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THE OECD'S WORK ON A NEW WORLD TAX ORDER: NEW RULES AGAINST NON AND LOW TAXATION

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Your global tax partner

Outline

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OBJECTIVE

I. Objective

Despite BEPS, **existing gaps** shall be be closed:

- **"Race to the bottom" of the tax rates**
  - Distortion of international investment activities
  - Digital business models in particular are subject to an effective average rate of less than 10%.

- **Erosion of tax base**
  - Tax avoidance practices
  - Profit allocation abroad

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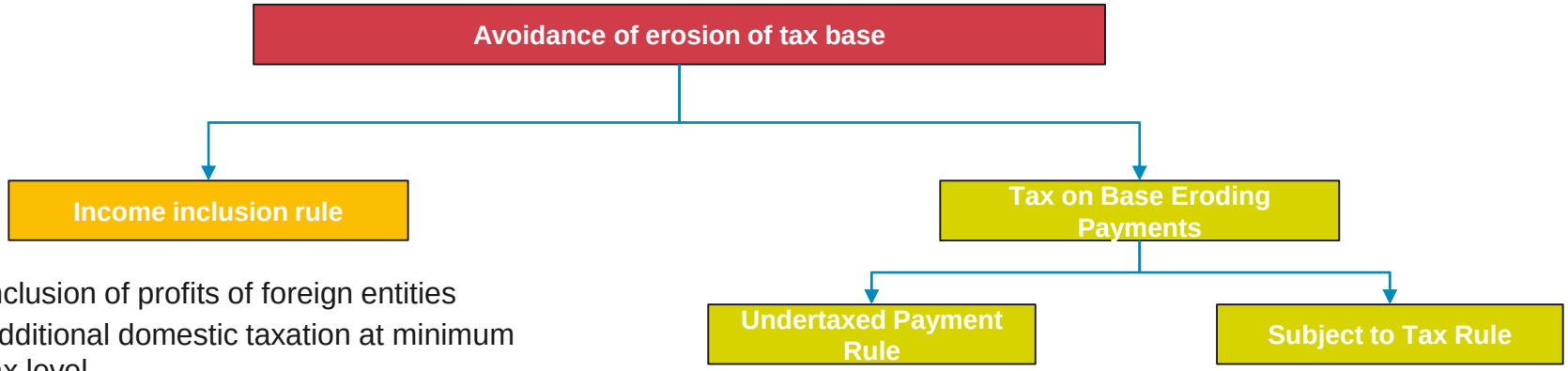
PILLAR II

II. Pillar II - Overview

Based on the German-French initiative "GloBE" (*Global anti-base erosion proposal*):



- Inclusion of profits of foreign entities
- Additional domestic taxation at minimum tax level

- No deduction for payments

- Restriction of DBA benefits

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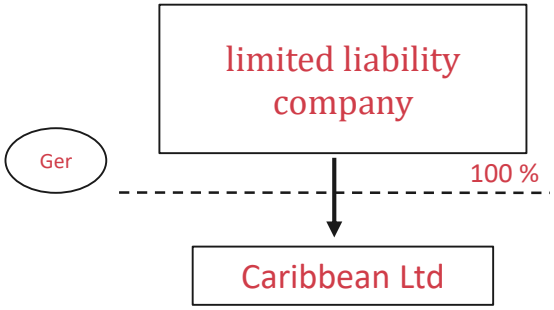
II. Pillar II - "Income Inclusion Rule"

Issue

- Foreign profits of domestic enterprises,
- earned at the level of controlled foreign subsidiaries,
- are subject to foreign taxation below a determined minimum tax rate.

Example:



Taxation 6 % below the minimum tax rate

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II. Pillar II - "Income Inclusion Rule"

Solution: „top up to a minimum rate“

1. **Determination** of a **minimum tax rate,**
   - which is applied worldwide as a fixed percentage, and
   - is not linked to the tax rate of the State of residence

2. **Post-taxation** in residence country
   - "Filling up" the tax rate
   - <u>But no</u> adjustment according to domestic tax level (cf. German CFC)

II. Pillar II - "Income Inclusion Rule"

Implementation alternatives

- Partial integration into national tax base
  - Advantage: losses can be offset in the country of residence
- Separate tax regime
  - Example: GILTI regime in the USA
- Exact implementation uncertain

II. Pillar II - "Income Inclusion Rule"

- Risk of **double taxation**
  - e.g. in case of qualification conflicts or
  - sequence of tax collection unclear

