



# Pillar 2 vs. GILTI and AMT / WHT on S-Corps

Grant Thornton LLP  
Grant Thornton AG

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# Ihre Referenten im Webinar Pillar 2 – Update



**Christina Busch**

Partner  
Duesseldorf

T +49 211 9524 8129  
E [christina.busch@de.gt.com](mailto:christina.busch@de.gt.com)



**David Sites**

Partner  
Washington

T +1 202 861 4104  
E [david.sites@us.gt.com](mailto:david.sites@us.gt.com)



**Norbert Miethe**

Partner  
Duesseldorf

T +49 211 9524 8653  
E [norbert.miethe@de.gt.com](mailto:norbert.miethe@de.gt.com)

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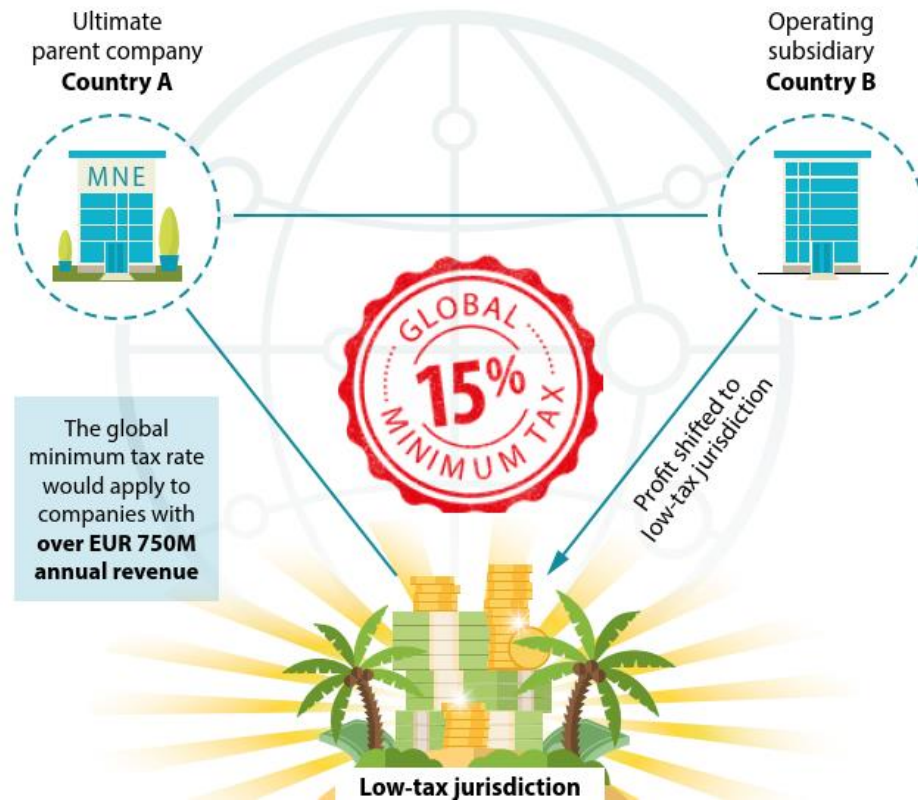




# German Legislative Update



# Pillar 2 concept and international tax landscape



Source of graphic: OECD/G20 Base Erosion and Profit Shifting Project, Addressing the tax challenges arising from the digitalisation of the economy, July 2021, p. 11

- Pillar Two concept was adopted by the Inclusive Framework states on Oct. 8, 2021, with broad approval.
- Pillar Two will be applicable to MNE and its affiliates with worldwide group revenues of at least mEUR 750 p.a.
- Sales limit must be exceeded in 2 out of 4 immediately preceding financial years.

## Goal: Implementation of an effective tax rate of 15%

- At the end of December 2021, the Model Rules for Pillar Two were adopted and published, which are to be used as a basis for implementation in the respective national law by the participating jurisdictions. Corresponding EU directive was released.
- German discussion draft for a national implementation law is closely aligned with the OECD model rules, but also contains some German concretizations and amendments.
- Draft includes permanent and transitional safe harbor rules which shall provide (temporary) relief, and simplify calculation requirements
- Final German legislation to be expected in August 2023

# Pillar 2 - Status of implementation in Germany

Despite recent developments, many questions remain unanswered

- Will further Permanent Safe Harbour Regulations be introduced?
- Discussion draft on German legislation released on March 20, 2023. Remaining questions are e.g.:
  - Scope of the documentation and filing requirements of the German authorities?
  - Will "Dispute Resolution Mechanism" be implemented as proposed by the OECD? How fast can necessary international agreements be introduced?
  - The OECD's proposals of December 20, 2023, on so-called "Penalty Reliefs" have not been adopted in the draft legislation. Will (procedural) simplifications be made possible at German level?

