Countries Advance Historic Global Tax Plan With New Details

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A majority of countries have reached a broad agreement on the details of a two-pillar corporate tax reform plan with implementation starting in 2022, but the road to the finish line remains long, stakeholders say.

In a July 1 statement, the OECD inclusive framework on base erosion and profit shifting confirmed that 130 of its 139 members have agreed on key elements of the plan, which aims to address the tax challenges of an increasingly digital and globalized economy. The inclusive framework intends to hammer out a detailed implementation plan for final approval in October, the statement adds.

The nine holdouts are Barbados, Estonia, Hungary, Ireland, Kenya, Nigeria, Peru, Sri Lanka, and St. Vincent and the Grenadines. However, the 130 countries, including the G-7 and G-20 nations, represent more than 90 percent of global GDP, according to an OECD release.

The inclusive framework has been working for several years on the plan, which follows up on the G-20-mandated OECD BEPS project, a 15-part initiative that sought to address corporate tax avoidance.

That project had left work to be done on action 1, which focused on addressing the tax challenges of the digital economy. The issues at the heart of action 1 have long confounded governments unable to effectively tax companies, especially digital ones, that have sales in their jurisdictions but lack the requisite physical presence under current tax rules.

The follow-up work has morphed over the years into two pillars, and the statement outlines the main components that have been agreed.

Pillar Details

Pillar 1 calls for revising profit allocation and nexus rules to give a new taxing right to market countries. This taxing right, amount A, would ensure that companies pay tax on a portion of residual, or nonroutine, profits earned from activities in those jurisdictions even if they lack sufficient physical presence.
Pillar 1 also calls for amount B, which represents a fixed return for the baseline marketing and distribution activities in market jurisdictions, aligned with the arm’s-length principle; and dispute prevention and resolution mechanisms to enhance tax certainty.

A preliminary pillar 1 blueprint, published in October 2020, suggested covering consumer-facing businesses and companies with automated digital services. However, countries disagreed on which companies would be affected. In April the U.S. Treasury proposed narrowing the scope of amount A to about 100 of the largest, most profitable multinational enterprises, using quantitative, rather than qualitative, factors. Treasury also proposed a $20 billion revenue threshold for MNEs subject to amount A.

The statement confirms that the scope of pillar 1 no longer relies on a consumer-facing business or automated digital services distinction. Companies that would fall under scope are MNEs with global turnover exceeding €20 billion with profitability exceeding 10 percent.

But that turnover threshold would decrease to €10 billion if the amount A regime, including its tax certainty elements, is successfully implemented, based on a review period that would start seven years after an agreement is in force, the statement says. Extractives and financial services remain carved out of the scope of pillar 1, it adds.

Pillar 1 would also have a new special purpose nexus rule that would allocate amount A to market jurisdictions if an in-scope MNE raises at least €1 million in revenues in those countries. A lower nexus of €250,000 would apply in smaller market countries with GDP of less than €40 billion, the statement adds, in an apparent concession to developing countries.

Countries also agreed on the allocation of 20 percent and 30 percent of in-scope MNE residual profits to market jurisdictions, with nexus based on an allocation key tied to revenues, the statement adds. In-scope MNE profits and losses will be calculated based on financial accounting income “with a small number of adjustments,” the statement says, confirming that losses would be carried forward.

Pillar 1 segmentation “will occur only in exceptional circumstances where, based on the segments disclosed in the financial accounts, a segment meets the scope rules,” the statement says. It also confirms a marketing and distribution safe harbor will impose a cap on amount A allocation and that a multilateral convention to implement the new taxing right would be developed and opened for signature in 2022. Amount A would take effect in 2023.

Countries also agreed that amount B would be streamlined and simplified, taking into account low-capacity countries’ concerns, the statement says, adding that the work would be completed by the end of 2022.

