

130 countries agree on a new international corporate tax framework

July 2, 2021

In brief

On July 1, 130 countries of the 139 members of the OECD Inclusive Framework on Base Erosion and Profit Shifting ('IF') committed to fundamental changes to the international corporate tax system. The 130 countries include the G7 members (Canada, France, Germany, Italy, Japan, the United Kingdom and the United States), emerging economies like Brazil, China and India, and jurisdictions like Switzerland, Singapore, Bermuda, and the Cayman Islands. However, Ireland, Hungary, Estonia, Barbados, Kenya, Nigeria, Peru, Sri Lanka, Saint Vincent and the Grenadines did not sign on to the consensus.

Under **Pillar One**, a formulaic share of the consolidated profit of a multinational enterprise (MNE) will be allocated to markets (i.e., where sales arise). Pillar One will apply to MNEs with profitability above 10% and global turnover initially above EUR 20bn. The profit to be reallocated will be 20 to 30% of the profit in excess of 10% of revenue.

Two sectors have been carved out from Amount A of Pillar One: extractive industries and regulated financial services.

Under **Pillar Two/GloBE**, the IF members have agreed to enact a jurisdictional-level minimum tax system with a minimum effective tax rate (ETR) of at least 15%. Companies with global turnover above EUR 750m will be within the scope of Pillar Two but headquarter jurisdictions could decide to apply the rules to smaller, domestic MNEs.

Exclusions from the GloBE rules are available for pension funds or investment funds that are Ultimate Parent Entities (UPE) of an MNE Group or any holding vehicles used by such entities, organisations or funds. International shipping services will also be excluded from the GloBE rules.

Importantly, IF members will not be required to adopt the GloBE rules. The rules will have the status of a common approach and not of a minimum standard.

The [Statement of the IF](#) ('the Statement') suggests both Pillar One and Two will come into effect in 2023, with the multilateral instrument for the former developed and open for signature in 2022 and legislation for the latter brought in 2022. This is an exceptionally ambitious timetable, and may reflect political considerations as much as technical feasibility.

In detail

The Statement reports that IF has agreed a two-pillar solution to address the tax challenges arising from the digitalisation of the economy. The agreed key components of each Pillar are described in the following paragraphs. An implementation plan together with remaining issues will be finalised by October 2021, although it is likely that even then details will remain to be developed.

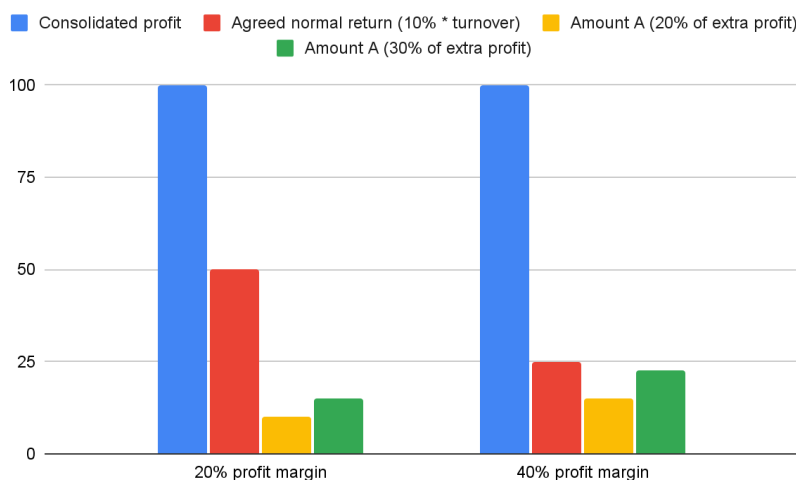
The announcement follows on from the recent G7 meeting (our insights [here](#)).

Pillar One

Pillar One will apply to MNEs with profitability above 10% (calculated as profits before tax over revenue) and global turnover above EUR 20bn, decreasing to EUR 10bn after 7+1 years from implementation if a year-long review establishes that the new system was successfully implemented in the first seven years, also from the point of view of achieving a satisfactory level of tax certainty.

