The law of minimums

How a global minimum tax rate may impact large and profitable multinationals doing business in the Middle East.

The G7 Summit held in June in Cornwall, England, discussed a range of topics, from climate crisis, the distribution of the covid vaccines to developing nations, rebuilding economies and overall international tax issues. During that meeting, G7 finance ministers reached an agreement on the language endorsing Pillars One and Two of the Organization for Economic Co-operation and Development (OECD) Inclusive Framework project, including a specific reference to a 15 percent minimum tax rate.

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As the leaders of the world's wealthiest nations wrapped up their first in-person summit since the outbreak of the pandemic, they released a joint communiqué underscoring areas of solidarity—and the differences that remain—when it comes to tackling a host of global crises. Additionally, on 1 July 2021, the OECD/G20 Inclusive Framework (IF) on Base Erosion and Profit Shifting agreed a two-pillar solution to address the tax challenges arising from the digitalization of the economy.

Out of 139 IF members, 130 members endorsed the introduction of a new global minimum tax rate of 15 percent. It is fair to say that the current global tax landscape has substantially changed from what it used to be 10 years ago. Today, we live in a connected world where decisions taken in one jurisdiction can potentially have tax impact in other parts of the world. Not to mention, as Gulf Cooperation Council (GCC) nations take a global eminence role in the world market, it is certainly important for all of us in the Middle East to be aware of what's happening in the current global tax landscape, at least at a very high level. When the Base Erosion Profit Shifting (BEPS) initiative was introduced few years ago, the notion was that it wasn't taken too seriously, as everyone doubted its relevance in this part of the region. And yet, here we are today in a globalized world where, as businesses invest across various jurisdictions, all these tax topics are in some way relevant to us in either a direct or indirect way. Not to mention, from a corporate governance standpoint, global tax issues and any reputational risks that may arise from them have been at the forefront of boardroom and audit committee discussions.

The action now turns back to the OECD-based Inclusive Framework (IF), which a majority of GCC countries are also members of. While IF is challenging, the impetus that this agreement will give to the entire process cannot be overstated. If this agreement were to move forward, this will be an important factor to consider for certain global multinationals that exceed certain thresholds.

A communique was issued on 5 June 2021 that highlights that the United States, Japan, Germany, France, the UK, Italy and Canada have all found common ground to stop companies from shifting profits to low tax jurisdictions, as well as ensure that large multinationals pay more tax where they operate. The tax statement in the G7 finance ministers' communique is as follows:

"We strongly support the efforts underway through the G20/OECD Inclusive Framework to address the tax challenges arising from globalization and the digitalization of the economy and to adopt a global minimum tax. We commit to reaching an equitable solution on the allocation of taxing rights, with market countries awarded taxing rights on at least 20 percent of profit exceeding a 10 percent margin for the largest and most profitable multinational enterprises. We will provide for appropriate coordination between the application of the new international tax rules and the removal of all Digital Services Taxes, and other relevant similar measures, on all companies. We also commit to a global minimum tax of at least 15 percent on a country-by-country basis. We agree on the importance of progressing agreement in parallel to both Pillars and look forward to reaching an agreement at the July meeting of G20 Finance Ministers and Central Bank Governors".

The statement is certainly a major boost to the OECD's Inclusive Framework, which has been working on implementing Pillars One and Two in the near future as part of a consensus-based solution; Yet it raises the question as to whether Middle East (ME) countries such as Qatar may have to increase their statutory tax rate of 10 percent to be aligned with the global minimum tax rate and avoid tax revenues being shifted to other advanced jurisdictions. It also raises the question whether zero tax rate jurisdictions such as Bahrain and the UAE have to consider introducing a corporate tax rate to be aligned with the new global minimum tax rate. The shift to a global minimum tax rate may reduce the incentive for large companies to declare profits in tax havens or low tax jurisdictions because the country in which the company is headquartered will be able to top up corporate tax payments to the global minimum effective level. It is noteworthy to mention that some large multinationals have stated that they have welcomed the G7's latest move.

This is a major endorsement for the OECD's long-standing effort to have a consensus-based solution among 130-plus inclusive framework member countries, but may reduce the incentive for large companies to declare profits in tax havens or low tax jurisdictions because the country in which the company is headquartered will be able to top up corporate tax payments to the global minimum effective level. To better assess the magnitude, based on an OECD economic analysis estimate, the introduction of Pillar Two could generate up to 4 percent of global corporate tax revenue (i.e. almost US$100 billion) and a further US$100 billion could be re-shifted to market jurisdiction through Pillar One. While all of this could be challenging, the impetus that this agreement will give to the entire process cannot be overstated. If this agreement were to move forward, this will be an important factor to consider for certain global multinationals that exceed certain thresholds. Given that this is relatively new and might undergo further changes during the next OECD inclusive framework meeting, we will continue to monitor the situation and will provide further updates/guidance as we get more details.

The agreement raises the question as to whether Middle Eastern (ME) countries may also have to introduce/increase statutory corporate tax rate to be aligned with the global minimum tax rate to avoid tax revenues being shifted to other advanced jurisdictions. While this may not be implemented in the immediate future, all indicators point to it being a matter of "when" and not a matter of "if". The shift also raises major tax policy questions for the ME tax authorities. But while it may be difficult, it is certainly possible to create a corporate tax system that better reflects the changes in the global economy.

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