Analysis

Pillar Two compliance: the view from the 100 Group Tax Committee

Speed read

Large UK businesses have given a cautious welcome to the OECD's BEPS initiatives. The OECD's forecasts of large amounts of additional revenue that will be raised from the new global minimum tax, however, seem at odds with expectations of the largest UK listed corporates, a majority of whom expect to pay 'nil or negligible' incremental tax arising from the Pillar Two regime. In view of the inevitably high cost of complying with these new rules, it is hoped that the UK takes a realistic approach to their implementation and perhaps also takes the opportunity to remove existing UK legislation that is duplicated or made obsolete by Pillar Two.

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The UK formally adopted the OECD's Pillar Two or so-called 'minimum tax' regime in Finance (No. 2) Act 2023. The purpose of this article is not to discuss the detailed rules or the many unanswered questions that abound. For that, see, for example, 'Multinational top-up tax: an overview' (M Mortimer and T Ruiz), *Tax Journal*, 11 September 2023. Instead, this article looks at the implications of those rules for UK PLC or, to be more specific, the implications for the largest PLCs in the UK.

> The priority for tax teams in the FTSE 100 is stability, predictability and effective compliance

Background

The OECD's Base Erosion and Profit Shifting (BEPS) initiative arose out of a widespread perception that companies, and multinationals in particular, were not paying their fair share of corporate income taxes. The first wave of BEPS 'actions' included initiatives to limit interest deductibility, combat the use of hybrid instruments in tax planning and tighten up transfer pricing rules, amongst other things.

There remained unresolved questions around how to tax the evolving digital economy – along with a view that the original BEPS actions were not sufficient to address tax avoidance. It was in this context that, in October 2021, more than 130 countries reached an historic agreement around a two-pillar approach.

Pillar One seeks broadly to reallocate a portion of taxable profits from countries where those profits are currently earned to the countries where goods or services are used or consumed, i.e. a partial move to destination-based taxation. Meanwhile, Pillar Two looks to ensure that corporate profits are subject at least to a minimum level of taxation, whether that tax is levied in the country of residence, a parent company jurisdiction or in countries where affiliates are located.

While Pillar One appears to be foundering on the not insubstantial rocks of US Congress, the ingenious design of Pillar Two means that the minimum tax regime looks certain to proceed, irrespective of the concerns of US legislators.

By and large, large UK businesses have cautiously welcomed these initiatives, reflecting that uniformity and consistency are generally preferable to the volatile and uncertain international tax environment they currently experience; one which looked set only to get worse with the proliferation of multiple unilateral measures.

How much tax will Pillar Two raise?

The OECD's latest study, published in January 2024, estimated that the proposed global minimum tax will result in annual global revenue gains of $155bn–$192bn per year, compared to their previous estimate of $220bn. Their November 2023 study of country by country tax reports concluded that jurisdictions with high tax rates account for more than half of the low-taxed profits reported globally by multinational enterprises, and the OECD speculates that may arise from use of tax incentives and other targeted concessions.

These impressive statistics certainly raised a few eyebrows amongst the UK tax director community, so the Tax Committee of the 100 Group, representing the largest UK headquartered businesses, undertook an informal survey of its membership to see how they compare to their expectations.

> An informal survey of the 100 Group revealed that for the majority of respondents (54%), there is expected to be 'nil or negligible' incremental tax arising from the Pillar Two regime

Interestingly, this revealed that for the majority of respondents (54%), there is expected to be 'nil or negligible' incremental tax arising from the Pillar Two regime. A further 24% of companies anticipated a Pillar Two tax liability of less than £10m, still a small amount in the context of over £8bn in UK corporation tax paid by 100 Group members in 2022/23.

So why are these amounts so low? It's not the result of some devious tax structuring; rather the explanation is far more mundane. Large UK listed companies generally operate and earn the bulk of their profits in mid or high tax regimes, and most have global effective tax rates (ETR) well above the global minimum tax rate. In fact, excluding REITs and investment trusts, where tax is levied on the shareholder, the average of reported ETRs between 2020 and 2022 was in excess of 30%.

The perception that big business makes profligate use of tax havens or aggressive tax planning strategies is rather out of date. The priority for tax teams in the FTSE 100 is stability, predictability and effective compliance.

In fact, the 100 Group companies already make a very substantial contribution in tax. In the UK alone, taxes borne amounted to £29.1bn in 2022/23, with a further £60.6bn of taxes collected on behalf of the UK Exchequer. The 100 Group total tax contribution of £89.8bn amounted to around 10% of all UK government receipts.

Why then is the OECD forecasting such large amounts of top-up tax will be raised? We can't know for sure where they expect the revenues to come from, but from our analysis it will not be from the largest UK listed corporates.

How much will it cost to comply?

The OECD set itself a very ambitious task: in effect, to design a whole new tax system, with its own, unique tax base – and one that could be applied consistently in every country around the world.

