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Briefing

International review for June

Speed read

In June, tax made global headlines as the G7 reached a consensus on proposals to address the challenges of the digitisation of the economy. A global minimum tax rate of at least 15% was agreed: a middle ground less than the 21% rate previously favoured by the Biden Administration. G7 finance ministers also found consensus on the allocation of global taxing rights, based on a reallocation of at least 20% of profit exceeding a 10% margin 'for the largest and most profitable multinational enterprises.' Meanwhile, significant progress was also made in the EU on the public country by country reporting proposal. This could see multinational enterprises required to make their first reports as soon as 2025. In other news, Brazil has been renewing its efforts to join the OECD and as part of this is understood to be looking at more fully implementing the arm's length principle for transfer pricing; Nigeria has temporarily suspended country by country reporting obligations for many subsidiaries and branches; and Italy is bringing in an exceptional notional interest deduction for FY21.

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G7 make progress on BEPS 2.0

Tax was in the media spotlight this month with the release of a communique in which G7 finance ministers and Central Bank governors committed to support for the OECD's pillar one (the re-allocation of taxing rights) and pillar two (global minimum taxation) proposals. This follows the OECD's publication of blueprints for the pillars in October 2020. While there are numerous issues still to work through, the consensus among the G7 evidenced in the communique is a significant development that increases the likelihood that broader agreement can be reached at the G20 level and ultimately by the rest of the OECD.

Pillar one: global taxing rights

The G7 proposal on global taxing rights will see 20% of profits over a 10% margin threshold redistributed to market territories. Essentially, the intention is that a portion of multinationals' residual profit (likely to be generated by capital, risk management functions, and/or intellectual property) should be taxed in the jurisdiction where customer or user is located. According to the communique, this will apply to 'the largest and most profitable multinational enterprises.' More detail is awaited including the full scope and how this will ultimately be calculated. The communique also provided no detail on whether certain sectors, such as financial services, might be excluded from pillar one, so this remains to be seen.

The reality of calculating which profits are allocated and to where is likely to be highly complex and involve several stages of calculation. The OECD's October 2020 blueprint gives us some indication of how this will work. According to the blueprint, user jurisdictions are to be allocated a share of 'residual profits' (referred to by the OECD as 'amount A') based on a formula, and a fixed return for routine marketing and distribution activities ('amount B'). Amount A is broadly proposed to cover profits earned from activities with an automated digital (mainly online) character or goods/services commonly sold to consumers (as well as associated IP licenses). This would be allocated out to jurisdictions based on local revenues with double taxation elimination measures. Amount B will be a fixed return that is broadly based on the arm's length principle. This may vary per industry and alternative amount B methodologies may be adopted if supported by evidence. We are yet to discover how exactly 'profit margin' will be calculated and what the revenue threshold for inclusion in the scope of pillar one might be.

So, what will the impact be? The shift in taxing rights is likely to be most pronounced for tech giants which have been operating based on no permanent establishment or cost-plus transfer pricing models. However, it is important to note that many of these tech giants are already subject to digital services taxes in a number of territories and, when considering the overall impact on their worldwide tax liabilities, there could be a trade-off with tax liabilities in the parent jurisdiction (for example, a number of large US tech giants had already changed their models so as to report foreign income as part of US taxable income). The biggest winners are likely to be the US and European countries with large wealthy consumer markets, at the expense of small wealthy trading hubs, such as Switzerland, Ireland and Singapore (the SIS countries). I would expect other territories, such as China and Japan, to see little difference in their tax take as a result.

Global minimum tax rate

On pillar two, a commitment was made to a global minimum tax rate of at least 15%. Of course, the work is not yet done; notably, we do not yet know what the tax base will be (i.e. what income the 15% tax will be applied to). A 15% tax rate feels like a reasonable middle ground or 'goldilocks' rate. It's not so low that only the true tax havens are caught, and not so high that countries are not able to manage their own tax policies. Notably, 15% is significantly lower than the new 21% rate previously proposed by the Biden administration (the US also plans domestic tax reforms to tax global intangible low-taxed income (GILTI) at 21%). It is, however, higher than the corporate tax rates of several OECD members, including the Republic of Ireland which has a rate of 12.5% for trading profits.

There is no requirement for countries to adjust their headline corporate tax rates as, where countries have an effective tax rate lower than 15%, there are several proposed mechanisms in the pillar two blueprint to implement the minimum taxation. Firstly, a 'top-up' minimum tax can be applied in the ultimate or intermediate parent company jurisdiction in relation to low-taxed profits of foreign branches and controlled foreign companies (the income inclusion rule), which is broadly what the US GILTI rules seek to do. Alternatively, an undertaxed payments rule would deny deductions in the source country or introduce

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source-based taxation under certain circumstances. A switch over rule would apply to undertaxed permanent establishments and works by switching from the exemption method to the credit method of providing double tax relief in the head office jurisdiction. Finally, there is also a proposed subject to tax rule that would expand source countries' withholding tax rights under tax treaties in relation to intragroup payments that are not subject to a minimum nominal rate of tax (to be fully effective this requires that the domestic law in the source country imposes withholding tax at least equal to the minimal nominal rate of tax).

It should be noted that a minimum rate of at least 15% will not only catch those countries with lower headline tax rates. Countries such as Singapore and Hong Kong both have rates above 15% but provide generous incentives which can reduce a company's effective tax rate to below this mark. Patent box regimes, offered by a number of countries including France and the UK, could also be impacted to the extent these incentives bring the effective rate to below 15%.

