ADVISORY | INDUSTRY INFORMATION

Pillar Two – global minimum taxation & Ireland

The following is a high-level summary of Pillar Two and its implementation in Ireland, including, in particular, the potential application of Pillar Two to Irish securitisation SPVs and regulated investment funds. It is intended for information purposes only and does not constitute legal advice. For more information on this, please contact any member of Walkers' Tax Group in Ireland or your usual Walkers' contact. Walkers has a team of dedicated professionals in Ireland and across our other offices where legislation implementing elements of Pillar Two is at various stages of implementation such as Bermuda, Jersey and Guernsey.

Overview of Pillar Two & Ireland

Pillar Two is one element of an October 2021 agreement by 137 jurisdictions (including Ireland) in the OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting, the overall aim of which is to reform the international tax framework as it applies to large corporate groups.

The Pillar Two rules, known as the Global Anti-Base Erosion Rules (GloBE Rules), are designed to ensure that MNEs pay a minimum level of tax on the income arising in each jurisdiction in which they operate. The rules seek to impose a top-up tax on profits arising in a jurisdiction whenever the ETR, determined on a jurisdictional basis, is below the minimum rate of 15%.

Ireland transposed Council Directive 2022/25/23 (the Minimum Tax Directive) into Irish law in Finance (No.2) Act 2023. The Irish Pillar Two rules are in force for in-scope entities for accounting periods commencing on or after 31 December 2023.

The Irish Pillar Two rules introduce a minimum effective tax rate ("**ETR**") of 15% for MNE groups or large-scale domestic groups with a global turnover of €750 million or more in two of the previous four fiscal years (the "**revenue threshold**").

A group will generally exist for the purposes of the rules where there is consolidation for accounting purposes (or would be under an acceptable financial accounting standard), and also includes entities that are excluded from consolidation solely based on their small size, on materiality grounds, or on the grounds that they are held for sale, as well as entities that are not part of a group but that have one or more permanent establishments in another jurisdiction. Consolidation for these purposes generally means consolidation on a line-by-line basis. The Irish Pillar Two rules are broader than the Minimum Tax Directive and can also apply to standalone entities (i.e. entities that are not part of a consolidated group) above the revenue threshold (subject to any applicable exemptions).

How the rules operate

Pillar Two operates through a series of interlocked rules, being an income inclusion rule (the "**IIR**"), an undertaxed profit rule (the "**UTPR**"), and an optional qualified domestic minimum top-up tax ("**QDMTT**").

The rules apply in a specific order and apply on a jurisdictional basis to levy tax where the ETR for a jurisdiction is below the minimum rate of 15%.

Effective Tax Rate (ETR)

The ETR for Pillar Two is calculated on a jurisdictional basis. The calculation is based on a blended rate that takes into account the income (or loss) and tax paid for all constituent members in the relevant jurisdiction. The income (or loss) calculation is based on consolidated financial accounts as adjusted in accordance with specific rules to ensure a harmonised base across jurisdictions and with the intention to better align the financial accounts for tax purposes. For example, when calculating the ETR, the rules require, inter alia, that transactions between constituent entities of an MNE group located in different jurisdictions are consistent with arm's length principles – an adjustment will be required to the ETR computation where this is not the case.

Specific rules also apply to calculate the tax attributable to such income, including what taxes can be taken into account (covered taxes), and to address temporary differences in the recognition of income or loss for financial accounting and tax purposes.

In addition, in the case of a minority-owned constituent entity ("**MOCE**") the ETR is to be calculated on an entity basis rather than a jurisdictional basis. A MOCE is a constituent entity of an MNE group in which the UPE has a direct or indirect ownership interest of 30% or less, which should be the case, for example, for an orphan entity where notes issued by the orphan entity are not accounted for as equity.

IIR

The IIR is the primary Pillar Two rule and requires the ultimate parent entity ("**UPE**") in the group to determine whether its constituent entities (e.g. branches and subsidiaries included in its consolidated financial accounts) in any other jurisdictions have an ETR below 15% on a jurisdictional basis for the relevant period, and if so, apply to IIR to pay its share of top-up tax relating to such low-taxed entities. The net effect is to seek to ensure that a minimum 15% tax rate applies on the consolidated profits in each jurisdiction in which an in-scope group operates. A substance-based income exclusion also applies whereby a percentage of expenditure on tangible fixed assets and payroll costs in a jurisdiction reduces profits on which top-up tax is imposed. There are also a number of exclusions for certain entities as well as an exclusion for international shipping income.