October 2021

Agreement on the implementation of Pillar 2 at OECD level

March 2022

Release of OECD commentary and illustrative examples

February 2023

Publication of the guidelines for implementation by the OECD

January 2024

Implementation date



December 2021

Release of Model Rules and draft of EU-Directive

December 2022

EU Announces agreement on mandatory implementation of Pillar 2; OECD publishes (Transitional) Safe Harbour Rules

March 2023

Discussion draft on German implementation law released



# US Legislative Update



# U.S. Prospects for Adopting Pillar 2

## Little chances for near-term implementation

- It appears that there **very little chance** that the United States will pass legislation enacting the provisions of Pillar 2 in 2023
- With Republicans controlling the U.S. House of Representatives, the prospects for legislation appear dim and **Republican lawmakers have voiced concerns over the deal** the U.S. agreed to in 2021
- Pillar 2 provisions were included in proposed versions of the Inflation Reduction Act (passed in August 2022) but were quickly removed during the negotiation process
- **Next major U.S. election will be held November 5 2024**, during which a President and many new lawmakers will be elected. The fate of Pillar 2 in the U.S. will hinge, in part, on this election outcome



# Revisiting the IRA

Democrats finally in 2022 pushed reconciliation bill over the finish line

- Impose a **15% minimum tax** on book income for large corporations
- Create a **1% excise tax on stock buybacks** by publicly traded corporations
- Reinstate a **Superfund excise tax on crude oil** at a rate of 16.4 cents per barrel
- **Extend the limit on losses** under Section 461(l) for two years through 2027
- Add a **\$268 billion** package of new, expanded, and extended **energy incentives**
- Double the cap on **refundable R&D credits** for eligible small businesses
- **Increase IRS funding** by \$80 billion
- **Superconductor** tax credit passed is separate tax bill



# Pillar Two and GILTI Regime

## 01

On Feb. 2, the OECD released highly anticipated guidance that addresses several issues including how the current U.S. GILTI system will co-exist with the GloBE rules

## 02

Current GILTI regime differences, include

- No revenue-based scope limitations
- Currently not imposed on a country-by-country basis
- The effective tax rate falls short of the 15% minimum tax rate (until 2026)

## 03

Guidance treats GILTI as a “blended controlled foreign corporation tax regime”

- Provides mechanical allocation formula
- Applicable for 2024 and 2025 then up for reassessment (syncs with schedule GILTI tax rate increase)

# Corporate AMT

- The [Inflation Reduction Act](#) (enacted August 2022) imposes, in addition to any other tax imposed, a tax equal to the excess (if any) of:
  - the [tentative minimum tax](#) for the taxable year, over
  - the regular tax for the taxable year plus, in the case of an applicable corporation, the tax imposed by section 59A (i.e., Base Erosion Anti-Abuse Tax/BEAT)
- The law provides that the [tentative minimum tax](#) for the taxable year of an “Applicable Corporation” is the excess of:
  - 15 percent of “[Adjusted Financial Statement Income](#)” for the taxable year; over
  - the “[Corporate AMT Foreign Tax](#)” credit for the taxable year (as defined in section 59(l))
- Applicable Corporation
  - AFSI Test is met if 3 year average AFSI exceeds \$1 billion without regard to an AFS NOL
  - A calendar year-end corporation determining Applicable Corporation status for 2023 will analyze its average annual AFSI for years 2020, 2021, and 2022
  - Alternative test for Foreign Parented US companies (\$1 billion group level, \$100M US company level)

