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BEPS 2.0 - a case study

Proactive tax solutions for a global client in the construction industry.

Utilising the strength and expertise of the Baker Tilly network, the Global Tax Solutions group understood the transfer pricing model of this major first-time client from the Construction industry, to provide proactive, tax-efficient advice.

Starting with a single project in one country, the group's success drove the expansion of this relationship into over 40 other countries. This resulted in not only a significant increase in revenue, but also the evolution of more complex projects involving different tax authorities from around the world.

Background

Who?

The OECDs BEPS 2.0 initiative will have major implications in the following scenarios:

- Multinational Groups with global turnover in excess of €20 billion and profits before tax above 10% of turnover.
- All Multinational Groups with marketing and distribution entities (Pillar 1 – Amount B).
- Multinational Groups with global turnover in excess of €750 million (Pillar 2).

What?

Pillar 1 - Amount A redistributes 25% of residual profits above the 10% mentioned above to other countries, where there is sufficient nexus, using a turnover based allocation key.

Pillar 1 - Amount B will simplify and streamline the assessment of transfer pricing arrangements for baseline marketing and distribution activities.

Pillar 2 is designed to ensure the effective tax rate for all countries is at least 15% and also levies a withholding tax on intercompany payments subject to tax below a minimum rate.

Where?

All groups operating in more than one country should be mindful of these rules.

When?

Pillar 1 is expected in 2024.

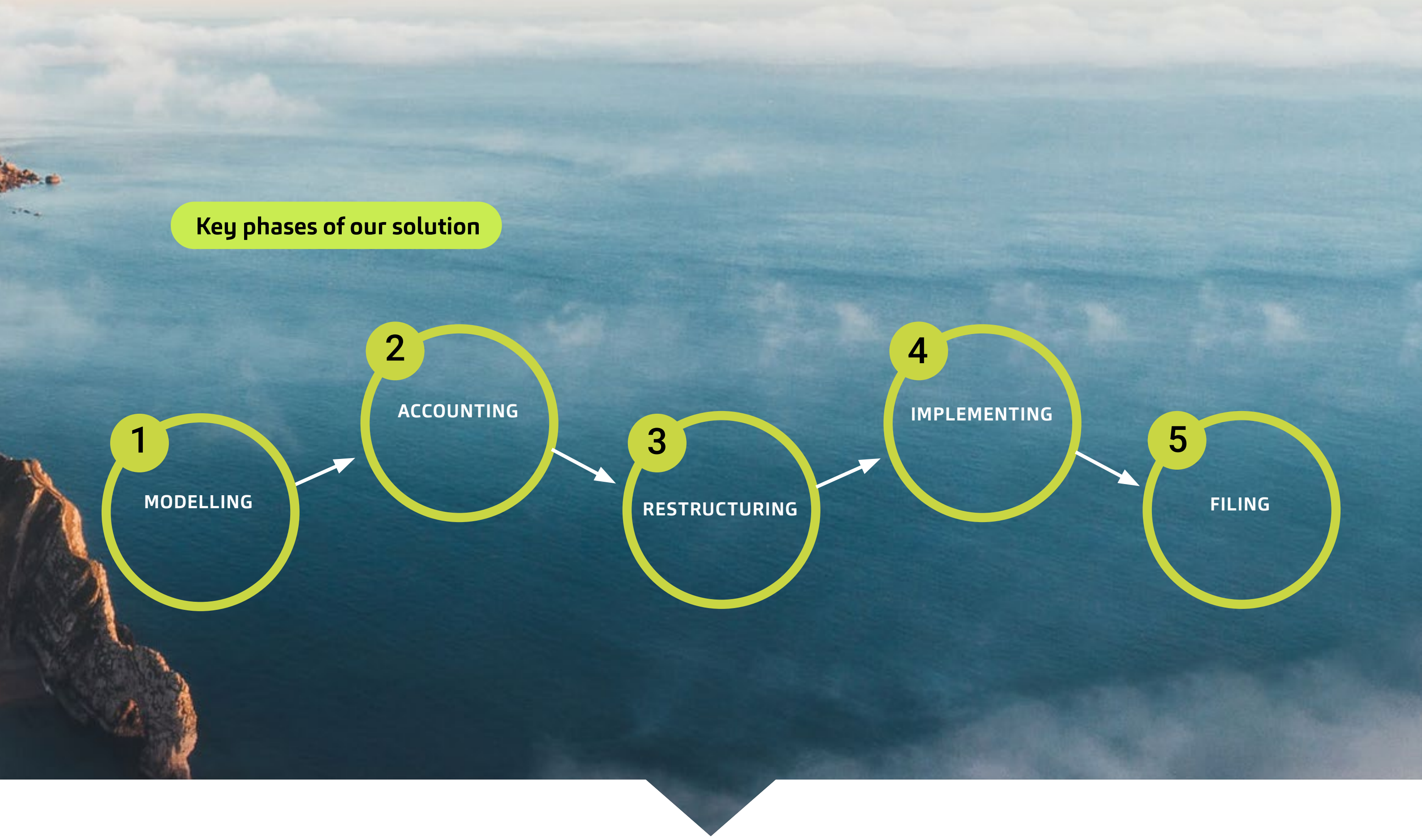
Pillar 2 is expected to largely come into force in December 2023, with certain aspects coming into effect in 2024.