The IIR is in effect in Ireland for fiscal years commencing on or after 31 December 2023. As further explained below, provided that Ireland's qualified domestic top-up tax (“**QDTT**”) obtains "qualified" status, the IIR should only apply in an Irish context to Irish resident UPEs. If the jurisdictional ETR for any jurisdiction in which a constituent entity of the Irish UPE is located is below 15% and that jurisdiction does not have a "qualified" status QDMTT, the Irish UPE will pay an additional amount of tax in Ireland through the IIR. Any low-taxed Irish resident entities that are in scope of Pillar Two but are not themselves UPEs would be subject to QDTT in Ireland rather than any top-up tax being collected by another jurisdiction through the IIR (or UTPR, if applicable).

UTPR

The UTPR is designed to operate as a backstop to the IIR by reallocating any residual top-up tax to group entities in jurisdictions implementing Pillar Two. Where the full amount of top-up tax is not collected under an IIR (for example, if a group does not have a UPE located in a jurisdiction that has implemented Pillar Two) the liability for the top-up tax falls on the jurisdiction(s) where other group companies are located that have implemented the Pillar Two rules and is to be collected via the UTPR.

The UTPR comes into effect in Ireland for fiscal years commencing on or after 31 December 2024. There are certain limited circumstances where it may apply on or after 31 December 2023.

Ireland's Qualified Domestic Top-up Tax (QDTT)

Ireland has also implemented its own domestic top-up tax regime which is in effect for fiscal years commencing on or after 31 December 2023. A QDMTT is intended to allow the jurisdiction where an entity or group is based to retain primary taxing rights instead of allowing other jurisdictions to collect such additional tax by way of the IIR and/or the UTPR. The Irish QDTT should enable Ireland to preserve its primary right of taxation over profits arising in Ireland and has been designed to obtain "qualified" status under the OECD Inclusive Framework peer review process and to be eligible for the QDMTT Safe Harbour (for which confirmation is awaited). Where a domestic top-up tax regime is not treated as a QDMTT Safe Harbour, the domestic top-up tax paid should be available as a credit against any Pillar Two minimum tax liability under another jurisdiction's IIR / UTPR as applicable.

The Irish Pillar Two rules also go beyond both the GloBE Rules and the Minimum Tax Directive to extend the application of the QDTT to Irish non-consolidated entities that exceed the revenue threshold on a standalone basis.

Transition Rules

Transition rules apply to simplify the application of the rules and reduce compliance burdens when in-scope groups first come into the scope of the Pillar Two rules. In an Irish context, these provisions may apply in certain circumstances to relieve any QDTT liability for the first five years of entities falling within the scope of the provisions for the first time. For example, in the case of an Irish entity that is a member of an MNE group, no Irish QDTT liability should arise for the first five years of the initial phase of the international activity of the MNE group, starting from the first day of the fiscal year in which the MNE group falls within the scope of the Irish Pillar Two rules for the first time. In the case of standalone non-consolidated entities, no Irish QDTT liability should arise for the first five years starting from the first day of the accounting period in which the entity falls within the scope of the Irish Pillar Two rules for the first time. The €750 million revenue threshold must be met for at least two accounting periods before an entity falls within scope. In practical terms, this should mean that for any newly incorporated Irish entities that are likely to exceed the revenue threshold but remain outside of any consolidated group for Pillar Two purposes, it should be at least seven years from their incorporation before they are subject to a QDTT liability, if any.

Impact of Pillar Two on Irish Securitisation SPVs

Irish securitisation entities are commonly known as Section 110 companies, being Irish resident companies which qualify to be taxed under the provisions of Section 110 of the Taxes Consolidation Act 1997 of Ireland, as amended.

Where the revenues of a Section 110 company for an accounting period equal or exceed the revenue threshold in two of the previous four accounting periods, either on a standalone or on a consolidated basis taking into account the revenues of all members of the consolidated group, the Section 110 company will, subject to certain exceptions, be in scope of the Irish Pillar Two rules.

A Section 110 company is subject to corporation tax in Ireland at 25% on profits calculated in accordance with special rules and should typically have an effective tax rate greater than 15% for Irish tax purposes. If Pillar Two adjustments are not required, no top-up tax should apply in Ireland to the profits of the Section 110 company.