The extent to which the global minimum tax has a truly transformational effect on tax competition is likely to depend on exactly how pillar two is worked up and then implemented on a consistent basis internationally

It will be interesting to see how the final global minimum tax rules address tax incentives, if at all. Singapore's finance minister has already made the case that 'the new rules should not inadvertently weaken the incentives for businesses to invest and innovate. Otherwise, countries will all be worse off, fighting over our share of a shrinking revenue pie.' Tax incentives are after all a useful tool for governments to encourage 'good' taxpayer behaviours as well as stimulating economic growth and promoting other desirable policy objectives, such as environmental goals.

The overall impact on tax incentives and reliefs will of course depend on the agreed tax base on which the global minimum tax rate of at least 15% is calculated. The detail of this will undoubtedly influence how jurisdictions decide to compete on tax and the types of incentives that are offered in the future. For example, we could see more 'above the line' incentives, such as the UK's research and development expenditure credit or more social security breaks linked to job creation. These would generally be taxable so they would not distort the accounting effective tax rate. Note, however, that the pillar two proposals include a mechanism for reviewing investment tax credits to ensure they are not harmful. The extent to which the global minimum tax has a truly transformational effect on tax competition is likely to depend on exactly how pillar two is worked up and then implemented on a consistent basis internationally.

A final point to note on pillar two is that it is likely that the rate will be applied on a jurisdiction by jurisdiction basis. This is supported by the US, although no formal consensus has yet been reached. Applying the tax rate on a jurisdiction by jurisdiction basis will ensure that multinationals pay tax of at least 15% in each country in which they operate, as opposed to cross-jurisdictional blending of high tax and low tax to an average of at least 15% (as is the case for the current US GILTI regime). Territorial blending will be important in ensuring there is a level playing field between countries with fiscal unity tax consolidation regimes and those like the UK who do not.

Digital services taxes

The G7 also made a further commitment to coordinate the implementation of BEPS 2.0 with the removal of all unilateral digital services taxes. This suggests that G7 countries, such as the UK, France and Italy, which have already implemented digital services taxes, might be prepared to eliminate these taxes, regardless of whether every company currently within the scope of its digital services tax would fall within the scope of the taxing right afforded under the final pillar one. This means that lower margin digital services businesses currently subject to digital services taxes might end up better off as a result of BEPS 2.0, as they will be less exposed to turnover-based taxes.

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In the interim, digital service taxes continue to be a source of contention. At the start of the month, the Office of the US Trade Representative (USTR) announced the conclusion of its investigations into the digital services taxes in Austria, India, Italy, Spain, Turkey and the UK. The investigations concluded that the additional tariffs should be imposed on certain goods from these countries; however, their imposition has been suspended for a period of 180 days to allow additional time for a multilateral agreement to be reached on international taxation at the OECD.

EU public country by country reporting

On 1 June, provisional political agreement was reached by the European Council and European Parliament. The introduction of public CbCR in the EU has been several years in the making and was first raised by the European Parliament in 2015, before the announcement of the European Commission's proposal on public CbCR in April 2016. The plans stalled for some time before being resurrected in March 2021.

Broadly, the EU public CbCR Directive will apply to both EU and non-EU headquartered companies with a consolidated revenue exceeding €750m for each of the last two consecutive financial years. The companies to which the Directive applies will be required to publish tax, financial and functional information, broken down for each EU member state in which they operate, as well as for countries on the EU lists of non-cooperative and monitored jurisdictions.

The Directive will be treated as adopted once the relevant bodies of the Council and Parliament have approved the provisionally agreed text. Member states will then have 18 months to incorporate the Directive into national law. This could mean that the rules may become applicable as soon as mid-2024, with the first

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reporting potentially due in 2025. However, it is possible that some member states could choose to implement the Directive even earlier than this, resulting in earlier first reporting.

There are a number of potential challenges for affected companies. For example, concerns have been raised around the risk that confidential business information could be disclosed, or that information recorded in prescriptive disclosure formats could be misinterpreted, resulting in unwarranted reputational damage for the companies in question. It will be interesting to see how this evolves.

Nigeria suspends CbCR for MNE branches and subsidiaries

Meanwhile, in Nigeria, the Federal Inland Revenue Service (FIRS) will no longer require CbC reports for branches and subsidiaries of MNEs that operate in Nigeria but are headquartered in another jurisdiction. Previously there was a requirement to file a CbC report with Nigeria's tax authorities in cases where no automatic exchange of information mechanism exists between Nigeria and the country of residence of the group's ultimate parent entity. This is a welcome development, however it should be noted that the suspension does not remove other obligations for all relevant entities including the filing of an annual CbC notification in Nigeria.

Possible new transfer pricing rules in Brazil

Brazil is renewing its efforts to reform its tax system to support its application to join the OECD. As part of this, the country's tax authority is looking at adopting OECD-style transfer pricing rules. It is currently in the process of gathering comments from taxpayers on the implementation of new safe harbours, advance pricing agreements, comparability factors, and other transfer pricing measures. It is understood from comments from the tax authority that Brazil will press ahead with applying the arm's length principle even if its request for accession to the OECD is not granted. Groups with operations in Brazil should therefore prepare for changes in the near future. This would be a very welcome development and may pave the way for renewed attempts to agree a double tax treaty between the UK and Brazil.

Exceptional notional interest deduction in Italy

Finally, outside of the transfer pricing world, and back in Europe, a decree has been published in Italy, allowing companies to benefit from an exceptional 15% notional interest deduction in FY21. Alternatively, companies can choose to instead benefit from a tax credit, which can be used against any type of tax, or potentially claimed as a refund. The exceptional 15% rate will apply to the equity increase between the end of FY20 and the end of FY21. Groups with operations in Italy should consider the impact. ■

- ▶ The G7 tax deal (R Kinghall Were & L Urwin, 10.6.21)
- ▶ Report: The road is long for pillars one and two (A Goodall, 10.6.21)
- ▶ EU watch: public country by country reporting (J Barros, 22.6.21)