



Tax and Legal Services

Tax Alert 10/2021

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Taxation in the digital economy: global minimum rate

On 5 June 2021, the G7 member nations issued a statement proposing the imposition of a global minimum tax to permit oversight of the digital economy.

Background

The emergence of information technologies and their growing adoption by different economic sectors have increased the demand for products and services offered via digital platforms.

Accordingly, the oversight of the digital economy has posed a challenge for tax systems worldwide as they seek solutions and alternatives to resolve the difficulties posed by this new paradigm.

As part of the efforts implemented by the Organization for Economic Cooperation and

Development (OECD) in response to the challenges derived from the digital economy, in 2015 it published the Action 1 Final Report entitled *"Addressing the Tax Challenges of the Digital Economy"*. This Action was primarily intended to identify the main difficulties arising from the digital economy for current tax laws, while proposing alternatives to resolve these problems.

The most salient points discussed in the Action 1 Final Report include the ability of digital era companies to have a significant economic presence in other jurisdictions without being subject to taxation due to the absence of an adequate definition of the concept of 'nexus' in current tax standards.

On 31 May 2019, the OECD published the document entitled *'Programme of Work to Develop a Consensus Solution to the Tax Challenges Arising from the Digitalisation of the Economy'*, through which it issued a Program of Work to respond to the challenges derived from the Digitalization of the Economy based on two fundamental Pillars: 1) the right of jurisdictions to tax profits (taxing right) and 2) the definition of actions still pending from the Base Erosion and Profit Shifting (BEPS) report according to a global blueprint to avoid base erosion.

The Pillars of the Program of Work were complemented by the reports entitled *Tax Challenges Arising from Digitalisation – Report on Pillar One Blueprint and Tax Challenges Arising from*

Digitalisation – Report on Pillar Two Blueprint, which were issued on 14 October 2020 by the OECD.

On 5 June 2021, the G7 member countries published a statement containing a high-level agreement related to global tax reform, which addresses the solutions proposed by the two fundamental Pillars of the 2019 Program of Work.

Essential aspects of the agreement

Pillar one: Revised nexus and the allocation of taxing rights

The first Pillar seeks to respond to two basic questions: where must taxes be paid? and on what basis? It therefore focuses on fundamental concepts such as the ‘nexus’ and allocation of taxing rights).

Accordingly, the main activities of the 2019 Program of Work included the development of the concept of **remote economic presence** so as to recognize a taxable presence (nexus), together with the allocation of a new taxing

right to each of the countries involved in the production chain of multinational companies (**taxing right**).

In response to the concept of **remote economic presence**, the Pillar One blueprint specifies that a physical presence is not required in a country for the creation of a new nexus. However, with regard to the **taxing right**, it proposes that a portion of a group’s global residual profits be reallocated to the countries involved in the generation of these earnings.

The G7 countries reached an agreement to ensure that the required measures are applied to the “largest and most profitable” multinationals. This replaces the scope of the OECD Pillar One blueprint, which only included “automated digital services” and “consumer-oriented companies”. However, further clarity is still required as regards the thresholds used to determine which companies lie within the range of the largest and most profitable entities.

Pillar Two: Global minimum tax

The second Pillar analyzes the possibility of designing a system to guarantee that, in the era of the digital economy, multinational companies pay a ‘minimum’ level of tax based on the enactment of regulations to counteract profit shifting to countries with low or zero taxation, as proposed by the BEPS initiative.

Accordingly, the Pillar Two blueprint encompasses a series of international tax rules designed to ensure that large multinational companies pay a minimum level of tax on the profits generated in all the countries where they operate. The plan contained in the second Pillar of the OECD proposed that multinational groups with consolidated income in excess of 750 million euros fall within the scope of this blueprint.

The G7 nations agreed that the minimum effective tax rate in each country where a company operates must be at least 15%.

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Any profits subject to an effective rate lower than the agreed rate would be subject to “income inclusion rules” to ensure that the parent entity makes an additional tax payment on these earnings to its tax authority.

Pillar Two recommends a consensual approach leading to the inclusion of these regulations in domestic laws and tax treaties to enhance simplification and avoid global-level

distortions derived from the implementation of uncoordinated, unilateral actions that generate negative consequences for governments and their taxpayers.

Agreement adoption

The G7 statement added that, within an inclusive framework, G20 / OECD will meet and discuss the revised Pillar One and Pillar Two blueprints from 30 June through 1 July 2021. Accordingly, an agreement is expected to be reached when the

G20 finance ministers meet from 10 through 11 July 2021.

Significant additional technical work is also needed for implementation purposes, albeit based on a multilateral instrument that facilitates amendments to tax treaties and other required measures. This work will take a fair amount of time and is not expected to become a reality before 2025.

