Over 130 jurisdictions agree on a new international corporate tax framework under BEPS 2.0

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Issue 3

In brief

130 out of the 139 member jurisdictions of the G20/OECD Inclusive Framework on Base Erosion and Profit Shifting (IF) jointly issued the *"Statement on a Two-Pillar Solution to Address the Tax Challenges Arising From the Digitalisation of the Economy"*[1] (the Statement) on July 1, 2021. As of July 5, 2021, 131 members of the IF have joined the Statement[2]. The Statement summarises, on a high-level basis, the key components of Pillar One and Pillar Two under BEPS 2.0 agreed by the IF as of July 1, 2021. In particular, the Statement confirms that the Global Anti-Base Erosion (GloBE) rules under Pillar Two will not be set as a minimum standard but will have the status of a common approach as explained below.

The Statement indicates that a detailed implementation plan together with the remaining technical issues for Pillars One and Two will be finalised by October 2021. The Statement also suggests that both Pillars One and Two will come into effect in 2023, with the multilateral instrument (MLI) for Pillar One to be developed and open for signature in 2022 and the model legislation of Pillar Two to be enacted into law in some IF member jurisdictions in 2022.

For sizable MNE groups with cross-border businesses, they should consider re-performing an impact analysis and scenario planning based on the new information in the Statement and revisit the options available to alleviate the potential impacts of the new rules on them. They should also monitor the implementation status of the GloBE rules in the jurisdictions where they operate on an ongoing basis as that may trigger the needs for further business restructuring. We also expect that the Hong Kong government will reassess the potential impact of the BEPS 2.0 package on the economy and tax revenue of Hong Kong as well as reconsider the most appropriate response measures given the main objectives of maintaining the competitiveness of Hong Kong.

In detail

The IF agreement on the two-pillar solution

The IF agreement came after the G7 announced on June 5, 2021 that its member countries agreed on a taxing right for market jurisdictions on at least 20% of the profits exceeding a 10% margin of large multinational groups under Pillar One and a global minimum tax of at least 15% under Pillar Two of the BEPS 2.0 project[3].

The 131 member jurisdictions of the IF include the G7 members (Canada, France, Germany, Italy, Japan, the UK and the US), other jurisdictions like China, the Hong Kong SAR, India, Japan, Korea, Luxembourg, the Netherlands, Singapore, Switzerland, and also no or nominal tax jurisdictions such as Bermuda, the BVI and the Cayman Islands. The eight jurisdictions that did not sign on to the consensus are: Barbados, Estonia, Hungary, Ireland, Kenya, Nigeria, Saint Vincent and the Grenadines and Sri Lanka.

The key updates on Pillar One and Pillar Two in the Statement

Key updates on Pillar One

Scope: Pillar One will apply to multinational enterprises (MNEs) with profitability above 10% (calculated as profits before tax over revenue) and global annual turnover above EUR 20 billion, decreasing to EUR 10 billion after 7+1 years from implementation if a year-long review establishes that the new system was successfully implemented in the first seven years, including achieving a satisfactory level of tax certainty. Extractives and Regulated Financial Services are excluded.

Our observations: *The new global turnover threshold for Amount A is higher than the originally expected one of EUR 750 million. Also, a new criterion of "profitability above 10%" is added. However, the Statement no longer mentions the exclusion of (1) infrastructure and general construction businesses and (2) international air and shipping businesses from the scope of Amount A as originally mentioned in the blueprint published in October 2020.*

Nexus: The new nexus for taxation of Amount A in the market jurisdictions will be purely based on revenue. In particular, most market jurisdictions will apply a revenue threshold of EUR 1 million, unless their GDP is below EUR 40 billion[4]. In that case, the nexus for taxation of Amount A will be established at EUR 250,000.

Quantum: Amount A will be calculated as 20% to 30% of the profit that exceeds a deemed normal return of 10%. 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.

Revenue sourcing: Revenue will be sourced to the end market jurisdictions where goods and services are used or consumed.