Pillar 1, largely seen as the part of the plan that will address digital activity, is expected to require all participating countries to repeal unilateral measures they have adopted to target digital sales, including digital services taxes, and refrain from introducing new measures. However, the statement does not provide any details about what other unilateral measures would be prohibited.

Pillar 2 proposes ensuring that large MNEs pay a minimum level of tax based on a yet-to-be-agreed-on rate. Pillar 2 would rely on a global anti-base-erosion (GLOBE) mechanism. That
mechanism contains the income inclusion rule and the undertaxed payments rule, both of which were inspired by the global intangible low-taxed income regime and the base erosion and antiabuse tax of the Tax Cuts and Jobs Act, respectively.

The income inclusion rule would apply a top-up tax to an in-scope MNE’s income that is taxed below an agreed minimum tax rate, while the undertaxed payments rule would deny deductions for payments that are taxed under the minimum tax rate. The minimum rate will be at least 15 percent, the statement confirms. Pillar 2 also includes the treaty-based subject-to-tax rule, which would allow source jurisdictions to apply limited source taxation to some related-party payments that are taxed below a minimum rate. The subject-to-tax rule rate will range from 7.5 percent to 9 percent.

The GLOBE rules will have a “common approach” status: Inclusive framework members won’t be required to adopt the rules, but they must accept the application of the rules that other inclusive framework members apply.

The GLOBE rules will also have a formulaic substance-based carveout “that will exclude an amount of income that is at least 5 percent (in the transition period of five years, at least 7.5 percent) of the carrying value of tangible assets and payroll,” the statement confirms.

While the statement reiterates many details about the scope, rule design, and effective tax rate calculation, it does not offer further details about how the GILTI regime will coexist with the GLOBE rules. It also notes that an implementation plan envisages legislation to be passed in 2022 to take effect in 2023.

‘An Historic Day’

Governments around the world hailed the inclusive framework’s announcement, including U.S. Treasury Secretary Janet Yellen. “Today is an historic day for economic diplomacy,” Yellen declared in a July 1 statement, adding that the end is near for the race to the bottom on corporate taxation.

“We have a chance now to build a global and domestic tax system that lets American workers and businesses compete and win in the world economy,” Yellen added.

President Biden also chimed in, focusing mostly on pillar 2 of the plan. “I want to thank all the signatories of the Paris OECD statement — 130 countries — for coming together to endorse a global minimum tax rate of at least 15 percent,” Biden said in a July 1 statement.

“These nations make up more than 90 percent of the world’s economy, which puts us in striking distance of full global agreement to halt the race to the bottom for corporate taxes,” Biden added.

The Biden administration has been especially keen to push pillar 2 as part of its Made in America Tax Plan, which calls for doubling the GILTI regime rate to 21 percent.

“With a global minimum tax in place, multinational corporations will no longer be able to pit countries against one another in a bid to push tax rates down and protect their profits at the
expense of public revenue,” Biden said.

“They will no longer be able to avoid paying their fair share by hiding profits generated in the United States, or any other country, in lower-tax jurisdictions,” Biden added. “This will level the playing field and make America more competitive.”

Democrats in the House of Representatives are coming together in support of Biden’s push for a global minimum tax. But House Ways and Means Committee ranking member Kevin Brady, R-Texas, warned that the Biden administration has given up significant U.S. ground by agreeing to a global minimum tax system that favors foreign-headquartered companies.

“This is a dangerous economic surrender that sends U.S. jobs overseas, undermines our economy, and strips away our U.S. tax base,” Brady said. “Further, any agreement at the OECD must result in immediate repeal of all existing digital taxes and prevent any new digital taxes by the EU or others.”

Across the pond, U.K. Chancellor of the Exchequer Rishi Sunak said the inclusive framework announcement marks another step in the U.K. government’s “mission to reform global tax.”

Italian Finance Minister Daniele Franco also welcomed the inclusive framework agreement, saying Italy is confident about finding agreement at the G-20 finance ministers’ July 9-10 meeting in Venice under the Italian presidency.

