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The G7 reaches an agreement on two-pillar solution on international tax reform

Cross Boarder

On 1 July 2021, 130 countries of 139 countries including the G7 members in the Inclusive Framework ("IF") issued a statement addressing two-pillar approach which committed to fundamental changes to international tax system. However, there are 9 countries that have not signed the agreement such as Ireland due to the reason that Irish tax rate is 12.5%.

The statement provides the additional details of Pillar 1 which are summarized below:

- MNEs with global turnover above €20 billion, which will be reduced to €10 billion after 7 years contingent on success implementation, will be taxed at 20-30% of profit exceeding a 10% margin. This revenue will be shared among governments by using a revenue-based allocation rule.

- Introducing a new special purpose nexus rule which will allocate Amount A to a market jurisdiction when the in-scope MNE derives at least €1 million in revenue from that jurisdiction. For small jurisdictions with GDP below €40 billion, the nexus will be set at €250,000.

- Profits and losses of the in-scope MNE will be measured using reference to financial accounting income, with a small number of adjustments. Losses will be carried forward.

- Applying a marketing and distribution profits safe harbor where the residual profits occur of an in-scope MNE are already taxed in a market jurisdiction.

- Double taxation will be eliminated through the exemption or credit method.

- Planning to apply the arm's length principle to in-country baseline marketing and distribution activities.

The statement provides the scope of Pillar 2, known as the GloBE rules, which are summarized below:

- The IF members agreed to impose minimum effective tax rate at least 15%.

- MNEs with consolidated revenues of EUR 750 million or more will be within the scope. However, countries can freely apply the income inclusion rule (IIR) to parent companies in their country even if the consolidated revenues do not meet the threshold.

- A formulaic substance carve-out that will exclude an amount of income that is at least 5% (in the transition period of 5 years, at least 7.5%) of the carrying value of tangible assets and payroll in a country, and a de minimis exclusion.

- Government entities, international organizations, non-profit organizations, Pension funds or investment funds, that are Ultimate Parent Entities (UPE) of an MNE Group, or any holding vehicles used by such entities, organizations or funds, are excluded from the GloBE rules.

However, there are remaining issues that need to be working on including removing digital-service taxes as proposed by the US and the implement plan of remaining issues will be finalized by October 2021, made to the law in 2022, and effective in 2023.

Should you have any question, please do not hesitate to contact us via info@bgloballaw.com