An Roinn Airgeadais
Department of Finance

International and EU Tax Developments Tax Strategy Group –TSG 21/06

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Contents

6 TSG 21/06 – International and EU Tax Developments

6.1 INTRODUCTION

The digitalisation of the economy in recent years has been transformative, affecting how civil society, government and business works and interacts. It has helped boost innovation and efficiency and has facilitated economic growth. Digitalisation has also played an important role in improving the provision of services, improving the welfare of citizens in many ways. As jurisdictions across the globe have sought to address the impact of Covid-19, digitalisation has been vital in keeping many sectors of the economy functioning. These technologies are facilitating efficient and effective home working, getting vital Government supports to businesses and individuals and, importantly, managing the roll-out of vaccinations for people throughout the world.

However, the scope and speed of the changes brought by digitalisation has brought challenges in many policy areas, including taxation. These tax challenges were first identified as one of the main areas of focus of the OECD/G20 Base Erosion and Profit Shifting (BEPS) Project, leading to the 2015 BEPS Action 1 Report (the Action 1 Report). The BEPS Action 1 Report concluded that the whole economy was digitalising and, as a result, it would not be practical to try to ring-fence the digital economy, and thus there has been a desire to reframe the international tax architecture to reflect the changing nature of digitalisation and globalisation. In March 2018, the Inclusive Framework, working through its Task Force on the Digital Economy (TFDE), issued *Tax Challenges Arising from Digitalisation – Interim Report 2018,* which recognised the need for a global solution.[1]

In parallel to the work at the OECD, the EU has agreed and implemented a substantial level of tax reform on the back of the BEPS process over recent years implemented through the various elements of the ATAD (Anti-Tax Avoidance Directive) Directives. Further to this, there have been a number of updates to the DAC (Directive on Administrative Cooperation) Directive to expand the scope of cross border EU cooperation amongst Member States most recently through DAC7, which will extend the tax transparency rules in 2023 to supplies via digital platforms. The European Commission recently published a Communication on *Business Taxation for the 21st Century*[2] detailing their ambitions for tax proposals in the short, and medium to long term and these proposals are discussed in the EU Tax Developments section of this paper.

[1] https://www.oecd.org/ctp/tax-challenges-arising-from-digitalisation-interim-report-9789264293083-en.htm
[2] https://ec.europa.eu/taxation_customs/system/files/2021-05/communication_on_business_taxation_for_the_21st_century.pdf

6.2 International Tax Developments

6.2.1 OECD INTERNATIONAL TAX PROPOSALS BACKGROUND

The OECD/G20 Inclusive Framework on BEPS (the OECD Inclusive Framework) comprises 140 member jurisdictions including Ireland. BEPS (Base erosion and profit shifting) refers to tax planning strategies used by multinational enterprises that exploit gaps and mismatches in tax rules to avoid paying tax. Working together within OECD/G20 Inclusive Framework on BEPS, 140 countries and jurisdictions are collaborating on the implementation of 15 measures, agreed in 2015, to tackle tax avoidance, improve the coherence of international tax rules and ensure a more transparent tax environment.

Work on delivering Action 1 – Addressing the Challenges of the Digitalization of the Economy has broadened since 2015 to address the structural challenges within the international tax framework arising from digitalisation and globalisation.

The OECD/G20 Inclusive Framework on BEPS is the formal decision-making body charged with addressing the tax challenges arising from digitalisation and has been diligent in seeking a solution. The necessary technical work has been proceeding at working party level, and has intensified over recent months with a view to achieving a comprehensive political agreement by October 2021.

Extensive technical working parties of the Inclusive framework have taken place at the OECD since 2019. The OECD published Blueprints in October 2020 detailing a two pillar proposal. Pillar One is examining a re-allocation of a proportion of profits to market jurisdictions, while Pillar Two seeks to apply a global minimum effective tax rate. Ireland has been supportive of a Pillar One solution but has reservations on Pillar Two. Ireland has expressed broad support for the agreement, but has a reservation, particularly about the proposal for a global minimum effective tax rate of ‘at least 15%’. Ireland’s position is that small countries, and Ireland is one of them, need to be able to use tax policy as a legitimate lever to compensate for advantages of scale, location, resources, industrial heritage and the real, material and persistent advantage enjoyed by larger countries. At the same time, it is fully accepted that there needs to be clear boundaries to ensure any competition is fair and sustainable.