However, Pillar Two prescribes specific rules to calculate the qualifying income or loss of in-scope entities which are complex and can result in the ETR of an entity being considerably different to its effective tax rate under domestic corporation tax provisions. Differences could arise, for example, to the extent that the mandatory application of a different financial accounting standard results in adjustments to the qualifying income of a Section 110 company for Pillar Two purposes, or if the qualifying income of a Section 110 company is increased as a result of an arm's length adjustment being applied to profit participating interest payable to constituent entities located in other jurisdictions. Where applicable, this could impact the ETR of the Section 110 company for Pillar Two purposes and bring it below the minimum 15% rate. In addition, as the ETR is generally calculated on a jurisdictional basis, the blended jurisdictional rate takes into account the income and tax paid for all constituent members in the same jurisdiction. This can be relevant, for example, for Section 110 companies engaged in domestic securitisations that are consolidated for financial accounting purposes with other Irish based entities. However, in circumstances where a Section 110 company is a MOCE (i.e. consolidated but its UPE has a direct or indirect ownership interest of 30% or less), the ETR is to be calculated on an entity basis rather than a jurisdictional basis which can be helpful where a Section 110 company is part of a domestic group. An orphan Section 110 company whose notes are not accounted for as equity should generally be a MOCE for these purposes. Accordingly, a detailed consideration of the Irish Pillar Two provisions will be required to confirm whether a Section 110 company is in scope of Pillar Two either through consolidation with an in-scope MNE group or large-scale domestic group, or otherwise on a standalone basis if its income is above the revenue threshold, and the impact of Pillar Two, if any.

In practice, it is expected that the significant majority of Section 110 companies should be outside of the scope of Pillar Two on the basis that they are typically structured as orphan bankruptcy-remote entities, are often not part of a group for Pillar Two purposes (for example, by not being consolidated on a line-by-line basis and not being excluded from consolidation solely based on their small size, on materiality grounds, or on the grounds that they are held for sale), and would be unlikely in most cases to have revenues in excess of €750 million on a standalone basis. However, where a Section 110 company is in scope of the Irish Pillar Two rules, a more detailed consideration will be required to confirm the impact of Pillar Two, if any. This analysis may also be impacted in the future depending on the manner in which Ireland implements June 2024 OECD Administrative Guidance with respect to securitisation entities, as explained further below.

OECD Administrative Guidance & Securitisation Entities

The OECD released updated OECD Administrative Guidance on 17 June 2024 which includes guidance on securitisation entities (the "**Guidance**") and, in particular, addresses the treatment of SPVs which are part of an MNE group under a jurisdiction's QDMTT regime. The Guidance covers various administrative aspects of the application of the Pillar Two rules and includes specific guidance on the treatment of securitisation entities which are consolidated into an MNE group under a QDMTT regime. The Guidance notes that the question of whether securitisation entities are consolidated is often not clear cut and there are many cases where the question of whether to consolidate a securitisation entity into its originator's group is difficult and nuanced, and that the outcome can have significant implications under the GloBE rules.

In the context of the application of QDMTT to a securitisation entity, the Guidance states that the Inclusive Framework agrees that jurisdictions adopting QDMTTs are not required to impose top-up tax liabilities on securitisation entities used in securitisation transactions. While the Guidance does not propose an exclusion similar to that for investment funds / excluded entities (discussed further below), it instead provides optionality for jurisdictions as to the treatment of securitisation entities under their own QDMTT regimes. These range from no change to domestic Pillar Two rules so that securitisation entities remain within the scope of the QDMTT, where applicable; imposing any top-up tax liability in respect of the income of an in-scope securitisation entity on another constituent entity of the MNE group within that jurisdiction that is not a securitisation entity; or deciding to not impose a QDMTT on securitisation entities by excluding them from the scope of the QDMTT in which case QDMTT Safe Harbour Status would not apply and the income of securitisation entities may be subject to the IIR and/or UTPR elsewhere depending on the facts and circumstances of the group.