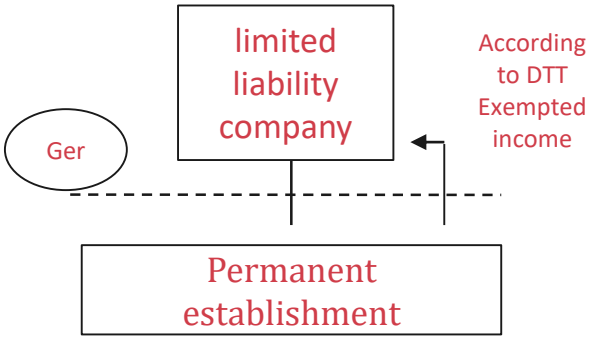
- **Workarounds**
  - relocation of tax residency possible (in case of not comprehensive implementation)
    - for example: Brexit - great interest in attracting companies through tax advantages

- Determination of the **effective foreign tax burden critical**
  - What rules/standards apply for determining foreign profits? How do timing advantages (tax holidays) affect tax burden?

II. Pillar II - "Switch-Over Rule"

- **Issue:** Income Inclusion Rule only applicable to income of subsidiary companies, not to income derived from permanent establishments
- **Solution:** Switch-Over Rule
  - Application of the imputation method if:
    - Income from permanent establishments is exempted in accordance with Double Tax Treaty (e.g. Germany), and,
    - Low taxation in the source country
- **Remarks**
  - Tax adjustment up to the German income tax level
  - Worse position compared to foreign subsidiary corporations, as there is only adjustment up to minimum tax rate

Example:

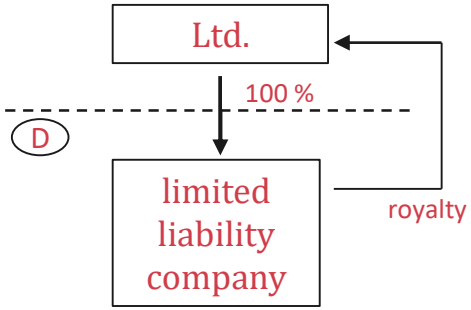


II. Pillar II – Tax on Base Eroding Payments - „Undertaxed Payment Rule“

- **Issue:**
  - Payment to related parties abroad,
  - which are <u>not subject to</u> minimum taxation abroad.

- **Solution:**
  - Indirect tax collection by the recipient through deduction restrictions, <u>or</u>
  - Independent (withholding) tax with crediting

Example:



II. Pillar II – Tax on Base Eroding Payments – „Subject to Tax Rule“

- **Issue:**
  - Income that is not subject to the minimum tax rate in the State of residence of the payee.

- **Solution:**
  - Denial of treaty relief
  - Especially in the case of reduction of withholding tax on interest and royalty payments

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REMARKS

III. Remarks

- Increased **compliance costs** and effort
- Compatibility with **constitutional and European law**
  - Infringement of the (German) net objective principle (limitation of the deductibility of certain payments in inbound cases)
- **Elimination of tax (rate) competition**
- **Attacks tax sovereignty of** low tax jurisdictions

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OUTLOOK

Outlook

- **November 2019**
  - Publication of a „Consultation Document“
- **December 2019**
  - "Consultation Meeting" for numerous open questions on Pillar II
- **By the end of 2020**
  - Final report of the OECD
  - EU Member States agree on European implementation

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Frédéric is Secretary General of the IACF – French tax practitioners association.

He also teaches restructuring tax law and tax consolidation in the Tax Lawyer Master's program at Paris V – Descartes University.

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OECD PILLAR 2

US TAX REFORM PRINCIPLES

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GILTI Overview

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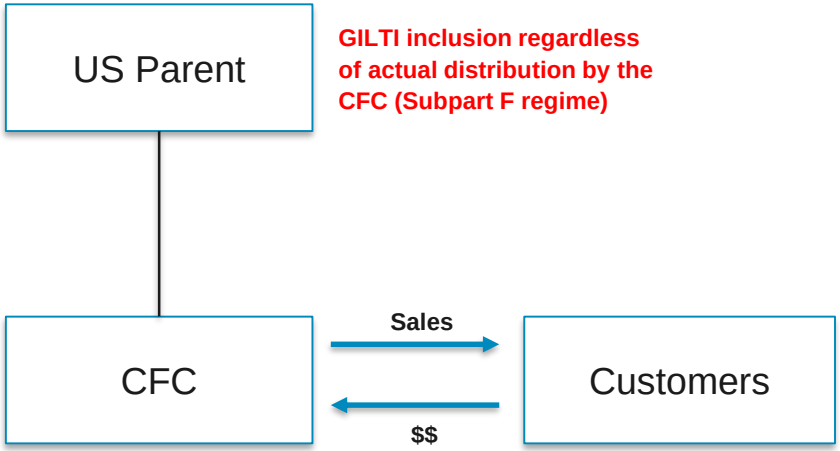

