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Pillars One and Two: Six Weeks Left to Fill In the Blanks



BY JEFFERSON VANDERWOLK

The global tax policy process being pursued by the OECD/G20 Inclusive Framework on base erosion and profit shifting (BEPS) has been quiet since mid-July, when the G-20 finance ministers blessed the Inclusive Framework's July 1 statement summarizing the revised features of the Pillar One and Pillar Two plans that would reallocate taxing rights regarding certain large multinational businesses and create a global minimum tax regime. The lack of news does not mean, however, that the Inclusive Framework has stopped working on the project or that it does not intend to present a more complete proposal to the G-20 finance ministers in October of this year, as promised in the July 1 statement.

Two more countries signed on to the July 1 statement during August, namely Barbados and Togo, bringing the total number in support to 134 jurisdictions. That leaves six holdouts: Ireland, Hungary, Estonia, Kenya, Nigeria, and Sri Lanka. Of these, five have particular significance—three because they are EU member states, raising doubts about how the EU could implement the agreed proposals in due course, and two because they are African leaders in international economic policy matters.

The July 1 statement leaves a number of important design features as blanks to be filled in through political negotiations among the Inclusive Framework countries. What has been agreed so far on Pillar One includes:

- It will apply to multinational enterprises (MNEs) with gross revenue of at least 20 billion euros (\$23.8 bil-

lion) globally and a profit margin of at least 10% (presumably calculated on the basis of net profit before tax over gross revenue), except for MNEs in the financial services and extractive industries.

- A portion of the global profits of an in-scope MNE, in the range of 20-30% of their profit in excess of 10%, will be allocated for tax purposes among the countries from which the MNE derives at least 1 million euros (\$1.18 million) in sales revenue (or, in the case of countries with GDP of less than 40 billion euros (\$47.4 billion), at least 250,000 euros (\$296,000) in sales revenue). The allocated amounts are designated "Amount A."

- All existing digital services taxes (DSTs) and "other relevant similar measures" will be repealed. Regarding Pillar Two, the Inclusive Framework has agreed that all member countries will enact global minimum tax legislation that is consistent with an approach that includes:

- an effective rate of corporate income tax of at least 15% (subject to the possibility that a higher rate will be agreed to by all member countries before mid-October) based on financial statement income, with certain adjustments, of MNEs having annual revenue of at least 750 million euros (\$889 million);

- an income inclusion rule imposing top-up tax in the MNE's home country on low-taxed income of foreign affiliates, and an undertaxed payments rule imposing top-up tax on low-taxed foreign affiliates in cases where an income inclusion rule does not apply;

- a subject-to-tax rule in tax treaties ensuring that a certain level of tax is paid on specified payments;

- country-by-country computation of effective tax rates; and

- a substance-based exclusion of income equal to at least 7.5% of the carrying value of tangible assets and payroll (reduced to at least 5% after the first five years).

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Major unresolved questions that will need to be answered before mid-October include:

- whether the U.S. GILTI regime must be amended to require country-by-country effective rate calculations in order to be considered a qualifying income inclusion rule;
- whether countries with DSTs can continue to apply them to MNEs that are not within the scope of Pillar One;
- whether new unilateral measures such as the proposed EU digital levy will be considered acceptable;
- what kinds of safe harbor mechanisms will be available to MNEs with respect to Pillar Two;
- what will the tax certainty mechanisms regarding dispute prevention and dispute resolution be;
- will there be a marketing and distribution income safe harbor to prevent double taxation under Pillar One; will the agreed global minimum tax rate be higher than 15%, as advocated by the U.S. and will the five Inclusive Framework members that have not yet agreed to the July 1 statement be persuaded to agree to a more com-

plete agreement on Pillars One and Two?

Current indications are that we should expect to see, in mid-October, a fairly short document summarizing the Inclusive Framework's agreement on Pillars One and Two, with these blanks filled in to some extent. Work on the details of the rules and their implementation is likely to go on for many months thereafter.

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