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The G7 Finance Ministers’ Announcement on Pillars One and Two: Does It Matter?

By Jeff VanderWolk

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On June 5, 2021, the finance ministers of the G7 (Canada, France, Germany, Italy, Japan, the U.K., and the U.S.) announced their support for a global minimum tax of at least 15% and for the reallocation of 20% of the profits above a 10% profit margin for large multinationals. Jeff VanderWolk of Squire Patton Boggs considers the implications.

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For the past three years, the OECD/G20 Inclusive Framework on BEPS has been engaged in an unprecedented attempt to make corporate income tax policy on a global basis. What started as a project on the tax challenges of digitalization, intended to update international tax rules to ensure that income tax would be paid by multinationals selling digitized services and products, morphed into broader proposals for formulary allocation of profits to market countries, and for a global minimum tax regime. By 2020, the number of jurisdictions involved in the negotiations on the two so-called “pillars” had reached 139.

Few people, apart from international tax policy geeks, knew much about this until recent, widespread media attention was given to the announcement by the finance ministers of the Group of Seven—Canada, France, Germany, Italy, Japan, the U.K., and the U.S.—that they had agreed on a global minimum tax of at least 15% on multinational corporations, and on certain parameters for the reallocation of taxing rights. Much of the reporting seemed to assume that the tax measures would become a reality in the near future.

In fact, however, the G7 finance ministers do not have the power to make such global rules on their own, and their communique implicitly acknowledged as much. But the communique suggested that the power lay with the Group of 20, and was formulated in a way that curiously excluded any mention of the Inclusive Framework, while seeming to state definitively what was going to happen:

“We commit to reaching an equitable solution on the allocation of taxing rights, with market countries awarded taxing rights on at least 20% of profit exceeding a 10% 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% on a country by country basis. We agree on the importance of progressing agreement in parallel on both Pillars and look forward to reaching an agreement at the July meeting of G20 Finance Ministers and Central Bank Governors.”

A bit of history is needed here, to explain why the omission of any mention of the Inclusive Framework is significant. In February 2013, the OECD Center for Tax Policy and Administration published a paper on multinational corporate tax avoidance, which it called “base erosion and profit shifting” or BEPS. In July 2013, the G20 leaders endorsed a proposal to have the OECD undertake a project aimed at making recommendations regarding 15 BEPS-related issues—the so-called BEPS Action Plan. The OECD duly invited the G20 members that are not OECD members to participate in the work, thus creating a body of 44 countries engaged in making international tax policy together.

After the OECD completed its 15 reports in late 2015, it invited all of the countries that had not been involved up to that point to join a new body called the Inclusive Framework on BEPS, where they could engage in global tax policymaking “on an equal footing” with the original 44 countries, provided that they were willing to commit to implementing the four agreed minimum standards that emerged from the 15 reports. The Inclusive Framework held its first meeting in mid-2016 and has met regularly since then.

The Inclusive Framework has provided regular reports to the G20 on the progress of its work, which has increasingly been focused on the two pillars mentioned above. Political pressure began in 2018 to find a global agreement that would replace proliferating unilateral tax measures such as digital services taxes, and the pressure has steadily increased due to U.S. threats—backed by action—to impose tariffs on various countries’ goods in response their DSTs. At the same time, some governments, such as those of Germany and France, felt that it was necessary to do more to prevent perceived tax avoidance by multinationals. The Trump Administration, however, was not convinced that the proposed tax changes would be in the interest of the U.S.

Enter Joe Biden—or, rather, the new U.S. Secretary of the Treasury, Janet Yellen, who quickly made it clear that the U.S. attitude would be different going forward. In early April, the U.S. proposed to the Inclusive Framework a somewhat simplified version of the plans regarding the two pillars. At the same time, the Biden Administration unveiled a plan to increase corporate taxes in the U.S., particularly on multinationals. The global minimum tax proposal before the Inclusive Framework was cited as key to minimizing the competitive disadvantage that U.S. multinationals would otherwise face if the U.S. tax hike were enacted, since both the global minimum rate and the U.S. minimum rate on foreign-earned income would be 21% under the two plans.

Meanwhile, the African Tax Administrators Forum issued a policy paper in mid-May, suggesting on behalf of a number of African countries significant changes to the two pillars, diametrically opposed to those proposed by the U.S. In Europe, relatively low-tax countries such as Ireland and Hungary spoke out in opposition to the idea of a 21% global minimum rate. Secretary Yellen responded by saying that the U.S. could live with a 15% global minimum rate, although it would prefer a higher rate.

Then the G7 finance ministers met, in early June, and agreed on the points mentioned in their communique, above. In light of the history of the two-pillar project, it is surprising that the communique made no mention of the need for consensus among the members of the Inclusive Framework. The G7 announcement was amplified by a media blitz, the like of which has never been seen in the international tax policy world.

The response of non-G7 countries to the G7 announcement has been limited. Ireland once again indicated that it was not ready to sign up to a global minimum rate in excess of its 12.5% rate, alluding to the need to find agreement among a larger group of countries, including small countries. Among the major non-G7 economies, support has been signaled by Indonesia, Mexico, and South Africa, whereas China has only made a brief, neutral statement about the need to discuss the issues among the G20, and India has been silent.

The next steps are, first, a plenary meeting of the Inclusive Framework at the end of June, and second, a meeting of the G20 finance ministers in early July. A number of important gaps in the plans for both pillars need to be filled before countries can understand what they are being asked to agree to. These gaps include the method of computing a multinational's effective tax rate in each country where it does business, the definition of which companies will be subject to the proposed formulary allocation of profits to market countries, and the rules regarding repeal of unilateral measures such as digital services taxes.

So—does the G7 announcement matter? Yes, insofar as it adds political momentum to the U.S.'s plan. However, the crucial political negotiations among the Inclusive Framework countries, including the G20 members that are not in the G7, matter far more.

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Author Information

Jeff VanderWolk is a partner at Squire Patton Boggs (US) LLP. The opinions expressed are those of the author and do not necessarily reflect the views of the firm, its clients, or any of its or their respective affiliates. This article is for general information purposes and is not intended to be and should not be taken as legal advice.

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