FIFTH INTERNATIONALSCIENTIFIC and PRACTICAL CONFERENCE: Changing the Structure of the International Tax System: The Two Pillar Solution

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OUTLINE

- Fundamental principles of the existing system
- Pressures on the existing system leading to its possible breakdown
- Unilateral responses
- Multilateral responses: the Two Pillar solution

Fundamental Principles of the Existing System

- Country where income is earned ("source country") has the first right to tax that income
- Country where taxpayers are resident ("residence country") has a right to tax them on their worldwide income, including their foreign source income
- Residence country has a corresponding obligation to provide relief for source country tax on source country income

Fundamental Principles of the Existing System

- Under tax treaties, a source country can tax a non-resident company on its business profits earned in the source country only if the profits are earned through a permanent establishment (PE) or subsidiary in the source country
- A PE is a fixed place of business or a dependent agent that has contractual authority or plays the principal role leading to the conclusion of contracts binding on the non-resident taxpayer

Fundamental Principles of the Existing System

- Profits are allocated among the members of an MNE group using the arm’s length standard (the separate entity principle)
- MNEs are able to avoid paying tax in source and residence countries in many ways including digital goods and services
- For example, no PE in source country or a subsidiary with little income

Changes to the International Tax System

- Pressures on the system from the beginning, especially tax avoidance by MNEs
- OECD Harmful Tax Competition (1998) and BEPS Projects (2013)
- 2017 US tax reform – GILTI regime (minimum tax on foreign income of US MNEs)
- Digitalization of the economy exposes the weaknesses in the existing system

Changes to the International Tax System

- Unilateral responses:
  - Digital services taxes
  - Expanded definition of PE
  - Withholding tax
  - Anti-avoidance rules
- Multilateral responses:
  - OECD Inclusive Framework work: Two Pillars
  - UN work: Articles 12A (Fees for Technical Services) and !2B (Automated Digital Services)

PILLAR ONE

- Applies only to largest and most profitable MNEs (about 100 companies)
- Source countries get new right to tax residual profits (25% of global profits in excess of 10% of revenue)
  - Formula apportionment not transfer pricing
- DSTs and similar measures must be eliminated
- Very complex

PILLAR TWO GLOBAL MINIMUM TAX

- Minimum tax on MNEs with global revenue in excess of EUR 750 million
- IIR top-up tax on parent entity if effective tax rate (ETR) in source country is less than 15%
- Tax imposed on ”excess profit” (net financial accounting income less substance based income exclusion SBIE)
- Supplemented by UTPR top-up tax and Subject-to-Tax-Rule (STTR)

PILLAR TWO GLOBAL MINIMUM TAX

- IIR and UTPR top-up taxes are reduced by Qualifying Domestic Minimum Tax (QDMTT)
  - Applies only to excess profit
- Very important aspect of Pillar Two – allows countries to avoid ceding tax revenue to other countries by increasing tax on domestic income in excess of SBIE to 15%

CONCLUSION

- If implemented successfully, Pillars One and Two represent a remarkable achievement
- A 15% minimum tax on the worldwide income of all large MNEs would be a positive change for the international tax system (increased tax revenues)
- A big boost for multilateral action