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International Tax Developments

Impact on the Isle of Man

Webinar | 21 July 2021

Agenda

- International landscape
- OECD/ G7 proposals
- EU Tax Developments
- Impact on the IOM
- Questions

A (selective) history lesson

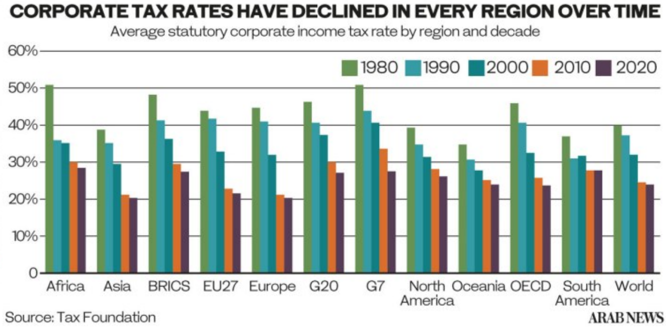
1980s onwards: IOM introduces tax exempt regimes for life companies and then (essentially) all non-locally owned companies

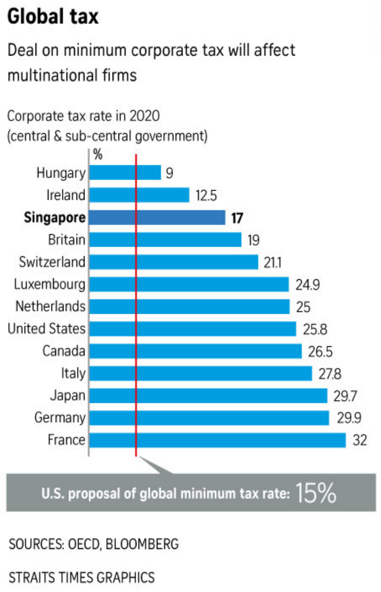
Late 1990s:
- Pressure from EU on these tax favoured regimes
- Start of discussions on EU Savings Directive (AEOI)

2000s:
- Tax favoured/ exempt regimes abolished and replaced by Zero/ Ten tax regime (2006)
- EU Savings Directive implemented (c2004)

2010s:
- FATCA and CRS implemented
- Economic Substance implemented
- Increasing pressures re taxation of digital economy

There is one certainty: taxes will go up





OECD/G7 International Tax Deal

Rob Rotherham, Tax Partner

Tax challenges of the digitalisation of the economy

The breadth and speed of change resulting from digitalization of the economy has introduced challenges in many policy areas, including taxation

Questionable whether tax policy based on a "brick-and-mortar" economic environment developed more than a century ago, remain fit for purpose today.

Need to rethink fundamental elements of the global tax system such as where taxes should be paid ("nexus" rules based on physical presence) and what portion of profits should be taxed ("profit allocation" rules based on the arm's length principle).

These challenges were identified as a main area of focus of the OECD Base Erosion and Profit Shifting ("BEPS") project, and was a driver behind the EU digital services tax proposal and various unilateral initiatives.

The G20 set an ambitious timeline to find a consensus solution to these issues

Without a comprehensive consensus-based solution, there is a risk that more jurisdictions will adopt uncoordinated unilateral tax measures, resulting in double tax, trade tensions, and tax disputes between countries

BEPS Pillar 1 and 2

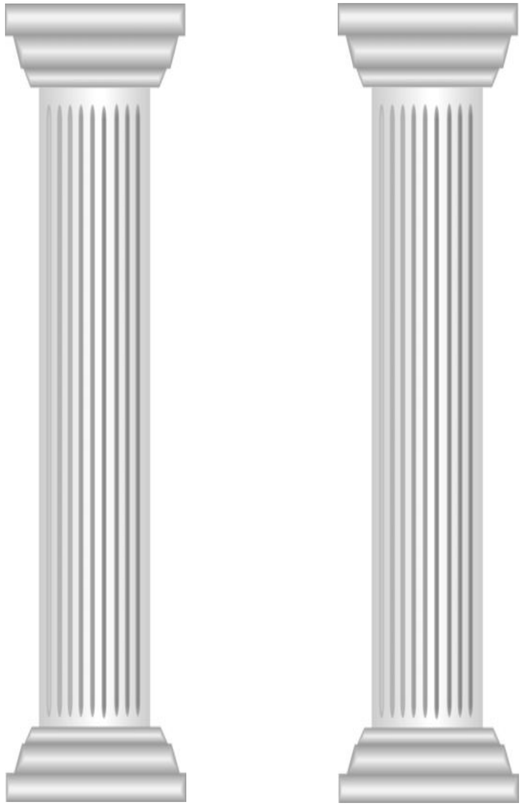
Pillar 1

— Focuses on the allocation of taxing rights between jurisdictions, new profit allocation and nexus rules