# Initial Reactions to Corporate AMT

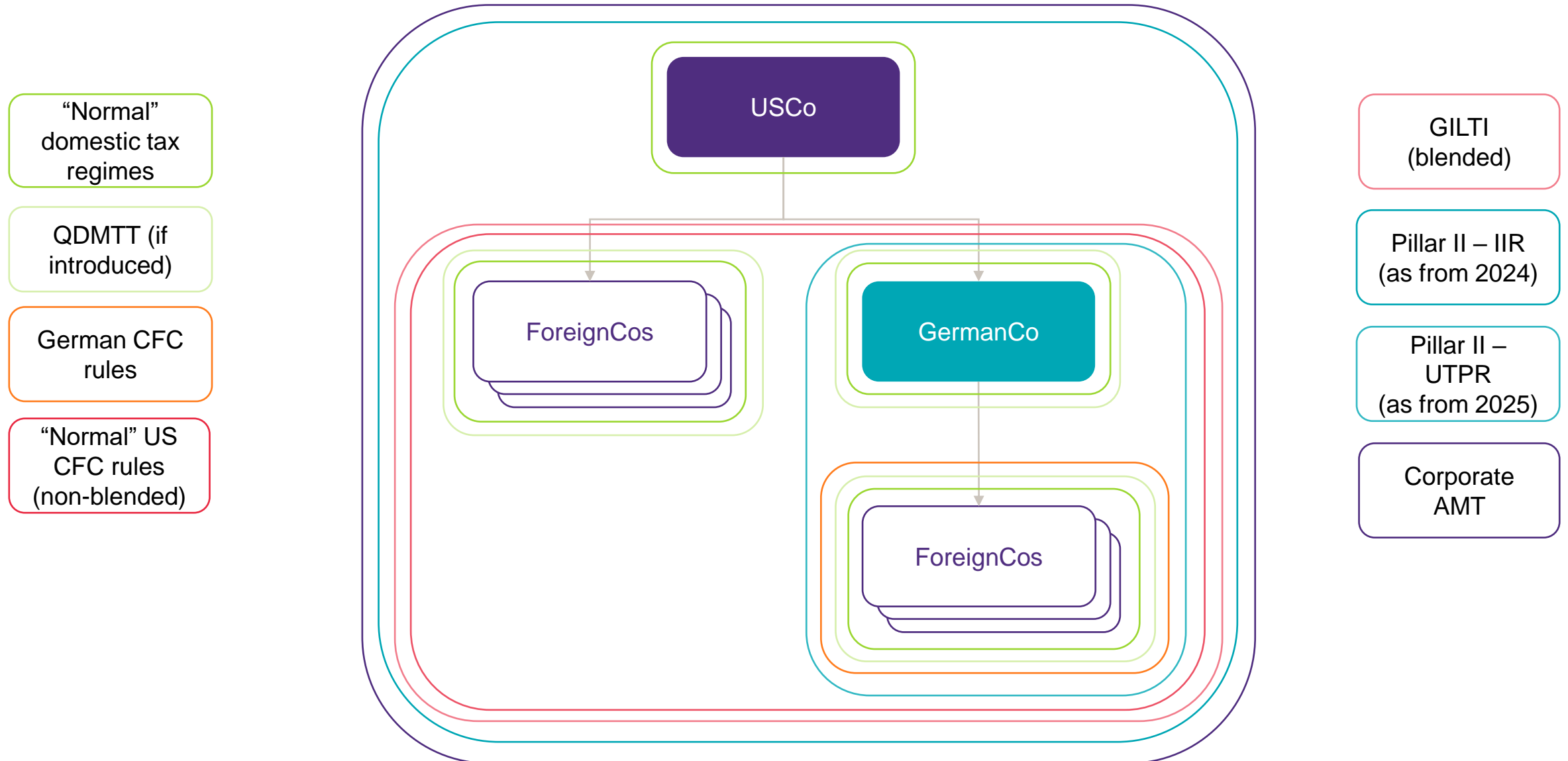
- 2023 is initial year of application for most impacted taxpayers
- Complexity arises for Foreign Parented group with multiple US subsidiaries
- Scope of the tax is expected to be very limited but compliance burden may not be so limited
- IRS continues to work on providing implementing regulations which will hopefully resolve many of the ambiguities