Removal of unilateral measures: The Pillar One package will provide for appropriate coordination between the application of the new international tax rules and the removal of all digital service taxes and relevant similar measures.

Implementation timeline: For Amount A, the MLI through which Amount A is implemented will be developed and opened for signature in 2022, with Amount A coming into effect in 2023. The work on Amount B has been postponed and it is now expected to be completed by the end of 2022.The rules on Amount B will be subject to further simplification and streamlining.

Key updates on Pillar Two

Rule status: The GloBE rules (i.e. the Income Inclusion Rule (IIR) and the Undertaxed Payment Rule (UTPR)) will have the status of a common approach. IF members are not required to adopt the GloBE rules but if they choose to do so, they will implement and administer the rules in a way that is consistent with the outcomes provided for under Pillar Two, and in light of the model rules and guidance to be agreed by the IF.

Our observations: *This means that the IIR and the UTPR will not be set as a minimum standard and it is up to each member jurisdiction to decide whether to adopt them or not. However, ultimate parent jurisdictions that do not implement the IIR may find that enterprises operating in their location with low-taxed income may still be caught by the UTPR applied by other jurisdictions.*

Scope: Jurisdictions are free to apply the IIR to MNE groups headquartered in their location even if the groups do not meet the EUR 750 million global revenue threshold.

Minimum rate: The minimum effective tax rate used for the purposes of the IIR and UTPR will be at least 15% and will be computed on a jurisdictional basis. The minimum rate for the subject to tax rule (STTR) will be from 7.5% to 9%.

Other exclusions: International shipping income (as defined under the OECD Model Tax Convention) will be excluded from the scope of the GloBE rules.

Our observations: *This exclusion is in addition to those already specified in the blueprint issued in October 2020, such as regulated investment funds (subject to certain conditions) and any holding vehicles used by these funds. Based on the OECD Commentary on Article 8 – International shipping and air transport, income from leasing a ship on a bare boat charter basis is not regarded as "international shipping income" except when it is an ancillary activity of an enterprise engaged in the international operation of ships.*

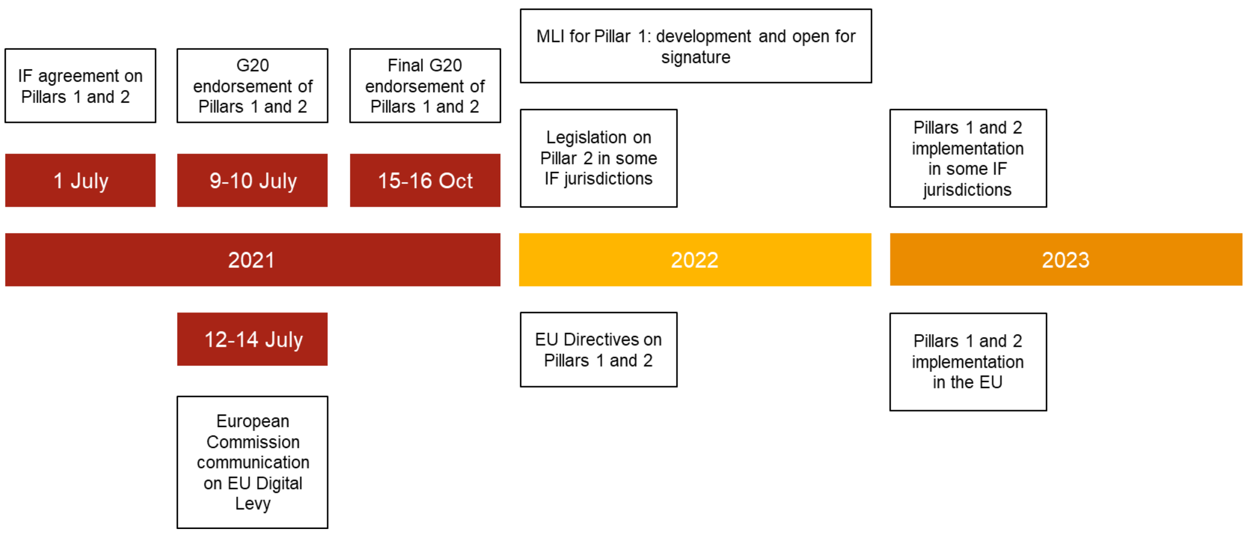
Carve-outs: The GloBE rules will provide for a formulaic substance-based carve-out which will exclude an amount of income that is at least 5% (in the transition period of the first five years, at least 7.5%) of the carrying value of tangible assets and payroll. The IF will explore the possibility of excluding MNEs in the initial phase of their international activities from the application of the global minimum tax.

