going to need a bigger boat" approach inherent in Pillar Two will affect every organization's external assurance and audit reviews as well. That's why companies that are moving ahead quickly and efficiently on Pillar Two are also getting ahead of communications with their external auditor. The introduction of new tax calculations, data, and reporting will require additional time to review, and any new systems must be tested and validated as well. Getting these processes right and in place the first time around—and more easily replicating them in ensuing years—will require close communication with a company's external partner early in the process.

Despite the significant new burdens that Pillar Two has placed on affected organizations, meeting the challenge today and streamlining support for the matrix of compliance obligations going forward is achievable.

Addressing the challenge early, aligning the organization, exploring new data and technology solutions, and working closely with external auditors are among the key strategies that many companies are using to put Pillar Two stress in their rearview mirrors.

Learn more

For ongoing Pillar Two updates and reports, be sure to check out our related Pillar Two coverage, which includes:

- BEPS 2.0: Pillar Two
- Pillar Two Gameplan
- Webacast: Finance's role in Pillar Two Enablement
- KPMG BEPS 2.0 Automation Technology

Look for our upcoming Hot Topic on Pillar Two from the Department of Professorial Practice coming later in Q4.

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