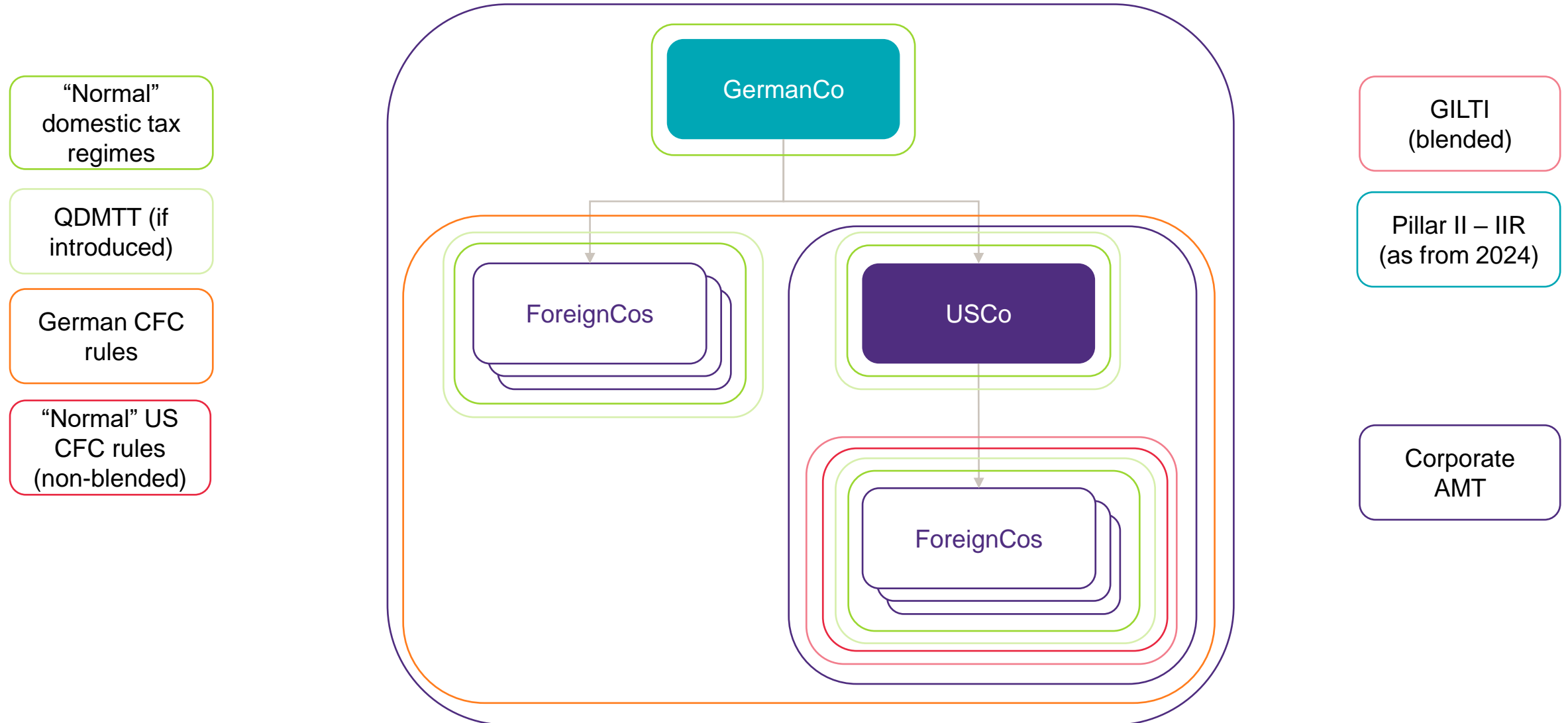
# What this means for US/German businesses



