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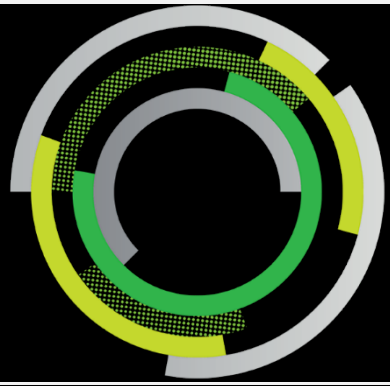

Corporate tax alert

International tax

G7 finance ministers agree on taxation of digitalized economy, global minimum rate

On 5 June 2021, OECD Secretary-General Mathias Corman issued a statement on the high-level political agreement of the G7 finance ministers on global tax reform, including the reallocation of a share of the global residual profit of certain businesses to market countries and a minimum effective tax rate in each country in which a business operates of at least 15%.

Since 2017, the 135+ member countries of the G20/OECD Inclusive Framework on BEPS ("inclusive framework") jointly have been developing a "two pillar" approach to address the tax challenges arising from the digitalization of the economy. This led to the publication of two detailed "blueprints" in October 2020 on potential rules for addressing nexus and profit allocation challenges (Pillar One) and for global minimum tax rules (Pillar Two). The proposals were updated and simplified by the US Biden Administration in April 2021 and formed the basis for the political discussions by the G7.

Key features of the G7 agreement

Nexus and profit allocation rules (Pillar One)

Pillar One's Amount A proposal reallocates taxing rights in favor of market countries through the creation of a new taxing right. A share of a group's global residual profit will be reallocated to market countries using a formulaic approach. No physical presence is required in a market country to create a new nexus (taxable presence).

The G7 have reached agreement that Amount A should apply to the "largest and most profitable" multinationals. This is in line with proposals put forward by the Biden Administration earlier this year. This supersedes the OECD Pillar

One blueprint's scope that included only "automated digital services" and "consumer facing businesses." Further clarity is needed in respect of the thresholds for determining businesses that are the largest and most profitable.

In-scope businesses would reallocate at least 20% of their residual profit above a 10% profit level to market countries. This is expected to be calculated as the ratio of profit before tax (derived from consolidated group financial accounts prepared under an eligible accounting standard such as IFRS with minimal book-to-tax adjustments) to revenue, as set out in the OECD Pillar One blueprint.

Also in line with the OECD Pillar One blueprint, any Amount A liability would be allocated between "paying entities" and relieved via either exemption or credit.

The G7 stresses that implementation will be coordinated with the removal of all digital services taxes (DSTs) and other relevant similar measures.

Global minimum tax (Pillar Two)

The Pillar Two proposal comprises a set of interlocking international tax rules designed to ensure that large multinational businesses pay a minimum level of tax on all profits in all countries. The OECD Pillar Two blueprint proposed that multinational groups with consolidated revenues of EUR 750 million or more would be in scope.

Where the tax on profits otherwise would be below an agreed minimum effective tax rate, the "income inclusion rule" would result in additional "top up" amounts of tax being payable by the ultimate parent entity of the group to its tax authority. The "undertaxed payment rule" would apply as a secondary rule where the income inclusion rule has not been applied.

The G7 have agreed that the minimum effective tax rate in each country in which a business operates should be at least 15%. (The OECD Pillar Two blueprint was silent on what the minimum effective tax rate should be, but 15% had been put forward by the US Treasury).

Next Steps

The G7 communiqué hopes that agreement will be reached between the G20 finance ministers in their meeting of 10-11 July 2021. The G20/OECD inclusive framework is due to meet and discuss the revised Pillar One and Pillar Two proposals on 30 June–1 July 2021.

Significant further technical work also is needed and implementation, including through a multilateral instrument to facilitate double tax treaty changes, will take time and is unlikely to be before 2025, at the earliest.

Comments

Political agreement among the world's largest economies is a huge step for international tax reform and signals a welcome return to a multilateral approach. Further political agreement (notably at the G20 and OECD inclusive framework) is needed, but businesses will recognize the impetus that the G7 agreement gives to addressing the tax challenges of the digitalized economy.

Key questions remain (in particular around scope) and there are technical areas that the OECD will continue to work through. The Biden Administration also will need to persuade the US Congress to pass the proposals.

The G7 have agreed that the largest and most profitable businesses should reallocate a share of global residual profit to market countries under Pillar One.

No detail is yet available on how to determine the largest and most profitable businesses, but the Biden Administration proposals indicated that the rules should focus on around 100 of the largest global businesses. Further discussions are expected in respect of whether segmentation would be required where a group has a mixture of highly profitable and less profitable activities, and whether certain sectors such as extractives and financial services should be excluded from scope.

A key component of the agreement is the commitment for the implementation of Pillar One to be coordinated with the removal of unilateral digital services taxes and similar measures.

The G7 also have agreed to a global minimum tax under Pillar Two of at least 15%, calculated on a country-by-country basis. The Biden Administration plan to amend the US global intangible low-taxed income (GILTI) regime to bring it into much closer alignment with Pillar Two's income inclusion rule, as well as raising the GILTI minimum tax rate, as part of domestic changes to increase corporation tax rates.

The G7 agreement is brief and focusses on the big picture framework. It makes clear that the two pillars will continue to progress, politically and technically, in parallel. Other areas of the Pillar One and Two proposals, such as a fixed marketing and distribution function return (Amount B), the design of an undertaxed payments rule, and any treaty changes for a "subject to tax" rule remain under discussion.

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