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G7 PLAN FOR TAXING MULTINATIONALS

Background

On June 4 and 5, 2021, the G7 committee along with representatives of the World Bank, IMF, OECD and Eurogroup met in London to discuss concerns about multinationals and the regulations related to global corporate tax rates and digital economies. The G7 intends to reduce the competition amongst tax administrations, which has historically resulted in countries competing for the lowest corporate tax rates.

Since 2019, 135 member countries of the OECD/G20 Inclusive Framework on BEPS have been working on developing "two pillars" to address the tax challenges raised by digitalization, an approach that could form the basis for a global consensus solution on the issue.

Pillar One relates to the re-allocation of taxing rights and addresses the question of business presence and activities without physical presence, and will determine where tax should be paid and on what basis. In addition, it will determine what portion of profits could or should be taxed in the jurisdictions where customers and/or users are located.

Pillar Two focuses on stopping the shifting of profits to low or no tax jurisdictions by ensuring that a minimum level of tax is paid by multinational companies, leveling the playing field between traditional and digital companies.

Outcome

Under Pillar One, 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 taxable presence (nexus).

The G7 committee has reached agreement that Pillar One should apply to the "largest and most profitable" multinationals which will be required to reallocate at least 20% of their residual profit above a 10% profit level to market countries. The G7 committee stresses that implementation will be coordinated with the removal of all Digital Services Taxes.

The G7 committee agreed that according to Pillar two, the minimum effective tax rate in each country in which a business operates should be at least 15%. The aim of the rule is to stop companies from shifting profits to low-tax jurisdictions on the basis that the country in which the company is headquartered is expected to be able to top-up the corporate tax payments to the global minimum effective level.

It is important to note that the US Treasury initially put forward 21% as the target rate for US Global Intangible Low-Taxed Income (GILTI), which is effectively the US version of Pillar Two.

BaseFirma's take

The members of the G20 are set to meet in Venice this July 9 and 10, to discuss the agreement on Pillars One and Two. It remains to be seen whether the world's financial leaders will endorse the framework.

BaseFirma believes that further clarity is needed with respect to the thresholds for determining businesses that are the largest and most profitable. Therefore, it is not yet possible to ascertain which multinational groups will be affected, although the Biden Administration has indicated that the rules should focus on around 100 of the largest global companies.

Further detail is also needed on how to implement multilateral instruments to generate tax certainty to facilitate the top-up amounts of tax being payable on cross-border income that falls below the agreed minimum tax. The top-up tax could be imposed by either the jurisdiction in which the parent company of an entity is located (through an income inclusion regime) or by a jurisdiction from which deductible payments are made (through an undertaxed payments rule).

More detailed rules are needed with respect to whether segmentation would be required in situations where a group has a mixture of highly profitable and less profitable activities.

Agreement on a minimum rate of taxation of 15% does not require the US to match the GILTI rate to the agreed OECD minimum tax rate, and the US has not indicated an intent to reduce the GILTI rate.

Decision needs to be taken regarding certain industries and whether certain sectors such as financial services or natural resources industries should be excluded from the scope.

BaseFirma projects that even with an agreement in July, implementation of any new rules is likely to take several years as countries are very unlikely to implement any agreed upon rules in exactly the same way and with the same effective dates.

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