# Applicable tax regimes for US multinationals



# Applicable tax regimes for GER multinationals



# Ordering of application of tax regimes

## Ordering of application for US multinationals



## Ordering of application for German multinationals



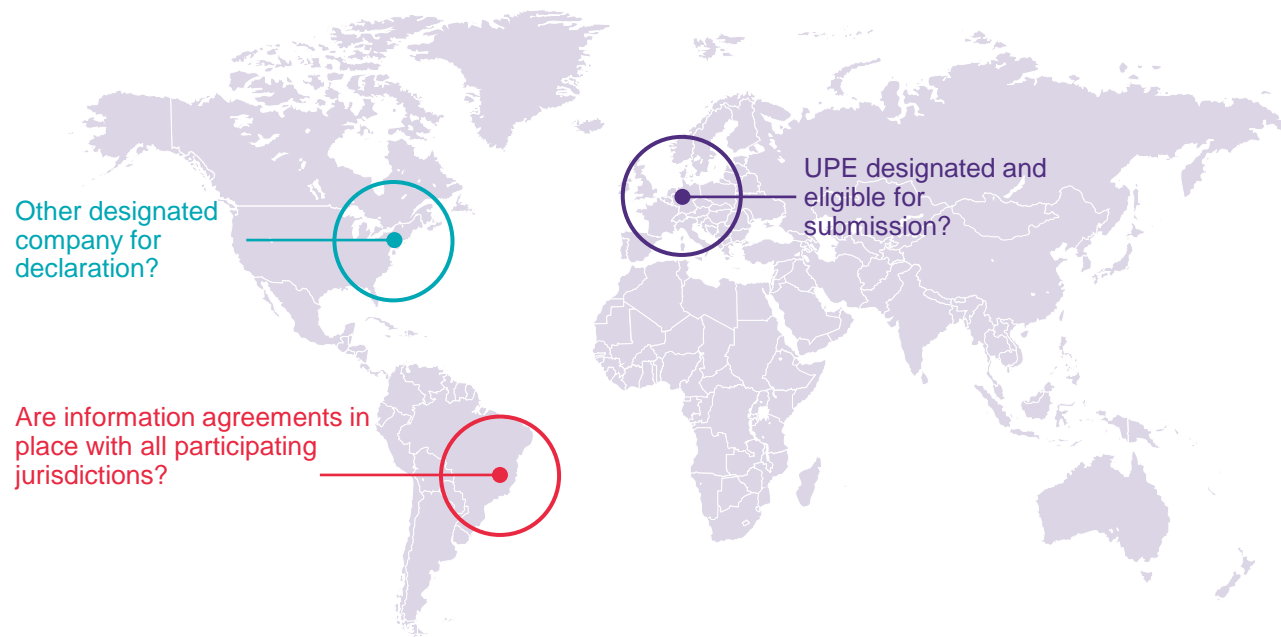
- High complexity from interaction of different rule sets (e.g. allocation of GILTI tax for Pillar 2 purposes)
- Additional complexity in case of multi-tier-jurisdictional structure (see previous slides)
- Requirement for technical solution to access (hundreds of) data points



# The GloBE Information Return

Information to be provided by each entity according to OECD and German tax draft in GloBE Information Return.

- General information about the company
- Group organization chart
- Calculation of the effective tax rate and the top-up tax including options exercised
- Allocation and assignment of top-up tax



## Possibility to centralize the declaration

General rule: Each company in participating jurisdiction files GloBE information statement.

Exceptions to this

- Filing by local entity in same jurisdiction on behalf of corporation, or
- GloBE information return is filed by UPE, or other designated entity located in a jurisdiction with which an appropriate information agreement has been reached

! Affected jurisdictions are to be closely monitored about outstanding information agreements. For jurisdictions without an agreement, it must be examined how local companies can be provided with the required information.

# Initial Safe Harbour Experiences



# Transitional Safe Harbors

## General

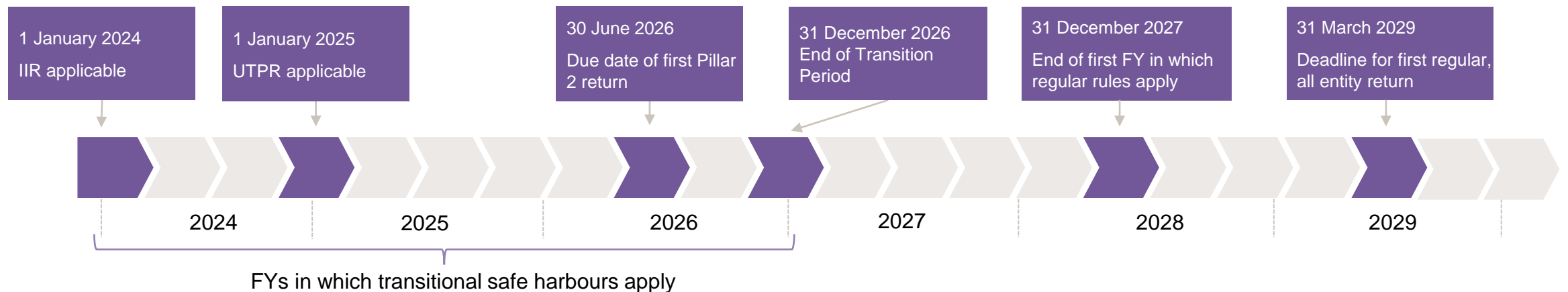
Provide relief for multinational enterprise (MNE) groups in FY 2024 – FY 2026 (FY 2025 – FY 2027 for deviating FYs)

## Country-by-Country Reporting / Financial Statements Safe Harbors






- Identifies “lower-risk jurisdictions” through the application of three alternative quantitative tests
- Quantitative tests are mainly based on CbCR data (and certain financial statements data)
- An MNE that qualifies with respect to one or more jurisdictions is still subject to the full GloBE Rules in respect of jurisdictions that do not qualify

## “Once out, always out”-approach

If an MNE group has not applied the safe harbor in a jurisdiction for a year it is subject to the GloBE rules, the MNE group cannot qualify for the safe harbor for that jurisdiction in a subsequent year.



