

Briefing

International review for July

Speed read

As has consistently been the case throughout this year, this month has seen some developments in respect of BEPS 2.0 pillar one continues to develop, with the OECD releasing a progress report and consultation document on Amount A. Progress on pillar two in the EU continues to stall, and this has created disagreement on how to progress with some EU bodies looking to alternatives to unanimity, such as enhanced cooperation. In the meantime, the UK became the first country to issue draft legislation implementing pillar two. The European Parliament made a breakthrough in agreeing revisions to some 'fit for 55' proposals, which created waves last month. Furthermore, as has been the trend over the last few months, more jurisdictions have had transfer pricing developments.

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BEPS 2.0: pillar one

On 11 July 2022, the OECD released its *Progress report on Amount A of pillar one*. The report is a consultation document issued for the purposes of obtaining further input from stakeholders on the technical design of Amount A, which is the mechanism for allocating profits according to a formula based on local revenues.

The report includes a form of domestic model rules which contain new details for stakeholders, for example on elimination of double taxation and the marketing and distribution safe harbour. There are also new (and complicated) rules on segmentation.

Many gaps still remain; the report does not yet include rules on the administration of the new taxing right, including the tax certainty-related provisions, which is expected before the Inclusive Framework meeting in October 2022.

The report makes it clear that any multilateral convention will only enter into force once it has been ratified by a critical mass of countries, which will include the residence jurisdictions of the ultimate parent entities of a substantial majority of the in-scope companies. In practice, this means that the US, where many of the impacted multinationals are headquartered, will be critical.

The report is subject to public consultation until 19 August 2022. The Inclusive Framework will seek to finalise the rules at its meeting in October 2022, with the aim to finalise a new multilateral convention by mid-2023, for entry into force in 2024.

BEPS 2.0: pillar two**UK**

On 20 July 2022, the UK government became the first country to issue draft legislation implementing pillar two.

The publication confirms that the income inclusion rule (IIR) will first apply to accounting periods beginning on or after 31 December 2023. The government expects to implement an under taxed payment rule (UTPR) but the timing of this is still to be determined. The government also still seems to favour a domestic minimum tax although no final decision on implementation has been made yet.

The government intends to legislate in Finance Bill 2022/23. This means that 'substantive enactment' of the legislation in spring of 2023 is likely, impacting the financial reporting disclosures for in-scope groups in 2022.

The UK may also be seen to be leading the way globally to find a pragmatic way to accommodate GILTI coexistence with the pillar two rules and other countries may look to this approach as they seek to implement pillar two in their jurisdictions. The UK government expects that the tax paid in the United States under the current GILTI regime would be included in the adjusted covered taxes of a US group's controlled foreign corporations for the purposes of both the IIR and UTPR. This approach recognises the challenges for US-headed groups in the absence of reform to the GILTI regime. It will be interesting to note the response of other countries which will need to grapple with the same challenge.

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Despite the draft legislation and over 200 pages of explanatory notes being published, uncertainty remains as some key policy and administration decisions are still to be decided by the OECD's Inclusive Framework and as part of the administrative guidance. This ongoing uncertainty will continue for some time and demonstrates the challenge of implementing rules on a global scale.

European Union

As discussed in my article last month (*Tax Journal*, 24 June 2022), progress on the EU Directive to implement pillar two (the Directive) stalled at the latest meeting of the Economic and Financial Affairs Council of the EU (ECOFIN Council) on 17 June 2022, when Hungary changed its position and withdrew its previous agreement.

In light of this development, the European Parliament adopted, on 6 July 2022, a non-binding resolution that included a recommendation to explore alternative options to honour the European Union's commitments at an international level, notably through enhanced cooperation.

This issue will remain at the forefront of European politics for some time. No progress on the implementation of the Directive was made at the latest ECOFIN on 12 July 2022, the last under the French presidency. The Czech presidency of the European Council has now begun, and the Czech Minister of Finance noted on 13 July 2022 that it will focus on the Directive with a view to reaching unanimous agreement at the ECOFIN Council meeting scheduled for 4 October 2022, although we may get an indication of progress at an 'informal' ECOFIN meeting in September 2022.

European Parliament: 'fit for 55'

As most readers will be aware, the 'fit for 55' package is intended to enable the EU to reduce its net greenhouse gas emissions by at least 55% by 2030 compared to 1990 levels and to achieve climate neutrality in 2050.

Despite these ambitions, 'fit for 55' has faced some challenges. The European Parliament (the Parliament) failed to pass several key 'fit for 55' climate change proposals in early June and the measures to reform the existing EU emissions trading scheme (ETS), create a social climate fund, and establish an EU carbon border adjustment mechanism (CBAM) were referred back to Committee level to be reworked.

