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Client Alert
Commentary

Latham & Watkins Tax Practice

June 11, 2021 | Number 2879

G7 Tax Agreement Marks Significant Step Toward Global Tax Reform

The agreement builds on the two-pillar approach outlined by the OECD and aims to tackle the challenges arising from an increasingly globalized and digital economy.

Key Points:

- Under Pillar One, the largest and most profitable multinational firms will be required to pay tax in the countries where they do business, rather than simply where the countries have headquarters or hold intangible property.
- Under Pillar Two, there will be a global minimum corporate tax rate of 15% operated on a country-by-country basis.

On June 5, 2021, the G7 Finance Ministers announced an agreement on global tax reform that builds on the two-pillar approach outlined by the Organisation for Economic Co-operation and Development (OECD) as part of its base erosion and profit shifting (BEPS) reforms.

The Pillar One proposals are most significant to the UK, France, and Italy, as these countries seek to ensure that the world's largest companies (including the US tech giants) pay more tax in countries where they have little physical presence but significant sales and market share. The Pillar Two proposals are most significant to the US, given that global minimum taxation is a key priority for the Biden Administration. The US is expected to be the largest beneficiary under the Pillar Two proposals. International consensus on a global minimum corporate tax rate should assist in minimizing any disadvantage caused by a future increase in the corporate tax rate in the US and is likely to help prevent US companies from moving their operations to countries with lower tax rates.

The OECD has been working on a two-pillar approach to tackle the challenges of a digital economy for the past two years. In October 2020, the OECD published a blueprint of key policy features, principles, and parameters of the two-pillar approach. The OECD's proposals are complex, and its aim is that the blueprint will serve as a "solid basis for future agreement". The G7 agreement does not shed much light on how the agreed principles will operate, leaving much to be decided in wider global negotiations.

This *Client Alert* provides further detail on the G7 agreement, along with information on other notable tax measures recently announced that aim to crack down on tax avoidance and will affect multinationals.

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Pillar One

The Pillar One rules will apply to large global firms with at least a 10% profit margin. Under the rules, at least 20% of any profit above the 10% margin will be reallocated and then subjected to tax in the countries in which the firms derive sales or otherwise operate. The threshold for determining which companies will be subject to these rules is still to be agreed.

The G7 Finance Ministers agreed on the need for appropriate coordination between the application of Pillar One international tax rules and the removal of all digital services taxes, and other relevant similar measures. The US has opposed digital services taxes being introduced by countries on a unilateral basis given that such taxes target US technology companies that have a large market share in the EU and/or the UK. The US recently announced retaliatory suspended tariffs on goods from the UK and five other countries while broader international tax negotiations continue with respect to the way the countries impose digital services taxes. Rishi Sunak, the UK Chancellor of the Exchequer, reaffirmed his commitment to remove the UK digital services tax — which he described as a temporary measure — once a Pillar One solution is in place.

The OECD estimated in October 2020 that the Pillar One proposals would lead to a 0.2%–0.5% (US$5 billion–US$12 billion) increase in global corporate tax revenues.

Pillar Two

Under the Pillar Two rules, multinationals will be required to pay a tax of at least 15% in each country in which they operate. The aim of the rules is to stop companies from shifting profits to low-tax jurisdictions on the basis that the country in which the company is headquartered is expected to be able to top up the corporate tax payments to the global minimum effective level. The agreed rate of global minimum taxation is below the 21% proposed by the Biden Administration in April. However, the Biden Administration reduced the recommended rate to 15% to gain support for the proposals from other countries. Whether President Biden can gain the support he needs in the US to ensure that legislation can be passed through Congress remains uncertain.

The OECD estimated in October 2020 that the Pillar Two proposals would lead to a 1.6%–2.8% (US$42 billion–US$70 billion) increase in global corporate tax revenues. However, these figures rely on a global minimum corporate tax rate of 12.5%.

Next Steps

The G7 agreement, while short on technical details, marks an important step forward in achieving the OECD's goal of global tax reform and revives international cooperation. The G7 Finance Ministers intend to officially sign the agreement during the G7 summit, which will begin on June 11, 2021. In addition, the agreement will be discussed in further detail at the G20 Financial Ministers and Central Bank Governors meeting in July. Any OECD-level agreement will require extensive negotiations (the OECD inclusive framework comprises 139 jurisdictions, including the G7 nations). The OECD's original intention was to reach a consensus on the two-pillar plan by mid-2021. Given the lengthy negotiations, a consensus is unlikely to be reached in the near term.

Other notable tax measures recently announced to help crack down on tax avoidance

Earlier this month, the US and the EU took steps toward public country-by-country reporting. Representatives of the European Parliament and EU Member States agreed on a draft directive that would require multinational companies to publicly disclose details about their economic activities in each country. The provisionally agreed text will be submitted to the relevant bodies of the EU Council and the

European Parliament for endorsement. In the US, the House Financial Services Committee approved a bill that would require public companies to disclose certain financial information on a country-by-country basis. This would include total income tax paid on a cash basis to all tax jurisdictions. The bill has advanced to be considered by the whole House of Representatives, and a companion bill has been introduced in the Senate.

Public disclosure would bring a new level of tax transparency with greater public and press scrutiny and would help shed light on tax avoidance measures adopted by multinationals.

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