International tax update: global complexities

International Tax

27 September 2024

We review the latest international tax developments, focusing on Pillar 1 and 2 and the EU.

Work continues on taking forward Pillar 2 – the 15% minimum corporate tax agreed by over 135jurisdictions as part of the OECD/G20 Inclusive Framework. Over 60 jurisdictions have implemented it, or are in the process of doing so.

On 19 September 2024, the OECD hosted the signing ceremony for the multilateral convention on the subject to tax rule (see tinyurl.com/59nvnxvf) – part of implementing the Pillar 2 minimum tax rate. The convention acts as a treaty protocol, unlike the BEPS multilateral convention. It allows countries to tax payments of interest and royalties and for services where the recipient country taxes them at less than 9%. It thus effectively overrides low or zero withholding rates included in many double tax treaties, to ensure that such payments bear tax at 9% in total. Nine countries have signed the convention, with a further ten indicating they will do so.

57 countries joined the ceremony, including the UK and the US.

The undertaxed profits rule

The focus is moving towards implementing the undertaxed profits rule, which is perhaps the most controversial element of Pillar 2. The first elements require countries to assess profits in their own jurisdiction and profits earned overseas by subsidiaries as an expanded controlled foreign companies' rule. However, the undertaxed profits rule requires that countries with a physical presence of a multinational may tax profits earned overseas by its affiliates, where the first two rules have not been applied.

It's a bit of cleverness to ensure that the 15% rule applies very broadly, even if the ultimate parent country and the activity country have not adopted it. The UK has announced that it will enact the rule in the next Finance Act, applying in 2025.

Republican members of the Ways and Means Committee in the US House of Representatives wrote to the OECD on 17 September to complain about the undertaxed profits rule agreed to by President Biden's administration (see tinyurl.com/5db4wphf). Their letter illustrates the complexity of US democracy, where only Congress has the power to enact tax legislation but the President and the administration manage foreign relations. The undertaxed profits rule, of course, doesn't require that the US enact anything – but it could apply where the US controlled foreign company rule (the GILTI) does not.

Digital taxes

The general feeling is that Pillar 1 is unlikely to go forward, since it relies upon a multilateral convention, which the US and China are highly unlikely to adopt. The result is that we are likely to see more digital services taxes levied on digital sales (and not digital profits). Canada has swung into action with its digital tax, applying it from 2022. Others will no doubt follow.

There is no common standard for digital taxes, with rates and coverage varying widely. The UK has a relatively narrow base and a low 2% rate but we have naturally seen some affected digital companies increase their prices to pass on the tax to their customers. It will always be naïve to assume that digital companies will simply accept the extra levy.

European Commission

The new European Commission for 2024-29 has finally been agreed, under President Ursula von der Leyen (see tinyurl.com/399xfxz4). The Commissioner responsible for taxation is Wopke Hoekstra, who includes it as part of a portfolio of Climate, Net Zero and Clean Growth. He is a former Dutch finance and foreign affairs minister. President von der Leyen has published a letter of instruction to Mr Hoekstra (tinyurl.com/2vdsvt7f).

The work on taxation covers energy taxation; a coherent framework for the EU’s financial sector; the reform of corporate taxation and the current corporate tax package; and implementing Pillar 2 – as well as naturally fighting avoidance and fraud. There is also an interesting (and no doubt unachievable) target to reduce the administrative burden on companies by 25% – and by 35% for SMEs.

Former OECD head of tax Pascal Saint-Amans, a non-resident fellow at Bruegel, a European economic think tank, has advice for the new tax commissioner (see tinyurl.com/48mjatkc). He points out that EU-US conflict on tax policy is likely as the EU joins the UK in collecting tax on third country profits through the under taxed profits rule. Conflict is also likely on digital services taxes, in view of the likely failure of Pillar 1.

It’s much easier for a former French Finance ministry official to point out that initiatives on EU direct taxation are unlikely to succeed, due to the reluctance of the member states to hand powers to the European Commission and the European Court of Justice. Instead, he recommends a discussion on a Code of Conduct on Individual Taxation, which could lead to reduced competition for high net worth individuals and digital nomads. Seeking to harmonise capital gains tax across the EU would be more productive than a global wealth tax. He also points out the diplomatic benefits of resetting the tax relationship with African countries, by reducing the scope of countries assessed for compliance with EU standards.