

# NEW GLOBAL TAX SYSTEM

## Decision of 8 October 2021: Who is affected?

The **global tax reform** is coming. On 8 October 2021, the OECD announced that **137 countries** have agreed on a comprehensive overhaul of the international tax system. This provides for a **minimum tax rate of 15%** for certain multinational enterprises (MNEs). It also reallocates **more than USD 125 billion** in profits from about 100 of the world's largest and most profitable MNEs to countries around the world. The agreement follows the original two-track plan: the first part regulates taxation rights and profit allocation, while the second deals with a global minimum tax. The leaders of the G20 approved the plan on 30 October 2021.

The result implies a **completely new approach of taxing** corporate profits, which is no longer linked to a physical presence through a legal entity or permanent establishment, but primarily to the **revenue in a given market**.

This approach was considered necessary because the foundation of the present taxation of companies with cross-border operations dates back to the **1920s** and cannot capture today's global business models. Initially, only the taxation of the digital economy was contemplated to be subject to the new rules, meanwhile, however, most industries are affected.

### THE CONCEPT OF REALLOCATION: PILLAR ONE

The first pillar provides for a reallocation of profits by shifting certain taxing rights from a MNE's home country to the countries in which it does business and earns profits, **regardless** of whether the company has a physical presence in these countries or not.

The first pillar will apply to MNEs with global turnover of **more than EUR 20 billion** and **profitability above 10%**. The turnover threshold could be lowered to **EUR 10 billion** after a review 7 years after the agreement comes into force.

A new special rule will be introduced to allow the allocation of a portion of the residual profits to market jurisdictions where a multinational enterprise derives **at least EUR 1 million** in revenue. For smaller jurisdictions with GDP lower than EUR 40 billion, the nexus threshold will be set at EUR 250,000.

The statement dated 1 July 2021 had left open the question of how much of the residual profit would be subject to the new reallocation rule. The statement dated 8 October 2021 now specifies that **25% of the residual profit in excess of 10% of revenue** should be reallocated.

### INCREASED LEGAL CERTAINTY

The new statement confirms that companies that fall within the scope will benefit from **dispute prevention and resolution mechanisms** in a mandatory and binding manner, which will avoid double taxation including all issues related to questions of transfer pricing and corporate profits.

### ABOUT BDO

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## REMOVAL OF DIGITAL SERVICES TAXES

Under the new statement, a multilateral convention (MLC) will require all parties to remove **digital service taxes (DST)** with respect to all companies and to commit not to introduce such measures in the future. From 8 October 2021 and until the earlier of 31 December 2023 or the coming into force of the MLC, no newly enacted DST will be imposed on any company.

On 21 October 2021, five European countries that impose taxes on digital services (Austria, France, Italy, Spain and the United Kingdom) reached a compromise with the United States on how they will phase out DST in light of the recent global Pillar One solution. The DST will remain in effect until the Pillar One enters into effect. The United States have agreed to terminate certain proposed trade actions and not to impose any further trade actions against any of the European countries with respect to their DST until the end of a transition period.

## THE GLOBAL MINIMUM TAXATION: PILLAR TWO

Pillar Two introduces a **minimum tax on corporate profits** of MNEs to achieve the goal of having one set of uniform rules and a global minimum effective taxation.

As part of Pillar Two, the OECD released detailed model rules related to the global minimum taxation (Global Anti-Base Erosion Model Rules or GloBE) on 20 December 2021 to assist in the implementation of reform to the international tax system. The new model rules define the scope and set out the mechanism for the GloBE rules to ensure certain MNEs will be subject to a 15% minimum tax rate from 2023.

The EU Commission has already published its proposal for an EU Directive on the basis of these model rules on 22 December 2021.

## SCOPE

The draft EU Directive provides for the general applicability of the rules under Pillar Two for MNEs with a **consolidated group turnover of at least EUR 750 million** in two of the last four preceding fiscal years. It further requires that either the parent company or a subsidiary must be tax resident in an EU member state.