Unsurprisingly, therefore, it results in a regime that is complex. Even determining which kinds of entities are in scope is not straightforward, let alone applying novel concepts such as a hybrid approach to timing differences that seeks (in certain circumstances) to combine the accounting concept of deferred tax with a cashflow realisations basis.

We have a new tax regime that seemingly raises relatively little tax but costs a large amount to administer

Reaching agreement among around 140 countries' tax authorities has required something of a lowest common denominator approach which, amongst other things, means companies will be required to file a 28 page 'GloBE information return', comprising an estimated 480 separate datapoints. Company systems aren't currently set up to collect all of these data so this will require costly changes to ERP systems. Having to extract, cleanse and report entity financial data for every country, even when it is clearly not lowly-taxed, is then typically a time-consuming manual exercise.

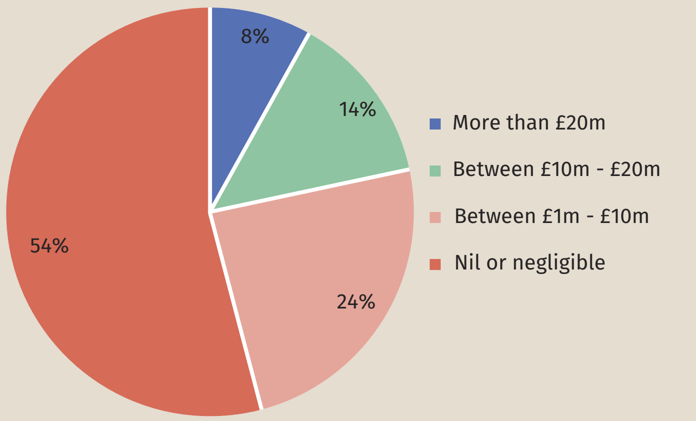
We surveyed the 100 Group membership to get their best estimate of the likely incremental cost of complying with these new rules. In view of the different business models and geographic footprints, the results varied widely, with annual compliance costs ranging from £10,000 to £4.5m, and an average of £300,000. On top of those ongoing costs, 100 Group companies also flagged significant one-off implementation costs, in some cases as much as £15m.

So where does that leave us?

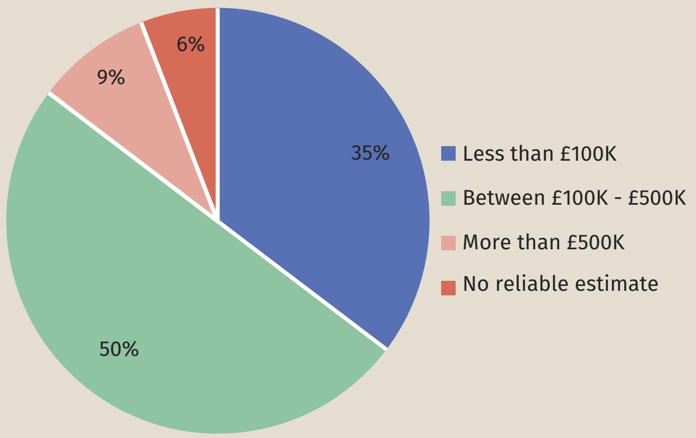
We have a new tax regime that seemingly raises relatively little tax but costs a large amount to administer. That doesn't mean we think it should be scrapped or the UK should withdraw from the global agreement. We recognise that having a consistent worldwide regime is an important and valuable, if challenging, objective. Like in so many other areas, this may just be a cost of doing business.

We do however think that there are important lessons that can be drawn from this survey. Firstly, we would hope that the UK takes a realistic approach to these rules and resists the temptation to apply their own 'gold-plating' to an already complex regime. The UK's rules need to be consistent with the OECD model in order to be accepted by other countries, but they should not go further than they need to. The so-called safe harbours are there for a reason.

Estimate for the annual incremental tax to pay



Estimate for the annual compliance costs



Inevitably for such an ambitious exercise, there are and will be numerous scenarios that were not envisaged by the legislation, so HMRC's interpretations and practice will be more important than ever. We hope HMRC will take a realistic view.

The UK's rules need to be consistent with the OECD model in order to be accepted by other countries, but they should not go further than they need to

Finally, the introduction of the Pillar Two minimum tax regime results in a significant expansion to the already extensive UK tax code. Perhaps this could be an opportunity for the Treasury to take a bold approach to slimming down the code by removing existing legislation that is largely duplicated or made obsolete by Pillar Two? ■

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- Multinational top-up tax: an overview (M Mortimer and T Ruiz, 11.9.23)
- OECD pillar talk: Pillar Two looming, Pillar One a step closer (B Rajathurai, J Burton & M Fraser, 6.7.23)
- Pillar Two: the consequences of staggered global implementation (A Greenbank & R Kinghall Were, 24.5.23)