Amount A will be calculated as 20% to 30% of the profit that exceeds a deemed normal return of 10% (Figure 1). When segments of an MNE meet the scoping rules and are disclosed as such in the financial accounts, the segment will be subject to the new allocation rules.

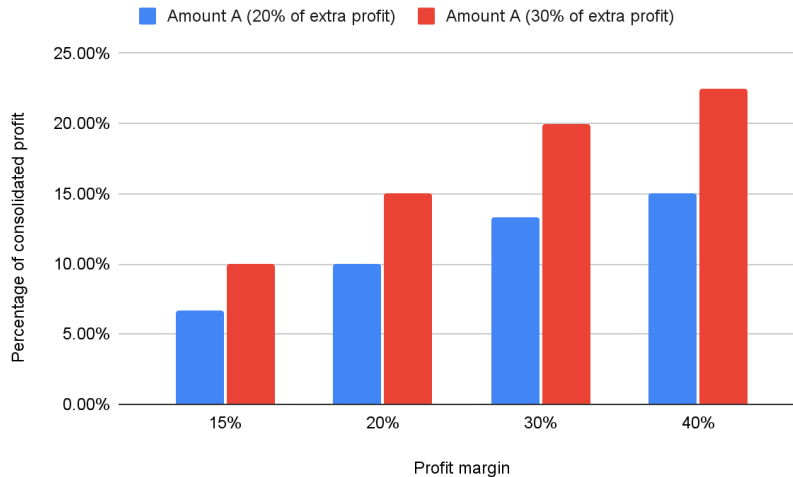
Figure 1. Examples of Amount A for two levels of profit margin; consolidated profit before tax of 100



Observation: Depending on the profit margin and the exact formula, Amount A will constitute between 7% and 22.5% of consolidated profit of an MNE, assuming a profit margin between 15 and 40% (Figure 2). This share of profit will be allocated to markets without using the transfer pricing system and irrespective of the current transfer pricing policies.

It seems reasonable to assume that the reallocation number will be closer to 30% than 20%. Also, while the threshold reduction seems intended to speak to developing country concerns, it will still not dramatically increase the base. Finally, one interesting question is the extent to which the proposed multilateral instrument will try to lock these numbers in -- and what the mechanism for changing them will be.

Figure 2. Amount A as a share of consolidated profits before tax, by profit margin



The new nexus for the taxation of Amount A in the markets will be purely based on revenue. In particular, most countries will apply a revenue threshold of EUR 1 million, + unless their GDP is below EUR 40bn ([countries and their GDP](#)). In that case, the nexus for the taxation of Amount A will be established at EUR 250,000.

The work on Amount B has been postponed and it is now meant to conclude in 2022.

Observation: The reduced nexus threshold is intended to help developing countries but will still only apply to the 'top 100' businesses. Hence, it may not raise much more revenue, but it will increase the compliance burden. The delay of the work on Amount B was expected, but nevertheless unfortunate.

Pillar Two

Pillar Two will apply a minimum effective tax rate of at least 15% at the jurisdictional level. The Pillar Two proposals consist of two main elements:

The GloBE rules which are the Income Inclusion Rule (IIR) and the Under Taxed Payment Rule (UTPR).

The Subject to Tax Rule (STTR).

Global Anti-Base Erosion Proposal (GloBE)

The IIR imposes a top-up tax on a parent entity in respect of the low-taxed income of a constituent entity (i.e., income that has not been subject to an effective minimum tax of at least 15%). The UTPR will apply where the IIR has not resulted in a top-up tax and it will ensure that the low-taxed entities pay a minimum effective tax rate of at least that 15% under a methodology to be agreed. This also applies to the entities in the UPE jurisdiction.

Where the rules are adopted, they must be locally implemented and administered in a way that is consistent with the stated outcomes for Pillar Two, including agreement as to rule order and the application of any agreed safe harbours.

The ETR calculation will consist of covered taxes (including taxes resulting from the STTR) over profits deriving from the consolidated financial statements. The measure of accounting profit will be subject to certain adjustments to address, for example, permanent and temporary differences between the taxable and accounting profits.

