

Briefing

International review for February

Speed read

This month has seen the release of the much-awaited Pillar Two administrative guidance. Although this has provided some clarification to multinational enterprises preparing for implementation of the rules, it is only the first in a tranche of further guidance to be issued in the coming months. Meanwhile, Qatar and Sweden are the latest Inclusive Framework members to take steps to implement Pillar Two into domestic law. In the US, President Biden has set out his plans for a wealth tax and a quadrupling in the excise tax rate on corporate stock buybacks to 4%. In Europe, the green deal industrial plan has been unveiled, including plans for tax incentives and easing of state aid rules. The initial public consultation on BEFIT closed on 26 January 2023, but some officials have recently expressed concern about the success of the initiative. The European Commission has reaffirmed its commitment to the Unshell Directive and has also issued a consultation on rules designed to eliminate double reporting for platform operators under DAC 7. Finally, formal notices were issued to 14 member states who have failed to implement DAC 7 into domestic law.



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Administrative guidance for implementation of Pillar Two

As part of the Inclusive Framework's (IF) ongoing work to implement Pillar Two, administrative guidance (AG) on the global anti-base erosion (GloBE) rules was released on 2 February 2023. The AG adds to the expanding body of guidance – exceeding 450 pages – that has been approved by the IF on the GloBE rules.

The AG consists of 111 pages, covering 26 items, which aim to clarify, and in some instances simplify, the application of the GloBE rules. The items cover five categories: scope, income & taxes, application of GloBE rules to insurance companies, transition and qualified domestic minimum top-up taxes (QDMTTs).

A detailed analysis of the AG is outside the scope of this article, but we note the following general observations.

Helpful clarifications: Many of the AG items are directed at 'helping' taxpayers. These clarify the application and interpretation of the GloBE rules in such a way as to avoid distortive outcomes that could otherwise arise. Examples include the AG items 'softening' the application of article 4.1.5 (to ensure no GloBE top-up tax is imposed in a year in which a GloBE loss arises), the various insurance-relevant rule clarifications, clarifications on the excluded entity definitions, the treatment of hedges of investments in foreign operations and clarifications of various transitional rules.

Legal effect of the AG: Article 8.3.1 of the GloBE rules provides that jurisdictions must apply the GloBE rules in

accordance with the AG. Furthermore, it is clear from the AG that, in order for the income inclusion rule (IIR), under taxed profits rule (UTPR) or QDMTT of a jurisdiction to be 'qualified', it must follow the AG. For AG that is released after a jurisdiction has transposed the GloBE rules into domestic law, this may raise issues regarding whether the AG should be applied on a dynamic or static basis (e.g. whether, in order to maintain its qualified status, a jurisdiction needs to update its domestic law to reflect the most recent AG).

In addition, there could be instances in which a local court determines that the AG interpretation of a provision is not supported by the wording of the rule, as incorporated into domestic law. Notably, in the UK's draft GloBE legislation, released in July 2022, elements of the commentary were integrated into the UK legislation, which should help alleviate this problem. Some jurisdictions may choose a similar approach.

QDMTT design flexibility: The AG provides jurisdictions with a degree of flexibility on the design of a QDMTT, provided that any variations do not produce outcomes inconsistent with the GloBE rules. Whether a minimum tax is to be treated as a QDMTT will be determined under a multilateral review process (peer review) guided by the AG. It is possible a jurisdiction might need to amend its minimum tax following review. The process to implement a QDMTT may therefore not be straightforward.

GloBE and accounting: Several of the AG items might be viewed as 'patches' to deal with peculiar interactions of the GloBE rules with accounting treatments. Examples include the application of the rules where historic cost is used for intragroup asset transfers, and where there is an asymmetric accounting treatment of preference shares at holder and issuer levels.

Spill over effects: Some of the AG items are directed at resolving specific issues but conceivably could have spill-over effects. An example is the assertion that article 3.2.3 (which requires that transactions between constituent entities (CEs) be adjusted to align with the arm's length principle) also applies to transfers of assets and liabilities between CEs covered by article 6.3.1. Before this clarification, the GloBE treatment would have followed the accounting treatment, which in some cases, may have recorded the transfer at historical cost.

The commentary had previously targeted the application of article 3.2.3 at transfer pricing adjustment. This seems to no longer be the case but raises questions as to where the limits on the application of article 3.2.3 now lie.

The AG is an initial tranche of additional clarifications that are to be incorporated into a revised version of the commentary to be released later this year. While the AG provides some welcome clarification in many instances it raises as many new issues for clarification as it addresses. The AG is not open to public comment and the mechanism through which businesses can raise issues, and input on their prioritisation, has been raised in responses to recent IF consultations.

The AG document highlights that further guidance is under consideration on QDMTT design features (including safe harbours), the treatment of an acquirer for intra-group asset transfers and the treatment of a creditor for debt releases. Multinational enterprises (MNEs), and countries trying to implement Pillar Two into national law this year, will be closely following the next tranche of IF releases in search of answers.

Pillar Two national implementation update

As my January article mentioned, a key feature of 2023 will be the implementation of Pillar Two into domestic law around the world.