PILLARS ONE AND TWO AT A GLANCE

PILLAR ONE

Pillar One will apply to Multi-National Enterprises (MNEs) with a global turnover of over €20bn and profitability, measured as the ratio of profit before tax to turnover, of over 10%. It is expected that, subject to certain conditions, this threshold will reduce to €10bn after 7 years. Pillar One will operate by allocating 20 to 30% of residual profit of MNE to market jurisdictions. Residual profit is profit which exceeds 10% of total revenue. The market jurisdictions will then subject that income, which is known as Amount A, to taxation. Amount B relates to simplifying the application of the arm's length principle to in-country baseline marketing and distribution activities; work on this amount is ongoing and is expected to be completed by the end of 2022.

PILLAR TWO

Pillar Two will apply to MNEs with a global turnover of over €750m and consists of three elements: an Income Inclusion Rule (IIR), an Undertaxed Payments Rule (UTPR), and a treaty-based rule, the Subject to Tax Rule (STTR).

Further details on both Pillars are detailed below in the *Main points of OECD Inclusive Framework Statement section*.

The OECD Inclusive Framework published a series of 'Blueprints' in October 2020, which went to public consultation.[3] The responses to the public consultation indicated that while there is a desire for an OECD solution expressed by the majority of stakeholders, businesses were not united in their responses, and many were critical in respect to compliance burdens, general uncertainty and indeed ensuring that the 2015 BEPS Actions are fully implemented before engaging in further reforms.

Following the consultation, technical work has been continuing at the OECD on developing detailed rules with significant political momentum driving the process, notably from the new US administration, the G7 and the G20.

[3] https://www.oecd.org/tax/beps/oecd-g20-inclusive-framework-on-beps-invites-public-input-on-the-reports-on-pillar-one-and-pillar-two-blueprints.htm

The G7 Finance Ministers agreed a communique at their meeting in London on 5 June which was reflected in the G7 Leaders' communique of 13 June. This includes firm commitments from the US, UK, France, Germany, Italy, Canada and Japan towards an agreement on the international tax framework including on a minimum effective tax rate.

> *We strongly support the efforts underway through the G20/OECD Inclusive Framework to address the tax challenges arising from globalisation and the digitalisation of the economy and to adopt a global minimum tax. We commit to reaching an equitable solution on the allocation of taxing rights, with market countries awarded taxing rights on at least 20% of profit exceeding a 10% margin for the largest and most profitable multinational enterprises. We will provide for appropriate coordination between the application of the new international tax rules and the removal of all Digital Services Taxes, and other relevant similar measures, on all companies. We also commit to a global minimum tax of at least 15% on a country by country basis. We agree on the importance of progressing agreement in parallel on both Pillars and look forward to reaching an agreement at the July meeting of G20 Finance Ministers and Central Bank Governors.*

The Minister for Finance attended the G7 Finance Minister's meeting in his capacity as President of the Eurogroup.

6.2.2 JULY MEETING OF THE OECD/G20 INCLUSIVE FRAMEWORK ON BEPS

Following an intensive series of technical meetings, the OECD Secretariat, working with the Steering Group (on which Ireland is not represented), produced a draft set of proposals which the Inclusive Framework were asked to agree at a meeting on 1 July.

At this meeting, the OECD Inclusive Framework reached agreement but not consensus on *key aspects* of the two-pillar solution to address tax challenges arising from the digitalisation and globalisation. It should also be noted that there are significant policy issues which are still not yet settled, and that technical discussions on the critical details of the proposals are continuing at the OECD working parties.

Ireland has expressed broad support for the agreement, but has a reservation, particularly in respect to the proposal for a global minimum effective tax rate of 'at least 15%'. As a result. Ireland was among nine jurisdictions which did not join the Statement, although three countries – Barbados, Peru, and St Vincent and the Grenadines – have subsequently joined. Two other EU Member States, Estonia and Hungary, also did not join.

