Briefing

International review for October

Speed read

The publication of new pillar one (profit allocation and nexus) and pillar two (global minimum taxation) blueprints by the OECD as part of its plans to modernise taxation of the digital economy have dominated headlines in the tax world this month, with the OECD now aiming to reach a consensus by mid-2021. The economic analysis published alongside the proposals suggests the reforms could generate an increase in corporate income tax revenues by $50bn–$80bn. The UK government is pressing ahead with its Brexit plans announcing a new streamlined freeports regime. Governments around the world continue to offer support to taxpayers in response to covid-19 with October seeing extensions to wage support schemes in the UK and the Netherlands. There have also been rumoured changes to planned reform of the Swiss withholding tax regime, and further guidance published on a new withholding tax in India which applies to e-commerce operators.

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Taxation of the digital economy

Rome wasn't built in a day, and the same can be said for the challenging task of reforming the international tax system to address the challenges arising from the digitisation of the economy. Nonetheless, October saw a significant architectural milestone reached with the OECD's public release of its 'blueprints' for pillar one and pillar two. The proposals have advanced considerably, with pillar two, in particular, being close to consensus. The blueprints are now under public consultation until 14 December 2020 with the OECD targeting a successful conclusion to discussions by mid-2021. Development of model legislation is planned to follow once agreement is reached.

Pillar one

The aim of the pillar one proposals is to align taxing rights more closely with local market engagement. Under pillar one, a portion of a multinational group's residual profit would be taxed in the jurisdiction that the revenues arise. It will apply to automated digital services and consumer facing businesses: effectively businesses that are able to profit from significant and sustained interaction with customers and users in a market. This represents a fundamental change to the existing tax nexus of jurisdictional presence and can represent a departure from the arm's length principle.

A considerable amount of detail is yet to be agreed including scale thresholds and how the nexus and revenue sourcing rules will work. There has also been a proposal from the US that departure from the arm's length principle should be on a safe harbour basis which remains unresolved. Perhaps most importantly for taxpayers, the scope of covered businesses is also not yet final, but it can be expected that the scope will extend beyond highly digitalised businesses and, as such, it is likely to have a far-reaching impact upon many multinational enterprises globally.

Pillar two

Pillar two effectively introduces a global minimum rate of taxation (the rate is yet to be finalised, but it may be around 10%) and will apply where, even after the effect of pillar one, if any, multinationals are regarded as 'undertaxed' by reference to this level. The intention is for pillar two to apply to multinational groups with a total consolidated revenue above €750m.

Under the current proposals, which are close to consensus, four new rules will be introduced granting jurisdictions additional taxing rights where another jurisdiction has not exercised their primary taxing right, or the income is subject to a 'low rate' of tax.

The new rules are as follows:

- Income inclusion rule: foreign income of branches and controlled entities is subjected to an agreed minimum rate of tax in the parent jurisdiction;
- Undertaxed payments rule: this would operate as a backstop to the income inclusion rule to deny deductions or introduce source-based taxation under certain conditions;
- Subject to tax rule: this would complement the undertaxed payments rule in certain cases; and
- Switch-over rule: this would apply where a permanent establishment (PE) is 'undertaxed', switching off a treaty-based exemption in the head office jurisdiction and replacing it with a credit based method of taxation.

The rules are designed to focus on 'excess income', particularly intangible-related income, which is regarded as most susceptible to diversion. The current proposals therefore include a 'carve-out' and simple fixed returns for payroll and certain tangible asset costs. While work in Pillar Two is well advanced some detail remains to be agreed, particularly around simplification measures.

Pillar two (either in isolation or in conjunction with pillar one) could have a significant impact on the effective tax rates of affected multinational groups. Affected groups should therefore bear this in mind when forecasting future results.

Economic impact

The OECD's economic impact assessment suggests that the combined effect of pillar one and pillar two would be to increase corporate income tax revenues by $50bn–$80bn, further increasing to $60bn–$100bn if the effect of the US global intangible low-taxed income (GILTI) rules is also factored in. The US GILTI inclusive numbers would amount to an increase of around 4% in global receipts from corporate income tax. The increase in tax take is significantly larger for pillar two (global minimum taxation) than pillar one (profit allocation and nexus).

Per the OECD analysis, high income, middle income and low-income jurisdictions would all stand to gain from the new measures with both pillars shifting tax base away from 'investment hubs' (for example, Ireland, Switzerland, Singapore, Hong Kong, Luxembourg and the Netherlands). The OECD acknowledges a modest expected increase in overall corporate taxation, but argues that the proposals would 'contribute to a more efficient allocation of investment … located where it is the most economically productive, rather than in the jurisdictions that provide the most favourable corporate tax treatment'.

The analysis acknowledges that the impact of covid-19 on the proposals remains uncertain and that the economic impact analysis is based on pre-crisis figures. The OECD's view is that

the pandemic makes the need for a consensus based solution to taxation of the digital economy even more critical than before due to the acceleration of digitisation that had occurred as well as the increased need for many jurisdictions to boost their public finances after heavy spending on economic support measures. It will be interesting to see how pillar one in particular develops once the consultation closes in December and whether the backdrop of covid-19 does give a renewed impetus to the final reaching of an agreement next year.