Why?

The BEPS 2.0 initiative has been designed to enhance taxing rights for source countries primarily where existing tax mechanisms do not capture sufficient value in the country of consumption.

How?

The impact of BEPS 2.0 is already being seen across the globe via countries who have a corporate tax rate effectively lower than 15% making announcements about increased corporate tax rates on the horizon.



Phase 1: MODELLING JOURNEY

Effective tax rate calculation

$$\frac{\text{Covered taxes (For each jurisdiction)}}{\text{Adjusted profits (For each jurisdiction)}} = \text{Effective Tax Rate (For each jurisdiction)}$$

Covered taxes:
current taxes on profits and other qualifying taxes, less excluded taxes (including multinational top up tax).

Adjusted profits:
Start with Profit / Loss per the accounts. Make adjustments to get to adjusted profits. These are specific for each jurisdiction and intended to bring accounting profit more aligned to taxable profits.

£2billion turnover
6,000 staff
~ 70 Countries

Country by Country Reporting information
Modelled for 2019 and 2020

Initial conclusions:
~ 10 countries (significantly more than expected)
<15% ETR

Potential impact Extra tax per annum ~£1m, Global ETR increase by 2%

Consider future business changes
Especially UAE

Process to eliminate jurisdictions as low risk

1. Eliminate R&D from Adjusted Profits
2. Eliminate dividends from Adjusted Profits
3. Eliminate jurisdictions with losses or with ETR >15%
4. Reduce impact by substance based exemptions

- Payroll costs in the accounts at 10% (reducing to 5%), estimated using average staff costs.
- Fixed Assets carrying value at 8% (reducing to 5%).

Modelling Journey

Main priority now and into 2023

OECD journey compared to unilateral measures such as UK draft legislation.

De minimus rules

Assess local rules regarding whether they include carve out for smaller entities with Adjusted revenue <€10m and profit before tax <€1m.

Data capture & efficacy

Review internal capabilities in relation to accurately capturing key information for continued proactive modelling and reporting to the authorities. Also consider what level of controls re required regarding the validity of information available.

Monitoring global rules

In a fast paced global tax environment, with countries adopting differing approaches, the ability for a business to ensure awareness of key global changes directly related to BEPS 2.0 (such as implementation specifics and timeframes) or indirectly related to BEPS 2.0 (such as increasing corporate tax rates in various countries) is vital.

Phase 2: ACCOUNTING

- **Accounting considerations -** FRS 101 "acceptable", though check overseas using "acceptable" GAAP / IFRS.
- **Deferred** tax adjustments to the modelling calculation.
- **Future effective tax rate** disclosures in the Financial Statements.
- **Start accruing additional taxes** from 1 January 2024 or once new rules apply globally.

Covered Tax Adjustments – Deferred Tax

Total Deferred Tax Adjustment Amount (per year) is equal to the deferred tax expense accrued in the financial accounts at or below Minimum Rate.

Therefore, deferred tax expense is subject to adjustment in countries with nominal tax rates above 15.0%.

