Pillar Two
Application to Trusts

Trusts can have filing and tax payment obligations under the Pillar 2 rules, and whether groups are in scope is determined on the basis of a deemed accounting consolidation, which can be difficult to apply to investments owned by trusts.

What is Pillar 2?

- The Pillar 2 rules are a new set of tax rules developed by the OECD which are intended to ensure that groups with consolidated revenues of over €750m pay a minimum tax rate of 15% on their income, calculated under specific Pillar Two principles.
- Trusts are entities for Pillar 2 purposes, and can be required to file tax returns and make tax payments in relation to both their own income and income arising in companies in which they have a shareholding. The fact that a trust has investments in two separate corporate groups can also bring the corporate groups within the scope of the rules when they would not otherwise be, because it may result in multiple companies or groups being combined in considering the €750m threshold.
- The main Pillar 2 tax collection rule is the income inclusion rule (IIR) which applies where income is taxed at a rate below the Pillar Two minimum rate of 15%. The IIR requires the parent entity of the group to pay a top up tax equivalent to the shortfall between the actual tax and the 15% rate. The top up tax is calculated on a territory by territory basis, and the nature of the calculation means that top up tax can be due even where the headline rate of tax which applies to an entity's profits is more than 15%.
- Where the parent entity of the group is in a jurisdiction which has not introduced the Pillar 2 rules but the group as a whole has revenues in excess of €750m, sub-holding entities based in Pillar 2 territories can instead be required to apply the IIR in respect of the entities which they own. This may well be relevant to trust-owned groups, as they will typically be based in jurisdictions which are either not looking to bring in Pillar 2 or are considering implementing it later than the first wave of territories to adopt it.
- Many countries are also considering introducing domestic minimum top up taxes for entities which are part of groups which are within the Pillar 2 rules, to ensure that any top up tax is collected in the local jurisdiction rather than in the parent entity. Top-up taxes may therefore need to be calculated and paid at a number of different levels within a group.
- The Pillar two rules also include a back-up rule, which is intended to ensure that the top up tax is collected even if the parent entity and other holding entities in the group are in jurisdictions which do not introduce the IIR. This is the under-taxed payments rule (UTPR), and it requires the top up tax which would not otherwise be collected to be paid by entities (including PEs) within the group which are in Pillar 2 territories.
- Where a group is within the rules, it will be required to prepare Pillar 2 tax calculations in addition to their local territory tax calculations, and file related returns. The data needed to prepare the calculations is extensive, and groups which are within scope are likely to need to put in place systems to capture and process significant additional amounts of data which may not currently be captured.

When do the rules apply?

- The first wave of territories to introduce the rules, which will include the UK and the EU, will apply the rules for accounting periods beginning on or after 31 December 2023. For the first year, it is expected that only the IIR will apply in most cases, with the UTPR likely to apply from the following year.
- A number of other territories, including some of the territories in which trusts are traditionally based, have indicated that they are considering introducing the Pillar 2 rules from a later date. While there is no obligation on territories to introduce the Pillar 2 rules, the UTPR has been designed to try to ensure that groups which have parent entities in jurisdictions which do not introduce the rules will generally not be at an advantage to those which do. It may be particularly relevant to trust-headed groups where both the trust and the holding entities are in territories which do not implement the rules.

How do you determine if investments held by a trust have consolidated revenues of more than €750m?

- A trust can be a member of, or the ultimate parent entity ("UPE") of, a consolidated group for Pillar 2 purposes.
- Where a trust is the UPE of a group, the question of whether the group has revenues in excess of €750m is tested on the basis of what the accounting revenue (as defined) would be in consolidated accounts prepared with the trust as the group parent, determined under an appropriate GAAP. The rules apply to a period when group revenues are in excess of €750m in two of the four preceding financial years.
- There are a number of areas of uncertainty in relation to the assumptions you would make in relation to 'deemed' consolidated accounts for a trust. The first is what rights etc the trust is treated as having as a Pillar 2 entity. A trust is an arrangement whereby trustees exercise legal control of the assets but other persons have beneficial entitlement to economic ownership of the asset - and consolidation tests typically look at a combination of control and economic benefits. This means that purposively, it is likely that the 'entity' should be treated as having both the trustees' powers and the beneficiaries' economic rights, but it is not a straightforward starting point.
- It will not usually be possible under IFRS for a trust to investment account (which would leave the consolidation tests at the corporate level).
- Particular trust arrangements may also raise different accounting issues:
  - If a trust is an interest in possession trust (whereby the life tenant is entitled to all the income from the company) how does this affect the consolidation given an individual is not an entity within the rules? Is the interest in possession treated as a minority interest, or does it result in the underlying asset being excluded from consolidation?
  - Are sub-funds within a trust treated as separate entities when considering consolidation?
  - Are resettlements to a new trust treated as demerged separate entities, or as continuing to be part of the original arrangement?
- It is likely that some of these questions can only be resolved through further consultation with the OECD/ Revenue authorities and it may be that different authorities take different approaches.
- Because the €750m threshold is based on revenues rather than profit, this is particularly likely to be relevant to trusts which have material shareholdings in one or more large trading entities among their investments, as the amounts taken into account if those entities are included in the deemed accounting consolidation would include their gross trading revenue as well as income and gains from investment activities and any extraordinary income.

