

# Future of Taxation in Construction

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### Tax trends and the impact on multinational engineering and construction enterprises

The international tax landscape has evolved in the last decade and is expected to change further in the near future.

A key driver of transformation in the international tax system is the political agreement reached by the Organization for Economic Co-operation and Development (OECD)/ G20 Inclusive Framework on Base Erosion and Profit Shifting (BEPS) on 1. how taxation rights on income should be allocated among jurisdictions (Pillar One), and 2. how much income should be taxed. (Pillar Two)<sup>1</sup>. Agreed measures, which should apply from 2023, and are expected to transform the international tax system.

There are also new international tax rules focusing on anti-tax avoidance and increased tax transparency requirements for Multinational Enterprises (MNEs) that will contribute towards shaping the international tax landscape.

### New tax rules which will impact the engineering and construction (E&C) sector:<sup>2</sup>

- Fair taxation: Pillars One and Two

#### 01. Pillar One

Amount A: aims to reallocate taxing rights in favor of the “market country”, introducing a new tax nexus, with or without local physical operations in the market country, and profit allocation rules, using a formulaic approach based on the sourcing of revenues. In-scope companies are MNEs with global turnover over €20 billion and profitability (profit before tax/revenue) above 10%<sup>3</sup>. Safe harbor rules are established for MNEs with physical operations in market countries where they are already taxed.

Amount B: establishes a fixed remuneration based on the Arm’s Length Principle for baseline distribution and marketing functions that take place in the market jurisdiction<sup>4</sup>.

#### 02. Pillar Two

The Global Anti-Base Erosion (GloBE) Rules contained in the Pillar Two provide for a coordinated system of taxation intended to ensure large MNE groups, recognizing annual revenue of €750 million or more in their Consolidated Financial Statements, pay a minimum level of tax on the income arising in each of the jurisdictions where they operate<sup>5</sup>. It does so

by imposing a top-up tax on profits arising in a jurisdiction whenever the effective tax rate<sup>6</sup>, determined on a jurisdictional basis, is below a 15% minimum rate. As a primary rule, top-up tax will be paid and collected in the jurisdiction where the MNEs’ headquarters are located. As a significant tax trend, it is expected that market countries progressively implement minimum taxes aligned with GloBE rules to try to retain the collection of taxes and, consequently, avoid the transfer of taxes to the headquarters’ jurisdiction.

- Anti-tax avoidance: Multilateral Instrument (MLI)<sup>7</sup>

The MLI intends to close the gaps in existing international tax rules by transposing results from the OECD/G20 BEPS Project into bilateral tax treaties worldwide. The MLI modifies the application of thousands of bilateral tax treaties by implementing agreed minimum standards, notably, specific counter treaty abuse rules<sup>8</sup>.

- Increased tax transparency requirements: public CbC, Unshell

At a regional level, the EU has agreed that, from mid-2024, EU MNEs will publicly disclose the tax information included in the Country-by-Country (CbC) report which includes aggregate data on the global allocation of income, profit, taxes paid and economic activity among the tax jurisdictions in which the MNEs operate.

Also, the EU Commission recently proposed new measures to establish transparency standards around the use of shell entities, which might enter into force from 2024. Under certain circumstances, some entities will be required to report information in their tax returns related to, for example, the premises of the company, its bank accounts and the tax residency of its directors and employees<sup>9</sup>.

### Impact on E&C MNEs: complexity and compliance

The largest E&C MNEs may not fall within the scope of Pillar One Amount A since it is unlikely that they exceed the 10% profitability threshold. In addition, E&C MNEs have physical presence (i.e., engineering and construction projects) in the market countries where they operate and, accordingly, are already taxed in these jurisdictions, so, even if Amount A comes into play, safe harbor rules may apply, totally or in part, mitigating the potential impact. E&C MNEs with operations in low tax jurisdictions may be affected by the GloBE rules. However, since E&C MNEs are often headquartered and operate in regions with medium-to-high corporate tax rates, the impact of this proposal in terms of materiality should not be significant.

Application of anti-tax avoidance measures, such as the MLI minimum standard on counter treaty abuse, should be limited to some specific abusive cases; for instance, to cases where Tax Administrations challenge forced interpretation of the tax nature of the income flows (i.e., business profit vs. royalty), triangulation of services through a country covered by a tax treaty without business substance, etc.

Increased tax transparency requirements, particularly the Public CbC report, will help Tax Administrations to perform tax risk profiling of E&C MNEs based on the different types of tax risk indicators that may be identified on the publicly disclosed information. In addition, public tax information will impact on the perception of analysts, investors, civil society, NGOs, etc., when analyzing the tax fairness, risks, and sustainability of the E&C MNEs.

New tax rules are highly complex and intertwined, so understanding all the implications and correlations of the new tax rules and their coexistence with the existing ones will be an important challenge for accounting and tax departments at E&C MNEs.

Besides the impact on additional taxes to be paid, tax compliance by E&C MNEs will be increased significantly. For efficient application of the new rules, it is crucial that procedures are coordinated at group level and it will be necessary to ensure unobstructed flow of information within the E&C MNEs and to tax administrations

### Next steps: anticipation and adaptation

Anticipating the impact analysis on a case-by-case basis and modelling the different scenarios before the new international tax rules enter into force is critical and would allow E&C MNEs to anticipate the implementation of actions to adapt themselves to the new rules and, consequently, mitigate potential undesired effects.

Adapting the systems, processes, and governance of the E&C MNEs to the new tax requirements is crucial in order to manage and monitor new global tax compliance and reporting requirements correctly and efficiently. Data extraction and tax calculation automation will be key to facing the increasing tax compliance requirements.

Finally, it is vital that tax information is disclosed consistently since it is under continuous scrutiny, not only by Tax Administrations, but also by stakeholders and analysts, and could impact, beyond taxation, on the reputation, (and potentially on the revenues) of the E&C MNEs.



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1. OECD (2021), Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy, as approved by the OECD/G20 IF on BEPS on 8 October 2021.

2. This section does not intend to include an exhaustive list of all recent and upcoming international tax measures but a summary of the most relevant new tax rules that will change the international tax system.

3. Rules to be potentially applicable as from 2023.

4. Rules to be potentially applicable as from 2024.

5. Rules to be potentially applicable as from 2023.

6. OECD (2021), Tax Challenges Arising from the Digitalisation of the Economy Global Anti-Base Erosion Model Rules (Pillar Two), as approved by the OECD/G20 IF on BEPS on 14 December 2021.

7. “Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting”.

8. MLI entered into force in July 2018.

9. [https://ec.europa.eu/taxation\\_customs/taxation-1/unshell\\_es](https://ec.europa.eu/taxation_customs/taxation-1/unshell_es)