

Briefing

International review for January

Speed read

It may be a new year, but political uncertainty and the influence of the United States are still the dominant themes in the international tax world. The OECD has released the much-anticipated Pillar Two Side-by-Side package, effectively excluding US-parented groups from the regime at the same time as trying to simplify the rules for those remaining in-scope. Japan has published proposals for 2026 tax reforms, including incentives for business investment in strategic areas, however these may not survive a snap election set for next month. Meanwhile in France, the saga to pass the 2026 Budget continues. Looking forward to the year ahead, international tax policy are likely to be shaped less by grand multilateral ambition and more by pragmatic adjustment, as governments grapple with geopolitical fragmentation and domestic fiscal pressures.



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OECD release Pillar Two Side-by-Side package

Following the G7's June 2025 statement to effectively exclude US parented groups from the Pillar Two Under Taxed Profits Rule (UTPR) and Income Inclusion Rule (IIR), on 5 January 2026 the OECD released the much-anticipated 'Side-by-Side' (SbS) package modifying key aspects of the Pillar Two framework. Key points to note include:

Introduction of a new SbS Safe Harbour

This deems the IIR and the UTPR to be zero if the Ultimate Parent Entity (UPE) of an MNE is located in a jurisdiction that imposes minimum taxation requirements with respect to domestic and foreign income, and provides a foreign tax credit for Qualified Domestic Minimum Top-up Taxes (QDMTTs), (a 'Qualified SbS Regime'). The only jurisdiction currently eligible for the SbS Safe Harbour is the US.

Importantly, the SbS Safe Harbour does not apply to a non-US parented MNE Group that has a subgroup with a US intermediate parent entity: IIRs and UTPRs will still apply to the US entity and its subsidiaries in all years.

Introduction of a new UPE Safe Harbour

This new Safe Harbour applies for financial years beginning on or after 1 January 2026 and effectively replaces the Transitional UTPR Safe Harbour, although it is harder to qualify for. When the UPE Safe Harbour is elected, the top-up tax for profits for constituent entities within the qualifying UPE jurisdiction is deemed to be zero for the purposes of the UTPR.

Simplification and tax incentive measures

The release also includes measures to simplify the Pillar Two rules, including temporary extension by an additional year of the Transitional Country-by-Country Reporting Safe Harbour (TCSH) and the introduction of a new permanent Simplified Effective Tax Rate (ETR) Safe Harbour (SESH)

with a 15% threshold rate. However, many MNE Groups have already raised concerns that the SESH is not a meaningful simplification of the GloBE rules. A new Substance-based Tax Incentive (SBTI) Safe Harbour has also been introduced.

What next?

Negotiations to reach an agreement on the SbS system were intensive and now countries need to consider the future direction of their domestic Pillar Two regimes. Some jurisdictions may find their current suite of incentives well-placed to attract investment and only require some refinements. Others, particularly those primarily offering income-based incentives, may now decide the time has come for a more thorough overhaul. Some countries, previously hesitant on Pillar Two adoption, may now forge ahead, while others reconsider their earlier plans to adopt the rules. Monitoring these jurisdictional responses will be key in the next 12 months.

Japan 2026 tax reform proposals

Japan provides the first example this month of how political uncertainty is impacting tax policy. On 19 December 2025, the ruling governing coalition of Japan agreed to an outline of tax reform proposals for 2026, designed to help stimulate the Japanese economy which has been hard hit by US tariffs and help households struggling with the cost of living. Measures of interest to business included special measures for promoting investment in specified productivity-enhancing facilities, including the possibility of full expensing and a new 40% tax credit for R&D investment in strategic industrial technologies (including AI and advanced robotics, quantum, semiconductors and communications, bio and healthcare, fusion energy and space).

However, at the time of writing Prime Minister Sanae Takaichi announced that Parliament would be dissolved on 23 January 2026, paving the way for an early election on 8 February 2026 – Japan's second election in less than 18 months. The Prime Minister, who took office late last year following an internal leadership vote, hopes the move will lead to a majority in the House of Representatives for her Liberal Democratic Party (LDP) and give her a convincing public mandate to pursue her political agenda without reliance on coalition partners.

The future of the 2026 tax reform measures therefore depends on the outcome of the election which, despite the Prime Minister's high personal approval ratings, could be a closely fought contest because of low approval ratings for the LDP. The election will also see new tax proposals emerge. For example, it is reported that cutting the sales tax on food to zero for two years, in an attempt to ease the cost of living for Japanese households, will be one of the key planks of the Prime Minister's election manifesto.

Update on French Budget 2026

It has not been a Happy New Year for the French Prime Minister Sebastien Lecornu as his minority government continues the battle to pass France's 2026 Budget in a hung parliament that disagrees on how the country should narrow its significant budget deficit.

Lecornu said in October 2025 that he planned to forgo a constitutional option enabling his government to force through Budget legislation without a parliamentary vote, opting instead to negotiate with his political rivals to try to reach consensus. However, a failure to pass the Budget in December 2025 led to an emergency bill to roll over last year's Budget into 2026, in order to avoid a US-style government shut down.