— Expected that the regulated financial services sector may be largely scoped out of Pillar 1, but e-gaming will not

— The gateway limit will be set high to limit impact to largest groups (initially >€20 billion and 10% profitability)

— Pillar 1 is likely to be a minimum standard



Pillar 2

— Global Anti-Base Erosion ("GloBE") proposal, seeks to address remaining BEPS issues and tax competition.

— Jurisdictions will have right to "tax back" where others have not exercised primary taxing rights or income is subject to low rate of tax

— Proposed as a "top-up" tax to provide a level playing field for jurisdictions and taxpayers, and avoid cliff effects

— Not a BEPS minimum standard but adopt a "common approach"

Digitalization of the economy is pervasive, raises broader issues, and is most evident in, *but not limited to*, highly digitalized businesses.

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Pillar 2

David Parsons, Tax Executive Consultant

Pillar 2 Overview

The Pillar 2 provisions are expected to apply in circumstances where income earned by an MNE is taxed at a rate that is less than a prescribed minimum rate.

Tax rate applicable to MNE income < Prescribed minimum tax rate =

Income Inclusion Rule	**Undertaxed Payment Rule**
Switch-over Rule	**Subject to Tax Rule**

It is anticipated that the minimum tax rate will ultimately be set at a fixed rate to be applied to all MNEs subject to the Pillar 2 provisions. Announced that it will be **it will be at least 15%**

Pillar 2 proposal – key components

The four key components of the Pillar 2 proposal are summarized below. The Income Inclusion Rule and the Undertaxed Payment Rule are designed to work in tandem and are collectively referred to as the Global Anti-base Erosion (“GloBE”) rules.