The GloBE rules will include a substance-based carve out which will exclude income that is at least 5% (and in the transition period of the first five years, at least 7.5%) of the carrying value of tangible assets and payroll. This formulaic substance-based carve out is meant to leave some room to attract economic activity via the tax system.

Observation: There is an intriguing reference to implementation of the UTPR being deferred. The language about rules being implemented and administered in a manner consistent with Pillar Two is quite broad and could allow for divergence in national law enactments. The substance-based carve out wording of 'at least' is also intriguing -- does this, as with the minimum tax rate, mean the carve out might be higher? And if so, how much higher? That could be important. Finally, the question of GILTI 'coexistence' is left hanging. Given the reference to jurisdictional blending in that regard, if the GILTI was in every way more onerous than GloBE, except for being on a worldwide rather than jurisdictional basis, would GILTI not be an equivalent regime, thus potentially subjecting US businesses to the UTPR?

Subject to Tax Rule

The STTR would apply to royalties, interest and other defined payments made to an IF member state that applies a nominal corporate tax rate lower than a minimum STTR rate of between 7.5 - 9%. The additional tax payable would be limited to the difference between the STTR minimum rate and the tax rate that would otherwise apply to the payment.

Switch Over Rule (SOR)

The SOR was part of the original Pillar Two rules, however, it is not mentioned in the Statement.

What's still to be agreed?

The Statement is very general with respect to some of the key design features of the two Pillars. This implies that the IF will continue to work in an effort to reach agreement on some of the key features of both Pillar One and Two until the G20 meetings in October 2021 (and, quite possibly, thereafter).

Pillar One

Some of the design features of Pillar One crucial in determining the effect on MNEs are still being discussed and negotiated:

- The mechanism for the identification of surrendering entities; The Statement only indicates that surrendering entities are those holding residual profit but it remains unclear how residual profit will be identified (formulaically or by using the transfer pricing system) and whether different entities will share in paying Amount A. An additional question relates to how entities in non-signatory countries will be treated and what the consequences for other surrendering jurisdictions will be.
- The safe harbour for marketing and distribution, which should limit the re-allocation of Amount A to markets under some specific circumstances;
- Segmentation, which seems to be allowed only under a very targeted and possibly ad-hoc set of circumstances;
- Amount B (fixed return for baseline marketing and distribution functions); it is unclear what the exact scope of Amount B will be and whether any work on it will be confined to developing countries. The Statement indicates that work on Amount B will be completed by the end of 2022.

- Dispute prevention and resolution mechanisms will be key for such a new and untested system, but the Statement very generally promises mechanisms that will resolve disputes in a “*mandatory and binding manner*” without further details and without explicitly referring to mandatory and binding arbitration. The Statement is clear that the binding dispute resolution will be limited to Amount A.

GloBE Rules

Although the [October 2020 Blueprint](#) (on which we commented in this [submission](#)) seems to indicate that cash taxes are to be used for the ETR calculation, there are situations where this choice can substantially distort the ETR calculated for the purpose of Pillar Two, e.g., when a government introduces accelerated capital allowances. The Statement suggests the IF members are considering how best to account for such distortions.

There are other key questions related to the concrete application of the constituent Pillar Two rules.

1. Given that Pillar Two is to be implemented mainly through domestic legislation, what is the level of standardisation across countries that the IF can agree upon, and how could that be enforced?
2. How will the UTPR apply? Will it apply to the entire income of a lower-tax jurisdiction or only to a part?
3. Assuming that not all countries will adopt an IIR, what is the required ‘critical mass’ of countries adopting the UTPR that is needed to achieve effective application of the rules on a worldwide basis?
4. Will GILTI (the current law regime or potentially as revised by Congress) co-exist with Pillar Two? The Statement does not detail whether GILTI will need to become a per-country minimum tax system to be compliant. If the proposed SHIELD (Stopping Harmful Inversions and Ending Low-Tax Developments) measure is accepted in the United States, how will that co-exist with the UTPR?
5. How will the Subject to tax Rule (STTR) be implemented? Which payments will it target?
6. What simplification measures will address the significant complexity involved in applying the rules?