What is the impact for trusts and their investments if the rules apply?

- If a trust is the UPE of the group the trust itself could be required to file the worldwide tax return, including detailed analysis of amounts in all of the entities which are treated as part of its hypothetical consolidated accounts (this would be the case if the the trust's local jurisdiction brings in the rules, but may be the case anyway: the UPE is the default filing entity under the draft UK legislation even if it is not in the UK).
- If the rules are introduced in the trust's local jurisdiction, the trust would also have tax payment obligations to the extent that any top-up tax is due under the IIR. Consideration would have to be given to how to fund any tax, the implications for beneficiaries of any income flows to fund the tax, and also whether consent needs to be sought from beneficiaries to amend trust deeds to ensure that trustees are able to use trust income in this way if needed.
- A trust owning material interests in a number of different companies, or corporate groups, can also mean that the revenues of those different companies and/ or groups may need to be combined to determine whether the €750m threshold is met. Corporate groups which are owned by trusts often have a deliberately limited awareness of the wider holding structure, so it is important that trustees take the lead in ensuring that the Pillar 2 position is considered across all of their investments as otherwise they risk a material compliance failure. Income arising directly in the trust, and any other trusts or sub funds which would be included in the top entity's deemed consolidated accounts would also need to be taken into account.
- If a trust which meets the threshold requirement would consolidate a less than 80% shareholding, that entity will be a 'Partly Owned Parent Entity' for Pillar 2 purposes, and will have its own tax payment obligations when the rules are introduced in its territory. It is therefore important that trustees identify these companies and ensure that they are aware of their obligations.
- If the jurisdiction in which the trust is resident/ formed does not introduce the Pillar 2 rules (or does not introduce them with effect from 2024, when the first wave of countries is expected to adopt), then for the first year of the Pillar 2 rules the impact is likely to be limited to meaning that sub-holding companies owned by the trust which are resident in territories which have implemented the rules may be required to pay top up tax in relation to their sub-group if the wider group headed by the trust has revenues of more than €750m, although a global income return may still be required. The overall deemed consolidated revenue number will also determine whether a domestic minimum top-up tax applies to local companies and PEs in many territories.
- As more territories introduce the rules, including some of the territories in which family trusts are more normally based, this may have the effect of switching the reporting and payment requirement from one level of holding companies within the group to a higher tier holding company, or from the corporate group to the trust.
- Transitional safe harbour provisions intended to simplify the application of the Pillar 2 rules in the first three years in which they apply only apply where a group files a qualifying Country by Country Report (CBCR). This is unlikely to apply to trust-headed groups, unless one can be filed voluntarily.
- The UTPR will be relevant to trust-headed groups where the trust and holding companies are in territories which do not introduce Pillar 2. The top up tax which would be due on all of the deemed consolidated group's income - including income in the trust itself, and income in investment vehicles in low tax jurisdictions which are not held by holding companies in Pillar 2 territories - will become payable by any entities within the consolidated group which are in Pillar 2 territories, to the extent that it's not already being collected through domestic top-up taxes or paid by intermediate holding companies which are in Pillar 2 territories. The tax will be effectively allocated between entities (including PEs) in Pillar 2 territories on the basis of their local headcount and fixed assets.

Contacts

Matt Gibson

Partner
M: +44(0)7932 062973
E: Matthew.david.gibson@pwc.com

Penny Proctor

Director
M:+44 (0)7802 660144
E:penelope.j.proctor@pwc.com