Relevant Attributes:

- Earnings
- Tangible Assets
- Foreign Taxes

- **Summary of the rule**: A US Shareholder of a CFC is subject to US tax (domestic rates) on the combined net income of its CFCs that exceeds a fixed routine return on the CFCs tangible business assets.
- Income subject to US tax is the net income of the CFC that exceeds 10% of the depreciable tangible assets of the CFC.
- A US corporate shareholder may generally deduct 50% of its GILTI inclusion, resulting in an tax of 10.5% over the GILTI income.
- FTC available for foreign income taxes attributable to the GILTI inclusion, but only for 80% of such foreign taxes.
  - No carry back or carry forward allowed.
- It was expected that GILTI should apply only to US shareholders with CFCs not otherwise subject to foreign tax of at least 13.125%.
  - Expense allocation / apportionment rules for FTC purposes may change that result.
  - GILTI high-tax exception.

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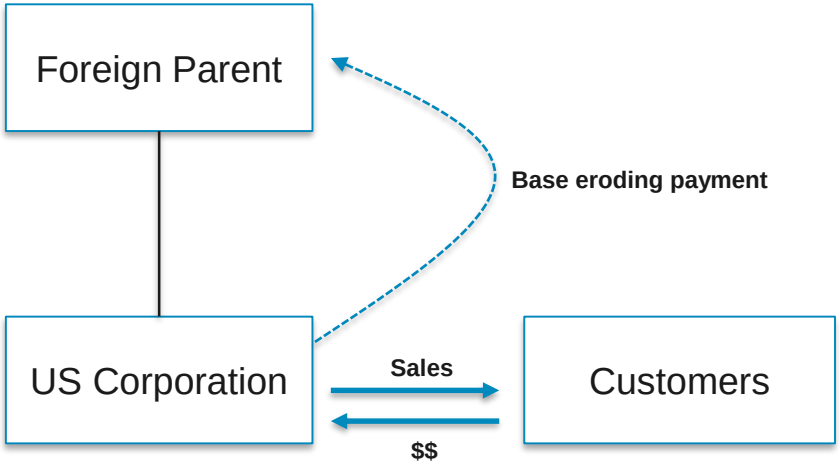
BEAT Overview

BEAT Overview



BEAT: Additional US tax liability resulting from inclusion of base erosion payments to US taxable income

- **Summary of the rule**: BEAT is a minimum US tax (10% rate, with a 5% introductory rate) calculated on a base equal to the taxpayer's income determined without tax benefits arising from base erosion payments made to foreign affiliates.
  - US Corporation should pay the amount of tax liability under BEAT that exceeds the regular tax liability.
- Base erosion payment is any deductible payment or payment for acquisition of depreciable/amortizable property made to a related foreign person.
  - Excludes FDAP payments, COGS, and non-markup payment for services using SCM method.
- BEAT applies only to C or S Corporations with $500 million average gross receipts (3-year period) with a base erosion percentage of 3% or higher.
  - However, both requirements apply on an aggregate basis by treating members of a controlled group as a single taxpayer.

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Comparison with Pillar 2

Income inclusion rule vs. GILTI

Apparent Similarities

- The income inclusion rule is expected to supplement the jurisdictions' CFC rules.
- Intention is to ensure that income of MNE group is subjected to tax at a minimum rate.
- In principle, OECD indicates that the tax base calculation would be determined by reference to the rules applicable in the shareholder jurisdiction.
- OECD's proposes a carve-out for routine return on tangible assets.
- Possibility to blend foreign tax rates for purposes of the minimum tax rate.