Co-existence with the US Global Intangible Low-taxed Income (GILTI) rules: The Statement only mentions that consideration will be given to the conditions under which the US GILTI regime will co-exist with the GloBE rules to ensure a level playing field, without providing any further details.

Implementation timeline: It is contemplated that Pillar Two should be brought into law in 2022 and be effective in 2023, with a possible deferred implementation of the UTPR.

What's next?

A significant amount of 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. The possible timeline and the upcoming key events are shown in the diagram below:



The Hong Kong government's response

In response to the Statement issued by the IF, the Hong Kong government issued a press release on July 2, 2021[5] saying that it welcomes the consensus largely reached by the international community on the key principles of the BEPS 2.0 package. The press release also indicated that the Advisory Panel on BEPS 2.0 set up by the government will submit a report to the Financial Secretary as soon as possible after the OECD finalises the technical details of the BEPS 2.0 package. The government will then carefully study the recommendations in the report and consult stakeholders on the specific response measures, with a view to rolling out the relevant legislative exercise.

The takeaway

The Statement is brief and general with respect to some of the key design features of the two pillars. This implies that the IF will need to continue to work towards reaching an agreement on some of the key features of both Pillars One and Two until the G20 meetings in October 2021 and possibly, thereafter.

The increased turnover threshold for applying Amount A under Pillar One means that a substantial amount of cross-border income could remain unaffected by the new rules. Also, given that the GloBE rules under Pillar Two will not be set as a minimum standard and the rules, if implemented, will be mainly through domestic legislation, it remains to be seen the level of standardisation of the rules across jurisdictions and how that can be enforced. In-scope MNE groups should monitor the implementation status of the GloBE rules in the jurisdictions where they operate on an ongoing basis and do or re-do an impact analysis based on their own situation where necessary.

Given the updates revealed by the Statement, we expect that the Hong Kong government will reassess the potential impact of the BEPS 2.0 package on the economy and tax revenue of Hong Kong as well as reconsider the most appropriate response measures given the main objectives of maintaining the competitiveness of Hong Kong. For sizable MNE groups with cross-border businesses, they should consider whether it is necessary to re-perform an impact analysis and scenario planning based on the new information in the Statement and revisit the options available to alleviate the potential impacts of the new rules on them.

Endnotes

1. The OECD's press release and the Statement can be accessed via this link: https://www.oecd.org/newsroom/130-countries-and-jurisdictions-join-bold-new-framework-for-international-tax-reform.htm

2. The list of members of the IF that have signed the Statement can be accessed via this link: https://www.oecd.org/tax/beps/oecd-g20-inclusive-framework-members-joining-statement-on-two-pillar-solution-to-address-tax-challenges-arising-from-digitalisation-july-2021.pdf

3. For more details about the G7 announcement on June 5, 2021, please refer to our *International Tax News Flash – Hong Kong, June 2021, Issue 2* via this link: https://www.pwccn.com/en/tax/publications/intl-tax-newsflash-jun2021-2.pdf

4. Please refer to this link for the GDP data of different countries and economies published by the World Bank: https://data.worldbank.org/indicator/NY.GDP.MKTP.CD

5. The Hong Kong government's press release can be accessed via this link: https://www.info.gov.hk/gia/general/202107/02/P2021070200714.htm

Let's talk

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