Briefing

International review for January

Speed read

It has been a busy start to what promises to be an eventful 2022 in the international tax world. The long-awaited BEPS 2.0 pillar two model rules were published on 20 December 2021, with some significant differences to the October 2020 blueprint. Despite this key development, much uncertainty remains, making the 2023 implementation deadline a challenge for governments and businesses alike. Whilst the EU has published a draft Directive to incorporate the pillar two rules into EU law, and the UK has launched a consultation on implementation, the current gridlock around the passage of the Build Back Better Act in the United States could have wider implications for the success of the BEPS project. Finally, EU public country by country reporting is progressing, further complicating an already challenging tax landscape for MNEs.

Tim Sarson
KPMG
Tim Sarson is a tax partner at KPMG and the UK head of tax policy. He has worked in the international tax and transfer pricing field since 1998, in both practice and industry. Email: tim.sarson@kpmg.co.uk; tel: 020 7694 4831.

Pillar two model rules

Work by the OECD to implement a minimum global corporate tax rate has continued in earnest. Following the release of the October 2020 blueprint for global anti-base erosion (GloBE) rules under pillar two of the BEPS 2.0 project, on 20 December 2021 the OECD/G20 Inclusive Framework (IF), involving 137 countries, released more detailed model rules.

The rules provide a template to help countries introduce domestic legislation to ensure multinational enterprises (MNEs) with a turnover of more than €750m pay a minimum level of 15% tax on income arising in each of the jurisdictions in which they operate. Where the effective tax rate (ETR) in a jurisdiction falls below 15%, the rules determine an amount of top-up tax for each constituent entity in the jurisdiction which is expected to be imposed on the parent company. The income inclusion rule (IIR) is the primary rule to impose this top-up tax, with the under-taxed payments rule (UTPR) acting as a backstop to the IIR. There are exclusions in the rules for pension funds, government, international and non-profit organisations, as well as investment funds and real estate investment vehicles that are ultimate parent entities.

The December publications confirm that the adoption of the new rules will be based on a 'common approach'. This means that jurisdictions are not required to adopt the rules, but if they chose to do so, they must implement them consistently with the OECD's model. It also means that where an IF member chooses not to adopt the rules, it must accept their application by other members.

The details of pillar two continue to be complex. A detailed analysis of the model rules is outside the scope of this article (for that, see 'The OECD's pillar two rules: what do we know now?' (J Hare, G Maffini & P Greenfield, *Tax Journal*, 7 January 2022). Instead, the main differences to the October 2020 blueprint have been summarised below.

Turnover threshold

The rules apply to an MNE where consolidated group revenue exceeds €750m. Whereas the threshold test in the October 2020 blueprint was based on the current year and immediately preceding year, the model rules provide for a four-year test period. Generally, if revenue of €750m is exceeded in two of the previous four fiscal years the threshold is met. Special rules apply to merger and demerger situations.

While many businesses will fall below the revenue threshold, the change to a four-year review period introduces additional complexity for groups at the margin, who will have to carefully monitor compliance obligations on an ongoing basis. It could also lead to some behavioural changes by those groups (for example when assessing M&A opportunities) and indeed for some countries looking to attract SME investment.

Domestic top-up tax

The model rules have added a new concept of domestic top-up tax. This allows a jurisdiction to introduce a rule, effectively duplicating the model rules for top-up tax, but ensures that the tax is collected by the local jurisdiction and is not ceded to another jurisdiction under either the IIR or the UTPR.

Assuming low tax jurisdictions take this path, it may reduce the complexity of the rules in many circumstances while still achieving the 15% tax floor.

Effective tax rate

The 2020 blueprint provided for a system of loss and excess tax carry forwards and credits to address issues with timing differences. The model rules replace this approach with an adjusted deferred tax accounting approach. The starting point for calculating a business's effective tax rate is the statutory accounts (with a few exceptions for certain types of timing adjustments), not cash tax. Whilst this approach is still not without its complications, it could have been worse, and should mean the worst distortions from timing differences will be avoided.

UTPR

The UTPR mechanism in the final rules differs significantly from the blueprint. The blueprint UTPR rules were much more limited, with deduction denials focused on related party payments from high-tax constituent entities, and with top-up tax dealt with separately for each low-taxed constituent entity. The final rules provide countries with more avenues for imposing the UTPR tax and incentivise them to do so expeditiously.

What's next?

With less than a year to go until enforcement a significant amount of detail remains unknown. Unusually the OECD did not publish commentary alongside the model rules (this is expected to be published in the coming weeks). Many organisations are relying on this commentary to clarify how the rules will apply to their business. In addition, an implementation framework is not due to be finalised until the end of 2022, leaving little time for groups to get to grips with the compliance burden facing them before the rules are due to go live in 2023.

The IF is also developing the model provision for a subject to tax rule (STTR), together with a multilateral instrument for its implementation, to be released in the early part of 2022 with a public consultation expected in March.

Watch this space as pillar two manoeuvres through what is expected to be a challenging year of work – it may not be smooth sailing. Of particular interest will be developments in President Biden's domestic tax agenda. The publication of the model rules shows that international political consensus

remains, but the current stalled status of the Build Back Better Act will raise some eyebrows. It is difficult to see how GILTI in particular can sit alongside pillar two without the reforms proposed in Biden's tax plan.