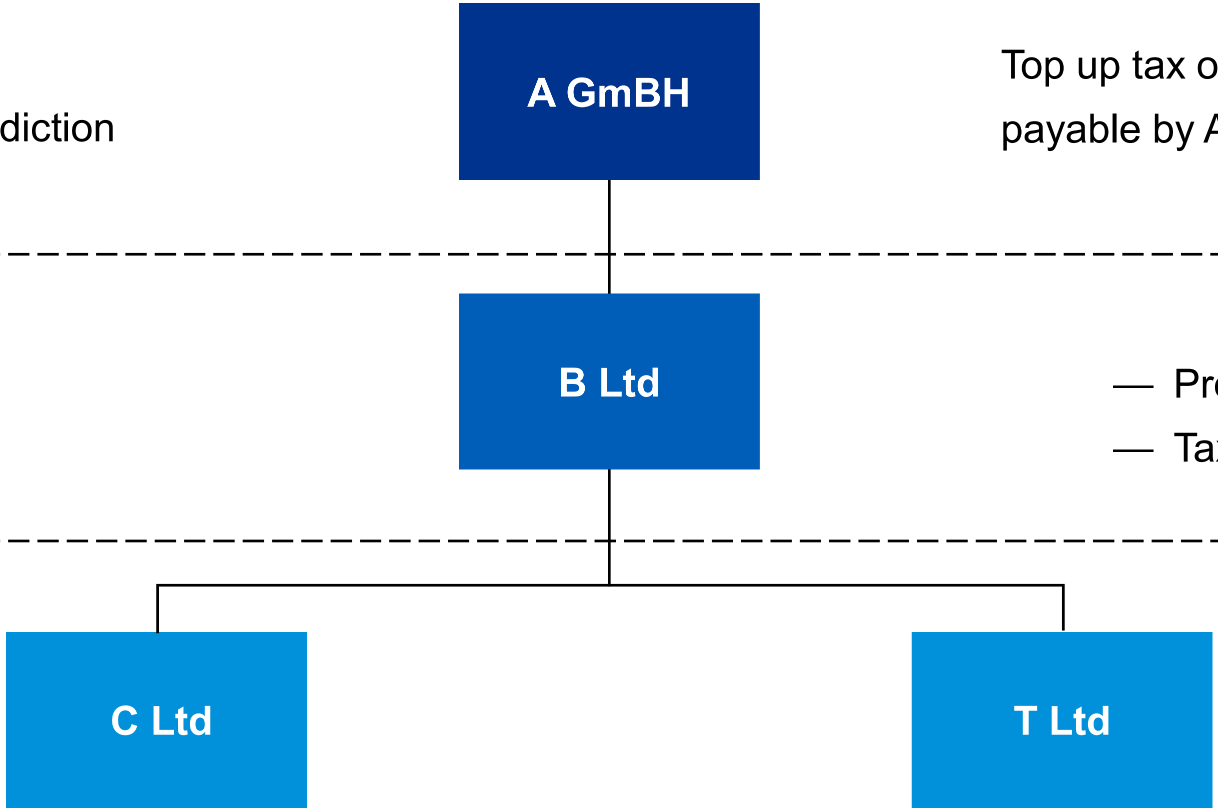
Income Inclusion Rule	Undertaxed Payment Rule	Subject to Tax Rule	Switch-Over Rule
Taxes the income of a foreign branch or controlled entity if such income was subject to tax at an effective rate less than a minimum rate; provisions likely to be enacted in domestic law as a supplement to parent jurisdiction’s CFC rules (similar to GILTI)	Denies deduction or imposes source-based taxation (e.g. withholding tax) for a payment to a related party if that payment is not subject to tax at or above a minimum rate; provisions to be enacted in domestic law (somewhat analogous to U.S. BEAT provisions)	Complements the undertaxed payment rule; payments subject to withholding or other tax at source, adjusts eligibility for treaty benefits on certain items where payment not subject to tax at a minimum rate (7.5%?); to be introduced through tax treaties	Ensures that the IIR applies to branches; allows resident state to switch from an exemption to a credit method where the profits attributable to a PE or certain property are subject to a tax rate less than a minimum rate; to be introduced through tax treaties