6.2.3 MAIN POINTS OF OECD INCLUSIVE FRAMEWORK STATEMENT[4]

Pillar One

- 20-30% of residual profit of in-scope Multinational Enterprises (MNEs) will be allocated to, and taxed in, market jurisdictions. Residual profit is profit which exceeds 10% of total revenue. Applies to MNEs with a global turnover of greater than €20 billion with this threshold being reduced to €10 billion in 7 years, subject to a review. 'Extractive Industries' and 'Regulated Financial Services' are excluded from scope.
- Profit or loss of the in-scope MNE will be determined by reference to financial accounting income, with a small number of adjustments. Losses will be carried forward.
- Where the residual profits of an in-scope MNE are already taxed in a market jurisdiction, a marketing and distribution profits safe harbour will cap the residual profits allocated to the market jurisdiction. Further work on the design of the safe harbour will be undertaken.
- Double taxation of profit allocated to market jurisdictions will be relieved. The entities that will bear the tax liability will be drawn from those that earn residual profit. In-scope MNEs will benefit from dispute prevention and resolution mechanisms.
- The application of the arm's length principle to in-country marketing and distribution activities will be simplified, with the focus on the needs of low capacity countries.
- Coordination between the application of Pillar One and the removal of Digital Services Taxes and similar unilateral taxes.
- Pillar One to be implemented via a Multi-lateral Instrument coming into effect in 2023.

Pillar Two

- Pillar Two consists of:
    - **I.** an Income Inclusion Rule (IIR), which imposes top-up tax on a parent entity in respect of the low taxed income of a constituent entity;
    - **II.** an Undertaxed Payment Rule (UTPR), which denies deductions or requires an equivalent adjustment to the extent the low tax income of a constituent entity is not subject to tax under an IIR; collectively the IIR and UTPR are called the Global anti-Base Erosion Rules (GloBE); and
    - **III.** a treaty-based rule, the Subject to Tax Rule (STTR), which allows source jurisdictions to impose limited source taxation on certain related party payments subject to tax below a minimum rate. The STTR will be creditable as a covered tax under the GloBE rules.

[4] https://www.oecd.org/tax/beps/statement-on-a-two-pillar-solution-to-address-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-july-2021.pdf

- The rules apply under 'common approach' – i.e. countries are not required to adopt the rules but if they choose to do so they will implement them in a certain way.
- Pillar Two will apply to MNEs with a global turnover of greater than €750 million. Countries are free to apply the IIR to MNEs headquartered in their country even if they do not meet the threshold.
- Government entities, international organisations, NGOs, 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 are not subject to the GloBE rules.
- The global minimum effective tax rate will be at least 15% for the IIR and UTPR.
- The MNEs' effective tax rate will be calculated on a jurisdictional basis. Consideration will be given to the conditions under which the US GILTI will co-exist with Pillar Two.
- There will be a formulaic substance carve-out that will exclude an amount of income that is at least 5% (in the transition period of 5 years, at least 7.5%) of the carrying value of tangible assets and payroll. There will also be a *de minimis* exclusion.
- International shipping is excluded from scope.
- The minimum rate for the STTR will be from 7.5% to 9%. The rule applies only to cross-border payments between members of the same multinational group.
- Implementation is planned for 2023.

The agreement was endorsed by G20 Finance Ministers at their meeting on 9/10 July, with further technical work continuing over the summer and autumn with a view to achieving a comprehensive agreement in October.

6.2.4 IRELAND'S POSITION

At the meeting on 1 July, Ireland re-iterated its support for the Pillar One proposals to re-allocate a proportion of taxing rights to market countries, recognising that the international tax framework must evolve to accommodate changes in how business operates in today's digitalised economy. There will be a cost to Ireland for this in terms of reduced corporation tax receipts but, overall, Pillar One will bring stability and certainty to the international tax framework and will help underpin economic growth from which all can benefit.

Ireland also expressed broad support for Pillar Two, but noted its reservation about the proposal for a global minimum effective tax rate of 'at least 15%'.

