BaseFirma

OECD Releases Statement Agreed by 136 Countries Regarding Core Design Features of International Corporate Tax System Overhaul

Background

On October 8th 136 countries, which collectively represent more than 90% of the world's GDP, reached an agreement on core design features of a two-pillar plan to overhaul and modernize the international corporate tax system. The OECD/G20 Inclusive Framework (IF)[1] on Base Erosion and Profit Shifting (BEPS) published a statement laying out the details of the agreement and an implementation plan of what is commonly referred to as BEPS 2.0. This latest statement follows the outline of the original plan[2].

Notably, Estonia, Hungary and Ireland, which did not join the previous agreement in July, joined the October Statement. Pakistan joined the July statement but did not join the October Statement. Kenya, Nigeria, and Sri Lanka did not join either statement.

[1]The Inclusive Framework (IF) is a global tax governance network created by the OECD and comprised of 140 countries. The IF was created to facilitate implementation of the OECD's Base Erosion and Profit Shifting (BEPS) initiative.

[2]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.

[3]Amount A refers to the amount correcting to the new taxing right for market jurisdictions over a share of residual profit calculated at an MNE group (or segment) level.

October 8th statement details

The main updates and relevant information from the October 8th statement are presented below:

Pillar One

• Scope: Amount A[3] is updated to apply to multinational entities (MNEs) with global turnover over 20 billion Euro and profit before tax/revenue profitability above 10%. These thresholds will be calculated using an 'average mechanism' which is yet to be fully described.

• Quantum: Amount A will allocate 25% of "residual profits", defined as the amount above the 10% of profit before tax/revenue, to market jurisdictions using a revenue-based allocation key. The 25% is updated from the prior estimate of 20-30% provided in the July Statement.

• Exclusions: Extractives and regulated financial services are excluded from implementation of Pillar One.

• Nexus: New special purpose nexus rule would allow the allocation of Amount A to a market jurisdiction when the MNE derives at least 1 million Euro in revenue from that jurisdiction. For smaller jurisdictions with GDP lower than 40 billion Euro, the nexus will be set at 250,000 Euro.

• Safe Harbor: Statement reiterated the need for a marketing and distribution safe harbor (i.e., Amount B), with final details expected by end of 2022.

• Dispute resolution: A mandatory and binding dispute resolution mechanism will be available for all issues related to Amount A. For certain developing countries, an elective binding dispute resolution mechanism will be available.

• Digital Services Tax: Implementation of Pillar One will be coordinated with the removal of all digital services taxes. No newly enacted digital services taxes or other relevant similar measures will be imposed on any company following the October 8th agreement.

• Target date for implementation: Multilateral convention through which Amount A is implemented will be developed and ready for signature in 2022. Further, Amount A is expected to come into effect in 2023.

Pillar Two

The Agreement with regards to Pillar Two is mainly in line with the July Statement with a few updates presented below:

• Minimum tax rate: Set at 15% and removes possibility of increasing it in the future.

• Exclusion: Explicit exclusions where MNE's in-country presence is less than 10 million Euro and profits of less than 1 million Euro.

• Implementation rules are restated: Income Inclusion Rule (IIR), Undertaxed payments Rule (UTPR), and the Subject to Tax Rule (STTR). Some exclusions from the UTPR will be available for MNEs in their initial phase of their international activities.

• Pillar Two model rules and accompanying commentary to be developed by the end of November 2021.

• No top-up tax liability if earnings are distributed within four years (as compared to the three or four years provided in the July Statement) and taxed at or above the minimum level.

• The substance-based carve out is modified from the July Statement, with a transition period of 10 years (rather than 7 years) during which the amount excluded will be 8% of the carrying value of tangible assets and 10% of payroll, declining annually for the first five years by 0.2 percentage points, and for the last five years by 0.4 percentage points for tangible assets and by 0.8 percentage points for payroll. After the transition period, the amount excluded will be 5% of the carrying value of payroll and tangible assets.

• Nominal Rate: The nominal tax rate used for the application of the STTR will be 9% (as compared to the 7.5-9% range provided in the July Statement).

• Confirmed that Pillar Two will apply a minimum rate on a jurisdictional basis, and considering to be given to how the US' Global Intangible Low-Taxed Income (GILTI) regime will co-exist with the GloBE rules

• Timeline: The October Statement reiterates that Pillar Two generally should be brought into law in 2022, to be effective in 2023. However, the entry into effect of the UTPR has been deferred to 2024.

• Implementation: IF members are not required to adopt GloBE rules, but if they do, they should be implemented and administered in a way that is consistent with the outcomes provided for under Pillar Two. It's also restated that IF members accept the application of GloBE rules applied by other IF members.

BaseFirma's Take

The October Statement provides several important updates and clarifications to the July Statement. However, there are several open points and clarifications to look out for in the next few months. Notably among the outstanding items: with regards to Pillar One is the mechanism for determining paying entities under Amount A, the target benchmarking margins under Amount B, the definition of the extractive and financial services and the mechanism by which they will be exempt, as well as the technical details of the treaty provisions, among other outstanding points. With regards to Pillar Two it's still unknown how the GILTI regime will co-exist with the GloBE rules.

Another important consideration is the aggressive timeline for implementation and the limited opportunities for MNEs and the business community to provide input (The OECD Statement says that there will continue to be consultation with business 'within the constraints of the timeline'). We expect this will cause issues post-implementation. In order to minimize these issues we recommend MNEs seek opportunities to provide feedback on the October Statement and clarify any questions they may have.

Last but certainly not least, MNEs should model the implications of BEPS 2.0 in their current operating models and proactively plan for alternative operating models if warranted.

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