# Applicable Tests per Jurisdiction

De Minimis Test	 Revenue < EUR 10 million  Profit before taxes < EUR 1 million	} based on CbCR data
Simplified ETR Test	 Covered taxes*, accounting data Earnings before taxes, CbCR data	> 15 %
Routine Profits Test	 5% of eligible payroll costs**  5% carrying amounts of tangible assets**	} Substance-based carve-outs > Earnings before taxes, CbCR data

\*Covered taxes are calculated on the basis of current and deferred tax expense as reported in the financial statements less taxes that do not qualify as covered taxes and less uncertain tax positions.

\*\*During a transition period, substance-based carve-outs are initially 10% of eligible payroll costs and 8% of eligible tangible assets

# Transitional Safe Harbors – Initial Experiences

## Initial calculations

- Sample calculations based on CbCR 2022 data shows **success rate of 70% - 100%**
- Jurisdictions/entities that likely fulfill Transitional Safe Harbor tests:
  - jurisdictions with non-complex operating functional profile
  - jurisdictions where no extraordinary transactions applied
- Jurisdiction/entities that are at risk:
  - jurisdictions with a complex functional profile and extraordinary transactions (regardless of the applicable nominal rate)
  - jurisdictions with generous tax incentive schemes (e.g. tax holidays)

## Implications

- Transitional Safe Harbors provide limited relief given that the full Pillar Two work still needs to be done for those entities / jurisdictions that do not meet the Safe Harbors
- Historic figures provide limited reliance

# Permanent Safe Harbors

Available Tests	De Minimis Test	ETR Test	Routine Profits Test
Criteria	<p>Average qualifying revenue of all constituent entities located in a jurisdiction is less than €10 million and average qualifying income or loss of all constituent entities in a jurisdiction is a loss or is less than €1 million.</p>	<ul style="list-style-type: none"><li>• MNE group determines ETR by using simplified income, revenue and tax calculations</li><li>• ETR is equal to or greater than 15%</li></ul>	<p>Excess profits of a jurisdiction are zero (i.e., a simplified measure of income that exceeds the jurisdiction's SBIE by zero, or the jurisdiction is in a GloBE loss).</p>

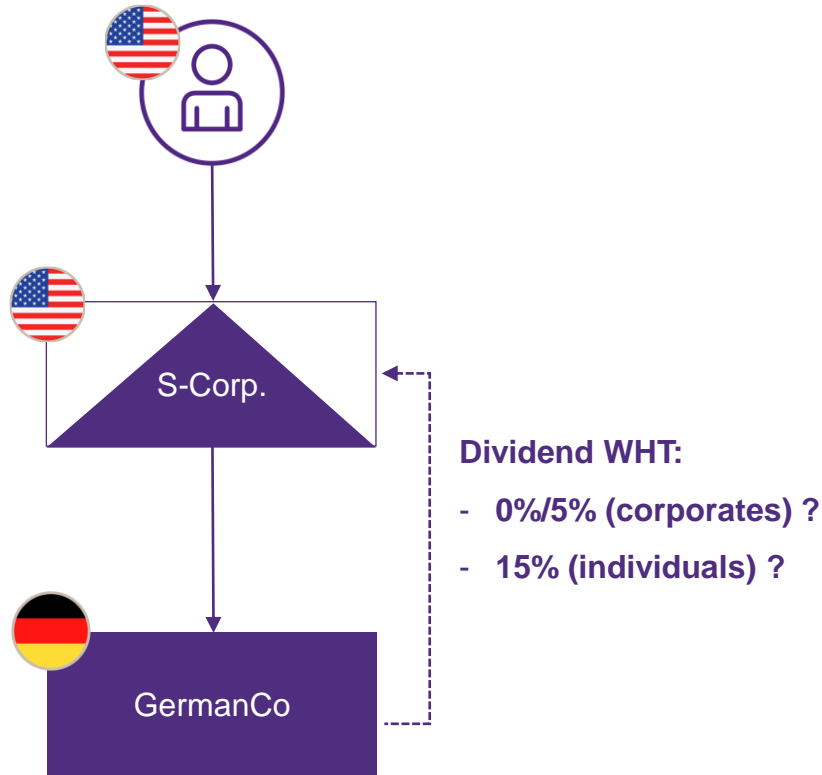
Although “same” tests, permanent safe harbor does not rely on the CbC report like transitional safe harbor.

