

Briefing

International review for October

Speed read

Packed into this month's article are highlights from the second batch of July OECD BEPS 2.0 releases and Pillar Two implementation updates from around the world. The EC has had a busy summer, adopting the transitional rules for CBAM, proposing two new Directives – a common EU corporate tax system (BEFIT) and harmonisation of transfer pricing in the EU – and issuing notices to 17 member states which failed to implement the EU public CbCR rules. Meanwhile, in the US, tax legislation appears to be stalled in the House and Senate.



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OECD July releases

Following the Inclusive Framework (IF) *Outcome Statement* on 11 July 2023 (discussed in my July update), on 17 July 2023 the OECD released its *Secretary-General Tax Report to G20 Finance Ministers and Central Bank Governors* (the report) alongside a tranche of BEPS 2.0-related documents. The highlights from these releases are below.

Pillar One: Amount A

The report states that the IF has delivered a text of the multilateral convention (MLC) to implement Amount A, but IF members have yet to agree the text.

Recognising the need to prevent disruption or delay in the ratification of the MLC, the report explains that IF members have agreed to refrain from imposing newly enacted digital services taxes (DSTs) or relevant similar measures on any company between 1 January 2024 and the earlier of 31 December 2024, or the entry into force of the MLC. This agreement is subject to at least 30 jurisdictions accounting for at least 60% of ultimate parent entities of in-scope MNEs signing the MLC before the end of 2023.

The US will be a key signatory if this threshold is to be met but much legislation is stalled in Congress. More on the US tax agenda at the end of this article.

Further complicating matters for Pillar One, some IF members are progressing their own DSTs. I reported in my July update that Canada, unhappy with the lack of a firm and binding timeline for Pillar One implementation, refused to agree to this continued ban on domestic DSTs. On 4 August 2023, Canada released draft legislative proposals for its new 3% DST, effective from 1 January 2024 and affecting certain online revenues beginning 1 January 2022.

Despite being one of the IF members who did agree to the ban, New Zealand introduced its own DST bill to parliament on 31 August 2023. The rules would not come into effect until 1 January 2025 at the earliest, so the

decision to introduce the bill now is interesting. Is it a vote of no confidence in the OECD's ability to get Pillar One over the line? Or, in advance of the general election on 14 October 2023, is it simply an attempt by the government to demonstrate its commitment to the 2020 Labour party manifesto pledge to ensure MNEs pay their fair share of tax in New Zealand?

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It will be interesting to see whether these developments start a domino effect of unilateral measures that undermine Pillar One completely.

Pillar One: Amount B

A public consultation on the design elements of Amount B, which provides for a simplified and streamlined approach to the application of the arm's length principle to in-country baseline marketing and distribution activities, was launched. The 'scope and pricing framework' consultation opened on 17 July 2023 and closed on 1 September 2023. The proposals do not represent the consensus view of the IF and further work is required to resolve open issues. The IFs plan is to agree a final Amount B report by the end of this year and incorporate key content into the OECD Transfer Pricing Guidelines by January 2024.

Pillar Two: subject to tax rule (STTR)

A new 72 page IF document sets out the STTR model treaty and commentary. The STTR is a treaty-based rule that protects the right of developing IF members to tax certain intra-group payments, where these are subject to a nominal corporate income tax that is below a minimum rate of 9%. The publication covers, amongst other issues, scope, covered income, adjusted nominal tax rate, excluded persons, mark-up threshold and materiality threshold. The inclusion in scope of a broad spectrum of connected party payments is notable, particularly payments in relation to services. Typically, tax treaties do not provide for the application of withholding taxes to cross-border service payments, so we are likely to see an increased application of source country taxation to such payments in the future.

The text may be implemented through modifications to bilateral treaties via a multilateral instrument (to be open for signature from 2 October 2023) or through bilateral renegotiation of treaties. It remains to be seen how many jurisdictions will be determined to have a nominal corporate income tax rate below 9% on an in-scope payment, and therefore how many of the world's 3,000+ bilateral tax treaties will be updated for the STTR.

Global anti-Base Erosion Rules (GloBE) information return (GIR)

A standard template for the GIR was released on 17 July 2023. This final template responds to some of the concerns stakeholders raised in earlier public consultations, most notably through transitional simplified reporting requirements that allow in-scope groups to report their GloBE calculations at a jurisdictional level for periods beginning before 31 December 2028. However, comprising 28 pages and around 480 data points covering all areas of the GloBE rules, the GIR continues to be an onerous compliance burden for in-scope groups.

Second tranche of Administrative Guidance (AG) released

The IF released its second tranche of AG, including two new safe harbours, one for jurisdictions that introduce a qualified domestic minimum top-up tax (QDMTT) and a transitional undertaxed profits rule (UTPR) safe harbour. The document also includes detailed AG on the QDMTT, general currency conversion rules and the substance-based income exclusion. Finally, it contains important new guidance on transferable tax credits such as those introduced by the US Inflation Reduction Act. The AG confirms these credits are effectively treated as qualified refundable tax credits for the purposes of the GloBE rules.

Pillar Two domestic implementation update

This summer has seen a range of activity from territories preparing for domestic implementation of Pillar Two.

At one end of the spectrum, some countries with headline corporation tax rates below 15% are starting to explore how best to reform their regimes. On 11 July 2023, Gibraltar announced it will implement new incentives as well as a distinct new tax regime for companies within the scope of Pillar Two no earlier than for accounting period beginning on or after 31 December 2024. On 8 August 2023, Bermuda launched a public consultation on implementation of a new corporate tax regime applicable to MNEs within scope of the Pillar Two rules, effective for tax years beginning on or after 1 January 2025. The government will conduct further analysis to determine the appropriate rate of corporation tax, but currently believes a rate within a range of 9% to 15% may be appropriate.