Apparent Disparities

- OECD intends to explore use of a fixed percentage or a range or corridor of minimum rates, instead of using the parent jurisdiction's CIT rate.
- Although the tax base for purposes of the minimum tax would be determined by the rules applicable in the shareholder jurisdiction, OECD proposes to adopt simplification measures as a way to simplify compliance and administrability for both taxpayers and tax administration.
- Indicates that the minimum tax rate may also apply to foreign branches.

Tax on base eroding payments vs. BEAT

Apparent Similarities

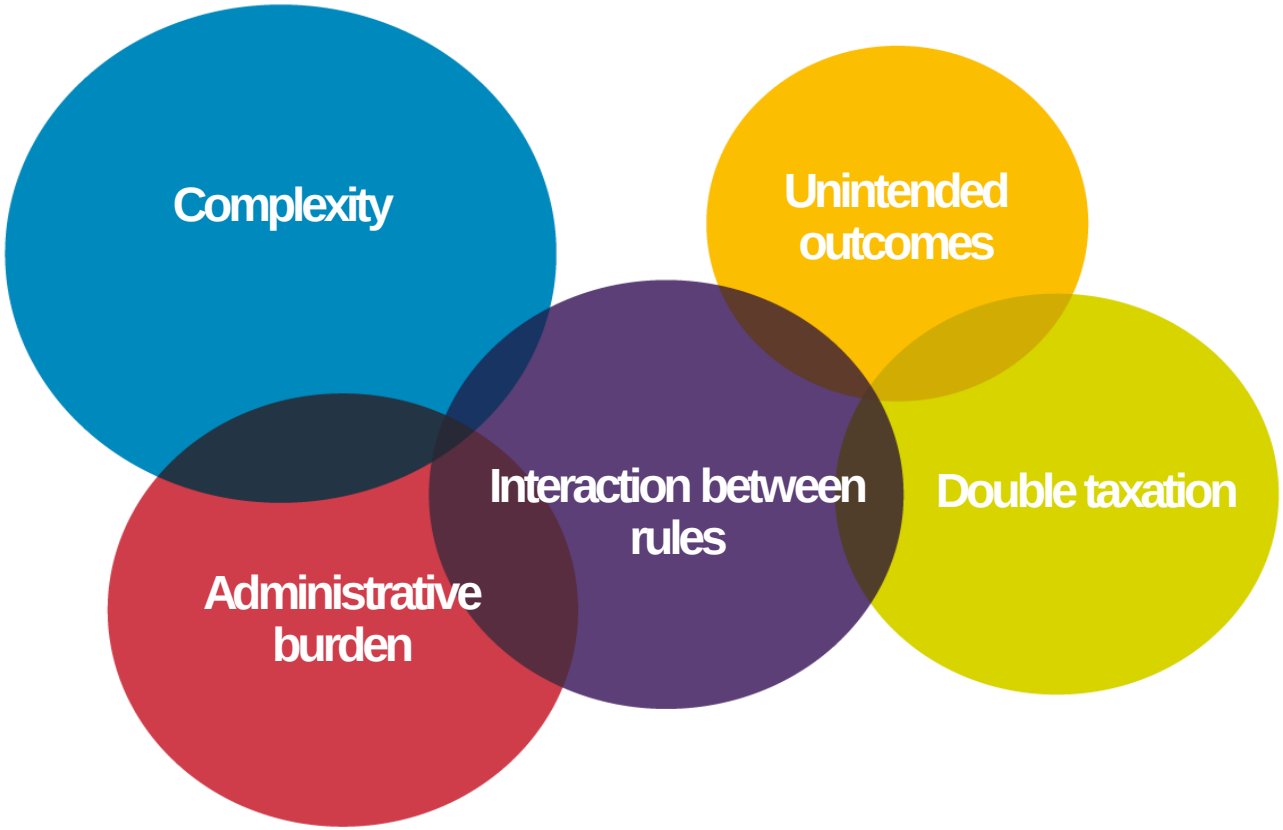
- Intention is to allow the source jurisdiction to protect itself from risk of base eroding payments made to related parties.

Apparent Disparities

- BEAT mechanics is not a simple disallowance of deduction, but requires re-calculation of the tax base that is subject to a lower tax rate.
- Taxation at the related party beneficiary of the eroding payment does not impact BEAT.
- Not clear whether OECD intends to limit the proposal to taxpayers with certain base erosion percentages.
- BEAT does not comprise a complement tax burden consisting in subjecting the payment to WHT and denial of treaty benefits.

FINAL REMARKS

Key Challenges Based on the US Tax Reform Experience



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