



The new Game-Changer in global taxation: Pillar II and the 15% Global Minimum Tax Rate

Introduction

The introduction of a minimum tax rate across the globe is under way and the international tax landscape is set to undergo a significant transformation. In this article, we explore the main provisions of Pillar II and how Cyprus will be affected.

What is Pillar II in a nutshell?

Pillar II is part of a 'two-pillar' approach, led by the OECD and the EU, aiming to address the tax challenges arising from the digitalization of the global economy.

Pillar I, which is still under discussion, seeks to adapt the international income tax system through changes to the profit allocation and nexus rules applicable to business profits. Pillar I would ultimately apply to the biggest and most profitable MNEs and distributes part of their profit to countries where they sell/provide their products/services.

Pillar II introduces a minimum tax rate on income arising in low-tax jurisdictions, ensuring that large MNEs pay their fair share of taxes, regardless of where they operate.

Which companies are in scope of Pillar II?

Pillar II rules apply to groups of companies, whose annual turnover exceeds €750 million. Within the EU, the rules apply to all large groups (whether they operate on a purely domestic or international basis) whose annual turnover exceeds €750 million, and which have either a parent company or a subsidiary in an EU Member State.

How will Pillar II be implemented within the EU?

An EU Directive, which is based on the OECD Pillar II Model Rules, has been unanimously voted in December 2022 and EU Member States (including Cyprus) are required to transpose the provisions of the Directive into their local legislation by the end of 2023.

How will Pillar II be implemented within the EU?

Specifically, the Directive aims to ensure that multinational and large-scale domestic groups with consolidated annual revenue of at least €750m are taxed at a minimum effective tax rate (ETR) of 15% on income arising in low-tax jurisdictions.

This will be enforced through the application of two interlocking rules, formally known as the GloBE rules: The Income Inclusion Rule (IIR) and the Undertaxed Profits Rule (UTPR).

The additional tax is imposed at the level of the Ultimate Parent Entity (UPE), in proportion to its shareholding percentage in entities that have low taxed income. The UPE pays the tax to its own tax authority for all its low taxed subsidiary entities wherever they are located worldwide. If the UPE is located in a jurisdiction that has not implemented the GloBE rules, then the responsibility for the application of the IIR falls on the Constituent Entity that is directly owned and controlled by that UPE, and so on, down the ownership chain.

The UTPR serves as a backstop to the IIR and is aimed at dealing with cases in which the IIR is unable to bring low tax jurisdictions in line with the 15% minimum ETR. The UTPR allocates the taxing rights over the under-taxed income to jurisdictions different from the UPE residence. In accordance with the Directive, Member States have the option to elect and apply a qualified domestic top-up tax (QDMTT) in their own low taxed jurisdiction. This will allow such jurisdictions to collect the top-up tax in their own jurisdiction instead of allowing a foreign jurisdiction to charge top-up taxes elsewhere. This is a very positive development for jurisdictions like Cyprus in which the ETR is below the minimum rate.

Will Cyprus implement Pillar II?

As mentioned above, EU MS are required to transpose the provisions of the EU directive into domestic law by the end of 2023, with an effective date of 2024 for the IIR and 2025 for the UTPR. Cyprus is currently working on drafting legislation to take effect on the same timeline.

Cyprus also has the option to elect and apply a QDMTT which would allow Cyprus to maintain its tax rate at 12.5% and impose and collect the top up tax domestically on in-scope groups instead of having other foreign jurisdictions collect such tax elsewhere. At the same time, as we move towards the global minimum tax rate, we would expect that other measures and incentives will be considered so as to mitigate the impact on Cyprus as an international business center and safeguard the competitiveness of Cyprus.

What next?

We recognise that these developments will have a major impact on a number of businesses that are based in Cyprus, and it is therefore critical to react promptly.

Do reach out to your tax advisors who can help you better understand how Pillar II may affect your business and determine what corrective actions (if any) can be made to mitigate such impact.

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