Furthermore, the amount is subject to adjustments, such as changes throughout the year, and/or exclusions like the deferred tax expense with respect to:

- items excluded from the computation of GloBE Income, or
- disallowed Accruals and Unclaimed Accruals.

Key point:

- careful regarding uncertainty in relation to any unrecognised deferred tax positions.

Phase 3: RESTRUCTURING

1. Movement of significant people functions →
2. Entity rationalisation →
3. Transfer pricing considerations
   - Assess functions in low tax jurisdictions
   - Baseline marketing / Distribution rules under Pillar 1, amount B

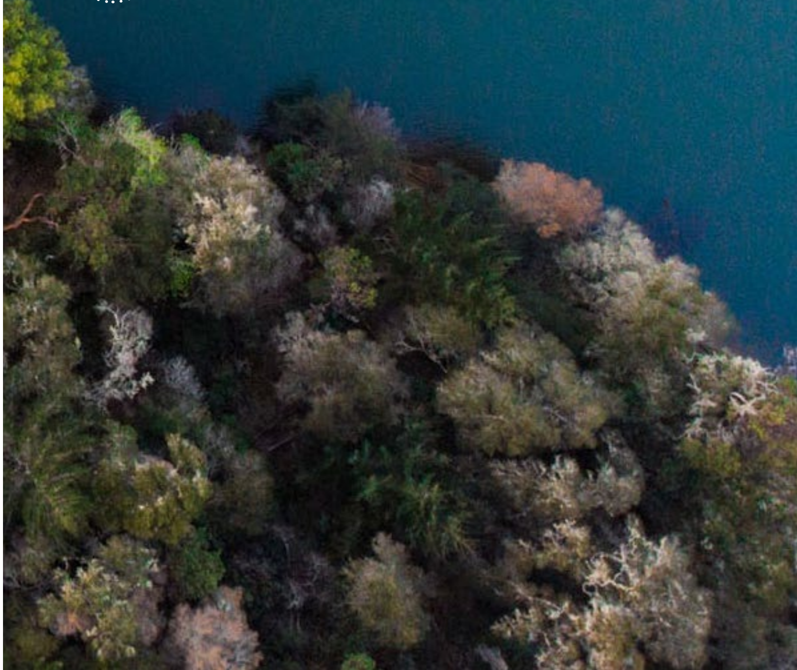
Phase 4: IMPLEMENTATION

- Ongoing communication with stakeholders
- Budgeting and resourcing
- Systems and data collection
- Utilisation of BEPS 2.0 tools for compliance phase
- Consider complexities on future business arrangements, such as JVs and incentives

BEPS 2.0 tools

Key areas where technology tools can support the process:

1. **Input of relevant data on individual country / company level.**
2. **Automatic calculation of Top Up Tax.**
3. **Amended Top Up Tax considering substance-based income exclusion.**



Phase 5: FILING

Timelines

Q4 2022
Agree BEPS 2.0 action plan for your business

By 31 December 2022
Communicate internally high level BEPS 2.0 impact re potential tax cost (factor in increasing tax rates in certain low tax jurisdictions), systems and resource perspective, as direct impact is one year away

By 31 March 2023
Model tax impact based on historic results (leveraging CBC Reporting) and future projections

By 30 June 2023
Based on modelling project, identify restructuring opportunities and requirements related to whether low tax jurisdiction in the group are strategic locations regarding assets, functions and risks

By 30 June 2023
Based on modelling project, identify information gaps then review systems in place and identify what tools and resource is required to comply

From 1 January 2024
Accrue additional BEPS 2.0 taxes as they apply

30 June 2025
Register with the Tax Authorities

30 June 2026
First Pillar 2 return to be filed in the UK for 2024

31 March 2027 and beyond
Second Pillar 2 return to be filed in the UK for 2025, then same day each year going forward

* Based on UK draft legislation as at November 2022.

Contact us | tax.desk@bakertillygts.com

Baker Tilly's Global Tax Solutions group work with clients in multiple tax jurisdictions to streamline and solve compliance issues. To further discuss the topics raised in this case study, or for any other global tax matters, please contact us.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