In light of the continuing deadlock, on 19 January 2026 Lecornu confirmed that he would invoke Article 49.3 of the Constitution, allowing the government to enact the tax revenue part of the Budget without a parliamentary vote. Opposition parties can respond to the move by calling a vote of no-confidence that, if successful, could not only block the Budget bill, but also lead to the collapse of the government.

What to expect in 2026

It's that time of year again when I dust off my crystal ball and try to predict what the next 12 months holds for international tax policy – a task made much harder than usual given the current geopolitical climate.

OECD

Pillar Two: The SbS package marks a watershed for Pillar Two and has raised questions about the sustainability of the entire project. Many (among them the German Chancellor Friedrich Merz) have suggested that Pillar Two is unviable without US support. The drafting of the SbS package is such that other countries, notably China and India, could seek to access the same carve-outs as the US. Some argue that further concessions would collapse the Pillar Two project, and take with it the OECD's role as an international tax standards setter.

Those hoping for a 'Pillar Three', going after mobile international private wealth, will be in for a disappointment

However, I think speculation of the death of Pillar Two and the OECD's influence are somewhat premature. The SbS package has successfully shored up Pillar Two: that in itself is impressive considering the geopolitical context. The SbS package was drafted to avoid any singling out of the US, but it leaves little space for other countries to seek a carve out unless they adopt their own US-style minimum tax rules. It's hard to see a critical mass of countries going down that route. We could see changes (for example, in the definition of qualifying tax incentives) dilute the 15% rate over time, but that remains to be seen – and even if it came to pass, it's unlikely it would represent a reversion to the pre-Pillar Two order.

It will take some time for the final picture to emerge, but what is certain in the meantime is that MNEs will spend 2026 grappling with the significant amount of bureaucracy left in the wake of the 'simplified' safe harbour release.

Whilst the OECD still has influence, I am however convinced that that Pillar Two marks the peak of its international tax ambition, and that of the G7 and G20. Those hoping for a 'Pillar Three', going after mobile international private wealth, will be in for a disappointment.

Pillar One: Despite the EU continuing to state its commitment to implementing Pillar One, the reality is the project has burned out and the international landscape will remain a patchwork of unilateral Digital Services Taxes (DSTs) for the foreseeable future.

The Trump Administration will continue to push for the removal of overseas DSTs in 2026, maintaining they discriminate against US technology companies. Although the threat of US tariffs was enough to make Canada rescind its DST last summer, other countries (notably France) show less willingness to concede and are still enacting and proposing DSTs and similar measures.

US

The November midterm elections could inhibit the President's ability to pass domestic tax legislation. The Republicans have slim majorities in Congress already, and history shows that the party in power almost always loses seats in either the House or Senate (and often both) at the midterms. Such losses could make for a quiet domestic tax landscape for the next few years. It would likely rule out any further s 899-style 'revenge tax' proposals on overseas territories – although the President still has a range of tariff measures at his disposal which he could use instead. Presidential use of tariffs could of course be litigated in the courts but the likelihood of a successful challenge will depend upon the lever deployed and the circumstances in question.

EU

The focus of EU tax policy will remain on the tax decluttering and simplification agenda to help boost EU competitiveness. Changes in EU tax law require that elusive requirement of unanimous approval by Member States, therefore expect mainly administrative changes in 2026. Cyprus assumes the Presidency of the Council of the EU for the first half of this year and its recently published work programme includes initiating work on the recast of the Directive on Administrative Cooperation (DAC recast proposal), a project to improve the functioning of the Directive, including by consolidating the various DAC amendments (DAC 1 to DAC 9) into a single cohesive text to improve clarity.

The Presidency also has to keep one eye tax developments outside of the EU. As well as responding to US tax and trade policy, it has also said it will advance tax discussions at the level of the United Nations (UN), to support a balanced and inclusive outcome that reflects both EU values and global consensus.

UN

Work on the UN Framework Convention on International Tax Cooperation will continue in 2026, albeit without the US who formally withdrew from the process in early 2025 stating the goals of the project were inconsistent with US priorities and represented an 'unwelcome overreach'. While negotiations are expected to continue into 2027, we are still some way off a final proposal – and even further removed from ratification and implementation by Member States – and MNEs should be closely monitoring developments. Some in the business community have expressed concern at proposals for expanding taxing rights without sufficient safeguards and relief from double taxation. The UN will be looking closely at the latest proposal for Workstream II, covering taxation of cross-border services which is expected ahead of the Fourth Session of the Committee that kicks off in New York in February.

In 2026, countries and institutions will continue to adjust to the new global dynamic in all key policy areas; tax is no exception. In his recent speech at the Davos World Economic Forum, Canadian Prime Minister Mark Carney spoke of the new reality for the 'middle powers' – countries who have historically relied on multinational institutions for collective problem solving. Japan's tax incentive push and France's Budget ructions illustrate the tax levers to try to address this new reality – how to handle the fiscal and growth challenges of ageing demographics in the face of less favourable international trade environments – at a domestic level. ■

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► The OECD's Pillar Two side-by-side package (A Lobb, L Shipley & E Wright, 14.1.26)