Tax Reimagined: *practical Pillar Two approach*

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On December 20, 2021, the OECD published the Inclusive Framework on Base Erosion and Profit Shifting (BEPS) report, involving 137 countries. The report describes the so-called Pillar Two rules and introduces a 15% global minimum tax for Multinational Enterprises (MNEs) with an annual revenue of above €750 million. On December 22, 2021, the European Commission published a draft EU Directive to incorporate the Pillar Two rules into EU law.

This memorandum outlines the main considerations for companies in scope of the Pillar Two rules so that they will be ready for this additional compliance obligation. To help organizations prepare, we will look at these considerations from three different perspectives, i.e. a tax director's perspective, a tax assurance perspective and a data management perspective.

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Part 1
Tax director's perspective

1.1 Yet another compliance obligation

What exactly does Pillar Two involve? Is it a compliance obligation that is typically handled by an organization's tax department? Does it need to be addressed at centralized or decentralized level? Will it bring a lot of extra work? Will it raise new questions or trigger new tax risks?

If we assume that your organization is subject to Pillar Two, you, as a tax director, will have three concerns: you want to be compliant with the new requirement, you want to know whether and where your organization faces tax compliance obligations and you want to minimize the burden for the business and for the tax team.

As a tax director, you are always looking for the most efficient way to meet each compliance or reporting obligation. In doing so, you identify the data you need and the sources from which to obtain that data. A tax team is a huge data consumer; it requires vast data sets to meet the many compliance and reporting obligations the team has, including information on group structure, financial results, intercompany transactions, third-party transactions, accounts payable and receivable, tax expenses, payroll, stock compensation, warehouse processes and more. All this data feeds into highly diverse outputs, such as tax returns, tax provision calculations, SAF-T filings, country-by-country reporting and DAC7, as well as outputs for self-imposed reporting requirements regarding transparency, ESG, carbon tax and so on.

1.2 Advancements in data discussion and tax risk management

In the past years, the tax authorities have started to demand more and more data. That dynamic is now changing. Their focus is shifting to ensuring the integrity of systems and controls governing the data. Who is responsible for the data and data quality? Tax from a risk management perspective is also taking on a new dimension. It could be argued that a new sense of risk has emerged.

Transparency is the buzzword, but what does that actually mean for tax directors and their teams in their day-to-day work? And what is their experience with transparency? Transparency simply means that tax directors are expected to provide more reports to more stakeholders. As a tax director, you begin to realize that there should be no differences between the reports. Data points that are being used for one document should ideally being re-used rather than being collected from a different source for another report – potentially leading to reconciliation differences across different tax reports. Is my CbCR in line with the local declarations? This reconciliation also raises the question of whether we actually use the same definitions. For example, what is income? With the introduction of Pillar Two, there are

now broadly speaking three income statements that have to be operated: financial statements (consolidated and stand alone), corporate tax returns, GloBE income.

And now for Pillar Two. How can you be compliant, gain a proper understanding of the tax effects and risks, and organize the entire process efficiently?

In the second part of this memorandum, we will take a closer look at Pillar Two, not from the qualitative perspective of whether and to what extent an organization should meet this new compliance requirement, but from the angle of what it takes to meet it. What data is needed, what risks do we see and how can they be mitigated?

In Part 3, we will introduce a practical approach from a data perspective. We will abstract from the introduction of Pillar Two and look at the new compliance obligation as just another item in a series of obligations a tax team is expected to comply with. In 2016, new TP compliance obligations with local and master files were imposed and IFRIC 23 tax accounting rules were implemented in 2019. GRI 207: Tax was introduced in 2021. Pillar Two and DAC7 are planned for 2023, before Public CBCR will come into effect in 2024.

Organizations should move away from looking at compliance obligations on an individual basis and take a critical look at their internal tax governance and data management models. Questions to ask include: do we use the right data and the correct definitions? Can we guarantee the quality of the data? Who is responsible for the data and data quality? Can we achieve efficiency by combining compliance processes? In Part 3, we will introduce a data-centric approach for all compliance obligations that allows for efficient add-ons of new obligations going forward.