However, a breakthrough was achieved on 22 June 2022, with a strong majority of the Parliament agreeing to the revised proposals on CBAM and the ETS. The Parliament is now ready to negotiate these legislative proposals with the EU member states.

The revised proposals:

- broaden the scope of CBAM to include chemicals, plastics, hydrogen and ammonia, in addition to products proposed by the Commission (iron and steel, refineries, cement, organic basic chemicals and fertilisers);
- extend CBAM to indirect emissions, i.e. emissions deriving from the electricity used by manufacturers, to better reflect CO₂ costs for European industry; and
- replace 27 competent authorities in each member state with one centralised CBAM authority, aiding transparency and efficiency. It is thought that this would also assist in combating forum shopping from importers.

Any free ETS allowances granted to EU industries will be phased out by 2032. The CBAM would apply from 1 January 2023, with a transitional period until the end of 2026.

Around 27% of global CO₂ emissions from fuel combustion is currently derived from internationally traded goods. Emissions arising from imports to the EU have been increasing, undermining any efforts by the EU to reduce its greenhouse gas footprint. A CBAM is expected to reduce global carbon emissions by incentivising non-EU countries to reduce their emissions and to reduce the risk of carbon leakage by moving production outside the EU to countries who have more lax climate policies: a broader scope and faster implementation would go a long way to meet the EU's ambitious climate targets.

The policies must still clear several hurdles before becoming law, the next one being passing the European Council, made up of the heads of state or government of each of the EU's 27 members.

In further encouraging news, on 29 June the Council of the European Union announced that it had adopted a common negotiating position on important legislative proposals in the 'fit for 55' package. These positions covered areas such as the EU ETS, effort-sharing between member states in non-ETS sectors and the creation of a social climate fund. This development means that the Council is now ready to negotiate with the European Parliament in order to reach an agreement on the final legal texts.

Differences still remain between the Parliament and the Council and so, while these latest developments are encouraging, the package may face further difficulties. But despite the possible hurdles ahead, this will be a welcome development for the proponents of the European green deal.

Transfer pricing Hungary

On 21 June 2022, the Hungarian government submitted a bill to parliament which contained proposals to tighten transfer pricing (TP) rules. The proposals include:

- A new reporting obligation. Taxpayers subject to the obligation to prepare TP documentation will also be required to provide data in connection with transfer prices in their annual corporate income tax return. The exact content of the reporting obligation will be determined by ministerial regulation and will be due at the time of filing the 2022 corporate income tax return.
- The maximum amount of the default penalty for failing to comply with the documentation and record keeping requirements will be increased from the current maximum HUF 2m to HUF 5m per controlled transaction.
- New definitions of the arm's length price and the arm's length range that are in line with the definitions set out in the OECD TP guidelines.
- The fee for advance pricing arrangement (APA) requests will be increased to HUF 5m for a unilateral APA and HUF 8m for a bilateral or multilateral APA.

Cyprus

On 30 June 2022, the Cyprus parliament approved comprehensive TP requirements, aligned with BEPS Action 13. The rules introduce new TP documentation requirements for tax resident companies and permanent establishments, who are required to maintain documentation in respect of transactions with related parties. While the required content will be specified in guidance at a later date, the documentation will need to be maintained in a local file, while a master file may also be required in certain cases. In-scope taxpayers will also be required to complete an annual summary information table (SIT) alongside the corporate income tax return, which will contain high level information on related party transactions such as the identity of the counterparties and the value of the transaction.

UK

In light of the OECD's guidance on documentation under BEPS Action 13, and the increasing adoption of prescriptive rules among comparable tax jurisdictions, the UK has been reviewing its approach to transfer pricing documentation. On 20 July, the UK government published additional material on the planned introduction of mandatory UK transfer pricing documentation for large businesses. The requirements will be implemented via regulations and although we need to wait for these regulations and accompanying HMRC guidance, it is likely that these will align closely with the OECD master file and local file content. As expected, the UK requirements will include a 'summary audit trail' (SAT) questionnaire, which details the main actions undertaken in preparing the local file. The SAT is a bespoke UK requirement aimed at encouraging taxpayers to undertake sufficient work to support TP policies. The requirements will apply for accounting periods on or after 1 April 2023 and we can expect the working draft of the SAT and draft HMRC guidance to be published later this summer. ■

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► Pillar two and the future of tax incentives (B Salehy, 6.7.22)