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Euro Tax Flash from KPMG's EU Tax Centre

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G7 communique on coordinated reforms of the international tax system

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On June 5, 2021, a Communique was released following meetings of the finance ministers and central bank governors of the G7 countries and reflects that as part of a "renewed and urgent effort towards deeper multilateral economic cooperation," agreement was reached to support efforts through the G20/OECD Inclusive Framework to address the tax challenges arising from globalization and the digitalization of the economy and to adopt a global minimum tax.

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 had announced that it will seek to reach a global and consensus-based solution building on the Blueprints, by mid-2021.

In the meantime, in the EU, in its May 18 Communication on Business Taxation for the 21st Century (see Euro Tax Flash issue 448 for details), the European Commission gave an overview on how the global agreement expected to be reached at the level of the OECD's IF would be implemented in the EU: the Commission intends to issue two Directives to implement each of the two Pillars in EU law.

Furthermore, with regard to the forthcoming proposal for an EU digital levy, the Commission noted that the levy will be independent of the expected global agreement on the international corporate tax reform and will be designed in such a way that it is compatible with WTO and other international obligations. The aim is for the digital levy to generate a new source of revenue that will support the longer-term sustainability of the EU budget and enable investments in the digital transition.

G7 Communique

The G7 Communique signals a political consensus among the Group of Seven (which includes Canada, France, Germany, Italy, Japan, the United Kingdom, the United States 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.

Next steps

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 and G20 Finance Ministers and Central Bank Governors will meet in Venice on July 9-10.

Technical details for both Pillars are then expected to be finalized at the G20 Rome Summit scheduled for the end of October 2021.

If agreement is indeed reached, the OECD will need to design a mechanism – such as a multilateral instrument (as was the case for the implementation of the OECD Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS – the MLI) for participating jurisdictions to implement the two Pillars. Each jurisdiction will then have to reflect the changes in their local legislation and relevant double tax treaties, or in the case of EU Member States, transpose the related EU legislation.

EU Tax Centre Comment

The consensus among the G7 evidenced in the June 5 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.

In the EU specifically, adoption of EU Directives implementing the new global standards would be subject to unanimous agreement among Member States, not all of which have expressed support for the proposals discussed at the level of the G7. France, Germany and Italy are part of the G7 and therefore party to the announced agreement, while the EU is represented as a block on the G20, over which Italy currently presides. Of the 27 EU Member States only Cyprus is not a member of the OECD Inclusive Framework.

Initial reactions to the G7 Communique have been mixed in the EU, with some Member States (e.g. Cyprus, Ireland) expressing concerns over the compatibility of an EU Directive introducing a minimum tax (Pillar Two) with Member States' sovereignty on policy matters, as laid down in the EU Treaties.

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).

As regards the future of unilateral digital services taxes (DST) imposed by some Member States, the Italian Finance Minister, for example, noted that once the proposed reform of the international tax system is agreed, Italy will abolish its unilateral DST. Other Member States are yet to announce their intentions; however, it is assumed that a sunset clause on such unilateral measures will be part of the overall global agreement. Furthermore, Member States will in any event most likely be required to withdraw any unilateral measures, if an EU-wide digital levy is introduced as a new own resource, as proposed by the European Commission. In its May 18 Communication, the Commission noted that, once set-up, the digital levy would co-exist with the Pillar One agreement, as implemented in EU law.

For KPMG In the US's observations on the G7 Communique from the perspective of the United States, please refer to the KPMG report: Tax measures in G7 communique - KPMG United States (home.kpmg).

Should you have any queries, please do not hesitate to contact KPMG's EU Tax Centre, or, as appropriate, your local KPMG tax advisor.

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