Income Inclusion Rule – min tax 15%

Germany

Income inclusion rule jurisdiction

Top up tax on IOM profits potentially payable by A GmBH of £4.5m



Jurisdiction rate 20%

- Profits £40m
- Tax paid £8m

IOM rate 0%

Profit £20m

Profit £10m

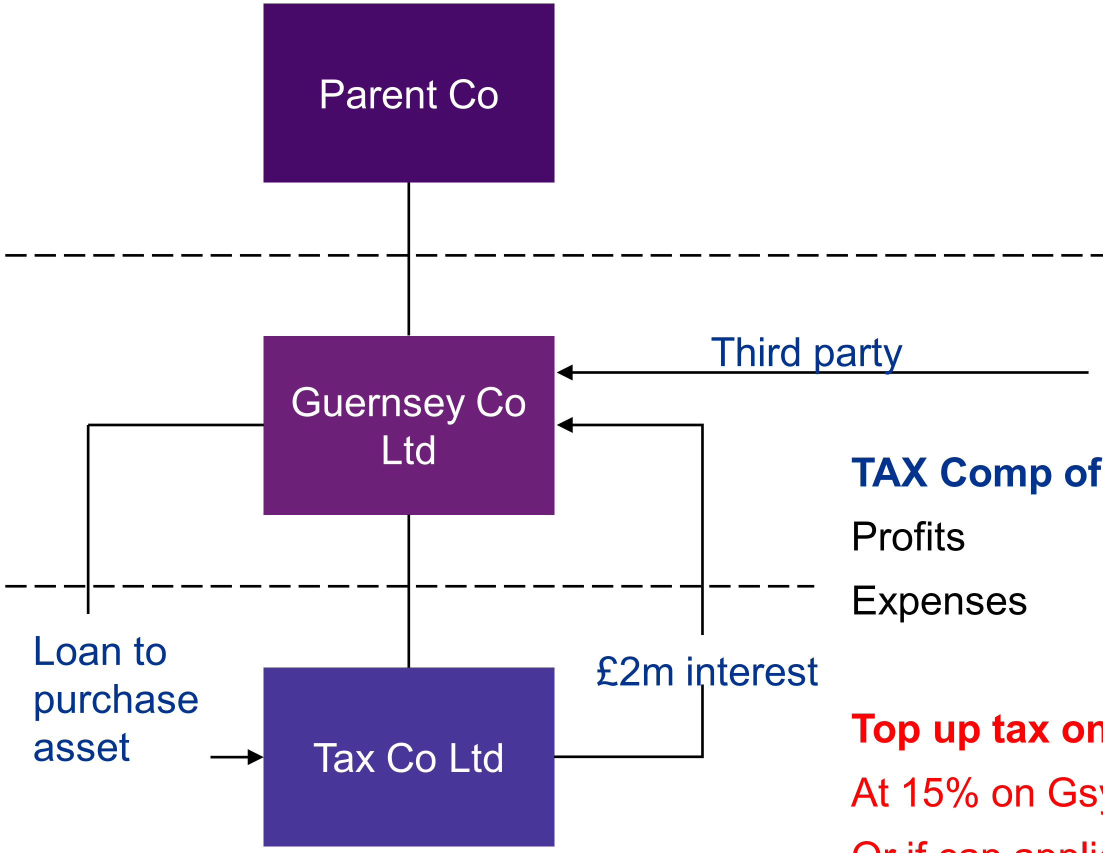
Undertaxed Payment Rule - Simplified

Non "income inclusion rule" jurisdiction – say Vanuatu

0% jurisdiction

Undertaxed Payment Jurisdiction

Rate 25%



TAX Comp of Guernsey Co

Profits	3,000,000
Expenses	(500,000)
	2,500,000

Top up tax on Tax Co Ltd

At 15% on GsyCo profits	£375,000
Or if cap applies	£300,000

Design considerations

Thresholds and carve-outs

— IIR takes preference over UTPR

— Threshold for IIR is consolidated revenue of €750 million, BUT jurisdictions are free to set a lower threshold

— Exclusion for Funds (but not portfolio companies) and ‘subsidiary’ dividends

— No carve-outs for regimes compliant with BEPS Action 5 standards (e.g. economic substance provisions)

— Carve-outs based on substantial local activities (e.g. return on tangible assets, payroll)

Coordination and integration

— Requires a detailed exchange of information protocol, especially for the UTPR

— Further work is required to address the complex interaction of the GloBE components with each other, as well as other rules and obligations in the broader international framework, to mitigate the risk of unintended outcomes (e.g. double taxation).

Issues to consider

- Pillar 1 is not really aimed at companies operating in the Crown Dependencies
- **Pillar 2 does not require each jurisdiction to implement a corporate tax rate of 15%**
- There are certain UPEs and a number of constituent entities that will be affected by Pillar 2
- The possible variable threshold will make it difficult to determine the number of companies caught by Pillar 2
- Funds are exempt as are 'subsidiary' dividends
- Unlikely to affect the policy around the 0% rate
- Should IOM implement the IIR for its UPEs?
- Consideration needs to be given whether the 10% rate should match the Pillar 2 rate

EU Developments in the last 6 months

Rob Rotherham, Tax Partner

EU Developments in the past six months?

EU Parliament resolution on the “Tax Haven” blacklist

Communique on Business Taxation In the 21st Century

Review of Foreign Source Income Exemption regimes

Presents a problem for us?

EU Parliament Resolution on the Tax Haven Blacklist

- In January 2021 the EU Parliament passed a Resolution on reforming the EU list of non-cooperative jurisdictions for tax purposes
- EU Parliament stated that current listing process was "confused and ineffective"
- Requests for greater transparency of the listing process
- Seeks to link Pillar 2 to the EU listing criteria
- Requests the screening of the UK in line with the listing criteria
- Requests a level playing field between EU Member States and third countries

Calls for the EU Council to include the automatic listing of 3rd jurisdictions with a 0% corporate tax rate or no company taxes as a standalone criterion

EU Parliament Resolution

The good news

— The EU Parliament does not have legal competence to change the terms of the listing process

— The resolution is NOT binding on the EU Council or Commission

— The EU Code of Conduct Chair (Ms Petkova) once more reiterated that the list was not a "Tax Haven Blacklist"

The not so good news

— The EU Council/Commission had previously agreed in July 2020 to reform the Code of Conduct on Business Taxation

