September 29, 2022

Pillar Two: Draft Income Inclusion Rule (IIR) Legislation and Consultation Response

On 20 July 2022, the UK government published draft legislation on the Pillar Two Income Inclusion Rule (IIR) and its response to the public consultation on the UK Implementation of Pillar Two with the governmental position in the key areas.

On 20 July 2022, the UK government released draft legislation on the Pillar Two Income Inclusion Rule (IIR) along with its response to the public consultation on the UK Implementation of Pillar Two.

The draft legislation is intended to be introduced in Finance Bill 2022-23 (expected to receive Royal Assent in early 2023) and will apply to accounting periods commencing on or after 31 December 2023 (which is aligned with the proposed EU implementation).

In the consultation response, the UK government reiterated their view that the UK implementation of Pillar Two rules should closely follow the OECD Model Rules. In areas where there is currently ambiguity, the UK intends to seek for resolution through working with its international partners as part of the OECD Implementation Framework to best ensure international consistency.

UK position on key issues

The response has also provided an opportunity for the UK Government to share their position on the following key areas:

(1) **Undertaxed Payments Rule (UTPR)**: Still intended to be introduced although an update on the timing and design of the UTPR to be released at a later date due to impact of wider developments internationally.

(2) **Domestic Minimum Tax (DMT)**: Considers there are strong arguments in favour of a UK DMT to ensure that the UK Exchequer receives any additional tax on UK economic activities applied from Pillar Two. The introduction will continue to be considered but, if introduced, it is envisaged that it would have the same threshold as the Pillar Two rules and apply to both UK and foreign headed MNE's (along with potentially wholly domestic groups).

(3) **GILTI:** Notwithstanding any reform to the GILTI rules to be Pillar Two compliant, expected that any tax paid under the current GILTI rules would be included in the covered taxes of the CFC for the purposes of both the IIR and UTPR. This is in contrast to the hybrid mismatch provisions where specific rules were introduced to prevent GILTI from being regarded as a foreign CFC charge.

(4) **Safe harbors**: Supportive of a safe harbour where there is a qualified DMT in place as this could provide real benefits to both businesses and tax administrations and is committed to taking this forward with international partners. Also open to other safe harbours using either CbCR data or statutory tax rates but considers it may be too difficult to gain a consensus.

(5) **Tax Compliance Process:** Intention to work with international partners to produce standardized GloBE Information Return along with a centralised reporting system. From a UK perspective there will be a one-off registration requirement along with annual notification requirements in line with the Model Rules. The UK penalty regime is aligned with the existing corporation tax penalties.

Reform of Sovereign Immunity from direct taxation

On 4 July 2022, the UK government released a public consultation on reforming the UK's policy towards sovereign immunity from direction taxation. The proposals in the consultation document intend to codify the UK's approach to sovereign immunity into tax legislation (rather than being founded solely on international law) and limit the income that is exempt to interest and dividends.

These changes would result in persons benefitting from sovereign immunity becoming liable to UK taxation on both rental profits and capital gains from UK real estate which appears to be a key policy objective.

The revised rules are intended to apply from 1 April 2024.

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