The Guidance also recognises the challenges to securitisation transactions under the Pillar Two rules, including the risk of the bankruptcy remoteness and the associated credit rating of a securitisation entity being significantly undermined if it became liable to top-up tax charges under the Pillar Two rules by reference to a top-up tax exposure elsewhere in the originator group, or the Pillar Two rules resulting in top-up taxes being payable that are not commensurate with the economic profit of the securitisation entity due to the treatment of hedging arrangements or as a result of securitisation entities not usually recognising deferred tax for accounting purposes. The Guidance notes that the Inclusive Framework will consider issuing further Administrative Guidance to ensure that the use of securitisation transactions (and arrangements of the kind entered into by securitisation entities that give rise to fair value movements) do not result in MNE groups paying top-up taxes that are not commensurate with the economic profit that the securitisation entity has made from the activities. While it is expected that the Guidance will be formally implemented in Ireland, the timing and manner in which it is implemented and therefore the treatment of in-scope consolidated Section 110 companies remains to be confirmed.

Section 110 companies with revenues below the revenue threshold and that are not part of a group for Pillar Two purposes, or which are part of a group where consolidated revenues are below the revenue threshold are not within the scope of the Irish Pillar Two rules.

Pillar Two & Irish Regulated Funds

Subject to certain exemptions, Irish regulated funds that fall within the definition of an "investment undertaking" for Irish tax purposes (such as an ICAV) will be within the scope of the Irish Pillar Two rules where they meet the revenue threshold on a standalone or consolidated basis. An "entity" for the purposes of the Irish Pillar Two rules includes any legal arrangement of whatever nature or form (e.g. a company or a partnership) that prepares separate financial accounts. This means, for example, in the case of an ICAV that is an umbrella fund, each sub-fund could be considered part of a separate group for Pillar Two purposes if each sub-fund prepares its own financial statements at sub-fund level and there is no consolidation as between sub-funds. If so, each sub-fund and entity with which it is consolidated, if any, should be considered as part of a separate group for the purposes of the Irish Pillar Two rules and application of the revenue threshold.

There is exemption from the application of the Pillar Two rules for an "investment fund" (as defined) that is a UPE (i.e. the top consolidating entity of an MNE group and which is not consolidated into any other entity). To be considered an "investment fund", an entity must satisfy a number of conditions, each of which must be met,

- it is designed to pool assets (which may be financial and non-financial) from a number of investors (some of which are not connected);
- it invests in accordance with a defined investment policy;
- it allows investors to reduce transaction, research, and analytical costs, or to spread risk collectively;
- it is primarily designed to generate investment income or gains, or protection against a particular or general event or outcome;
- investors have a right to return from the assets of the fund or income earned on those assets, based on the contributions made by those investors;
- the entity or its management is subject to a regulatory regime in the jurisdiction in which it is established or managed (including appropriate anti-money laundering and investor protection regulation); and
- it is managed by investment fund management professionals on behalf of the investors.

It is expected that most genuine collective investment vehicles will fall within the definition of an "investment fund". However, there are certain conditions that may not be met by certain structures, in particular the requirement for the fund to be designed to pool assets from a number of investors (some of which are not connected). Bespoke 'fund-of-one' structures may not meet this condition, although where the sole investor is a feeder fund for unconnected investors to invest into the underlying fund one would expect the condition to be met. Further guidance from the OECD and/or the Irish Revenue Commissioners may address this and other points with respect to the treatment of investment funds generally which should provide some welcome clarity for the investment funds industry as to the application of Pillar Two.

Irish Regulated Funds

Where an Irish regulated fund that is a UPE meets the "investment fund" conditions it will be considered an "excluded entity" and out of scope of Pillar Two irrespective of whether it meets the revenue threshold. An "excluded entity" for these purposes also includes 95% or more investment subsidiaries of such UPE investment funds, as well as entities which are at least 85% owned by UPE investment funds where substantially all of their income is derived from dividends or gains that are excluded from the calculation of income for the purposes of the Pillar Two rules.

An Irish regulated fund that it not a UPE but meets the "investment fund" conditions will be considered an "investment entity" but not an "excluded entity" under Pillar Two. However, in order to preserve the tax neutrality of Irish regulated funds, "investment entities" are expressly excluded from the Irish QDTT.