Part 2
Tax assurance perspective

2.1 Introduction

With the introduction of Pillar Two, an organization's tax function faces challenges. The new regulation potentially affects all entities that are part of the consolidated financial statements, thereby creating an additional compliance burden. In this section, we will address three tax assurance topics that are relevant in the context of Pillar Two:

- Roles and responsibilities
- Process with work instructions
- Pillar Two key data points

The complexity under Pillar 2 arises where reconciliations have to be made from the financial accounting net income to GloBE Income and from income taxes as reflected in the financial accounts (e.g. IAS 12 or ASC 740) to the Covered tax recognized under GloBE. Complexity also arises when the GloBE Income and Covered taxes are determined, but for GloBE purposes, the amounts have to be alloated to a different entity. This calls for strong tax data management and Pillar Two operating procedures with controls. Effective management of Pillar Two requirements starts with a clear understanding of all roles and responsibilities (see 2.2 below) and the different Pillar Two process steps (see 2.3 below).

2.2 Roles and responsibilities

The Pillar Two rules are likely to fall within the responsibility of the tax function. This requires a new process with accordingly assigned roles and responsibilities.

One of the first questions an organization should ask itself is how it wants to organize Pillar Two: at centralized or decentralized level? A centralized model calls for a more mature tax infrastructure where data is easily accessible and GloBE calculations can be made at group level. This works differently in a decentralized model, where an infrastructure with Pillar Two technical skills should be available at local level. Our view is that, while Pillar Two processes should be coordinated centrally, the complexity of the rules also requires local input. For that reason, some level of decentralization will have to be considered.

Another question that should be addressed in this context is the level of available resources. Where an MNE Group is considering to have the Pillar 2 integrated with their quarterly tax accounting process, this puts more pressure on the tax function. Even when the MNE Group aims for an annual process adequate resources should be made available. Here we already see a trend where MNE's are considering to (partially) outsource the Pillar 2 activities varying from 'review only' of the GloBE ETR to full outsourcing of the data extraction and the GloBE assessment. In both situations, the data must be unlocked to determine the GloBE Income and Covered taxes on a jurisdictional level.

For effective tax risk management procedures, the tax function should be able to commit to these new sets of rules. That means that roles and responsibilities should be assigned. Before doing so, officers needs to be sufficiently aware of what is expected from them. Training may be needed. At the same time, consideration should be given to soft controls, such as clarity and sufficient resources at group and local level in terms of data, technology and staffing.