Contacts:

Eduardo Barrón

Tax and Legal Partner
Tel. 55 5080 6452
edbarron@deloittemx.com

Eduardo Peralta

Tax and Legal Partner
edperalta@deloittemx.com
Tel. 55 5080 6699

Laura Rodríguez

Tax and Legal Partner
lrodriguezberon@deloittemx.com
Tel. 55 5080 7219

Josemaría Cabanillas

Tax and Legal Partner
jcabanillas@deloittemx.com
Tel. 55 5080 7625

Herminia Diaz

Tax and Legal Partner
hdiaz@deloittemx.com
Tel. 81 8133 7339

Laura Acevedo

Tax and Legal Partner
lacedo@deloittemx.com
Tel. 55 5900 2411



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Aguascalientes

Universidad 1001, piso 12-1
Bosques del Prado
20127 Aguascalientes, Ags.
Tel: +52 (449) 910 8600
Fax: +52 (449) 910 8601

Cancún

Avenida Bonampak SM 6, M 1, lote 1,
piso 10, 77500 Cancún, Q. Roo
Tel: +52 (998) 872 9230
Fax: +52 (998) 892 3677

Chihuahua

Av. Valle Escondido 5500
Fracc. Des. El Saucito E-2, piso 1,
31125 Chihuahua, Chih.
Tel: +52 (614) 180 1100
Fax: +52 (614) 180 1110

Ciudad Juárez

Baudelio Pelayo No. 8450
Parque Industrial Antonio J. Bermúdez
32400 Ciudad Juárez, Chih.
Tel: +52 (656) 688 6500
Fax: +52 (656) 688 6536

Culiacán

Insurgentes 847 Sur, Local 103
Colonia Centro Sinaloa
80128 Culiacán, Sin.
Tel: +52 (33) 1454 2000

Guadalajara

Avenida López Mateos Norte 2405, piso 29
Colonia Italia Providencia
44648 Guadalajara, Jal.
Tel: +52 (33) 3669 0404
Fax: +52 (33) 3669 0469

Hermosillo

Blvd. Eusebio Francisco Kino No. 315
Piso 8, Suite 804, Colonia Lomas del Pitic
83010 Hermosillo, Son.
Tel: +52 (662) 109 1400
Fax: +52 (662) 109 1414

León

Paseo de los Insurgentes 303, piso 1
Colonia Los Paraísos
37320 León, Gto.
Tel: +52 (477) 214 1400
Fax: +52 (477) 214 1405 y 1407

Mérida

Calle 56 B 485 Prol. Montejo Piso 2
Colonia Itzimna
97100 Mérida, Yuc.
Tel: +52 (999) 913 4032
Fax: +52 (999) 913 4052

Mexicali

Calzada Francisco López Montejano 1342
Piso 7 Torre Sur
Fracc. Esteban Cantú
21320 Mexicali, B.C.
Tel: +52 (686) 905 5200
Fax: +52 (686) 905 5231 y 5232

Ciudad de México

Paseo de la Reforma 505, piso 28
Colonia Cuauhtémoc
06500 México, D.F.
Tel: +52 (55) 5080 6000

Monclova

Blvd. Harold R. Pape # 307-C
Colonia Guadalupe
25750 Monclova, Coah.
Tel: +52 (866) 190 9550
Fax: +52 (866) 190 9553

Monterrey

Av. Juárez 1102, piso 40
Centro
64000 Monterrey, N.L.
Tel: +52 (81) 8133 7300

Puebla

Edificio Deloitte, Vía Atlixcayotl 5506, piso 4 Zona
Angelópolis
72190 Puebla, Pue.
Tel: +52 (222) 303 1000
Fax: +52 (222) 303 1001

Querétaro

Avenida Tecnológico 100-901
Colonia San Ángel
76030 Querétaro, Qro.
Tel: +52 (442) 238 2900
Fax: +52 (442) 238 2975 y 2968

Reynosa

Carr. Monterrey-Reynosa 210-B, PA
Fracc. Portal San Miguel
88730 Reynosa, Tamps.
Tel: + 52 (899) 921 2460
Fax: +52 (899) 921 2462

San Luis Potosí

Av. Salvador Nava Martínez 3125, 3-A
Fracc. Colinas del Parque
78294 San Luis Potosí, S.L.P.
Tel: +52 (444) 102 5300
Fax: +52 (444) 102 5301

Tijuana

Misión de San Javier 10643, Piso 8
Zona Urbana Río Tijuana.
Tijuana B.C., 22010
Tel: +52 (664) 622 7878
Fax: +52 (664) 681 7813

Torreón

Independencia 1819-B Oriente
Colonia San Isidro
27100 Torreón, Coah.
Tel: +52 (871) 747 4400
Fax: +52 (871) 747 4409



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