Briefing

International review for April

Speed read

The international tax landscape continues to be dominated by BEPS 2.0 developments. The US has published its FY 2023 Budget including further proposals to make the US tax regime more consistent with the pillar two Model Rules. However, ongoing political uncertainty means that it is not clear if these proposals will ultimately be passed by Congress. Meanwhile in the EU, the text of the Directive to implement pillar two still has not been finalised, with Poland continuing to withhold its agreement to the proposals. Pillar one continues to quietly progress in the shadow of pillar two, with the OECD issuing another public consultation on the draft rules. Finally, in something of a quantum leap, Brazil has announced it will reform its unique transfer pricing regime to align with OECD standards.

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US 2023 Budget

On 28 March 2022 the Biden Administration ('the administration') presented its Budget recommendations to Congress for fiscal year (FY) 2023.

The Budget sets out the administration's annual discretionary spending plan for FY 2023, as well as its longer-term plans to 'execute a new economic vision, reduce costs for families, reduce the deficit and build a better America'. These plans include many of the economic policy proposals from the Build Back Better Act (BBBA) released last year – either in original or modified form – as well as some new policy initiatives.

The US Treasury Department's 'Green Book' set out its explanation of the tax proposals in the Budget. It is not possible in this article to give a comprehensive overview of the 120 pages of the Green Book, so I have set out a few high-level comments on significant measures from an international tax perspective.

It should be noted that the Green Book proposals are only recommendations and still need to be approved by Congress. With Democratic majorities in the House and Senate remaining razor thin, this will by no means be an easy process, and one made more challenging given the short time before the US Midterm elections in November 2022.

Increase in corporation tax rate

The FY 2023 Budget proposes raising the corporation tax rate from 21% to 28% effective for taxable years beginning after 31 December 2022. The Green Book states that this rate increase is an administratively simple way to raise revenue to pay for the administration's infrastructure proposals and other longstanding fiscal priorities. It also points out that 'a significant share of the effects of the corporate tax increase would be borne by foreign investors.

Previous attempts to increase the corporation tax rate under the Biden administration have failed, so it will be interesting to see if this attempt will prove successful and, if so, what impact this will have on investment in the US.

Repeal and replacement of BEAT with an UTPR

One of the most significant international tax developments is the proposal to repeal and replace the base erosion and anti-abuse tax (BEAT) with an undertaxed profits rule (UTPR) which is intended to increase alignment with the OECD pillar two model rules.

The UTPR proposal represents a fundamental departure from the principles underlying BEAT and goes significantly further than previous reforms proposed by the administration.

The proposed UTPR would be effective for taxable years beginning after 31 December 2023 and would generally apply to foreign-parented financial reporting groups that have global annual revenue of $850m or more in at least two of the prior four years. It would not apply with respect to income subject to an income inclusion rule (IIR) that is consistent with the pillar two model rules. Accordingly, the UTPR proposal would generally be expected to exempt US-parented multinationals because the UTPR would not apply with respect to income subject to the proposed 'global intangible low-taxed income (GILTI), sub-part F, and foreign branch income regimes, as modified under the BBBA bill (which has yet to be passed).

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Unlike previous proposals to modify BEAT, the UTPR proposal would apply a top-up tax by reference to low-taxed income of foreign entities and foreign branches, as determined on a jurisdiction-by-jurisdiction basis, and would coordinate the allocation of the top-up tax among the US and the other foreign members of the group that apply a qualified pillar two UTPR. Specifically, US corporations and US branches of foreign corporations would be disallowed US tax deductions to the extent necessary to collect the hypothetical amount of top-up tax required for the financial reporting group to pay a 15% effective tax rate in each profitable foreign jurisdiction.

Introduction of a domestic minimum top up tax

The Budget introduces a domestic minimum top up tax (DMT) to protect US tax revenue from the imposition of a UTPR by other jurisdictions. The proposals introduce a DMT if and when another jurisdiction adopts the UTPR. The DMT would equal the excess of (1) 15% of the financial reporting group's US profit (based on the UTPR methodology) over (2) all the group's income tax paid or accrued with respect to US profits. However, some of the wording used in the proposal is vague, meaning the scope and applicability date of the DMT rule is not entirely clear at this stage.

As detailed above, there remains significant political challenges in the journey to implement any tax reform in the US and proposals that lack bipartisan support remain very uncertain.

