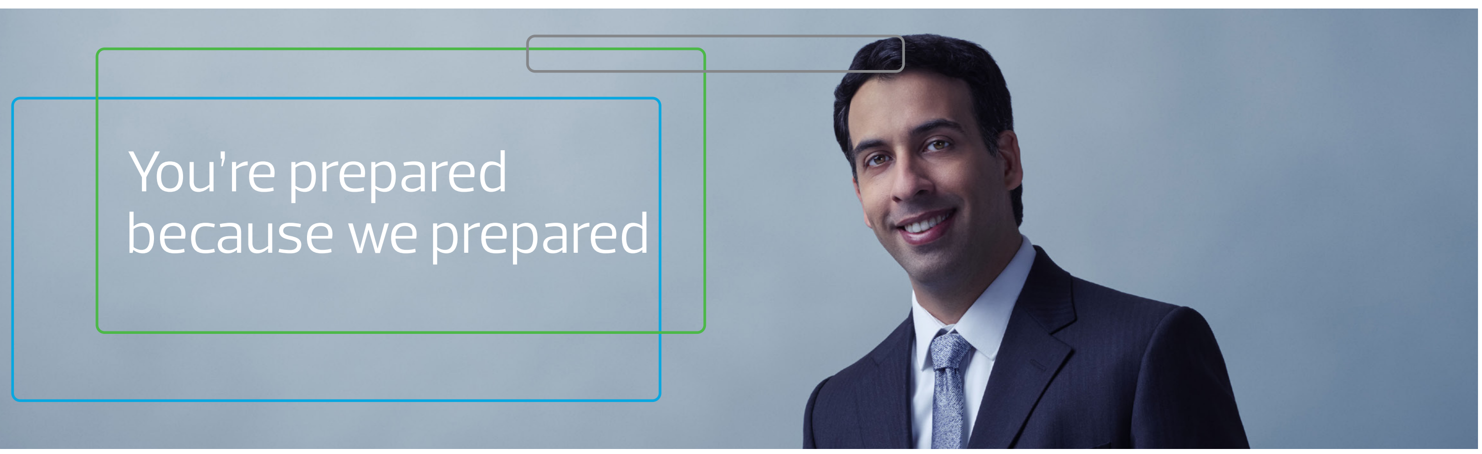

GLOBAL TAX POLICY IS NOW TRULY GLOBAL

On July 1, 2021, the OECD announced that 130 countries joined a new two-pillar plan to reform international taxation rules and to address the tax challenges arising from the digitalization of the economy. A small group of the Inclusive Framework's 139 members have not yet joined at this time.

The two-pillar package aims to ensure that large Multinational Enterprises (MNEs) pay tax where they operate and earn profits, while adding much-needed certainty and stability to the international tax system. The two-pillar package should also provide much-needed support to governments needing to raise necessary revenues to repair their budgets while investing in essential measures necessary to help optimize the strength and the quality of the post-COVID recovery.

Thursday's agreement by 130 countries (including countries such as China, the United States, UK and India) representing more than 90% of global GDP is a clear sign: the race to the bottom is one step closer to coming to an end.

Many of the details within the deal, such as possible exemptions for the financial industry and extractive companies, have been left out of the current pact and should be addressed by October 2021. Each of the 130 nations, including the United States, must convert its endorsement of the five-page plan into detailed domestic legislation once detailed implementation plan together with remaining issues will be finalised by October 2021. The agreement follows an endorsement by the G7 group of wealthy nations last month at a meeting in Britain. The negotiations now move to a meeting of the G20 group of developed and emerging economies on July 9 and 10 in Venice, Italy.

Objective

The initiative aims to introduce a global tax for the world's biggest companies and reallocates taxing rights and set an international minimum effective corporate tax rate of at least 15 percent.

The OECD statement stated the two-pronged accord would reallocate the right to tax $100 billion MNE profits, including digital companies' profits, from their home nations to countries where they earn money regardless of whether such MNEs have a physical presence there (Pillar One). The deal also sets a minimum corporate profits tax of at least 15 percent, which is expected to raise $150 billion annually, according to the OECD (Pillar Two).

Pillar One was originally aimed solely at tech giants and would have forced them to pay tax on profits, above a certain threshold, in all countries where they have operations. But after the USA unveiled new proposals in April, the scope of those measures was expanded to include the world's top 100 companies, both digital and nondigital, with global annual revenue of more than $20 billion. The tax will apply to the companies' profit margin above 10 percent. Also, the deal should facilitate that companies' respective business units will be brought into scope even if the overall operations are not.

Pillar Two shall set a global minimum corporate tax rate so that MNEs cannot not shop around for jurisdictions that offer them the lowest rate. Countries opposes to that idea saying that it threatened to undermine their sovereignty by not allowing them to set their own national tax policies.

Thought Leadership

The consensus reached this week will lead to a huge shift in global tax policy. It is also proof that so many of the world's largest economies are looking at international cooperation on tax policy and not at individual country priorities in dealing with the consequences of the global Covid pandemic and working on increased tax revenues.

We expect that the upcoming changes will affect more internationally active companies than just the top MNEs in the world. The current proposals will lead to a significant change in the tax legislation of all participation countries of the Inclusive Framework. These changes will in many countries be combined with further legislative changes affecting local taxpayers. Also the permanent establishment concept will change even further to accompany the Pillar 1 changes and the new taxation principles could potentially also impact local tax exemptions, tax credit rules and offshore systems.

The experience from implementation of recent multinational tax initiatives (OECD and EU) has also shown that implementing such an overhaul almost always leads to very complex local rules. Even though the July 1 OECD statements refer to keeping compliance and administration costs low, companies dealing with complex new rules do expect this to come with a compliance (and advisory cost) burden.

The rapid pace of the implementation, which aims for approval in 2022 and rules taking effect per 2023, will contribute to countries choosing a wider scope over a more specific targeted approach. Companies should therefore start preparing for the upcoming changes. Whether this relates to the assessment of the impact of the tax rate changes, the use of low tax jurisdictions or local taxable presence vs revenues, tracking the progress of the new Inclusive Framework plans and the more detailed implementation items coming later this year will be very important.

More information?
If you would like more information about the above, please contact your trusted RSM advisor.

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