Department of Finance officials previously estimated that the cost to the Exchequer of the OECD reforms may be up to €2 billion annually which is approximately one fifth of corporate tax revenues. This is the estimate included in the Stability Programme Update published by the Department in April to apply from 2025. It is very difficult at this point to provide an update to this estimate given the complexities and many open issues which are still to be resolved at the OECD in the months ahead.

The outcome of the OECD work has the potential to significantly impact Ireland's fiscal, budgetary and industrial policy. Ireland's competitive 12.5% corporation tax rate has been in place for over two decades. It is an important component in our economic policy and has contributed towards our success in attracting real investment and employment.

6.2.5 OPEN ISSUES IN THE PROPOSALS

Despite the agreement among the majority of the Inclusive Framework, it is clear that a number of important questions remain to be resolved in the ongoing negotiations:

- Notable issues on Pillar One include the percentage of residual profit which will be allocated to, and taxed in, market jurisdictions; measures to deliver Tax Certainty; and clarity of how existing digital services type taxes will be phased out.
- Ireland's principal reservation relates to the proposals for a global minimum effective tax rate of 'at least 15%'. Ireland's competitive 12.5% corporation tax rate has been in place for over two decades and it offers taxpayers and investors the certainty required to make long-term investment decisions. Implementing the changes proposed will have an impact on its competitiveness. The lack of certainty on what the proposed global minimum effective rate will be would undermine the certainty that Ireland has provided to taxpayers and investors for many years.
- It is envisaged that the Pillar Two proposals will be implemented in such a way that they will be compatible with an existing US tax provision, Global Intangible Low-Taxed Income (GILTI). However, the current US Administration is attempting to reform GILTI and other aspects of the 2017 Tax Cuts and Jobs Act. US Congress is divided on this reform programme and it is uncertain whether sufficient support can be achieved before the timeline for agreement at OECD in October 2021.
- A further consideration is how any OECD agreement would be implemented at an EU level, as there may be challenges with respect to the compatibility with the fundamental freedoms of EU law, such as freedom of establishment and the free movement of capital. Any divergence from the OECD agreement at an EU level, or indeed less rigorous implementation outside the EU, has the potential to place the EU and its Member States at a competitive disadvantage.

6.2.6 PUBLIC CONSULTATION

Given the importance of the OECD proposals, the Minister for Finance launched a public consultation where interested parties are invited present views on Ireland's approach to the international tax proposals being discussed at the OECD.[5] The consultation runs from 20 July to 10 September and it will be helpful in identifying the challenges and opportunities of the proposals in respect of Ireland's corporate tax code and broader industrial policy.

6.2.7 NEXT STEPS

Negotiations are continuing as there remain important issues which still need to be addressed. The ambition now is to resolve these issues in time for political level agreement in October 2021. Technical meetings have resumed and Ireland's officials are engaging constructively with a view to finding an agreement on an international tax rules solution to which Ireland can agree.

The Minister for Finance has been clear that he wishes to achieve a comprehensive, sustainable and equitable agreement on the international tax rules at the OECD that meets the needs of all countries, large and small, developed and developing.

6.2.8 KEY DATES

- September: Technical meetings on Pillar One and Pillar Two.
- September/early October: Meetings of the Steering Group.
- 8 October: Meeting of the Inclusive Framework to endorse revised Statement of Agreement.
- 15-16 October: Meeting of G20 Finance Ministers to agree revised statement on Pillars One and Two and a detailed implementation plan.

[5] https://www.gov.ie/en/consultation/d03f6-minister-donohoe-launches-public-consultation-on-the-oecd-international-tax-proposals/

6.3 European Union (EU) Tax Developments

6.3.1 OVERVIEW

The International Taxation agenda is currently dominated by the ongoing work of the G20/OECD Inclusive Framework, on a two Pillar approach to *address potential changes to the international taxation system to reflect the Globalisation and Digitalisation of the Economy.*

In addition to the work at International level the European Commission has outlined its intentions for Business Taxation in two communications published in July 2020[6] and most recently on 18th May 2021 in a Communication on *Business Taxation for the 21st Century*[7]. The latest Communication sets out both a long-term vision to provide a fair and sustainable business environment, and EU tax system, after the current work at the OECD is complete.

