

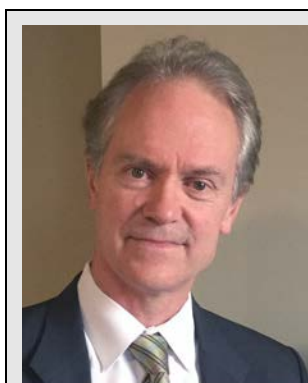
Global Minimum Tax: The Road Ahead

by Jefferson VanderWolk

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Jefferson VanderWolk is a partner with Squire Patton Boggs (US) LLP in Washington.

In this article, VanderWolk considers the European Union's decision to implement the global anti-base-erosion rules and its implications for the EU member states as well as the United States and other non-EU countries.

On December 15, 2022, the EU member states agreed to implement in their domestic tax laws the global anti-base-erosion (GLOBE) rules, which provide for a 15 percent global minimum tax on the profits of large multinational enterprises.¹ The plan is for the main parts of the rules to become effective in each EU country by 2024, with a backstop rule coming into effect in 2025.

Assuming that the plan is not derailed in some way in the coming months — and given the EU's track record of failing to implement proposals for harmonized direct tax laws, derailment must be acknowledged as a possibility — the GLOBE rules will apply not only to EU-parented multinational groups but also to MNEs with non-EU parent companies. Moreover, the rules will apply not only to profits arising from EU operations but also to profits derived from non-EU countries.

It's worth considering, at this stage, how the new rules might play out in practice. They are complex and will require MNEs to keep an entirely new set of books to compute the group's taxable profits and the effective tax rate on those

profits in each country in which the group operates. If the effective tax rate in a given country is less than 15 percent, the group's EU-resident parent company will have to pay top-up tax in its country of residence to bring the group's effective rate on the profits from the low-tax country up to 15 percent. For example, if a French parent company of a large multinational group has a single subsidiary in Kenya that benefits from Kenya's tax exemption for companies located in export processing zones, the French parent company will have to pay top-up tax to the French government equal to 15 percent of the Kenyan company's taxable profits (computed under the GLOBE rules).

Separately, EU countries will have the option to enact a domestic minimum top-up tax based on the new rules, which would require all companies resident in the country that are part of a large multinational group to pay tax locally at an effective rate of at least 15 percent. For example, if Ireland were to adopt the domestic minimum top-up tax, and a Canadian parent company had an Irish subsidiary that paid tax in Ireland at an effective rate of less than 15 percent (computed under the GLOBE rules), the Irish subsidiary would have to pay top-up tax to the Irish government to increase the effective tax rate on its GLOBE taxable profits to 15 percent.

In addition to the two main top-up tax mechanisms just described, the new rules contain a backstop top-up tax rule known as the UTPR (which started out as an acronym for undertaxed payments rule but later became simply the four-letter name of the backstop rule, because the rule has nothing to do with payments). Starting in 2025, each EU member state will apply the UTPR to collect its allocated share of the total global top-up tax on profits of a large multinational group whose parent company is resident outside

¹ See Elodie Lamer, "EU Reaches Deal on Pillar 2," *Tax Notes Int'l*, Dec. 19, 2022, p. 1525.

the EU in a country that has not enacted the GLOBE rules.

Each UTPR country's allocation of the group's total global top-up tax amount is based on the number of the group's employees in the country and the value of the group's tangible assets in the country, in equal measure. Only employees and assets in countries that have enacted the UTPR rules are taken into account, so it is possible for a country's allocation of a group's global top-up tax to be a much larger percentage than the country's share of the group's global business. It is also possible (and indeed it is likely in most cases) that the UTPR top-up tax in a given country will relate to profits that have no connection to the country imposing the tax.

For example, assume that a large multinational group with a non-EU parent company resident in a country that has not enacted the GLOBE rules conducts business throughout the world, and its EU businesses account for 20 percent of its worldwide profits. Assume further that only the EU member states have implemented the new rules, and that the MNE in question has earned profits in several non-EU countries in which the effective tax rate on those profits (computed under the GLOBE rules) was less than 15 percent. The total top-up tax amount needed to increase the rate to 15 percent on those profits will be allocated to the EU member states — and only to the EU member states — based on the MNE's employee headcount and the value of its tangible assets in each EU country as a proportion of the MNE's total headcount and tangible assets value in all GLOBE-implementing countries, which in this example is only the EU member states. Each EU country will collect its share of the total global top-up tax from the group's local subsidiary or branch, even though that subsidiary or branch may have had nothing to do with the group's operations in the non-EU countries in which the effective tax rate was less than 15 percent.

In light of this summary of how the rules will be applied by the EU countries, a number of questions arise.

Will Non-EU Countries Follow the EU's Lead and Implement the GLOBE Rules Domestically?

A few non-EU countries have already signaled their intention to do so. Others, however,

particularly developing countries, have indicated that they see little reason to take on the burden of administering a complex set of new rules that may yield little revenue while taking away their ability to compete for foreign investment and develop local industries by offering tax incentives (such as the Kenyan export processing zone incentive mentioned earlier).

In response, proponents of the GLOBE rules point out that local tax incentives will be negated by the top-up taxes that will apply in the EU countries and other countries that adopt the new rules. Although EU politicians say that the global minimum tax is all about fairness, politicians in the developing world may be more likely to see it as an unwelcome development, designed by the rich countries, that infringes on their sovereign right to determine how profits from business activity within their borders should be taxed.

On December 20, 2022, the OECD issued public consultation documents on the proposed GLOBE information return that MNEs would file in every country where they do business, and on possible approaches to preventing and resolving disputes arising under the GLOBE rules. In addition, the OECD issued, on behalf of the inclusive framework, a paper on safe harbors aimed at easing some of the burden of complying with the new rules. Some countries may wish to consider this new material before deciding whether to implement the rules.

What About the United States?

Ironically, the United States already has tax rules — the global intangible low-taxed income regime, the base erosion and antiabuse tax, and the new corporate alternative minimum tax — that do much the same thing as the GLOBE rules would do if enacted in the United States. Yet the EU directive expressly rules out the possibility of treating a foreign country's rules as functionally equivalent to the GLOBE rules if they are nonconforming in some respects, as the U.S. rules are. Therefore, the United States will be treated as a country that has not adopted the GLOBE rules, raising the possibility of UTPR top-up taxes being levied on EU subsidiaries of U.S. parent companies.

Republican members of the taxwriting committees in Congress sent a letter to Treasury Secretary Janet Yellen on December 14, 2022,

asking for her department to oppose, on the basis of tax treaties, UTPR top-up taxes on the profits of U.S. MNEs. The letter indicated quite clearly that the likelihood of U.S. enactment of the GLOBE rules, during the next two years at least, is extremely low.

Will the United States Revoke Its Termination of the Hungary-U.S. Tax Treaty?

In mid-2022, shortly after Hungary had refused to agree to the EU directive on the global minimum tax, the U.S. Treasury Department announced that it had given Hungary notice of termination of the Hungary-U.S. tax treaty. Now that Hungary has agreed to go along with the directive, observers are wondering whether the United States will revoke its notice of termination before the termination takes effect in January. ■

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