Covid-19

Covid-19 of course continues to dominate headlines globally. Developments in October included the announcement of a third relief and recovery package in the Netherlands to provide support to employers that maintain workers on their payrolls and provides subsidies for payroll costs for a period of nine months. Similarly, in the UK it was announced that the job support scheme would be extended to support businesses with covering the wages of employees of businesses required to close as a result of either local or national lockdowns. In light of the second wave of the virus we are seeing across Europe, the UK government has deferred its planned autumn budget until the spring with it delaying rumoured tax rises.

A number of jurisdictions have continued to offer easements to taxpayers including deferrals of payments and reporting deadlines. In Belgium, for instance, there has been a further extension of the deadline for filing corporate income tax returns until 16 November 2020 (previously, the filing deadline had been extended to 29 October 2020). Meanwhile in Thailand, penalties have been reduced for late submissions of transfer pricing disclosure forms as a relief measure for taxpayers economically affected by the pandemic.

EU list of non-cooperative jurisdictions for tax purposes

On 6 October, the Economic and Financial Affairs Council of the EU (ECOFIN) adopted a revised EU list of non-cooperative jurisdictions for tax purposes. The list, first adopted in December 2017, is part of the EU's efforts to clamp down on tax avoidance and harmful tax practices. In this latest update, the first since February, Anguilla and Barbados were added to the list while the Cayman Islands and Oman were removed. The list now includes the following twelve jurisdictions: American Samoa, Anguilla, Barbados, Fiji, Guam, Palau, Panama, Samoa, Seychelles, Trinidad and Tobago, US Virgin Islands, Vanuatu.

Readers may remember that the Cayman Islands were only added to the list in February this year due to concerns around taxation of collective investment vehicles (CIVs). Within just days of the decision to add the Cayman Islands to the list their government had passed the Private Funds Law and the Mutual Funds (Amendment) Law, which sought to address the EU's concerns for CIVs and, as a result, the Cayman Islands have been removed from the list at the first subsequent opportunity.

Freeports

In spite of continued uncertainty regarding the nature of the UK'S future trading relationship with the EU, the UK government continues to press ahead with its plans for the end of the Brexit transition period on 31 December 2020. On 7 October, responding to HM Treasury's recent consultation, the UK government gave an update on its proposals for a new freeport model which is part of its overall strategy to digitise the border process and make access to customs reliefs and procedures easier and more streamlined. The operation of the freeports are intended to be 'duty free' with simplified declarations being used for goods entering the freeport and standard import declarations required for freeport goods subsequently entering the UK market or standard export declarations for exports outside the UK.

The government's consultation response also notes that tax incentives will be offered within freeport sites including enhanced capital allowances and relief for non-residential SDLT on commercial land and property transactions however very few details on the incentives have been provided at this stage.

The government has confirmed that sea, air and rail ports in England will be invited to bid for freeport status before the end of this year, with the first of the new sites planned to be open for business in 2021.

India

India's Finance Act 2020 introduced a new provision taking effect from 1 October 2020 providing that an e-commerce operator must withhold tax at a rate of 1% of the gross amount of sales of goods or provisions of service facilitated through its digital or electronic facility or platform. India's Central Board of Direct Taxes has issued guidelines that are intended to clarify these new rules. Nonetheless, uncertainty remains over a number of areas, including the treatment of goods returned by customers and consideration made by way of gift vouchers and discount codes. It is hoped that further clarity on these will be provided by the Indian tax authorities in due course.

Swiss withholding tax reform

Last but not least, on 1 October, the Swiss Banking Association reported that the Swiss Federal Council will abandon proposals made in relation to withholding tax. Proposed changes were to require a Swiss paying agent to be responsible for deducting and paying over withholding tax to the Swiss tax authorities on interest payments made to individuals based in Switzerland. In addition, the 35% withholding tax applicable in Switzerland was to be extended to non-Swiss sources of interest.

The latest 'unofficial' proposal of the Federal Council is reported to be the abolition of the 35% withholding tax liability on interest from Swiss bonds and bond-like instruments. However, it should be noted that this new proposal to abolish the Swiss withholding tax liability on interest only applies to bond interest and bond-like interest. It does not include interest from deposits held at Swiss banks, irrespective of the underlying currency. As a result, interest on deposits at Swiss banks paid to Swiss resident individuals will remain subject to 35% withholding tax.

This restriction means that Swiss banks will have to properly classify their clientele and properly identify the Swiss resident clients who will continue to suffer from the 35% withholding tax on deposit interest. In addition, they will also have to keep on monitoring the repatriation of cash associated with fiduciary deposits made by Swiss individuals at related foreign entities and properly assess whether bond-like instruments could qualify as bank deposits. Indeed, Swiss tax regulations do not provide a clear definition of bonds, bond-like instruments and bank deposits.

The latest proposal is probably not final, and we will no doubt hear more from the Swiss Federal Council in due course. ■

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- The three Ps of pillar one (M Bevington, 7.10.20)
- Digital taxation: a bluffer's guide (E Walker, 3.2.20)