Presidency Issues Note for the Informal ECOFIN Working Session IV

Taxation in the 21st Century

The focus of the Slovene Council Presidency in the field of EU tax policy is on the ongoing global reform of international corporate taxation and its possible wider application. The aim of this informal discussion is to hold a wide-ranging exchange of views among the Ministers on the key political aspects in this area, which would provide further impetus for progress within the Council.

Introduction

A comprehensive and ambitious EU tax policy agenda is essential in contributing to the overall objective of enabling fair and sustainable growth by supporting wider EU policies, such as the European Green Deal, the EU Digital Agenda, the New Industrial Strategy for Europe, and the Capital Market Union.

Moreover, against the background of ongoing major trends that are shaping our economies and societies (including ageing of population, climate change, environmental degradation and globalisation, and the transformation of the labour market), the occurrence of the Covid-19 pandemic has had an unprecedented economic impact and demonstrated the importance of the functioning of the internal market.

The ongoing OECD/G20 work on reform of international taxation, once completed, will be a milestone achievement, especially as it will include developed as well as emerging economies. Multilateral approach presents the crucial advantage of this process, and there is a remarkable opportunity to ensure that tax rules are designed to follow closer the development of business models and to distribute fairer tax bases and revenues among the jurisdictions concerned.

There are two clear objectives that have to be pursued: fair and effective taxation and level playing field for all businesses, combined with the new framework that meets public financing needs and safeguards revenues in the long term.

Background

For over a decade, through multilateral cooperation the OECD and the EU have sought to secure a fairer global tax system. This has included curbing bank secrecy and many forms of the aggressive tax planning strategy, conducive to large scale international tax evasion and financial crime. The central objective has been to align taxation with value creation. The OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting (BEPS) – the Inclusive Framework – has worked on these matters since its foundation. The EU and its Member

States have actively supported this work and ensured swift implementation of the agreed international rules.

Since the OECD/G20 report on BEPS of 2015, it was clear that more work was required to address the tax challenges arising from the digitalisation and the globalisation of the economy, as the combined effects thereof continue to cause distortions and inequalities. The century-old international tax system is no longer fit for purpose and not able to appropriately address these growing challenges. This could only be done effectively through a multilaterally agreed solution.

After years of intense and challenging negotiations, and consistent with the mandate by the G20, on 1 July 2021, a "*Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy*" (the July Statement) laid out the key elements of a new global corporate income tax system.[1] As of 13 August 2021, 133 countries and jurisdictions – representing more than 90 % of global GDP – have joined the July Statement.

The July Statement lays the foundations for the two-pillar solution to reform the international taxation rules and ensure that multinational enterprises pay their fair share of tax wherever they generate relevant profits and brings much needed tax certainty and stability to the international tax system. The two pillars aim to address different but related tax issues resulting from the increasing globalisation and digitalisation of the economy. At the same time, the stability and predictability of the international tax system will be strengthened.

It is expected that the Inclusive Framework on BEPS will finalise a detailed implementation plan together with remaining issues on 8 October and report to G20 Finance Ministers and Leaders by the end of October, with a view to implement the revised international tax rules by 2023. Essentially, the new rules will not function in isolation as separate "Pillars". They will be inseparable parts of an overall agreement and will be integrated into the legal framework that is already being applied where issues of international taxation arise.

What has been agreed?

The July Statement provides the key elements of a two-pillar package.

- Pillar One updates the outdated international tax rules by aiming at a fairer distribution of profits and giving market jurisdictions new taxing rights over the largest and most profitable MNEs (those with a global turnover above EUR 20 billion and profitability above 10 %) regardless of their physical presence in the market jurisdiction. It recognises that in an increasingly "digital age", taxing rights can no longer be determined exclusively by physical presence. Extractive industries and regulated financial services are excluded from the scope of Pillar One. The key features of Pillar One are the following:

    - The new taxing right for market jurisdictions involves the reallocation of a portion of profits (20-30 %) above a 10 % profit margin to the market

[1] https://www.oecd.org/tax/beps/statement-on-a-two-pillar-solution-to-address-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-july-2021.pdf

jurisdictions where an MNE's users and customers are located. This amounts to taxing rights relocation of over approximately USD 100 billion.
    - Pillar One will contain measures to ensure tax certainty through effective dispute prevention and dispute resolution mechanisms for covered MNEs to address the risks of double taxation.
    - Pillar One will also entail the standstill and withdrawal of unilateral measures, such as digital services taxes (DSTs), thereby restoring stability to the international tax system.