In addition, a de minimis exception is provided, according to which the top-up tax for the constituent entities shall be equal to zero if the revenue of the constituent entities located in that jurisdiction is less than EUR 10 million and the profit is less than EUR 1 million.

In particular, for the purpose of preserving the tax neutrality principle, the following entities are excluded from the scope of the draft Directive: governmental entities, international organizations, non-profit organizations, pension funds and, provided that they are at the top of the ownership chain, investment funds and real estate investment vehicles. Entities that are owned at least 95% by one or more excluded entities are also excluded from the scope of the Directive.

## STEPS OF IMPLEMENTATION

Pillar Two basically consists of two main rules:

The **Income Inclusion Rule (IIR)** is considered as general rule and provides that an additional top-up tax is imposed on the ultimate parent company in respect of the income of subsidiaries if the effective tax rate of the subsidiaries is lower than 15%.

The draft Directive contains detailed steps of implementation for calculating the effective tax rate, which provide that the so-called "qualifying income" must first be determined at the level of the constituent entities. The calculation of "qualifying income" starts from the financial accounting net income or loss for the fiscal year, adjusted by necessary tax adjustments. The effective tax rate is calculated by dividing the taxes paid in a country ("adjusted covered taxes") by the "qualifying income". The calculation follows a country-by-country approach, which considers the entities and any permanent establishments located in one jurisdiction together.

In addition, the draft Directive contains a substance-based income exclusion, which provides that the "qualifying income" shall be reduced by an amount equal to a percentage of the payroll costs and of the carrying value of certain tangible assets. The applicable percentages are to be decreased gradually to 5% over 10 years.

The **Undertaxed Payment Rule (UTPR)** acts as a backstop and applies only to the extent that the IIR is not able to reach a minimum tax of 15%. Under the UTPR, a share of the top-up tax is imposed in the jurisdictions where the subsidiaries are tax residents according to an apportionment formula, if the effective income tax rate is less than 15%. The UTPR will become relevant in cases where the ultimate parent entities are located in jurisdictions outside the EU.

## COMPLIANCE OBLIGATIONS

Local compliance obligations are generally provided for each constituent entity of an MNE group that falls within the scope of the Directive. These entities are required to file a **top-up tax information return** in a standardized format in each jurisdiction that has implemented the GloBE rules. This requirement does not apply if the return has been filed by the ultimate parent entity or a designated filing entity located in a jurisdiction that has a qualifying agreement in effect to exchange return information with the EU member state that the constituent entity is located in.

Special attention should be paid to the national implementation of possible penalty provisions by each EU member state in the event of non-filing or incorrect filing of the relevant returns. The draft Directive provides for a penalty amounting to 5% of the annual turnover of the respective entity and can hence be of considerable value.

## COMING INTO FORCE

The OECD Task Force on the Digital Economy has been mandated to finalize the text of the multilateral convention and the explanatory statement by early 2022. **The new regulations are expected to enter into force and take effect as early as 2023**, once a critical mass of jurisdictions have ratified it.

With respect to Pillar Two, it is planned to implement the **GloBE rules** into domestic law by the end of 2022, to become effective as of 1 January 2023, with the UTPR coming into effect in 2024.

## NEED FOR ACTION

Companies with cross-border operations should already have the possible effects for themselves reviewed. The further development of the implementation in the individual OECD and non-OECD member states should be kept track of. The risk of double taxation can be limited through OECD-compliant structures, which should be established.

## STATUS QUO ANALYSIS BY BDO

With our **Pillar One and Pillar Two analysis tools**, we support you in identifying the possible tax consequences and the need for action. If necessary, we will involve colleagues from other specialist areas, such as in the review or adaptation of compliance structures and IT-systems or the integration of IT-tools. If required, we also work together with colleagues from other BDO member firms from our international network in 167 countries.