A man with a beard and glasses, wearing a dark suit jacket over a light blue shirt, is sitting on a set of concrete stairs. He is smiling and looking towards a woman. The woman has blonde hair tied back in a ponytail, is wearing a black blazer over a white top, and is also smiling. She is sitting on the stairs next to him, with her hands clasped together. The background shows more of the stairs and a metal railing. A semi-transparent purple banner is overlaid across the middle of the image, containing the text and a logo.

# Update on withholding tax for S-Corps



# Dividend WHT for S-Corps



## Structure

- “Typical” US-outbound S-Corp structure, where
  - US individuals own S-Corp;
  - S-Corp owns share in GermanCo
  - GermanCo pays a dividend to S-Corp

## Qualification of S-Corp

- Transparent/**flow-through** from **US tax** perspective
- **Intransparent** from **German tax** perspective > hybrid

## German Dividend withholding tax

- Domestic rate: 26,375%
- Treaty withholding tax for individual shareholders: 15%
- Treaty withholding tax for corporate shareholders: 0% / 5%



# Dividend WHT for S-Corps

## Historic View

### Art. 1 (7)

*“In the case of an item of income ... derived by or through a person that is fiscally transparent under the laws of either Contracting State, such item shall be considered to be derived by a resident of a State to the extent that the item is treated for the purposes of the taxation law of such State as the income, profit or gain of a resident.”*

### Case Law Supreme Tax Court from 2013

- Art. 1 (7) determines “whether” an item of income is derived by a resident person but it does not “by which” person
- Domestic law determines “by which” person the income is derived:
  - S-Corp as corporation from a German viewpoint
  - thus dividend withholding tax **is 0% / 5%**

## Current View

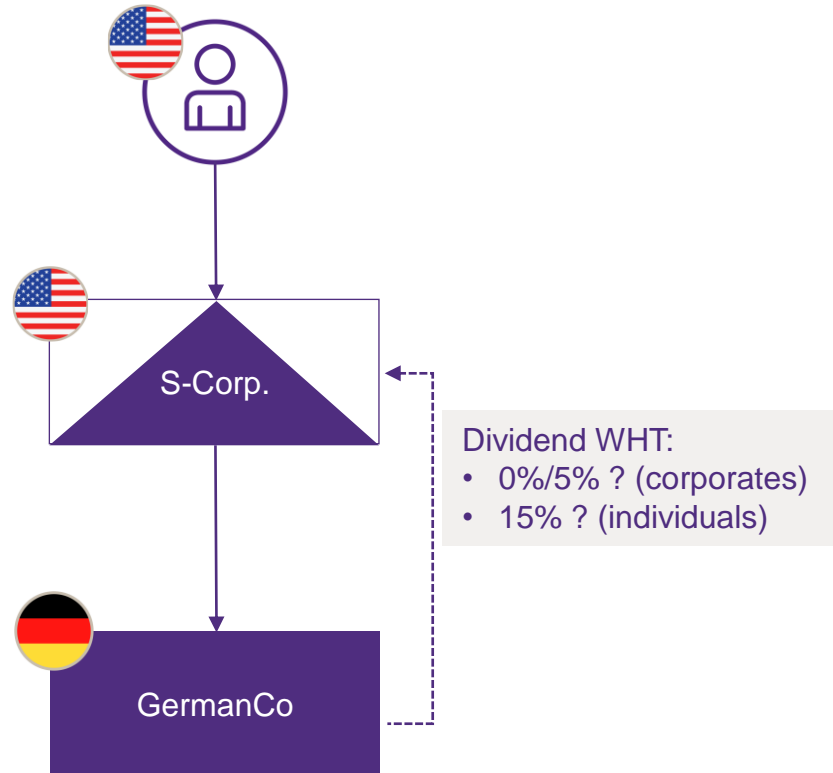
### Treaty override of Sec. 50d (11a) German Income Tax Act introduced in 2013 as reaction to the prior case law