The Communication outlines the Commission's intentions to table a number of proposals, to include the following;

- A legislative proposal setting out union rules to neutralise the misuse of shell entities for tax purposes (by Q4 2021)
- A legislative proposal for the publication of effective tax rates paid by large companies, based on the methodology under discussion in Pillar Two of the OECD negotiations (by 2022)
- a legislative proposal creating a Debt Equity Bias Reduction Allowance (DEBRA) (by Q1 2022)
- A legislative proposal for BEFIT (Business in Europe: Framework for Income Taxation), moving towards a common tax rulebook and providing a mechanism for allocating taxing rights between Member States for fairer allocation of taxing rights between Member States (by 2023)

6.3.2 IMPLEMENTATION OF OECD SOLUTIONS (2021-2022)

It is noted that any successful outcomes at OECD will be implemented at EU level by the Member States, and the EU Commission has indicated its intentions to speedily table legislative proposals to implement any OECD agreement. The Commission has signalled that Pillar Two will be implemented by way of an EU Directive. To date a decision on EU Pillar One implementation has not yet been made. It is expected that the implementation of any OECD agreement will be the focus of EU work on business taxation for the current (Slovenian) and upcoming (French) Presidencies of the Council of the European Union.

[6] Draft Communication on Tax Good Governance (europa.eu)
[7] communication_on_business_taxation_for_the_21st_century.pdf (europa.eu)

6.3.3 PROPOSAL TO ADDRESS MISUSE OF SHELL COMPANIES (2021)

In its most recent communication, the Commission outlined its intention to tackle the abusive use of shell companies in the EU. The Commission has determined there is a need for further action within the EU to tackle entities and structures created for the main purpose of reducing the tax liability or disguising improper conduct of the group or operations they belong to, without substance and real economic activities in the countries where they are incorporated.

The Commission intends to table a proposal by the end of 2021. The Commission has indicated that the proposal will aim to introduce measures requiring companies to report to the relevant tax administration the necessary information to assess whether they have substantial presence and real economic activity in the Member State. In the circumstances of a company being deemed to be an abusive shell entity, the Member State shall apply denial of tax benefits, and further introduce monitoring and tax transparency requirements on the entity.

Currently there is limited detail on the Commission's proposal. A public consultation on the concepts concluded on 27 August 2021.

6.3.4 PUBLICATION OF EFFECTIVE TAX RATES PAID BY LARGE COMPANIES

The Commission has signalled it will bring forward a new proposal mandating the annual publication of the effective corporate tax rate of certain large multi-national enterprises with operations in the EU, using the methodology agreed for the Pillar Two calculations. The intention is to have the effective corporate tax rate paid based on the proportion of profit made rather than on their 'taxable profits', which can be reduced through various means such as tax allowances.

This proposal will seek to build on the *Public Country-by-Country Reporting Directive*, which was agreed by the COMPET Council formation earlier this year in spite of objections to the legal base. Ireland was one of seven Member States that supported the Council Legal Service view that the legal base should be a tax base and, therefore, a matter for ECOFIN, not Competitiveness Council.

6.3.5 DEBRA (DEBT EQUITY BIAS REDUCTION ALLOWANCE)

The Commission will also launch a proposal to address a perceived mismatch in the tax treatment of debt vis-à-vis equity when used as funding for the financing of a business. Currently, a tax deduction is provided for interest on debt, and it is held that this results in a pro-debt bias of tax rules. For example, as a company can deduct interest attached to a debt financing but not the *costs* related to an equity financing, such as the payment of dividends, the outcome of this scenario is an incentive to finance investments by borrowing rather than through equity.

This bias towards debt may also place innovation at a disadvantage in some cases as it creates a situation where it is more beneficial from a tax perspective to raise debt over equity for start-up companies. However, it can also be challenging for start-ups, with no track record, to raise debt.

