KPMG

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KPMG report: Analysis and observations about tax measures in G7 communique

The G7 finance ministers and central bank governors’ communique (G7 Communique) expresses strong support for the OECD/G20 Inclusive Framework efforts to achieve consensus on globally coordinated reforms to address the tax challenges arising from globalization and the digitalization of the economy and to adopt a global minimum taxation regime.

The G7 Communique (5 June 2021) signals a political consensus among the Group of Seven (which includes the United States, Canada, France, Germany, Italy, Japan, the United Kingdom and representatives of the EU) on several key issues related to the ongoing negotiations.

- With respect to Pillar One, the G7 Communique indicates agreement of the G7 to award taxing rights to market jurisdictions of at least 20% of profit exceeding a 10% margin for the largest and most profitable multinational enterprises.

- Further, the G7 Communique commits to provide for appropriate coordination between the application of the new international tax rules and the removal of all digital services taxes (DSTs), and other relevant similar measures, on all companies.

- With respect to Pillar Two, G7 finance ministers commit to a global minimum taxation rate of at least 15% determined on a country-by-country basis.

- Significantly, the G7 finance ministers also agree on the importance of progressing both Pillars in parallel and reaching agreement at the July 2021 meeting of the G20 finance ministers and central bank governors.

The G7 Communique has additional statements relating to energy, climate and sustainability reporting that have relevance to tax. These items will be covered in a separate KPMG report.

Read the **G7 Communique** [PDF 231 KB]

KPMG observation

The consensus among the G7 evidenced in the G7 Communique is a significant development that increases the likelihood that broader agreement can be reached at the G20 level and with the full OECD/G20 Inclusive Framework. Several of the policy priorities of the Biden Administration are reflected in the G7 Communique including agreement on adoption of a global minimum taxation regime at a rate no lower than 15%; the limitation of the new Pillar One taxing right to only the largest and most profitable companies without a specific tie-in to digital activities that might disproportionately impact U.S. companies; and a commitment to rollback all DSTs and other unilateral measures as a condition of agreement on a new taxing right. A number of open issues remain, however, including the scope of Pillar One; the level of commitment to tax certainty through an agreed dispute prevention and resolution structure; and the final agreement on the acceptable minimum rate for taxation.

KPMG observation

Several of the tax provisions included in the Biden Administration's budget intersect and align with aspects of the reforms being discussed at the OECD. Achieving a commitment to a consensus at the G7 and ultimately at the G20 and OECD/G20 Inclusive Framework could boost the prospects for passage of some of Biden's proposals in the U.S. Congress. Equally, several members of the G7 and G20, in considering their commitment to various aspects of the Pillar One and Two proposals, will be carefully watching whether Congress will enact the relevant tax proposals in the administration's budget in their current form.

Pillar One

KPMG observation

The G7 Communique indicates significant progress in the G7 in determining the "quantum" of Pillar One, and specifically Amount A, but also leaves open a number of important questions relevant to scope. With respect to quantum, the agreement to allocate at least 20% of profit exceeding a 10% margin is consistent with illustrative assumptions and examples used in the OECD Pillar One Blueprint.

In terms of "scope", the G7 Communique indicates that the new taxing right would apply for only the "largest and most profitable multinational enterprises" but provides no further detail on how that would be determined. In particular, the G7 Communique is silent on the revenue threshold for inclusion, and on whether segmentation would be required in the determination of profit margin. Notably the reference to "largest and most profitable" is consistent with the language used in the U.S. Treasury Department's April 8 presentation to the OECD/G20 Steering Group of the Inclusive Framework, in which Treasury made clear that it would not be supportive of any scope that discriminates against U.S. multinationals. The G7 Communique also is silent with respect to whether certain industries or sectors would be excluded from the scope of Pillar One. Agreement on these open questions will be important to achieve politically acceptable results for several jurisdictions.