2.3 Process with work instructions

Once an MNE has determined the roles and responsibilities with a high level design of how to organize it (e.g. Pillar Two \ blueprint), the operating procedure needs to be worked out in detail. The Pillar Two operating process consist of a number of standard process steps, i.e. Plan, Gather, Analyze, Deliver and Evaluate. The company will have to determine how it wants to interpret each step.
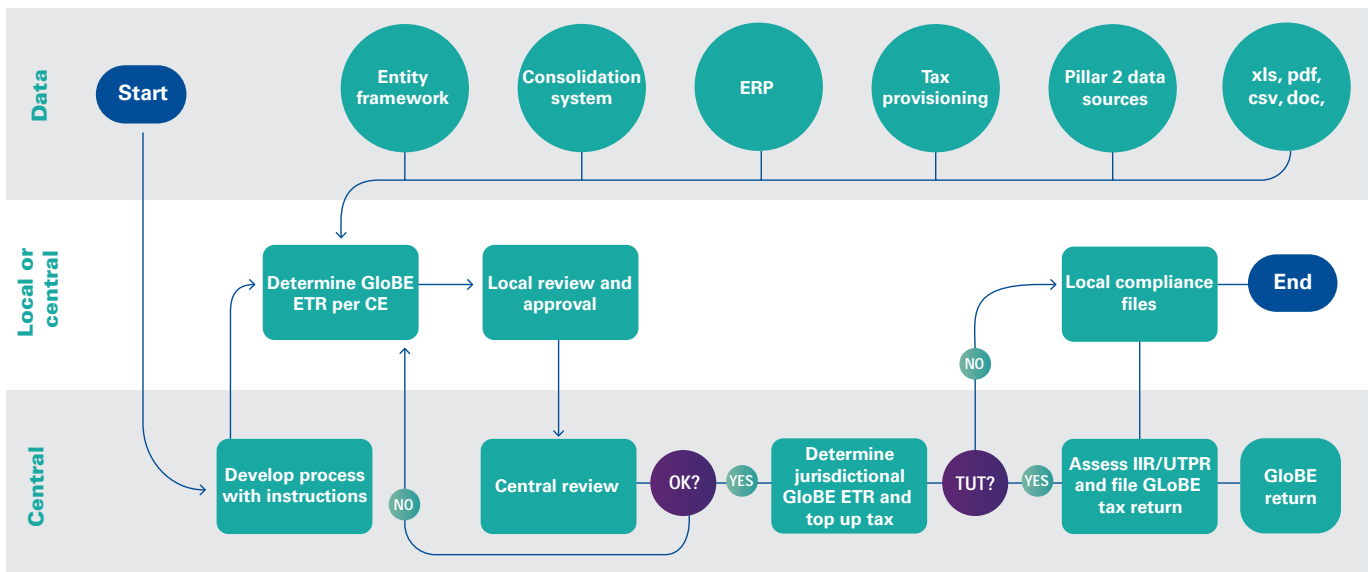
Plan: The company needs to determine and agree on the frequency it wants to make the GloBE ETR computation. From an initial assessment, the company may have concluded that the financial impact is rather limited and that an annual compliance and reporting program is sufficient. A quarterly program may be considered when it can not be excluded that a GloBE liability arises via the IIR or UTPR for a certain period. In that case, it is likely that the MNE wants to plan the GloBE operating process in line with the periodic tax accounting process. At the same time, the MNE Group will also have to determine the annual compliance program in order to meet any domestic compliance deadlines. For that reason, understanding the local Pillar 2 compliance requirements is a necessity. The compliance program will include clear instructions with roles and responsibilities assigned, a timetable and expected deliverables for the constituent entities in scope.

Gather: In this phase, all relevant information that is required for the preparations of the in-scope constituent entities is collected. An efficient method for data collection and validation (i.e. automated or manual) will be agreed during the planning phase. A Pilot run may be helpful in this area as this provides valuable information on which data is required and where in the organizations this is captured. Based on our initial assessment, we have already identified over 300 different data elements that are needed under Pillar 2.

There are two choices of gathering the data:
- Local data collection and processing
- Centralized data collection and processing

Summarized Pillar 2 process

Process	Local	Central
Data sourcing	(✓)	✓
Data validation	✓	
Prepare & analysis	✓	
Review & approval		✓
Reporting & submission		✓
Evaluate	✓	✓

MNEs can develop their own procedures for data retrieval, cleaning and validation. They can opt to do so using low-key Pillar Two reporting templates or using cutting-edge data management solutions. Many organizations already use data discovery models. The tax function should therefore make use of what's already in place.

Analyze: The GloBE ETR and top-up tax with IIR/UTPR charging provisions are determined based on the data that has been gathered. The data is loaded into a Pillar 2 calculation model. This data load can be automated via using automated data transformation solutions, but manual processing is also still a possibility. In that respect it should be noted that a lot of data needs to be captured and stored, such as deferred tax asset recognized for GloBE purposes or items of income or expenses that are excluded from the GloBE income and covered tax computation. As such, the MNE Group should consider to make use of technology already in place so it can document and analyze the GloBE ETR computation in a structured manner.

Technologies which may already in place for Country By Country Reporting or tax accounting and reporting could be considered to be repurposed for Pillar Two calculation.

For the analysis, the MNE will ensure that all deliverables (i.e. Pillar 2 compliance reports) are subject to basic checks in accordance with established procedures and work instructions. The deliverables are subject to a more tax-related review as well especially where domestic law triggers additional compliance obligations. Depending on the level of outsourcing, officers working with Pillar Two may have to be trained in order to ensure compliance with the rules.

Deliver: Pillar Two compliance reports are made available during this phase to the local tax authorities. Some tax jurisdictions may require a certain level of assurance that the MNE meets its Pillar Two compliance obligations. If so, the report will address the agreed-upon procedures based on which an assurance opinion is issued. Such a report may also include a true up between the tax return and the group tax provision required for tax accounting purposes.

