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G7 leaders take step forward on global tax reform agreement

The G7 finance ministers published a communiqué on June 5 that sets out a high-level political agreement on global tax changes, but even though this marks a notable step forward in a process that was slowed down by the coronavirus pandemic and by demands from the Trump administration, there are still significant hurdles to an agreement and implementation by all participating countries, and the news was received warily by the top Republican taxwriters on Capitol Hill.

Since 2017, the 135-plus member countries of the G20/OECD Inclusive Framework on BEPS (IF) have been developing a "two-pillar" approach to address the tax challenges arising from the digitalization of the economy. This led to the publication of two detailed blueprints in October 2020 on potential rules for addressing nexus and profit allocation challenges (Pillar One) and for global minimum tax rules (Pillar Two). The 2020 proposals were updated and simplified by the Biden Administration in April 2021 and formed the basis for the recent political discussions by the G7.

What the agreement includes

In the communiqué, the G7 finance leaders committed to a Pillar One approach suggested by the Biden administration that would focus new profit allocation rules on the "largest and most profitable multinational enterprises" – rather than solely on companies providing automated digital services and consumer-facing businesses and at much lower revenue thresholds – and agreed that market countries would be awarded "at least 20 percent" of profit exceeding a 10 percent margin. They also agreed to a global minimum tax of "at least 15 percent on a country by country basis" and to 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."

This latter point has been of significant interest to congressional taxwriters from both sides of the aisle over the past couple of years as more countries, especially in Europe, have implemented or threatened digital service taxes (DSTs) that largely impact US technology companies. The Biden administration's April presentation to the IF steering committee proposed what it dubbed a "standstill and rollback" workstream to address the various unilateral measures that have proliferated, but stakeholders in the IF process have not yet reached agreement on how to determine which ones will be considered "relevant" for repeal, and the European Union, for example, says it is still pushing ahead on a new bloc-wide DST this year regardless of the OECD talks.

GOP concerns

In response to the news of the G7 agreement, Senate Finance Committee ranking member Mike Crapo, R-Idaho, and House Ways and Means Committee ranking member Kevin Brady, R-Texas, noted in a joint statement that these ongoing unilateral measures and talk of new DSTs "demonstrate that the United States cannot expect other countries to act in the interest of American businesses and workers."
URL: https://www.finance.senate.gov/ranking-members-news/crapo-brady-urge-caution-on-g-7-agreement

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More broadly, Crapo and Brady said, "[a] speculative agreement appears premature given the many unanswered questions about the Pillar 1 and Pillar 2 proposals and their potential effect on American companies and US revenues. The United States enacted the most robust global minimum tax in the world in 2017. No other country has moved to enact a similar minimum tax since, and it remains to be seen whether any agreement will result in consensus from the United States' biggest foreign competitors."

The move towards a global minimum tax under Pillar Two has now been entangled with Democrats' push to increase the tax rates on corporate profits and global intangible low-taxed income (GILTI) enacted in 2017's Tax Cuts and Jobs Act (TCJA), and this has altered the previously bipartisan approach congressional tax leaders had taken towards the OECD process. President Biden supports a corporate rate of 28 percent and a GILTI rate of 21 percent, and Republicans argue that higher rates will put the US at a disadvantage, especially if other countries don't agree to a global minimum tax – or if they agree to one as low as the 15 percent referenced as the floor by the G7 finance ministers.

The new divide between Republicans and Democrats on the OECD talks has played out recently in an exchange of letters between Crapo and Treasury Secretary Janet Yellen regarding the administration's negotiating position. (For prior coverage of Crapo's initial letter to Yellen laying out his concerns over the negotiations, see *Tax News & Views*, Vol. 22, No. 27, May 28, 2021.)
URL: https://dhub.blob.core.windows.net/dhub/Newsletters/Tax/2021/TNV/210528_4.html

In her June 4 reply, Yellen told Crapo that their objectives are "aligned" and agreed that any international accord "must neither harm US businesses and workers nor undermine the United States' tax sovereignty." However, Yellen also insisted that the administration's domestic tax proposals will be helpful in driving agreement within the IF process, particularly calling out the proposal to replace the TCJA's base erosion and anti-avoidance tax (BEAT) with a new measure known as Stopping Harmful Inversions and Ending Low-tax Developments (SHIELD).

"The SHIELD proposal would function as a strong incentive for other countries to adopt global minimum taxes, thus protecting the US minimum tax on global intangible low-taxed income and the competitiveness of US businesses. Specifically, the SHIELD rule would disallow deductions when payments are made to low-tax affiliates, and in doing so encourages foreign jurisdictions to adopt a strong minimum tax along the lines we are proposing at the OECD," Yellen wrote.

What now?

Attention now turns back to the IF, which will meet June 30 and July 1 to determine what sort of consensus political agreement – if any – can be reached there with respect to both pillars. The G20 finance ministers will meet July 10-11 in Venice – when they could endorse any IF progress – and October 15-16 in Washington. Assuming a consensus, the focus would then turn to the technical work of drafting the necessary legal rules (including possible treaty provisions) that would need to be enacted and agreed to by participating countries with respect to both pillars.

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This technical work and the related implementation by countries is expected to take several years, and it is not expected to be completed in time for action by Congress in 2021, when lawmakers could take up tax changes to pay for infrastructure investments. Furthermore, while it may be possible to implement Pillar Two just through changes to US law, Pillar One is likely to require Senate passage of a treaty or other multilateral instrument, which may complicate the path forward, as treaties require approval by two-thirds of the Senate. It is also worth noting that DSTs imposed by a treaty partner may not be removed until the relevant treaty is ratified, a process that could take years.

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