Briefing

International review for June

Speed read

The OECD has released its fourth tranche of Administrative Guidance on Pillar Two, as well as additional guidance on Amount B of Pillar One. The OECD has also released a statement saying it is on track to release the Amount A Multilateral Convention for signature by the end of June 2024, although it is still uncertain whether a critical mass of signatories will be achieved to make the rules effective. This month sees the United Nations progress work on its proposal for a Framework Convention on international tax cooperation. Australia has introduced its public country-by-country reporting legislation in Parliament. Finally, the Isle of Man, Guernsey and Jersey have released further details of how they intend to implement Pillar Two.

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OECD: release of fourth tranche of Administrative Guidance on GloBE Model Rules

On 17 June 2024, the OECD/G20 Inclusive Framework (IF) released its fourth tranche of Administrative Guidance on the Global Anti-Base Erosion (GloBE) model rules ('June 24 AG'). At 140 pages, a detailed analysis of the June 24 AG is outside the scope of this article. I have summarised below some key points of interest, but note this is not exhaustive.

Detailed recapture rules for Deferred Tax Liabilities (DTLs)

The GloBE rules stipulate that the accrual of a DTL that does not reverse within five years will be subject to recapture, with a MNE group required to re-compute its GloBE effective tax rate (ETR) excluding such DTLs and pay any additional top-up tax due.

MNE groups had raised concerns with the IF that their existing accounting systems did not allow for sufficient granularity to track the movement of DTLs on an asset-by-asset basis. The June 24 AG attempts to address this by permitting MNE groups to track DTLs on an aggregate basis, whilst simultaneously ensuring that this aggregation does not undermine the original policy objective of the DTL recapture rule.

In jurisdictions where MNE groups are subject to the GloBE Rules and do not qualify for the transitional CbCR safe harbour, they will need to put in place the necessary systems to track DTLs at an appropriate level going forward. The June 24 AG gives MNE groups a variety of options for tracking DTLs, including whether to opt to exclude DTLs as an unclaimed accrual or under a new unclaimed accrual five-year election. The guidance is highly complex, though ultimately many MNE groups may find that they are not actually impacted.

Divergence between GloBE and accounting carry values

The June 24 AG provides additional guidance on how to determine adjusted covered taxes of constituent entities in cases where the accounting and GloBE carrying values (and the associated deferred tax assets/liabilities) diverge. The guidance effectively requires MNEs to track 'GloBE carrying value' in their accounting system which will lead to an increase in compliance costs, and may move some MNEs further in the direction of needing a full set of 'GloBE accounts', alongside existing financial and local tax accounts. Recognising this, the June 24 AG notes the IF will further consider potential simplification measures to mitigate the compliance burden in this area.

The guidance also addresses differences between accounting standards in respect of intercompany asset transfers. A significant limitation with the guidance is that it only applies in respect of intercompany asset transfers executed after the transition year. This means MNEs preparing consolidated financial statements using accounting standards that account for intragroup transactions at cost, and that have transferred assets prior to the transition period, will continue to have less favourable outcomes as compared to MNEs preparing consolidated accounts accounting for intragroup transactions at fair value.

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Finally, the guidance clarifies that certain measures governing reorganisations do not apply pre-transition year. Companies should review all historic M&A transactions (at least to the extent the historical transactions resulted in attributes that are still present in 2024 and future years) and determine if a basis step-up was provided for local tax purposes and how the GloBE rules, including the June 24 AG, will respond to those historic transactions.

Allocation of cross-border current taxes

The June 24 AG revises the method provided in prior commentary for allocating current taxes of a main or parent entity to another constituent entity (CE) under a tax system where multiple sources of income are blended and cross-crediting of foreign taxes is allowed. The latest guidance provides for a four-step methodology that generally attempts to determine how much of the main or parent entity's tax expense arises from the GloBE income of each particular CE.

The approach of the June 24 AG is a stark departure from the method of allocating taxes under the temporary allocation of taxes due to a blended CFC tax regime, which applies to the allocation of US taxes related to US Global Intangible Low Taxed Income (GILTI), and would cause US taxes incurred as a result of US shareholder expense allocation to be included in the US ETR calculation. That different approach may be helpful, harmful, or neither depending on a taxpayer's facts.

Allocation of cross-border deferred taxes

The guidance provides a five-step process for the allocation of deferred CFC taxes from a parent entity to its CFC. The same principles apply to allocate deferred taxes to hybrid entities, reverse hybrid entities and permanent establishments. Notably, GILTI deferred taxes are not

allocated under article 4.3 (and are also disregarded on transition), so that they are only taken into account when they reverse and become current tax items.

The June 24 AG also contains clarifications on the rules regarding allocation of profits and taxes in structures including flow through entities and the treatment of securitisation vehicles. Additional guidance is expected from the OECD later this year, which may be an extension of some of the June 24 AG and some of which will be new subject material.