Evaluate: Evaluation is an ongoing process. Especially when tax liabilities arose unexpectedly, improvements should be considered. Evaluation also includes frequent Pillar Two update calls or meetings. Experiences are shared and Pillar Two developments are discussed during this phase.

2.4 Pillar Two key data points

As stated in the previous section, data management is one of the most important aspects of Pillar Two. It covers the flow from data collection, transformation and load into for example a Pillar Two compliance report. Pillar Two data is available across the group, which brings the challenge of unlocking it. While a lot of data is available at group level, it may not provide the granularity that is required for Pillar Two purposes. The tax team has to rely on other data sources that may be available at a regional or local level only.

Overall, we see four main data sources:

Entity structure: this provides information on such aspects as consolidated group companies, tax residency, branches and fiscal unities.

Enterprise Performance Management (EPM) system: this provides financial accounting information, information on the net income or losses of constituent entities, consolidation adjustments and some other data that is required to determine the GloBE Income or Loss and Covered Taxes.
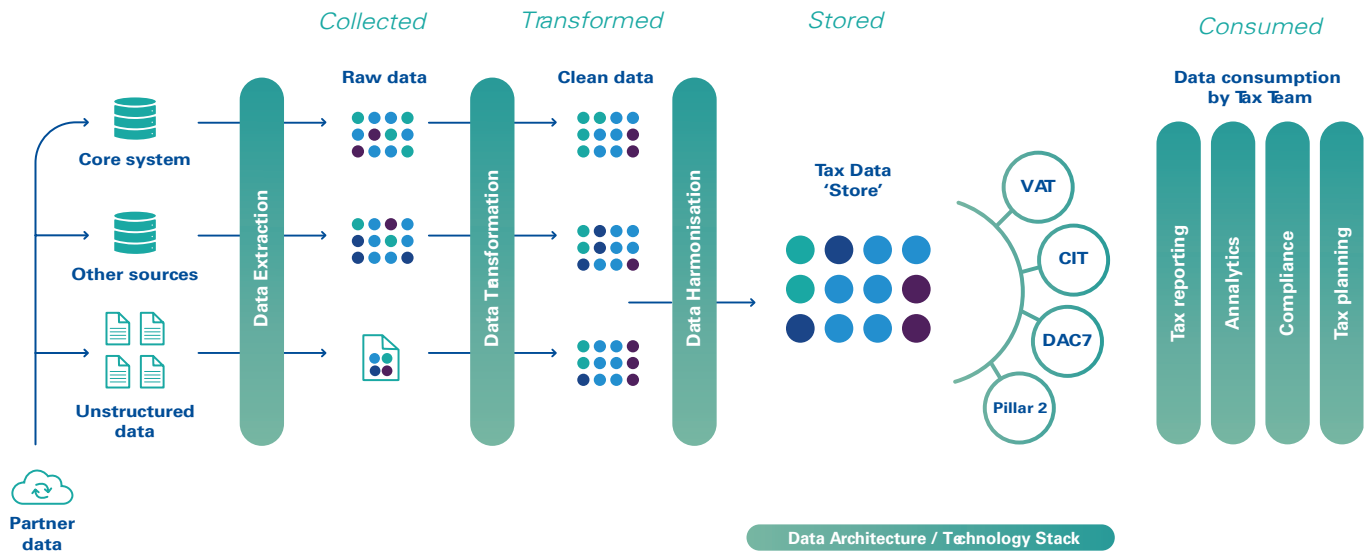
Enterprise Resource Planning (ERP) system: where the EPM system may not provide all data to determine the GloBE Income or Covered Taxes, the ERP system often provides more detailed data.

Tax pack: especially for determining Covered Taxes, the tax pack with underlying data and information provides the final source of data that will help to finalize the GloBE ETR calculation.

Complexities arise when a company has multiple data sources or where the above main data points cannot be linked to the Pillar Two data requirements. With the introduction of Pillar Two, tax data management has been put in the spotlight. We will elaborate on data management in Part 3.

