



US International Tax Alert

European Union adopts 15% minimum tax directive

The European Union on December 15, 2022, secured a long-sought unanimous agreement to implement the global minimum tax component - known as “Pillar Two” - of a 2021 OECD/Inclusive Framework agreement through an EU directive. Pillar Two is designed to ensure a 15% global minimum level of taxation for multinational enterprise groups with annual revenues greater than 750 million euros and with either a parent company or a subsidiary located in the EU. The directive requires EU member states to transpose the directive into domestic law before the end of 2023, with the result that the Income Inclusion Rule (IIR) component of Pillar Two will take effect in 2024, and the Undertaxed Profits Rule (UTPR) will take effect in 2025.

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Under the IIR an Ultimate Parent Entity or Intermediate Parent Entity pays a “top-up tax” with respect to jurisdictions in which it has branches or subsidiaries that have an effective rate of tax (determined under special Pillar Two rules) less than 15%. This rule could apply, for example, to European holding companies through which US multinationals often hold other non-US subsidiaries. The top-up tax percentage is generally equal to 15% less the effective rate in the subsidiary/branch jurisdiction, after taking into account any “qualified domestic minimum top-up tax” owed in the relevant jurisdiction. The top-up tax percentage is owed only with respect to “excess profits” in a jurisdiction, which are those profits (determined under the special Pillar Two rules) in excess of a specified return on tangible assets and payroll in a jurisdiction.

The OECD/Inclusive Framework continues to develop an “implementation plan,” parts of which are expected to be released very soon, with the remainder early in 2023. The implementation plan will provide “safe harbors” designed to simplify the application of the rules. We are also anticipating the first draft of the “Global Anti-Base Erosion (GloBE) Information Return” with which taxpayers will provide the information to tax authorities to comply with the terms of Pillar Two; that information will be further shared with other relevant jurisdictions. The implementation plan will also contain additional technical guidance necessary to implement the Pillar Two rules in a jurisdiction. It is expected that guidance contained in the implementation plan will be referenced and adopted in any domestic litigation that EU Member States enact to comply with the recently adopted directive.

Because these rules will now come into effect in 2024 and 2025 as noted above, businesses will want to consider both compliance and financial reporting aspects of Pillar Two, including quantifying the potential impact of these rules and the data, systems, and processes needed to comply with them.

Contacts

[Bob Stack](#) (Washington, DC)

[James Petrie](#) (Milwaukee)

[Ryan Bowen](#) (Washington, DC)

[Ryan Duchene](#) (Pittsburgh)



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30 Rockefeller Plaza
New York, NY 10112-0015
United States

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