OECD: further details on Amount B simplified approach

On 17 June 2024, the OECD also published additional guidance on key definitions related to Amount B, its effort to simplify transfer pricing as part of Pillar One.

The February 2024 Amount B report included political commitment from IF members to respect the outcome determined under Amount B when applied by a low-capacity jurisdiction, and take all reasonable steps to relieve potential double taxation that may arise from the application of Amount B by a low-capacity jurisdiction where there is a bilateral tax treaty in effect between the relevant jurisdictions.

The latest release reflects political commitment requiring Amount B outcomes to be respected when applied by a broader set of jurisdictions (referred to as 'covered jurisdictions') than those originally envisaged in the February 2024 Amount B report. The latest guidance establishes criteria to identify 'covered jurisdictions' and lists over 60 covered jurisdictions, including Egypt, Malaysia, Nigeria, Thailand and Viet Nam – although interestingly it is not clear that these jurisdictions will implement or apply Amount B.

The publication of a definition of 'covered jurisdictions' represents a step towards implementation. It is notable that significant emerging markets, such as Brazil, Mexico and South Africa have now indicated their willingness to adopt Amount B. However most jurisdictions appear to be waiting for further announcements on the Amount A Multilateral Convention (MLC) before signaling whether or not they intend to implement Amount B.

The latest guidance also contains lists of qualifying jurisdictions for the purposes of the operating expense cross-check mechanism (applied as a guardrail to the Amount B pricing matrix) and the data availability mechanism (which provides for upward adjustments to the returns provided in the Amount B pricing matrix in certain circumstances). These lists are to be fixed prospectively for five years and further updates will be published on the OECD website every five years.

The OECD have noted that work on an Amount B framework, i.e. a political agreement on which jurisdictions will implement Amount B, remains ongoing as part of the broader work on the Pillar One package. Pending the finalisation and implementation of any such agreement, Amount B remains optional for jurisdictions.

OECD: statement by co-chairs of IF on Amount A of Pillar One

On 30 May 2024, the OECD released a statement by the co-chairs of the IF following its 16th meeting from 28 to 30 May 2024.

The statement indicates that the IF is nearing completion of the negotiations on a final package on Pillar One with the goal of reaching a final agreement in time to open the Amount A MLC for signature by the end of June 2024.

The statement mentioned that both France and Brazil had expressed interest in hosting a signing ceremony as soon as practical after the MLC is opened for signature. The statement also mentioned plans for a signing ceremony for the Subject To Tax Rule (STTR) on 19 September 2024.

Getting the text of the Amount A MLC ready for signature is only the first hurdle to overcome. The bigger – potentially insurmountable – challenge is achieving sufficient signatories to make the agreement effective. Remember, to enter into force the MLC needs to be ratified by at least 30 jurisdictions including the headquarter jurisdictions of at least 60% of MNEs within the scope of Amount A. The US is a key signatory to achieving this threshold and the difficulty in passing tax legislation through Congress, particularly in an election year, is well documented.

Interestingly, the US is claiming that it is opposition from other countries that is delaying progress: the statement did not explicitly address questions about whether India and China would join the Pillar One deal, raised by U.S. Treasury Secretary Yellen and Italian Finance Minister Giorgetti during the G7 Finance Ministers meeting on 23 to 25 May 2024.

If the timetable in the statement is met, and the MLC open for signature by the end of June, then the second half of 2024 will be decisive for Amount A.

It is noteworthy that the UN also has taxation of high-net worth individuals in its sights

United Nations

In January, I reported on a United Nations (UN) resolution to establish an ad hoc intergovernmental committee (the Committee), mandated to develop draft terms of reference for a UN framework convention on international tax cooperation (the Framework Convention).

On 7 June 2024, the Committee released a proposal for zero draft terms of reference (ToR) for the Framework Convention. The ToR sets out the basic parameters and mechanisms of a Framework Convention and aims to provide flexible guidance for the negotiation process.

The ToR states the Framework Convention should be clear on its purpose and guiding principles and that it should therefore (among other things):

- set out the fundamental principles that ensure the full inclusiveness and effectiveness of international tax cooperation in terms of substance and process;
- be universal in approach and scope and fully take into account the different needs, priorities and capacities of all countries, in particular countries in special situations;
- provide for rules that are as simple and easy to administer as the subject matter allows;
- increase certainty for taxpayers and governments;
- establish a system of governance for international tax cooperation capable of responding to existing and future tax challenges;
- ensure fairness in the allocation of taxing rights under the international tax system;
- be sufficiently flexible, resilient and agile to ensure equitable results as technology and business models in the international tax cooperation landscapes evolve; and
- respect the tax sovereignty of each Member State.

The ToR calls for five early protocols to be negotiated simultaneously with the Framework Convention, covering several controversial topics:

- the taxation of the digitalised and globalized economy;
- taxation of income derived from cross-border services;
- tax-related illicit financial flows;
- prevention and resolution of tax disputes; and
- taxation of high-net worth individuals.

