

October 2021

Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy

On 8 October 2021, 136 countries, including Poland, issued a joint document titled Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy.

The document refines the previous statement of 1 July 2021, affirming support for establishing a new global corporate taxation framework with respect to the largest Multinational Enterprises (MNEs), including digital companies. Consistent with the previous statement, the document endorses introduction of solutions for global taxation of large corporates benefiting from progressing globalization and digitization. Two Pillars are covered – Pillar 1 deals with the reallocation of certain profits from large MNEs to market jurisdictions, Pillar 2 deals with a Global Minimum Tax.

The statement includes also a detailed implementation plan with timelines for the development of detailed rules and for legislative implementation.

Pillar 1: Reallocation of profits

Pillar 1 encompasses activities aimed at developing new rules regarding allocation of profits to the countries in which the revenues are earned (i.e. market jurisdictions).

The statement confirms that the new rules will apply to MNEs with worldwide revenue greater than EUR 20 billion and profitability above 10 percent.

The taxation mechanism elaborated under Pillar 1 will involve three elements:

- Amount A – mechanism of partial redistribution of profits of large multinationals involved with “consumer facing businesses” (CFB) and “automated digital services” (ADS) to those countries where the consumers of goods and services sold by the entities are located;
- Amount B – a mechanism intended to streamline the application of the arm’s length standard to baseline marketing and distribution activities;
- Tax certainty – a dispute prevention and resolution mechanisms, which will allow to avoid double taxation for Amount A (with a possibility to be extended to other tax disputes).

The 1 July statement indicated that the allocation under Amount A would be between 20 percent and 30 percent. The statement of 8 October states that this amount will be 25 percent. According to the statement, jurisdictions from which EUR 1 million or more revenue are earned will receive an allocation. It is estimated that Pillar 1 will globally result in the reallocation of USD 125 billion of profit.

Pillar 2: Global minimum Tax

Pillar 2 provides for introducing a global minimum corporate tax (GloBE – Global Anti-Base Erosion) that countries can use to protect their tax bases. The main goal thereof

is to hinder shifting untaxed income from the countries where it was generated to jurisdictions pursuing harmful tax competition practices (tax havens).

The minimum tax rate used for these purposes will be 15 percent (the 1 July statement indicated that it would be ‘at least 15 percent’). The new taxation mechanisms will apply to MNEs with global consolidated annual income exceeding the EUR 750 million threshold.

At the same time, according to the statement, the minimum tax is to be designed in such a way that it does not increase the tax burden on entities conducting actual business activity in a given state. To achieve it, a formulaic substance carve-out will be provided. The GloBE rules will also provide for a *de minimis* exclusion for those jurisdictions where the MNE has revenues of less than EUR 10 million and profits of less than EUR 1 million.

Government entities, international organizations, non-profit organizations, pension funds or investment funds that are Ultimate Parent Entities (UPE) of an MNE Group or any holding vehicles used by such entities, organizations or funds will be excluded from the scope of application of the new rules.

Furthermore, the Pillar 2 provides an Income Inclusion Rule (IIR), which imposes top-up tax on a parent entity in respect of low taxed income of constituent entities within an MNE group, and a supporting Undertaxed Payment

Rule (UTPR) which denies tax deductions or requires an equivalent adjustment to the extent the low tax income of a constituent entity is not subject to tax under an IIR.

The rules will provide for an exclusion from the UTPR for MNEs in the initial phase of their international activity. This is defined as those MNEs that have a maximum of EUR 50 million tangible assets abroad and that operate in no more than 5 other jurisdictions. This exclusion is limited to a period of 5 years after the MNE comes into the scope of the GloBE rules for the first time. For MNEs that are in scope of the GloBE rules when they come into effect the period of 5 years will start at the time the UTPR rules come into effect.

The statement confirms also the importance of the Subject to Tax Rule (STTR) to developing countries and provides that member jurisdictions that apply nominal corporate income tax rates below the STTR minimum rate to interest, royalties and a defined set of other payments (which will be subject to further discussion) would incorporate the STTR into their

bilateral treaties with developing countries when requested to do so. The statement defines "developing countries" as those with GNI per capita of USD 12,535 or less in 2019. The taxing right under the STTR will be limited to the difference between the minimum rate and the tax rate on the payment, with the minimum rate for the STTR being 9 percent.

Implementation plan

The implementation plan included in the statement notes that the countries are fully committed to use all efforts within the context of their legislative process in achieving the timeline goals.

The model rules on global minimum tax and the STTR model treaty provision and commentary will be developed by the end of November 2021. The multilateral convention (MLC) containing the Amount A rules and its explanatory statement, as well as model domestic legislation and commentary, are to be concluded by early 2022. The STTR multilateral instrument (MLI) is to be developed by mid-2022.

For Amount A it is noted that implementation through the MLC is with a view to allowing it to come into effect in 2023. The Pillar 2 rules (IIR and STTR) are to be brought into law in 2022 to be effective in 2023, with the UTPR coming into effect in 2024. It is recognized however that countries face limitations in speed of their legislative processes, so it remains to be seen by what stage a significant number of countries have the rules in place.

The statement commits also that no new digital services taxes or other relevant similar measures will be enacted and imposed on any company from 8 October 2021 and until the earlier of 31 December 2023 or the coming into force of the Multilateral Convention (MLC). The MLC will require all parties to remove all existing digital services taxes and other relevant similar measures with respect to all companies, and to commit not to introduce such measures in the future. The statement provides that a detailed definition of what constitutes relevant similar measures will be finalized as part of the adoption of the MLC.

If you would like to learn more about the of issues discussed, please do not hesitate to contact us.

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