KPMG observation

The G7 Communique provides for "appropriate" coordination between the application of the new taxing right and removal of all DSTs, and other "relevant similar measures," on all companies. The reference to "all" DSTs and "all" companies is significant because it suggests that the G7 countries that have implemented DSTs—including France, Italy, and the United Kingdom—are prepared to eliminate such measures for all companies, even if the company is not within scope of the new taxing right provided by Pillar One. In addition, the reference to other relevant similar measures represents agreement that the commitment to remove unilateral measures is not limited to DSTs, though it remains to be seen which other measures will be deemed "relevant" including potentially U.S. measures such as the base erosion and anti-abuse tax (BEAT). The G7 Communique, however, does not address the timing for the removal of such measures. It has been reported that the United States wants such measures to be removed at the time of an OECD/G20 agreement—i.e., prior to full implementation, such as after the G20 finance ministers and central bank governors meeting in July 2021— whereas other G7 countries may prefer to tie the rollback of unilateral measures to the time of implementation. The reference to "appropriate coordination" appears to leave room for negotiation as to timing and potentially scope of repeal of DSTs and other similar measures.

KPMG observation

Among other open items, the G7 Communique does not discuss:

- The revenue threshold for market countries to be allocated taxing rights under Pillar One, which is important to developing nations
- A commitment on tax certainty, or
- Amount B

The omission of any language on tax certainty is particularly notable in light of the U.S. Treasury Department's April 8 presentation to the OECD/G20 Steering Group of the Inclusive Framework which established tax certainty as a key policy goal of the United States. The omission of these items is most likely a sign of ongoing negotiations in these areas, rather than a policy shift by the United States, or other G7 countries.

Pillar Two

KPMG observation

Agreement by the G7 on a rate of at least 15% under Pillar Two is a significant development and a departure from 12.5%, the most frequently cited rate by government officials over the last year and the rate used in the OECD's Economic Impact Assessment. The U.S. Treasury Department had proposed a rate of at least 15% to the OECD/G20 Steering Group of the Inclusive Framework in late May 2021. Some countries that are not part of the G7 have expressed opposition to a 15% rate, so while agreement in the G7 makes a 15% rate more likely, there is no guarantee that such a rate ultimately would be agreed by the G20 or in the OECD/G20 Inclusive Framework.

KPMG observation

Consensus at the OECD on a global minimum taxation regime under Pillar Two would not compel jurisdictions to modify their corporate tax rates to be above the minimum. The proposal instead contemplates agreement on a set of coordinated measures designed to top-up the tax on cross-border income that falls below the agreed minimum tax. The top-up tax could be imposed by either the jurisdiction in which the parent company of an entity is located (through an income inclusion regime) or by a jurisdiction from which deductible payments are made (through an undertaxed payments rule).

KPMG observation

The 15% rate is significantly lower than the 21% rate proposed for global intangible low-taxed income (GILTI) by the Biden Administration in the Green Book. Agreement on a minimum rate of taxation of 15% at the OECD does not require the United States to match the GILTI rate to the agreed OECD minimum tax rate, and the United States has not indicated an intent to reduce the GILTI rate. A multilaterally agreed minimum tax rate of 15% may affect legislative negotiations in the United States over the appropriate rate for GILTI.

Background

In October 2020, the OECD/G20 Inclusive Framework released "Blueprints" on Pillar One and Pillar Two, reflecting the efforts made towards reaching a multilateral, consensus-based solution to the tax challenges arising from the digitalization of the economy.

The three primary components of Pillar One are Amount A, Amount B, and the development of dispute prevention and resolution mechanisms that will promote tax certainty.

- Amount A would apply a formulary approach to allocate a portion of a multinational enterprise's deemed residual profits to market jurisdictions, and provide those jurisdictions with nexus for taxing that allocation.

- Amount B would provide a fixed return for certain baseline marketing and distribution activities that is intended to be consistent with the arm's length principle.

- To increase tax certainty, the Pillar One Blueprint outlines a proposed approach to mandatory binding dispute prevention and resolution for Amount A and explores approaches to enhance dispute prevention and resolution more broadly.

Pillar Two of the OECD initiative would secure a comprehensive agreement on a regime for global minimum taxation that is intended to ensure that all internationally operating businesses pay at least a minimum level of tax on their income in each jurisdiction regardless of where they are headquartered or the jurisdictions in which they operate.

The OECD held a public consultation meeting on the Pillar One and Two Blueprints on January 14-15, 2021. As part of the consultation process, the OECD received more than 200 submissions, running more than 1,700 pages on Pillar One, and 197 submissions, running more than 1,800 pages on Pillar Two. As a next step, and consistent with recent G20 communiques, the OECD will seek to reach a global and consensus-based solution building on the Blueprints, by mid-2021. The next meeting of the OECD/G20 Inclusive Framework is June 30-July 1, 2021.