*“If the creditor of the ... income ... is a person to whom the ... income ... is not attributed under this Act or under the tax laws of the other Contracting State, the right to a ... refund of the [withholding] tax ... on the basis of a convention for the avoidance of double taxation shall be available only to the person to whom the ... income ... is attributed under the tax laws of the other Contracting State ...”*

### Case Law Local Tax Court from 2023

- Sec. 50d (11a) applicable in case of US/German double tax treaty despite Art. 1 (7)
- However, Sec. 50d (11a) only determines the person that is entitled to the refund, but is not relevant for the determination of the extent (0%/5% or 15%) of the refund
  - thus, **0%/5%** continues to be available, however, refund claims needs to be filed by individuals

# Dividend WHT for S-Corps – implications



## Implications

- Case is now pending before the German Supreme Tax Court that will finally decide on the issue.
- Request for 0%/5% should be filed.
- Filing should be made by individuals (PoAs possible).
- Pending cases should be appealed with references to the pending Supreme Court case

# Thank you for listening!

Any questions? Then just send an email to the speakers.

Stay informed with us.

You can connect with us on LinkedIn [here](#).



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20. September 2023 | 9:00 – 17:00 Uhr  
Digitalveranstaltung



EVENT

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#### **Berlin**

Grant Thornton AG  
Wirtschaftsprüfungsgesellschaft  
Cicerostraße 2  
10709 Berlin  
T +49 30 890482 0  
F +49 30 890482 100

Grant Thornton  
Rechtsanwalts-gesellschaft mbH  
Cicerostraße 2  
10709 Berlin  
T +49 30 890482 0  
F +49 30 890482 100

#### **Duesseldorf**

Grant Thornton AG  
Wirtschaftsprüfungsgesellschaft  
Johannstraße 39  
40476 Duesseldorf  
T +49 211 9524 0  
F +49 211 9524 200

Grant Thornton  
Rechtsanwalts-gesellschaft mbH  
Johannstraße 39  
40476 Duesseldorf  
T +49 211 9524 0  
F +49 211 9524 200

#### **Frankfurt am Main**

Grant Thornton AG  
Wirtschaftsprüfungsgesellschaft  
Senckenberganlage 19  
60325 Frankfurt am Main  
T +49 69 905598 0  
F +49 69 905598 677

Grant Thornton AG  
Rechtsanwalts-gesellschaft mbH  
Senckenberganlage 19  
60325 Frankfurt am Main  
T +49 69 905598 0  
F +49 69 905598 677

#### **Hamburg**

Grant Thornton AG  
Wirtschaftsprüfungsgesellschaft  
Große Bleichen 23-27  
20354 Hamburg  
T + 49 40 32088 1200  
F + 49 40 32088 1222

#### **Cologne**

Grant Thornton  
Rechtsanwalts-gesellschaft mbH  
Habsburgerring 2  
50674 Köln  
T +49 221 669932 0  
F +49 221 669932 00

#### **Leipzig**

Grant Thornton AG  
Wirtschaftsprüfungsgesellschaft  
Humboldtstraße 25  
04105 Leipzig  
T +49 341 59083 0  
F +49 341 59083 733

#### **Munich**

Grant Thornton AG  
Wirtschaftsprüfungsgesellschaft  
Ganghoferstraße 31  
80339 Munich  
T +49 89 36849 0  
F +49 89 36849 4299

Grant Thornton  
Rechtsanwalts-gesellschaft mbH  
Ganghoferstraße 31  
80339 Munich  
T +49 89 36849 0  
F +49 89 36849 4299

#### **Lower Rhine**

Grant Thornton AG  
Wirtschaftsprüfungsgesellschaft  
Eindhovener Straße 35-37  
41751 Viersen  
T +49 2162 91811 0  
F +49 2162 91811 60

#### **Rostock**

Grant Thornton AG  
Wirtschaftsprüfungsgesellschaft  
Am Vögenteich 26  
18055 Rostock  
T +49 381 3756 6300  
F +49 381 3756 6315

#### **Stuttgart**

Grant Thornton AG  
Wirtschaftsprüfungsgesellschaft  
Jahnstraße 6  
70597 Stuttgart  
T +49 711 16871 0  
F +49 711 16871 40

#### **Wiesbaden**

Grant Thornton AG  
Wirtschaftsprüfungsgesellschaft  
Hagenauer Straße 59  
65203 Wiesbaden  
T +49 611 18890 0  
F +49 611 260133