European Directive on pillar two

To ensure a consistent and harmonized implementation of the pillar two rules into domestic law across the EU, the EC has proposed that the agreement reached at OECD level will be implemented through a Directive, and it published a draft of this on 22 December 2021. As expected, the rules in the Directive generally mirror the OECD model rules but have a broader scope that includes large-scale purely domestic groups. This is to achieve consistency with EU law, particularly the principle of freedom of establishment.

A goal of Spring 2022 has been set to reach agreement on the implementation of the rules across the EU, which means that the transposition process will need to be conducted at significant pace. However, some member states have cautioned against the rushed implementation of an EU Directive without the parallel implementation approval of the OECD agreement in other jurisdictions, particularly the US.

As mentioned above and as discussed further below, with US tax reform currently stalled, it will be interesting to see how this will impact on the EU transposition process

> It is increasingly looking as though pillar two could go ahead whilst pillar one stalls. If so, have the reports of the death of digital services taxes been greatly exaggerated?

UK public consultation on pillar two

On 11 January 2022, HM Treasury opened a public consultation on the implementation of pillar two in the UK. The consultation stays close to the model rules and specifically seeks feedback from taxpayers on the introduction of the domestic minimum tax, application of the common approach, how domestic rules could be simplified and administration matters. The consultation closes on 4 April 2022 with draft legislation expected to be published in the summer of 2022.

Pillar one

The OECD has conceded that the timeline for pillar one is not as advanced as pillar two and that technical negotiations remain ongoing. Currently, it is expected that an OECD multilateral convention containing the Amount A rules of pillar one as well as its explanatory statement and model rules for domestic implementation and commentary are expected in early 2022.

Again, US tax reform is casting a shadow over pillar one. If the Biden administration cannot pass the Build Back Better Act with its reforms to align GILTI and BEAT with pillar two, it is difficult to see how the relevant changes to implement pillar one will be passed.

It is possible, if not probable, that pillar two will ultimately go ahead even if the US does not pass its tax reforms. However, successful implementation of pillar one is heavily dependent on the US as the rules are anticipated to result in a reallocation of profit from the largest companies to market destinations. And many of the largest companies are US headquartered.

The OECD has presented the two pillars as a package but it is increasingly looking as though pillar two could go ahead whilst pillar one stalls. If so, have the reports of the death of digital services taxes (DSTs) been greatly exaggerated? The IF previously committed to removing all DSTs and 'other relevant similar measures; and to not introduce such measures in the future. But if pillar one falls away then this commitment would also and we could see a host of unilateral DSTs.

US tax reform

The Build Back Better Act (BBBA) continues its arduous journey to be passed into law. The Bill proposes significant spending on areas such as education, childcare and climate change and includes proposals on tax reform. These tax proposals were significantly watered down over the course of 2021 due to narrow Democratic majorities and Republican opposition. However, the Bill included a number of important amendments to the GILTI regime to ensure its co-existence with pillar two: an increase in the rate to 15% and proposals to move the calculation of GILTI to a jurisdictional basis (as opposed to its current global basis).

The Biden administration aimed to pass the Bill by the end of 2021: instead, it spent the lead up to Christmas attempting to avert the complete collapse of the legislation. As it stands, BBBA is in limbo, with uncertainty over what proposals will have to be amended or removed to secure its passage. With US mid-term elections to be held later this year, the changing US political landscape may further complicate the already challenging international tax scene.

EU public country by country reporting

Finally, the EU published the public country by country reporting (CbCR) Directive on 1 December 2021 and this came into force on 21 December 2021. The Directive will require multinational groups (both EU and non-EU headquartered) with total consolidated group revenue of at least €750m to publish certain tax, financial and functional information on a country by country basis for each EU member state that the group is active in, as well as for countries on the EU lists of non-cooperative and monitored jurisdictions. While multinationals will already be comfortable with providing CbC reports to tax authorities, public disclosure will bring a whole new level of tax transparency with greater public scrutiny.

EU member states have until 22 June 2023 to transpose the Directive into domestic legislation, with the rules being applicable from June 2024. Member states can apply the rules earlier than the set deadline and businesses should therefore monitor further developments closely on a jurisdiction by jurisdiction basis. Taxpayers will also have to monitor how different jurisdictions decide to implement specific provisions of the Directive, including the safeguard clause and penalties for non-compliance.

2022 promises to be an eventful year for international tax. ■

For related reading visit www.taxjournal.com

- Profit recognition under GloBE and domestic rules: it's all in the timing (B Salehy, 20.1.22)
- Turning theory into practice: implementing pillar two in the UK (C Sanger & J Gifford, 20.1.22)
- The OECD's pillar two model rules: what do we know now? (J Hare, G Maffini & P Greenfield, 7.1.22)
- International accords on tax, but what will happen (S Edge, 9.12.21)
- US roadblocks to the OECD deal (J Havard & H Self, 18.11.21)
- The two pillar framework: what does the October statement tell us? (P Greenfield, C O' Hara & G Maffini, 14.10.21)