On 2 February 2023, the State of Qatar issued the tax law of 2022 in which it expressed its commitment to introducing the global minimum tax. Future executive regulations will provide more details on the design of the rules.

On 7 February 2023 an interim report containing proposals to implement Pillar Two was put before the Swedish government. The proposed domestic legislation broadly corresponds to the EU Pillar Two Directive (which requires member states to implement the rules by 31 December 2023), although certain details, including rules on safe harbours, have yet to be decided.

There was an expectation that India would use its 2023/24 Union Budget on 2 February 2023 to provide guidance on India's adoption of the rules, however, surprisingly no mention of Pillar Two was made and the timing of any such announcement remains unclear.

US: statement on economic plan, including tax proposals

In advance of the president's State of the Union address to Congress on 7 February 2023, the White House released a fact sheet setting forth the president's statement on his economic plan.

The statement mentions a number of tax proposals the president intends to include in his budget he expects to send to Congress on 9 March 2023, including:

- an increase in the excise tax rate on corporate stock buybacks to 4% (from the current 1% as enacted in the Inflation Reduction Act of 2022);
- a minimum tax on the ultra-wealthy, presumably in line with the proposal included in the Biden administration's budget recommendations for FY 2023 (which proposed a minimum tax of 20% on total income (generally including unrealised capital gains) on taxpayers with 'wealth' of more than \$100m); and
- an unspecified expansion of the child tax credit.

It remains to be seen whether these proposals will pass through a Congress now under divided control. The wealth tax, in particular, is likely to face significant Republican opposition.

European Commission: green deal industrial plan

My January article advised readers to expect European action in quarter one of 2023, in response to concerns that the targeted incentives for companies contained in the US Inflation Reduction Act (IRA) would result in Europe losing out on investment. As expected, on 1 February 2023 the EC presented its 'green deal industrial plan'.

One of the key pillars of the plan is promoting faster access to sufficient national and EU funding to speed up investment and financing for clean tech production in Europe. Policies under this pillar include better access to tax breaks for sustainable companies, redirecting cash towards clean-technology industries and relaxing state aid rules. For example, under the proposals member states would be allowed to implement schemes to support new investments in production facilities in defined, strategic net-zero sectors, including through tax benefits.

Following discussion of the plan during the EU leader summit on 9–10 February 2023, the Commission will now come up with more detailed proposals ahead of the March European Council.

There are significant complexities in translating EU policies into domestic law at member state level and the proposals have generated a range of responses within the bloc. It will be interesting to see how the proposal is packaged for final approval, bearing in mind that speed is of the essence. Approval by all member states and the European Parliament

is required for most EU legislation that binds member states: such unanimity could lead to delays. There are exceptions to this, including in the case of tax legislation, which requires unanimous agreement of the Council, but with the European Parliament only having a consultative role.

Business in Europe: framework for income taxation

On 26 January 2023, the EC's public consultation on Business in Europe: framework for income taxation (BEFIT) closed. This consultation was an early stage gathering of views on different design options for BEFIT. The current indicative timing for the EC's adoption of a legislative proposal is the third quarter of 2023, after which we expect that more detailed input from stakeholders will be collected through a second public consultation. It will be interesting to see if BEFIT retains this planned momentum given recent comments from members of the European Parliament expressing concern that BEFIT would not succeed where previous similar initiatives have failed.

ATAD 3 ('unshell') progress

On 17 January 2023, the EC published its work programme for the first half of 2023. ATAD 3, the directive to prevent the misuse of shell entities for tax purposes ('unshell') is a priority workstream, alongside the EC's proposal for a new EU common system for the avoidance of double taxation of withholding tax payments (FASTER).

Also on 17 January 2023, the European parliament approved the report on unshell. While the report is generally supportive of the text proposed by the EC, parliament recommends a number of amendments, including in relation to gateways and substance indicators. However, the report reflects the parliament's consultative role in the legislative process and is not binding on the council. It remains up to member states to agree on the final text of the directive, and they are free to disregard the parliament's recommendations.

It is understood that a draft compromise text on unshell could be discussed at ministerial level as early as May. However, even if progress is made on the text in the next few months, it is unlikely that the original deadlines (member states to transpose the rules into domestic legislation by 30 June 2023 and the rules applying as of 1 January 2024) will be met.

EU reporting obligations for platform operators (DAC 7) developments

In order to eliminate double reporting for non-EU platform operators, DAC 7 waives the obligation to report where member states receive equivalent information from non-EU countries that apply similar reporting regimes (e.g. under the OECD's multilateral competent authority agreement). On 20 January 2023, the EC launched a public consultation on proposed criteria to establish whether information automatically exchanged under an agreement between the tax authorities of member states and a non-EU country is equivalent to that specified in DAC 7. The consultation closed on 17 February 2023.

Meanwhile, on 27 January 2023, the EC sent letters of formal notice to 14 member states that had not notified, or partially notified, the national measures transposing DAC 7 into domestic legislation by the deadline of 1 January 2023. The deadline for member states to reply and complete their transposition is two months. Since issue of the notices several affected member states have published/adopted DAC 7 implementing legislation. ■