— Therefore, any consideration of the Resolution would take place during the review process, the outcome of which is likely to be the 2nd quarter of 2022

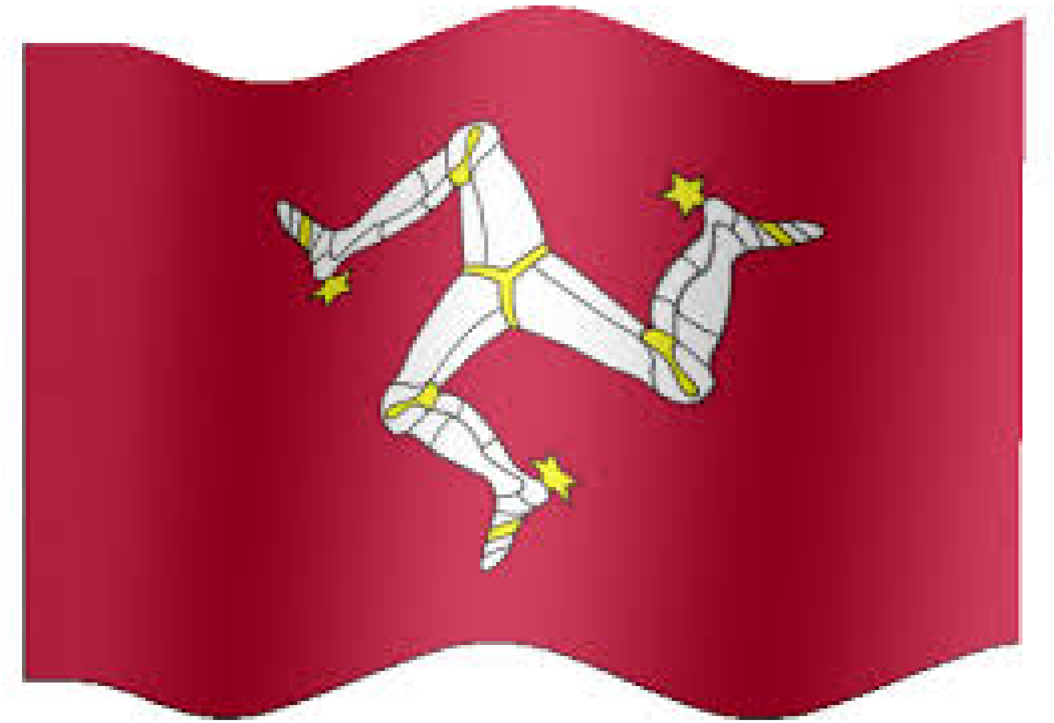
Communique on Business Taxation in the 21st Century

- Billed as an EU tax reform for the next 2 years, with "..targeted measures that… ensure effective taxation"
- Mainly deals with internal EU tax matters
- Implies that Pillar 1 is a minimum BEPS standard
- EU will issue a Directive for implementation of Pillar 1 and 2 in the EU
- **Commission will propose to introduce Pillar 2 in the criterion used for assessing 3rd countries in the EU listing process**
- References the EU Commission July 2020 paper on Tax Good Governance in the EU and beyond
  - Calls for the reform of the Code of Conduct following the agreement or otherwise of Pillar 1 and 2
  - Extend the scope of the Code such as tax residency rules for individuals which encourage the re-location of business
  - Implement a monitoring process to ensure that reforms are effectively implemented and there is no backtracking

Impact on IOM sectors

David Parsons, Tax Executive Consultant

IOM sector impact



To conclude

- Jurisdictions will soon be looking at ways on how to rebuild their balance sheets….
- Pillar 1 and 2 is one way, but not the end
- Pillar 1 and 2 of itself is unlikely to change the tax policy in relation to the 0% rate
- Need to consider if CDs implement Pillar 2
- Corporate behaviour will be interesting in a Pillar 2 environment
- Clarity needed on the link between implementation of Pillar 2 and the EU listing process
- Need to maintain a watchful eye on the reform of the EU Code of Conduct and the EU listing process, with particular interest on whether 0%/no tax policy is an automatic listing criteria
- Even if the IOM is required to move away from their current zero/ten model, tax neutrality may be provided by internationally accepted means

Questions

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Thank you

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