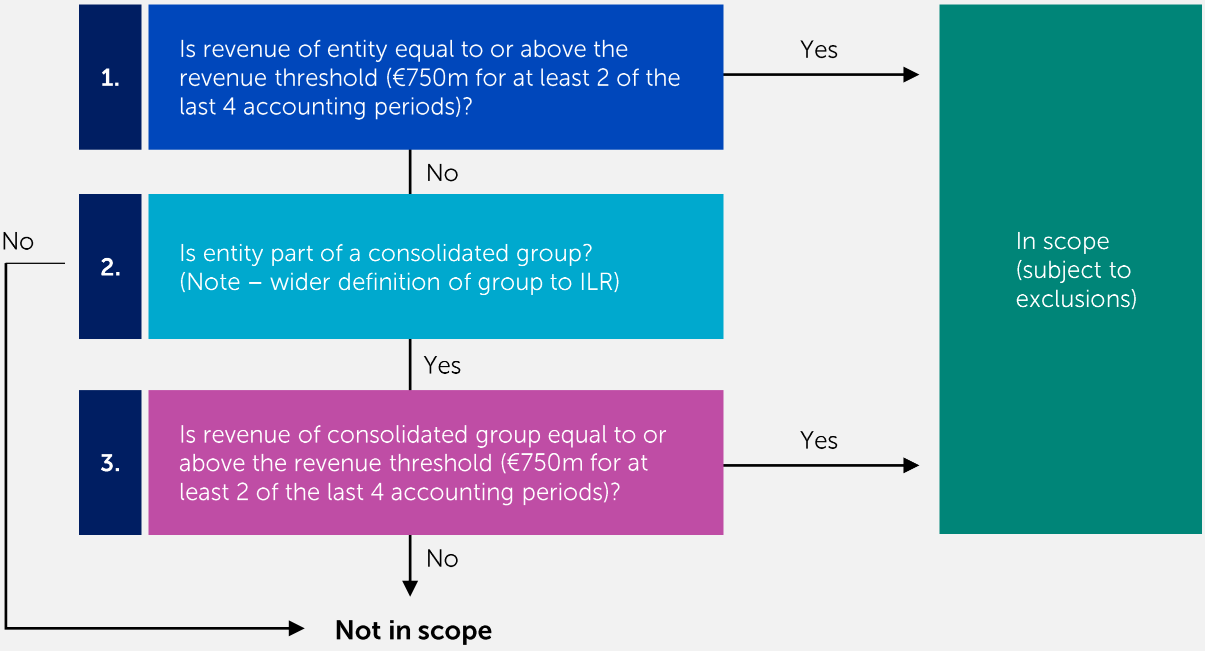
Accordingly, Irish regulated funds that meet the "investment fund" conditions should be excluded from Pillar Two either as an "excluded entity" in the case of funds that are UPEs, or by way of specific exemption from QDTT in the case of "investment entities" that are not UPEs. Nevertheless, while a non-UPE "investment entity" will not be subject to tax under a QDTT, IIR or UTPR, where the fund is part of a consolidated MNE group, other entities within the MNE group may have a tax liability under the IIR or UTPR rules in their home jurisdiction on behalf of the fund.

In practice, it is likely that the many Irish regulated funds should fall outside of the scope of Pillar Two, either because they are not consolidated and fall below the revenue threshold, or they qualify as "investment entities", and as "excluded entities" where they are themselves a UPE. However, it should not be automatically assumed that fund structures are fully outside the scope of the Irish Pillar Two rules and an analysis will be required particularly where consolidation is likely. Further guidance from the OECD and/or the Irish Revenue Commissioners may also provide clarification. In addition, going forward we can expect to see disclosure of Pillar Two risks in applicable offering documents and/or consolidation representations being sought from investors.

Conclusion

Pillar Two has entered the common lexicon very quickly and we expect it to feature prominently for large corporate groups and in the context of large cross-border transactions and investment structures for some time as revenue authorities, practitioners and in-house tax and compliance teams navigate the Pillar Two rules and their application in practice. Further Administrative Guidance and updated Commentary will be issued by the OECD and adopted by implementing jurisdictions over time to address specific fact patterns and as the application of the Pillar Two rules in practice continues to develop.

Pillar Two in Ireland – Scope Questions



1. Is revenue of entity equal to or above the revenue threshold (€750m for at least 2 of the last 4 accounting periods?

2. Is entity part of a consolidated group? (Note – wider definition of group to ILR)

3. Is revenue of consolidated group equal to or above the revenue threshold (€750m for at least 2 of the last 4 accounting periods)?

In scope (subject to exclusions)

Not in scope

Further information

We practice Bermuda, British Virgin Islands, Cayman Islands, Guernsey, Irish and Jersey law from an international network of ten offices across Europe, the Americas, Asia and the Middle East. For more information, please get in touch with your usual contact at Walkers or any of the contacts in your region listed below.

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