G7 finance ministers commit to Pillars One and Two, including global minimum tax rate of “at least” 15% 2/24/21

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The G7 finance ministers announced an agreement on 5 June in which the participating countries committed to new taxing rights allowing countries to reallocate some portion of large multinational companies’ profits to markets (i.e. where sales arise – “Pillar One”) as well as enacting a global minimum tax rate of at least 15% (“Pillar Two”). The meeting marked an early test of whether the US position on the OECD Inclusive Framework’s “Taxation of the Digitalising Economy” project would provide momentum to finding a common base for agreement.

In the communiqué, the G7 finance ministers noted a commitment 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.”

Observations

The agreement would involve a careful mix of political trade-offs, as it would result in both winners and losers for different countries on separate issues. At least in theory, large developed countries may benefit in the sense that the largest markets would attract most of the new income reallocated under Pillar One. Under Pillar Two, many of them already have higher tax rates and often represent the headquarters jurisdiction that should receive a large part of the top-up relating to low-tax jurisdictions (if any). By contrast, smaller jurisdictions such as Ireland, Singapore and Switzerland may stand to lose some tax revenues under Pillar One and would face stiffer competition for inward investment as a result of Pillar Two. There is also the question of whether this agreement would benefit developing countries.

The G7 members (Canada, France, Germany, Italy, Japan, the UK, and the USA) have no formal power to fashion an agreement binding on other countries, the G20 being the mandated group, although any actions the seven largest world economies take often have significant effects on global issues.

The next important tests for the agreement are the OECD Inclusive Framework meetings in late June and the next G20 finance ministers meeting on 9–10 July in Venice. Any decision the G20 might take is more likely to affect the forward movement of the OECD project. This group includes countries like Brazil, China, India and Russia, which have so far been more hesitant about some of the elements discussed in Pillars One and Two. The G20 countries account for a major share of global economic investment, production, and corporate tax base, so any agreement in July would go a long way towards creating a consensus on how mostly developed economies intend to resolve frustrations voiced around the current international tax rules. However, given some outstanding differences still to be settled, including the thorny issue of repealing various G20 members’ Digital Services Taxes, it is not clear how much detail the finance ministers may agree. Some tough and important decisions are likely to be deferred until October.

So, although public officials and media outlets have termed the agreement “historic” and conveyed the sense that global adoption is inevitable, and there is clearly momentum, there still remain numerous political and technical elements of disagreement among the countries that will have to be bridged for a real consensus to emerge. There is also an implementation challenge, as the EU, which forms an important bloc of economic power, must unanimously agree to certain legal changes for tax issues in its directives. To date, several member states have expressed strong opposition to any global minimum tax that impinges on their sovereignty to establish corporate tax rates, especially if the agreed rate is set at 15% or above.

The takeaway

While a lot of attention is paid to statements resulting from the G7 meeting, a more important indicator of whether major corporate tax changes are coming will be determinations made by the Inclusive Framework in late June and by the G20 finance ministers in July. Even with an agreement in July, further important design elements will still need to be decided. We also expect that the coordination between applying any new rules and repealing Digital Services Taxes may have its own dynamics. Implementation of any new rules is likely to take several years and create more complexities for globally-engaged taxpayers, as the countries are very unlikely to implement any agreed rules in exactly the same way and with the same effective dates.

For a deeper discussion of how the G7 finance ministers’ agreement might affect your business, please contact with head of transfer pricing, PwC Latvia
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