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Pillar Two Global Minimum Tax

Impacts and Implications for Private Equity

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1. Rules Complexity

The Global Anti-Base Erosion (GloBE) rules, implementing Pillar Two, are complicated. The GloBE rules include multiple, interconnected, component parts. Not all the components are being implemented at the same time, and not all jurisdictions have legislated to introduce the GloBE rules. To complicate matters further, the Model GloBE rules have been supplemented by three sets of formal Administrative Guidance, published by the OECD. The Administrative Guidance, however, does not (generally) have legal effect in the countries that have already implemented the GloBE rules. Tracking the timing and extent of implementation of the GloBE rules, and assessing subtle differences, across relevant jurisdictions is critical, but remains exceptionally difficult.

2. Scope

Where implemented, the GloBE rules are intended apply to any multinational group (essentially all entities included in a set of consolidated accounts under an Acceptable Financial Accounting Standard (AFAS)) with annual revenues of at least €750m or more. All entities in such a group are potentially within the scope of the GloBE rules and could be subject to a liability to a top-up tax where their effective rates of tax fall below 15%. In the private equity market, entities in a fund portfolio, which are included in consolidated accounts, with annual revenues in excess of the threshold, will be potentially subject to the rules. Equally, depending on the structure of the fund, and the way fees, carried interest and co-invest arrangements operate, the management entities in the fund itself could also be in scope.

It being a key scoping point for Pillar Two, PE funds will therefore need to critically assess whether their reliance on the investment entity consolidation exemption is robust.

3. Exclusions and safe harbours

The GloBE rules provide for various exclusions and safe harbours. These include a special exclusion for certain investment entities that meet certain criteria, another requiring an assessment of substantial economic activities, de minimis exclusions, plus administrative simplifications that may ease compliance obligations in certain circumstances. The availability of, and desirability of taking advantage of, these safe harbours and exclusion will need to be carefully assessed by entities in affected groups.

4. Effective Tax Rate (ETR) Calculations

Where they apply, private equity funds will need to be proficient in accurately calculating the relevant ETR of each in-scope entity operating in each of the jurisdictions that the fund has operations or investments. The calculation is complex, involving several parameters, including adjustments for deferred taxes, assessing the eligibility (for the purposes of the GloBE rules) of tax credits and incentives, and many other variances across jurisdictions. Calculating ETRs will, however, be critical because it will reveal the extent of the group's (and so the fund's) potential exposure to Pillar Two top-up tax(es).

Within a PE context, it will be important to review the treatment of all items of income (positive and negative) of the fund incl. the partnership profits by the LPs/GPs, management fees, carried interest payments etc.

5. Double Taxation

Private equity portfolios caught within the scope of the GloBE rules will, inevitably, cover multiple jurisdictions. Due to a combination of the way in which the component parts of the GloBE rules work, the differing pace of implementation, and subtle differences in the way the rules are implemented domestically, there is a genuine risk of increased double taxation across the entities making up the fund. Identifying, managing, and addressing this risk appropriately will need careful and comprehensive analysis and consideration.

6. Fund Structures and Investment Strategies

The introduction of GloBE rules could affect certain tax benefits traditionally secured by private equity funds pursuant to the way their cross-border investments and transactions have been structured. The introduction of the global minimum tax might make the conventional practice of channelling investments through low-tax jurisdictions less advantageous. Similar considerations apply to traditional fund structures. It will be imperative to conduct a thorough analysis of a fund's current structure, funding strategies, and investment efficiency. In some cases, private equity funds may need to reassess those strategies, structures and arrangements. The potential for substantial modifications and restructuring should not be ignored.

7. Tax Data Compilation and Reporting

Ensuring compliance with the GloBE rules will need meticulous collation and reporting of granular tax data on a jurisdiction-by-jurisdiction basis. This challenge is potentially particularly pressing for private equity funds due to the traditional, international, fund and portfolio holding structures. Beyond collating the necessary data, compliance with the GloBE rules will require additional restatements beyond normal tax compliance processes. In some cases, compliance timelines do not align with the usual domestic corporate tax reporting and payment windows. Finally, the GloBE rules mandate the submission of a specialist information return, adding to entities' compliance burden.

8. Compliance Cost

The combination of the complexity of the rules, the need to assess and model the impact of their application on the overall tax-efficiency of the fund, and the extended reporting and compliance obligations, will, inevitably, result in a marked increase in compliance costs (alongside additional top-up tax liability and double tax exposure) for a private equity funds. This will inevitably affect management fee structures and, therefore, could justify a review of the overall commercial arrangements of the fund.



9. Tax Software and Technology

The complexity of the GloBE rules, their data-dependent features, and the consequent compliance burden and resource requirements, suggests that private equity funds should consider adopting (or evolving existing) appropriate tax technology and software solutions to help meet the challenges. Properly integrated into a fund's administrative processes, tax technology and software can, among other things, help collect the necessary data, assess the impact of the rules, and complete compliance calculations and reporting submissions.

10. Empowering the Tax Department

Irrespective of the help afforded by tax technology solutions and tools, the complexities of the GloBE rules will also require building capacity and abilities within a private equity fund's existing tax department. This will include not only enhancing tax technical competencies on Pillar Two globally, but also building expertise in data analysis and software management. Multiple strategies are available to private equity funds to build this expertise including recruitment, in-house training, and employing outsourcing solutions.



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