The Commission has signalled an intention to launch a legislative proposal to address the debt-equity bias in corporate taxation, through the introduction of an allowance system for equity financing with the intention of contributing to the re-equitisation of financially vulnerable companies.

Ireland will engage in the Council negotiations of the proposal and seek to ensure that it is compatible with our current tax system.

6.3.6 BEFIT (BUSINESS IN EUROPE: FRAMEWORK FOR INCOME TAXATION)

The Communication indicates an intention by the European Commission to create a new framework for business taxation in the EU. The "Business in Europe: Framework for Income Taxation" (or BEFIT) aims to provide a single corporate tax rulebook for the EU, based on a formulary apportionment and a common tax base.

The BEFIT proposal will replace the existing proposal for a Common Consolidated Corporate Tax Base (CCCTB), which will be withdrawn by the European Commission.

To date the precise details of the BEFIT proposal are unknown, however, Ireland will maintain the position that matters of direct taxation remain a Member State competence under the treaties, and that unanimity in tax matters is maintained. Ireland will continue to engage actively on this issue.

6.3.7 DAC8 – CRYPTOCURRENCY

The EU tax reform agenda will continue with a proposal to amend the DAC (Directive on Administrative Cooperation) further by extending the EU rules to keep pace with the technological developments and extend the scope of exchange of information to include areas such as crypto-assets and e-money. This will build on work that is currently ongoing at the OECD.

The European Commission held a public consultation from March 2021 to June 2021 and the responses to that public consultation are publicly available on the European Commission website[8] It is anticipated that the Commission will launch a legislative proposal providing for the introduction of reporting obligations and the exchange of information that will enable tax administrations to obtain information necessary to ensure tax compliance in the area of crypto-assets and e-money.

Ireland fully supports the exchange of information by tax authorities and looks forward to the launch of this proposal later in 2021. Ireland will actively participate in the Council negotiations to ensure that any Directive aligns with OCED work and interlinked regulatory requirements, such as the OECD's FATF (Financial Action Taskforce) and the EU's MiCA (Regulation on Markets in Crypto-assets). It will also be of significant importance to Ireland that the Directive provides for reasonable timelines for Member State implementation and avoids excessive compliance burden on business.

6.3.7 UNANIMITY IN TAXATION MATTERS - ARTICLE 116

The Action Plan on fair and simple taxation, which was published in July 2020, contains a desire from the European Commission to make full use of the provisions of the Treaty on the functioning of the EU (TFEU) that allow proposals on taxation to be adopted by ordinary legislative procedure, including using article 116 of the TFEU as a legal basis to propose Directives in the area of tax under QMV (qualified majority voting). EU initiatives on taxation must have unanimous support from Member States to be approved and also utilise the special legislative procedure, which limits the role of the European Parliament to a consultative one.

Article 116 of the TFEU provides that, QMV, under ordinary legislative procedure, is possible in order to eliminate distortions of competition due to different tax rules. The Article provides that the Commission can launch a legislative proposal to address the distortion only where the distortion could not be removed following consultation with Member States. There is no precedent for using Article 116 of the Treaty of the Functioning of the European Union which provides that a legislative proposal may be agreed using the ordinary voting procedure if a difference between the provisions laid down by law, regulation or administrative action in Member States is distorting the conditions of competition in the internal market.

It is Ireland's position that the current unanimity based voting procedure is the most appropriate voting system in the area of taxation. Indeed, over the lifetime of the Juncker Commission (2014 – 2019), over twenty taxation initiatives were agreed by Member States using the unanimity voting process. This includes important Directives on VAT, administrative co-operation, Anti-Tax-Avoidance and also the EU list of non-cooperative tax jurisdictions. Ireland does not accept the need for, or the merits of, any attempt to move away from the special legislative procedure for taxation matters.

[8] https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12632-Tax-fraud-&-evasion-strengthening-rules-on-administrative-cooperation-and-expanding-the-exchange-of-information/feedback_en?p_id=16161038

In this context, it is relevant that the Programme for Government affirms that taxation is a national competence and Ireland’s position remains that unanimity is the appropriate voting system for any tax proposals at EU level.

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