Part 3
Data management perspective

3.1 Growing need for tax data management

As outlined earlier, in-house tax teams face challenges to comply with an increasing number of tax reporting requirements as well as internal reporting requirements. Compliance with tax requirements is nothing new, but lately the level of detail that is expected for meeting these requirements has grown significantly. Tax calculations need to be substantiated with a granular level of detail and a transparent audit trail.

On top of this, the frequency of tax reporting is increasing as well. There is a trend among tax authorities globally to impose close to real-time reporting obligations with a view to gaining better control of tax collections.

In order for organizations to manage their reporting obligations effectively, they need to elevate their tax data management capabilities and reconsider current processes and supporting technology solutions.

But what does it mean to manage tax data?
Tax data management is the ability of tax teams to implement the right governance, processes and technologies that will allow them to access the right data at the right time with the right level of trust that the data is correct and complete.

From a higher perspective, end-to-end tax data management consists of four steps:

1. Data collection: the ability to retrieve the required information from a reliable data source.
2. Data transformation: the ability to automatically convert different types of data into a structured format, removing IT or other system-specific elements, performing automated logical checks and reconciliations, and organizing it in such a way that it can be mapped to a common data model.
3. Data storage: a centralized data store that serves as the "single source of truth" for tax and other teams. Unique data points are stored once and allow tax teams to carry out multiple use cases (re-use of data)
4. Data consumption: this is where a tax team can start using the data to deliver the required outputs, carry out data analytics and tax planning activities, or respond to ad-hoc queries from internal and external stakeholders.

It is our experience that tax professionals currently spend asignificant amount of time (sometimes up to 70%) on data collection and data transformation activities – very often in error-prone Excel spreadsheets – due to an organization's lack of more advanced data management capabilities.

For each of the four data management components, the questions that should be asked include: who is responsible (e.g. Tax or IT), does the data need to be managed centrally or decentrally, is standardization required (and who owns and sets the standard) and which technology (if any) is needed? In an ideal situation, when data is stored in systems, the data collection, transformation and storage processes are highly automated and owned by IT and data professionals, while tax teams own the data for the data store and are only responsible for using this data as part of their day-to-day activities.

3.2 Pillar Two and data management

As explained earlier, the data that is required for Pillar Two may originate from different sources. We distinguish between two types of data inputs:

1. Source extracts: data sitting in a system that is not dependent on another data source, e.g. a trial balance, G/L extract or fixed asset register. This data typically is available in an ERP system.
2. Derived data: data that is produced based on data from source extracts, e.g. audited financial statements or information about tax payments or tax losses. This data can usually be retrieved from EPM consolidation systems or tax packs. Typically source extracts are the main input for systems (like EPM) that produce derived data.

The starting point for designing an effective data management solution for Pillar Two is to develop a 'tax data matrix' that defines the required data points for performing the GloBE ETR calculation and a mapping of these data points to reliable data sources. Ideally, an organization already has a tax data matrix in place against which the Pillar Two data requirements can be assessed. This ensures that the Pillar Two-dictated data points that are being used for other purposes (e.g. CbCR) are re-used rather than being collected from a different source – potentially leading to reconciliation differences across different tax reports.

Data management solutions can be implemented to automate the collection of source and derived data, carry out logical checks, run automated data validation and perform cleaning and transformation routines. The type of solution that is most suitable very much depends on the agreed governance model. If the collection of country/entity data is a local responsibility, for instance, a dynamic questionnaire-based solution would be the appropriate choice. If global data collection under Pillar Two is identified as a central responsibility, it would make more sense to consider the implementation of ERP/EPM-based automated data extractors and to use more sophisticated data modelling technologies to collect and transform data from IT and other systems at centralized level and to generate Pillar Two calculation-ready outputs with limited manual intervention.

In conclusion

Yet another reporting obligation. One in which both tax and accounting knowledge is essential from a content point of view. For the implementation, data management, automation and risk management experience have to added to the project team. In short, Pillar Two requires a multidisciplinary approach.

The authors note that the implementation of Pillar Two does therefore not differ from the implementation of other reporting or compliance obligations. What strikes them is that if the processes for such obligations are seen from a birds-eye view, there are clear parallels to be drawn. To simplify the implementation, it is recommended to divide the process into data sourcing, data transformation and data consumption. Such a more conceptual approach makes the tax function more scalable, efficient and effective.

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