- Pillar Two contains a commitment for a global minimum tax on corporate profit of at least 15 %, putting a floor on the "race to the bottom" between the jurisdictions concerned. Pillar Two does not eliminate tax competition but sets multilaterally agreed limitations on it. Governments that have joined the July Statement have agreed to allow additional taxes on low taxed foreign profits of MNEs headquartered in their jurisdiction up to an agreed minimum rate. Further key features of the Pillar Two are:
    - These rules will apply to MNEs with a consolidated EUR 750 million revenue, (with exclusions for certain entities like government entities, and pension or investment funds).
    - Pillar Two will include a substance-based carve-out where companies carry on real activities.
    - Pillar Two is expected to generate more than USD 150 billion in new tax revenues globally.

The two-pillar package will encourage MNEs and jurisdictions to compete on other grounds than tax policy, such as the quality of infrastructure, qualification of staff, overall investment "climate", etc. In addition, it will re-establish the stability of the international tax system and reduce trade tensions arising from the proliferation of unilateral measures that are being designed to address, at national level, the tax challenges arising from the digitalisation of the economy. Any further increase of trade tensions would also be a negative trend in the context of the much-needed "post-COVID" economic recovery.

What remains to be done?

Only a few key elements remain to be finalised by October at the Inclusive Framework level.

As regards Pillar One, there is a need to agree on the precise percentage of residual profit to be allocated to market jurisdictions, within the agreed 20 % to 30 % range. The agreement may also require further clarification on the elimination of double taxation rules and on tax certainty modalities. Equally, the rollback and the standstill of Digital Services Taxes (DST) and other similar measures must be further detailed, particularly the definition of "other similar measures".

Concerning Pillar Two, the Inclusive Framework should agree on a precise effective tax rate as the current text of the Statement provides for "at least 15 %". Linked to this rate, is the issue of the quantum for the substance-based carve out (so far "at least 5 % of payroll and the carrying value of assets"). A further carve out for MNEs in the initial phase of their initial development is being explored. Finally, the scope and rate of the subject to tax rule will also require finalisation.

Further to October, the Inclusive Framework will have to finalise the detailed implementation tools including Model Rules for the implementation of Pillar Two and complete developing a Multilateral Convention for the implementation of Pillar One. These implementation tools should be finalised as soon as possible (the Model Rules - by the end of 2021, and the Multilateral Convention should be open for signature in 2022).

Key issues for the European Union

The EU has strongly supported the development of both Pillars and has worked closely with the OECD to ensure that the outcome of the ongoing negotiations is compatible with EU law.

Moreover, the European Commission has announced it will postpone the proposal for a digital levy, till the agreement is finalised, and that the digital levy will be designed in such a way that it is independent of the forthcoming global agreement on international corporate tax reform, that it will be compatible with the commitment not to introduce new DSTs or similar measures, and will coexist with the implementation of an OECD agreement on sharing a fraction of the taxable base of the largest multinational enterprises, once the latter is ratified and transposed in EU law, and that the "digital levy" will be compatible with WTO rules and other international EU obligations.

Once the OECD/BEPS IF/G20 agreement is finalized, the Council will have to look to its implementation at EU level. The basis for this work will be the European Commission legislative proposals covering those elements of the OECD agreement, which will fall into the scope of EU competences.

It is of key importance, that all Member States remain supportive of the new international agreement. For the agreement to work globally and to ensure efficient implementation in the EU, solving the remaining open issues must be a priority.

Reaching the agreement at the IF on BEPS would not only facilitate transatlantic ties but also seize the opportunity to modernise the tax system and increase tax certainty.

Furthermore, reaching a consensus would allow the EU to move towards a modern tax environment. It would increase tax certainty for EU businesses operating abroad and would limit tax tensions within the internal market, while preserving the ability of Member States to keep legitimate tax incentives where there is relevant substance.

Questions for discussion:

1. What should be the next steps till and the next Inclusive Framework meeting in October to ensure consensus of all Member States on the remaining details of the two Pillars, as well as timely and effective implementation thereof in the EU?

2. What would the new, internationally agreed, paradigm for taxation of multinational companies mean for the long-term EU tax policy?