European Directive on pillar two

My January article (*Tax Journal*, 28 January 2022) noted the publication of the draft EU Directive to implement pillar two. Discussions to reach member state consensus on the text of the Directive are ongoing and are not proving to be straightforward.

Following technical discussions in the Council working groups, a compromise text was published on 12 March 2022 in advance of the 15 March 2022 Economic and Financial Affairs of the EU (ECOFIN) meeting. This provided for several amendments to the initial text of the Directive to incorporate the ongoing work of the OECD and to rectify areas of discrepancy between the initial text and the model rules.

Due to concerns raised by several member states regarding the short timeline for transposing the model rules into domestic law within the 31 December 2022 deadline, the compromise text referred to a transposition deadline of 31 December 2023. It also included an option for member states to defer the application of the IIR and the UTPR until 31 December 2025, where no more than ten ultimate parent entities (UPEs) of in-scope MNE groups are located in those member states.

The majority of member states supported the compromise text proposed by the French presidency at the 15 March ECOFIN meeting. However, Estonia and Malta requested a broader scope and timeframe in respect of the optional IIR and UTPR deferral. Poland also restated its concerns regarding the adoption of the Directive independent of pillar one, whilst Sweden maintained a parliamentary scrutiny reservation. Due to the concerns of these four member states, the 15 March ECOFIN meeting failed to reach political agreement on the text.

On 5 April 2022, ECOFIN reconvened to discuss a revised compromise text that was published on 28 March 2022. This includes the following updates to address reservations raised by the four member states above:

- The revised compromise text extends the application period of the deferral to six years instead of five and increases the maximum number of UPEs in a member state to 12 as opposed to 10.
- It includes provisions stating that member states that opt to defer the application of the IIR and the UTPR should transpose the Directive in a manner that allows the application of the UTPR in other member states and third country jurisdictions. To facilitate the UTPR application, the relevant member states shall require domestic constituent entities to share the relevant information within the MNE group.
- To support legal certainty and efficiency, the revised compromise text empowers the Commission to determine, a list of third country jurisdictions that have implemented a legal framework in their domestic law which is considered by the EU to be a qualified IIR. The assessment prepared by the Commission should refer to the assessment of IIR regimes carried out at OECD level.
- According to the note to the Council, the French presidency maintains its proposal that the agreement on the Directive should be accompanied by a statement confirming the Council's full commitment to the successful implementation of the OECD's pillar one solution, within the agreed timeline.

Despite these revisions, Poland restated its request for a legally binding link on the implementation of both pillar one and pillar two and therefore did not support the revised compromise text. Accordingly, the EU Minimum Tax Directive will be added to the agenda for the next ECOFIN meeting on 24 May 2022 and the French presidency continues to pursue the goal to find consensus among all EU member states.

OECD pillar one consultation

Pillar one continues to progress in the shadow of pillar two, with the OECD issuing a request for public comments on the draft model rules for domestic legislation on scope under Amount A of pillar one on 4 April 2022. The purpose of the scope rules is to determine whether a multinational group will be in scope of Amount A. Draft rules for the exclusions for extractives and regulated financial services will be released for public consultation at a later date.

As with the previous pillar one rolling consultations, the proposed rules do not reflect consensus by members on substance, rather they are a working draft of the rules released for comment given the tight implementation timetable for pillar one.

At the time of writing this consultation had closed and the OECD are in the process of analysing the responses received.

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Brazil transfer pricing regime

Finally, on 12 April 2022 representatives of the Brazilian government and the OECD met to discuss proposals to align Brazil's unique transfer pricing (TP) rules to the OECD transfer pricing paradigm.

This follows work that began in 2019 to assess the similarities and differences between the Brazilian TP system and the OECD TP framework. The 12 April announcement contradicts expectations that Brazil would adopt a hybrid TP system: rather, in something of a quantum leap, Brazil now seems to be inclined to fully adopt OECD TP standards. This would represent a huge shift for a country which until now has been seen as one of the true exceptions in international tax, where everything you thought you knew about global tax principles were turned on their head.

In 2022 and 2023, taxpayers can expect to see actions towards the adoption and operational steps of the new TP framework. However, no clear timeline for implementation of the new regime has been given. Brazilian government representatives stressed the importance of an 'appropriate moment' to present the legislative proposal to its Congress. However, 2022 is an election year in Brazil and, in this environment, anything can happen – or perhaps not happen. ■

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- 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)
- BEPS 2.0: the two-pillar approach (I Zeider & L Hodgson, 16.9.21)