Some countries that had agreed to the two-pillar plan noted their continued reservations about its details. Switzerland said it had given conditional support to the plan in order to continue work on the project, despite major reservations, especially about the tax rate and base in pillar 2.

The African Tax Administration Forum (ATAF) called the agreement a new milestone but continued to have concerns about the plan. The ATAF had proposed its own approach to simplify pillar 1 so that total in-scope MNE profits, instead of just residual profit, would be allocated to market jurisdictions.

“We are disappointed that the inclusive framework has decided not to adopt this approach but note that it has agreed to allocate between 20 percent and 30 percent of residual profit,” the ATAF said in a July 1 statement.

However, civil society groups, including the Tax Justice Network, criticized the inclusive framework agreement for not giving enough concessions to developing countries.

Irish Finance Minister Paschal Donohoe explained Ireland’s decision not to sign on to the inclusive framework statement, saying that Ireland fully supports the pillar 1 proposals but continues to have strong reservations about the pillar 2 minimum tax rate.

“I was not in a position to join the consensus on the agreement and specifically a global minimum effective tax rate of ‘at least 15 percent’ today,” Donohoe said in a July 1 statement. “I have expressed Ireland’s reservation, but remain committed to the process and aim to find an outcome that Ireland can yet support. Ireland will continue to play our part in reaching a comprehensive and, indeed, historic agreement.”
The inclusive framework’s agreement accommodates many interests, including those of small and developing economies, according to OECD Secretary-General Mathias Cormann. “It is in everyone’s interest that we reach a final agreement among all inclusive framework members as scheduled later this year,” he said.

**On Your Marks . . .**

The inclusive framework agreement is just the beginning, according to Daniel Bunn of the Tax Foundation. “For a while I’ve seen a potential agreement as a starting gun for a long, difficult process of implementation,” he said. “Today that starting gun has been fired, and the U.S. Congress and governments around the world are going to begin working on understanding how this deal might be implemented.”

There remains some flexibility in the framework of the agreement, leaving open the potential for further changes in the years to come, Bunn said.

Rick Minor of the U.S. Council for International Business said the group’s company members will follow the inclusive framework’s progress closely. “I understand the next significant document will be the design and implementation plan mentioned in the statement,” he said. “We should expect consultation with the business community will continue more earnestly now.”

Jason Oxman of the Information Technology Industry Council said the political agreement “represents a pivotal moment” for the inclusive framework. The group also plans on engaging with governments before October “to ensure a functioning and dependable global tax system that promotes investment and innovation and provides certainty and predictability for businesses,” Oxman said.

Agreement on pillar 1 represents a “significant pivot toward fair taxation,” the Coalition for a Prosperous America said, saying it uses a limited sales factor apportionment model. “It is incumbent on us to continue common-sense corporate tax reform in the United States,” the group added.

Certainly, the inclusive framework has its political and technical work cut out for it, according to Barbara Angus of EY. “With a conceptual agreement, it may well be that nothing is really agreed until all the details are spelled out and agreed,” she said.

Although the business community will welcome the possibility of a comprehensive multilateral agreement, hesitation may persist until the political and technical details are pinned down, according to Will Morris of PwC. He pointed to uncertainty about the GILTI coexistence with pillar 2 and the link between the agreement and the repeal of DSTs as points of concern for U.S. businesses.

There aren’t enough confirmed details for businesses to start preparing for change, but with thresholds that the inclusive framework has confirmed, “businesses can now more realistically begin to model out the effects of this on their worldwide group,” Morris said. “That aspect of preparation would now be timely as we wait for October’s developments.”
Robert Stack of Deloitte, a former U.S. Treasury deputy assistant secretary for international tax affairs, acknowledged the challenges countries face.

“While there is a long road ahead to implementation of the agreement announced today by the [inclusive framework] and there will be many twists and turns, this is a major accomplishment for the Biden administration and for those who advocate a multilateral approach to international tax issues,” Stack said.