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Despite Relief, Pillar Two Problem Remains for US Multinationals

By Kevin Brogan, Marcus Heyland, and Alistair Pepper

The latest guidance from the OECD may assuage some frustrations from US businesses about the undertaxed profits rule, even if temporarily, say three experts at KPMG.

The latest tranche of administrative guidance from the OECD on Pillar Two was released Monday. Guidance on the treatment of tax credits and a transitional undertaxed profit rule safe harbor are the most consequential for US-based multinationals.

The latest guidance comes on the heels of increasing political tension in the US about the impact of Pillar Two on the US fisc and the application of the undertaxed profits rule, or UTPR, to US multinationals. A recent report from the Joint Committee on Taxation showed that the US loses revenue under any scenario where the rest of the world implements Pillar Two.

The transitional UTPR safe harbor provides a taxpayer election whereby top-up tax under the UTPR in respect of the jurisdiction in which a multinational is headquartered is deemed to be zero if such jurisdiction has a nominal corporate rate of at least 20%. Thus, the safe harbor is available for US-parented groups with respect to their US income. For a calendar year company, the transitional UTPR safe harbor is available for years prior to 2026.

Although the safe harbor provides immediate-term relief, US businesses are still looking for a permanent solution that addresses the underlying factors exposing them to top-up tax on their US income in the first place.

The guidance provides a permanent solution for the treatment of transferable credit, which would apply to many of the energy credits enacted by the Inflation Reduction Act. The seller of the marketable transferable credit must treat the face value of the credit (or transfer price, if sold at a discount) as an increase to its income for Pillar Two purposes instead of a reduction to covered taxes. The buyer of the transferable credit in turn will reduce its adjusted covered taxes by the amount of the discount.

Transferable credits will therefore still negatively impact both an originator's and buyer's US effective tax rate, but to a lesser extent than if the entire amount of the credit were treated as a reduction to adjusted covered taxes.

Nevertheless, once the safe harbor period ends, US multinationals will remain

vulnerable to top-up tax on their US income under a UTPR for a variety of reasons—namely research and development credits, foreign derived intangible income deductions, foreign tax credits, and goodwill amortization. As a result, the temporary relief offered by the latest OECD guidance simply delays, but doesn't resolve, the concerns of many US businesses, and the controversy surrounding Pillar Two, and the UTPR more specifically, likely remains.

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Author Information

Kevin Brogan is a principal in the international tax group of Washington national tax practice of KPMG LLP.

Marcus Heyland is a managing director in the economic and valuation services group of the Washington national tax practice of KPMG LLP.

Alistair Pepper is a managing director with KPMG US Tax Services London.

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