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The Channel Islands' Commitment to Implement the Pillar 2 Global Tax Framework

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On 19 May 2023 Jersey and Guernsey confirmed their commitment to implementation of the Organisation for Economic Co-operation and Development (OECD) Pillar Two global minimum tax framework for large multinational groups and presented their intended approach (the **Pillar 2**). This followed an earlier 'Tax Policy Reflection' paper published in April 2022.

The Pillar 2 rules are the cornerstone of a global initiative aiming at preventing multinationals from jurisdiction shopping in order to circumvent the ultimate effective tax rate. Jersey and Guernsey's participation, however voluntary, is therefore a matter of continuing to be part of the global market through supporting and applying globally implemented tax policies.

The GloBE Rules

The Pillar 2 framework defines the scope and sets out the mechanism for the so-called Global Anti-Base Erosion (**GloBE**) rules, which introduce a global minimum corporate tax rate of 15% achieved through a coordinated system of tax rules in each jurisdiction where 'in-scope' multinationals operate. It applies to multinational groups with global annual revenue equal to or exceeding EUR750m unless an industry exemption applies (see below).

Aside from working on the implementation of GloBE, Jersey and Guernsey have already agreed to implement the minimum standard, which includes the Subject To Tax Rule (the **STTR**) – the second component of the Pillar 2. The STTR effectively introduces a special withholding tax on certain types of related party payments (e.g. royalties) when such payments are not subject to a minimum tax rate. Currently, withholding taxes in cross-border scenarios are largely managed through double taxation treaties and domestic reliefs, independently from generally effective tax rates.

The GloBE rules consist of two main mechanisms:

- the Income Inclusion Rule (the **IIR**) which works from the top of the group down, i.e. any top up tax necessary to arrive to the global 15% tax rate is payable by the Ultimate Parent Entity in its jurisdiction; and
- the Undertaxed Payments Rule (**UTPR**) which applies when the Ultimate Parent Entity's (the **UPE**) jurisdiction does not apply the IIR and tax cannot be collected partially or in full under that rule; in such cases, the top up tax (or part of the tax) is collected by the next intermediate parent entity in the group.

The Approach Taken by Jersey and Guernsey

The Pillar 2 rules envisage an option for participating jurisdictions to introduce a domestic tax top up, i.e. a domestic levy applicable to multinational groups in scope of the Pillar 2 rules, so group entities resident in those jurisdictions can demonstrate effective taxation at the minimum 15% level. **Jersey and Guernsey have decided to exercise that option**. It effectively means that although our local income tax continues to be so-called the '0/10' system, multinational groups which have reached at least EUR750m of global annual revenue and do not benefit from an exemption will pay a top up tax to bring the effective taxation of their Jersey and Guernsey resident entities to 15%.

The GloBE rules apply to all entities forming a multinational group, defined as any group that includes at least one entity that is not located in the jurisdiction of the UPE, where entities are related through ownership or control and included in the group's consolidated financial statements (or excluded but only on the grounds of size, materiality or through being an entity held for sale). In that sense, the GloBE rules correspond to the existing Country-by-Country Reporting regime.

GloBE Exemptions

The GloBE rules prescribe a number of exemptions for certain entities (Excluded Entities) who would otherwise be in scope, including for pension funds, investment funds which are UPEs and real estate investment vehicles which are UPEs. Equally important in the context of Jersey and Guernsey's funds and investment industries, is that the rules go further and allow exemption of entities where:

- at least 95% of their value is held directly or indirectly by one or more Excluded Entities, as long as they are holdings / investment vehicles for the benefit of their Excluded Entities or only carry out ancillary activities; or
- at least 95% of their value is held directly or indirectly by one or more Excluded Entities, as long substantially all of their income is excluded dividend / gain / loss (as separately defined by the GloBE rules).

Whilst it seems too early to make predictions on the final impact and application of the GloBE rules and the domestic top-up tax in Jersey and Guernsey, the exemptions already provided by the current global framework substantially soften the potential impact of those rules on the Channel Islands' client base.

Moreover, most investment funds do not consolidate their portfolio companies and therefore would fall outside the basic value threshold of the Pillar 2. The OECD recently published Administrative Guidelines which clarify that the deemed consolidation condition would not apply in this scenario, as it's not intended to modify the rules in circumstances where recognized accounting standards do not require consolidation.

Differing International Approaches to Global Tax Rates

The GloBE rules are currently undergoing different stages of consultation and drafting processes across the world. The EU has already implemented the Directive 2022/2523 on ensuring a global minimum level of taxation for multinational enterprise groups and large-scale domestic groups in the EU, which entered into force on 23 December 2022. EU Member States have now time to transpose it into their domestic systems by 31 December 2023 for the IIR and 31 December 2024 for the UTPR. Any Jersey multinationals operating entities in any EU Member States should therefore keep track of the relevant domestic updates and amend their policies and operations accordingly.

The UK has released its draft Pillar 2 legislation on 23 March 2023, with a similar timeline, i.e. introducing the application of the IIR and domestic tax top up for accounting periods starting on or after 31 December 2023.

Whilst Pillar 2 implementation for the UK, EU and most of the rest of the world appears to be rather standardized, those multinationals involved with the US may face additional layers of complexity. US law already includes a minimum tax in the form of GILTI (Global Intangible Low Taxed Income) but it is not currently aligned with the IIR and is therefore not compliant with the Pillar 2 rules. One of the key reasons for this is that GILTI applies on a global basis allowing businesses to engage in profit-shifting as tax rates are blended between the high and low tax jurisdictions in which they operate. Whilst the US legislator is currently working on agreeing a regime corresponding with the IIR, through The Build Back Better Act, it is uncertain when and in what form that Act is going to be implemented. More recent developments included a 15% minimum tax for certain large corporates but with a number of details differing from the Pillar 2, which leave a question mark as to how multinational groups in scope of GILTI and the Pillar 2 rules anywhere else in the world are going to operate both regimes simultaneously. The OECD has recognized that issue and, in February 2023, OECD Administrative Guidelines made an attempt to bring GILTI treatment of controlled foreign corporations into the scope of the GloBE, rules, however long term application remains an open question.

Irrespective of details implemented at the local level, all Jersey and Guernsey multinational groups which meet the EUR750m annual global revenue threshold, including entities operating within a fund structure, should consider the impact of the GloBE rules on their tax, operational and accounting policies, as well as seek advice on any exemptions and exclusions.

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