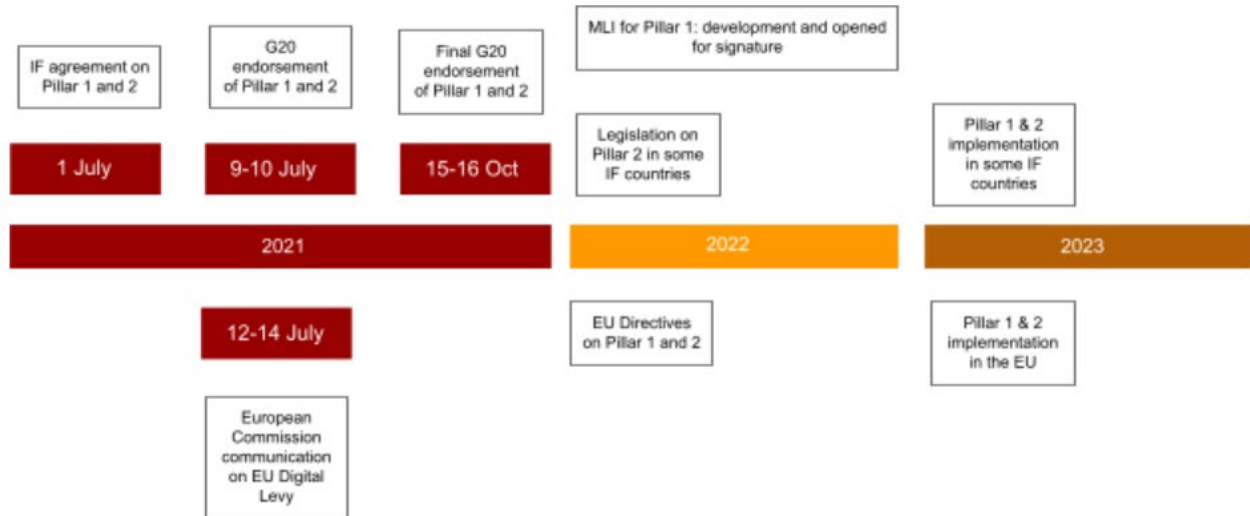
Digital Services Taxes (DSTs)

The Statement does not have many details on the repeal of DSTs, but it covers coordination. Does coordination mean the same as repealing DSTs? Or will countries keep their DSTs in place for groups headquartered in countries that will not sign the MLI or are not able to get approval of their parliaments (or Congress). What about the EU Digital Levy? The document is quite vague on this.

What’s next?

A significant amount of political and technical work still remains to be completed by October 2021, with key design issues still to be resolved. Implementation will follow swiftly according to the Statement (Figure 3). Nonetheless, the suggested timeline seems optimistic and, perhaps, politically driven. The announcement of a quick implementation could be intended to bolster the US Administration, arguing that, in terms of reforming GILTI, other countries will be legislating right behind the United States. It could also help other jurisdictions that need/desire to show progress to their citizens.

Figure 3. Possible timeline



The takeaway

Pillar One and Two represent a major overhaul of the international corporate tax system. Note again that the application of Pillar One to the residual profit of 100 corporate groups means that a substantial amount of cross-border income could remain unaffected. Although a lot of political and technical work is needed before the end of the year, political pressure and an ambitious implementation timeline imply that Pillars One and Two now constitute some of the key tax factors for large MNEs to consider in their scenario planning.

There also remains broader uncertainty around the effective implementation of the agreement. While the commitment of the US Administration to the project is beyond doubt, their ability to secure Congressional support before other countries actually move ahead with national legislation to implement the proposed changes is less clear. Additionally, given that a number of EU member states currently do not support the Statement, it could be difficult for the European Union to unanimously pass EU directives implementing the new framework.

In short, while this is an important forward step on the road to a multilateral agreement, it is by no means the last and there are still some significant uncertainties on the final shape, and timing of any such agreement.

See also

- [Tax Readiness: Are uniform corporate tax rules finally on the horizon?](#) (July 20)
- [EU Parliament and Member States agree on public country-by-country reporting](#) (June 22)

Let's talk

For a deeper discussion of how the international corporate tax framework might affect your business, please contact:

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