The eagle eyed will spot that the last topic was something I covered in my May update: a global wealth tax is already on the agenda of G20 Finance Ministers. It is therefore noteworthy that the UN also has taxation of high-net worth individuals in its sights.

Written comments from Member States and other stakeholders are invited by 21 June 2024. The current intention is for the circulation of draft ToR to Member States and other stakeholders in mid-July 2024, in advance of the second session of the Committee that will be held from 29 July to 16 August 2024.

The ToR provides that the negotiation of the Framework Convention should be done in accordance with established practice, presumably meaning based on the procedures of the UN General Assembly, which operates based on majority vote. It will therefore be interesting to watch negotiations unfold, as developed countries that prefer the status quo at the OECD compete for votes against developing countries advocating for greater UN power in international taxation.

Australia: public country-by-country reporting legislation introduced

On 5 June 2024 the federal government introduced legislation to the Australian Parliament that proposes to implement public country-by-country reporting (public CbCR) for MNES for periods beginning on or after 1 July 2024.

As a reminder, the Australian rules are broadly based on the narrative and quantitative reporting aspects of Global Reporting Initiatives' (GRI) Sustainability Reporting Standards, in particular GRI 207-1 and 207-4. Under the rules, in-scope groups will generally be required to provide the following information to the Australian Commissioner of Taxation (Commissioner):

- names of each entity in the CbC reporting group;
- description of the CbC reporting group's approach to tax; and
- quantitative tax information for the income year shown for the relevant jurisdictions in which the CbC reporting group operates.

The submission of the prescribed tax information is required within 12 months of the end of the reporting period. This information will then be made publicly available on an Australian government website.

Limited changes have been made in finalising the legislation compared to the last draft I reported on in my February 2024 update. This means there continues to be inconsistencies between the Australian rules and the EU Public CbCR requirements. This will increase the compliance burden for many MNE groups, who may need to undertake additional work to comply with Australian-specific data requirements. Challenges also remain in the timeframe for submitting public CbCR within 12 months of the year end, considering the simultaneous preparation and submission requirements for existing OECD CbCR.

The legislation does not prescribe the requirement for some form of assurance over the information to be published. However, given the scope for enhanced external scrutiny, as well as the level of potential penalties, MNE groups will need to factor in mechanisms to achieve confidence in the data being made public.

Another important point to note is that disaggregated country level reporting is required for specified jurisdictions, with the list implemented by way of a determination/legislative instrument. However, the finalised list has not been published in parallel with the introduction of the bill.

Now that it has been introduced to Parliament, the earliest the legislation could be passed is late June/early July with the next opportunity being mid-August.

Public CbCR is the epitome of 'contagion' in international tax policy: with these rules now in play in the EU and Australia it is now only a matter of time before other jurisdictions follow suit.

EU: failure to transpose Directives into national law

'A matter of time' before other countries implement public CbCR is a perfect segue into the news that, on 23 May 2024, the EU sent reasoned opinions to six Member States that have failed to transpose completely the EU public CbCR Directive into domestic legislation by the deadline of 22 June 2023. These Member States are Austria, Belgium, Cyprus, Italy, Finland and Slovenia.

On the same day, reasoned opinions were sent to six Member States for failure to notify domestic transposition of the EU Minimum Tax Directive by the deadline of 31 December 2023. These Member States are Cyprus, Latvia, Lithuania, Poland, Portugal and Spain.

The Member States in question now have two months to reply and take the necessary measures. In the absence of a full communication of all national implementing measures, the Commission may decide to refer the case to the CJEU.

Pillar Two national implementation update

No international tax review would be complete without a Pillar Two national implementation roundup. It should be noted that the focus here is only on countries implementing Pillar Two into domestic legislation for the first time, rather than countries that are amending existing Pillar Two legislation.

This month attention is on the British Crown Dependencies of Isle of Man, Guernsey and Jersey, who have released further details on their commitment to Pillar Two. The Isle of Man plans to introduce a qualified domestic minimum top-up tax (QDMTT) from 1 January 2025. The decision on whether to introduce an Income Inclusion Rule (IIR) will be made later in 2024.

Guernsey also plans to introduce a QDMTT from 1 January 2025 and has indicated its intention to implement an IIR from the same date. Guernsey has said it will engage with the business community on specific design elements of the QDMTT. Jersey plans to introduce an IIR from 2025 and instead of a top-up tax, proposed a new domestic tax measure to align to Pillar Two – the multinational corporate income tax (MCIT) – alongside its existing 0/10 corporate income tax system.

While all the islands have expressed their intention to work cooperatively, each is adopting a different approach based on unique economies, client bases and administrative considerations. ■

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- News: New guidance on Pillars One and Two (19.6.24)
- Multinational top-up tax: an overview (M Mortimer & T Ruiz, 20.9.23)
- International tax cooperation: the UN's call for greater inclusivity and effectiveness (S Blakelock, 11.10.23)