The Inclusive Framework on BEPS reaches final agreement on Pillar 1 and 2

In brief
On 8 October, 136 countries of the Inclusive Framework on BEPS (IF) endorsed the historical agreement on Pillar 1 and 2 (IF October Statement). Barbados, Estonia, Hungary, Ireland and Peru also joined the agreement despite having publicly aired reservations back in July. Kenya, Nigeria, Pakistan and Sri Lanka did not support the agreement.

In detail
General
The October IF Statement is similar in many respects to the July 2021 Statement of the Inclusive Framework, with some exceptions.

Pillar 1
Pillar One will apply to Multi-National Enterprise (“MNE”) with profitability above 10% and global turnover above EUR20bn. The profit to be reallocated to markets will be calculated as 25% of the profit before tax in excess of 10% of revenue (Amount A).

Principles for determining the surrendering entities from which Amount A will effectively be reallocated to markets have not been clarified. The same can be said for the safe harbour for marketing and distribution.

On sourcing rules, the Statement generally indicates that “Revenues will be sourced to the end market jurisdictions where goods or services are used or consumed” but admits that “detailed source rules for specific categories of transactions will be developed”, recognising that for some B2B activities, it is not clear what the end market is.

Two sectors that remain carved out from Amount A of Pillar One are extractive industries and regulated financial services.

Timeline: The Multilateral Convention (MLC) through which Amount A is implemented, will be developed and opened for signature in 2022, with Amount A coming into effect in 2023.
Digital Services Taxes (DSTs)

The MLC will imply a repeal of DSTs for all countries.

The Statement highlights a commitment for countries not to implement new DSTs between 8 October 2021 and until the earlier of 31 December 2023 OR the coming into force of the MLC.

Pillar 2

The Pillar Two minimum tax rate is now firmly expressed as 15% rather than ‘at least 15%’.

Companies with global turnover above EUR750m will be within the scope of Pillar Two, with headquarter jurisdictions retaining the option to apply the rules to smaller, domestic MNEs.

Exclusions from the Global Anti-Base Erosion proposal (GloBE) rules are available for pension funds or investment funds that are Ultimate Parent Entities (UPE) of an MNE Group or any holding vehicles used by such entities, organisations or funds. Various international shipping services will also be excluded from the GloBE rules. Countries also agreed on a number of carve-outs to the GloBE rules.

Details of the substance based carve-outs are more specific, with an initial mark-up on tangible assets of 8% and of 10% on payrolls, both declining to 5% in 10 years.

The application of the Subject To Tax Rule (STTR) has been restricted to double tax treaties between a developing country and a country with a corporate statutory tax rate lower than 9% (previously 7.5% to 9%).

There is still no definitive statement on the status of the US minimum tax regime (GILTI) as a compliant Pillar Two regime.

Timeline: Pillar Two should be brought into law in 2022, to be effective in 2023, with the Undertaxed Payment Rule coming into effect a year later, in 2024.

Timeline

The Statement of the IF (the Statement) still maintains that both Pillar One and Two will come into effect in 2023, with the multilateral convention for the former developed and open for signature in 2022 and legislation for the latter brought in 2022 via national, domestic legislation.

This remains an exceptionally ambitious timetable and appears to elevate political considerations over technical feasibility.

Next steps

The next important steps are the G20 Finance Ministers meeting on 13 October and the G20 Leaders meeting on 30 October 2021 where it is expected that the largest economies on the Globe will provide their final political endorsement of the agreement.

However, technical work will continue, probably with more detailed rules on the Pillars being made public around the end of November.

Our Tax Policy Alert has more details on the deal and its timing.

Should you want to discuss in more detail how Pillar 1 and 2 will affect your business model with our experts, do get in touch. We also have extensive experience in modelling the impact of both Pillars.