Meanwhile, countries more advanced in their Pillar Two journeys continue to progress their domestic legislation. The majority of activity remains in the EU, as member states have until 31 December 2023 to transpose the EU Minimum Tax Directive into domestic law. On 27 July 2023, Ireland released a Pillar Two feedback statement, including draft domestic legislation for public consultation that closed on 21 August 2023. On 4 August 2023, Luxembourg filed its draft Pillar Two law with Parliament. On 15 August 2023, Finland launched a consultation on its draft Pillar Two legislation. On 17 August 2023, Germany approved an updated draft bill to implement the Directive.

Outside of the EU, on 4 August 2023, Canada issued draft Pillar Two legislation for consultation, with comments requested by 29 September 2023. Further updates will be made as necessary to reflect elements of recently released OECD guidance (including on the treatment of transferable and other tax credits).

Finally, in a welcome development for in-scope MNEs operating in the region, on 27 July 2023, South Korea announced tax reform proposals that included plans to defer implementation of the UTPR, originally set to be effective from 1 January 2024, by one year to 1 January 2025.

EU update

Carbon border adjustment mechanism

On 17 August 2023, the European Commission (EC) adopted the rules governing the implementation of the Carbon Border Adjustment Mechanism (CBAM) during its transition phase, which starts on 1 October 2023 and runs until the end of 2025.

The transition phase is intended to give businesses adequate time to prepare, and to allow the EC to fine-tune

the shape of the CBAM, in advance of its definitive phase from 1 January 2026. In the transition phase, traders will only have to report on the emissions embedded in their relevant imports, without paying any financial adjustment.

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The implementing regulation details the transitional reporting obligations for EU importers of CBAM goods, as well as the transitional methodology for calculating embedded emissions released during the production process of CBAM goods. Penalties will be imposed if reporting declarants haven't taken necessary steps to comply with the obligations to submit a quarterly CBAM report or correct an incorrect or incomplete CBAM report in the transition phase.

As with most tax policies, where the EU goes others inevitably follow. The UK is currently digesting the feedback from its consultation earlier this year on introduction of a domestic CBAM from 2026. On 16 August 2023, Australia announced it will be conducting a review of whether a CBAM or other carbon leakage policy options are suitable for Australia. Companies currently preparing for EU CBAM may find consolation in the thought they can leverage their hard work for further CBAMs – provided, of course, that other territories closely follow the EU blueprint.

EC publishes BEFIT and TP proposals

On 12 September 2023, the EC issued proposals for two Council Directives: one on Business in Europe: Framework for Income Taxation (BEFIT) and one on transfer pricing. It is expected that the EC will launch a public consultation seeking feedback from interested stakeholders on both proposed Directives.

BEFIT aims to provide common rules for determining the corporate tax base for EU-based entities that are part of a group with global consolidated revenues above a certain threshold. The proposed BEFIT Directive covers scope and definitions, calculation and allocation of the BEFIT tax base, a simplified approach to transfer pricing compliance, administrative provisions and domestic transposition provisions.

The TP proposal meanwhile seeks to address the lack of harmonisation of TP rules at EU level because of the differing status and role of the OECD Transfer Pricing Guidelines between member states. The TP proposal will deal with these issues by the inclusion of the OECD arm's length principle and OECD guidelines in EU law, alongside the gradual development of common approaches to the practice of applying TP.

The BEFIT Directive may be one to watch. Successful adoption of the Directive will require unanimous approval in the Council therefore, given attempts to gain consensus on similar initiatives have failed, the chances of success seem slim. That being said, many did not expect BEFIT to gain as much traction as it has done this year, so perhaps it will continue to surprise.

EU Public Country-by-Country Reporting (CbCR) Directive

On 20 July 2023, the EC sent letters of formal notice to

17 member states that had not transposed the EU CbCR Directive into domestic legislation by the deadline of 22 June 2023. These member states are: Austria, Belgium, Bulgaria, Croatia, Czechia, Cyprus, Estonia, Finland, Greece, Italy, Latvia, Luxembourg, Malta, Netherlands, Poland, Portugal, and Slovenia. The deadline for member states concerned to reply to the letters of formal notice and complete their transposition is two months. Should they fail to do so, the Commission may decide to issue a reasoned opinion.

However, since the issue of formal notices, Croatia, Luxembourg and Portugal have all adopted the rules. Belgium, the Czech Republic, the Netherlands and Poland have also published draft legislation. This leaves 10 member states who have not initiated the transposition process at the date of writing.

US tax agenda for 2023

Finally, as Congress settles back into the Capital after the extended Autumn recess now is a good time to reflect on the US tax agenda. Tax legislation is generally stalled in the House and Senate. The best chance of Congress

enacting meaningful tax law this year seems to lie with the Tax Cut and Jobs Act 'extenders', particularly R&D expensing which has quite strong bipartisan support. How great that chance is hard to predict, and the situation may not become clear until late December.

There is a real possibility that all best efforts around taxes could, in the end, fail to achieve consensus in 2023. But if Congress does not act this year, the chances of expired items getting reinstated in 2024, an election year, is even more uncertain. This makes the legislative negotiations around the budget and taxes a high stakes event for taxpayers, and one worth watching this Autumn. ■

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