Agreement on the Two-Pillar Global Tax Reform

Background

Base Erosion and Profit Sharing (“**BEPS**”) refers to tax planning strategies used by multinational enterprises that exploit gaps and mismatches in tax rules to avoid paying tax.

The Organisation for Economic Co-operation and Development (“**OECD**”) BEPS Project is an OECD/G20 project to set up an international framework to combat tax avoidance by multinational enterprises (“**MNEs**”) using base erosion and profit shifting tools.

In response to the call of G20 leaders in November 2015, the OECD and G20 members established an inclusive framework which allows interested countries and jurisdictions to work on an equal footing with the OECD and G20 members in the next phase of the BEPS project.

In July 2019, the OECD agreed to Gibraltar becoming a member of the Inclusive Framework on BEPS. For several years, the Inclusive Framework explored how to go beyond the BEPS Action Plan, which have been developed in the context of the BEPS Project, and adapt international tax rules to an increasingly digitalised economy.

Last week, 136 out of 140 members of the OECD/G20 Inclusive Framework (including Gibraltar), representing more than 90% of global GDP, officially agreed on certain key parameters for a new framework for international tax and agreed a Detailed Implementation Plan that envisages implementation of the new rules by 2023.

This new framework will see the reallocation of some taxing rights to market jurisdictions ("**Pillar One**") and introduction of a global minimum effective taxation ("**Pillar Two**"). As a result, MNEs with a global turnover exceeding EUR 750 million will be subject to a minimum tax rate of 15%, with the profit of the largest MNEs reallocated to countries worldwide. Read on for the criteria by which the profitability of aforementioned MNEs is determined.

Pillar One

Scope

The new taxing right in market jurisdictions on "Amount A", which corresponds to a deemed "residual profit" will only affect those MNEs with a global annual turnover exceeding EUR 20 billion (instead of EUR 750 million previously contemplated) and a pre-tax profit margin above 10%. This threshold will be reduced to EUR 10 million 7 years after the agreement comes into force, contingent on successful implementation of Pillar One.

Subject to the new taxing right, Amount A will be 25% of the residual profit (defined as profit in excess of 10% of revenue).

Extractives industry sectors and regulated financial services are excluded from Pillar One.

Nexus
A new 'special purpose' nexus rule will be applied whereby the allocation of Amount A to a market jurisdiction will be permitted when the in-scope MNE obtains a minimum of EUR 1 million in revenue from said jurisdiction, or EUR 250,000 for smaller jurisdictions with a gross domestic product ("**GDP**") of less than EUR 40 billion.

Double Taxation
In order to prevent the issue of double taxation of profit allocated to market jurisdictions, relief will be offered via either the exemption or credit method.

Unilateral Measures
All parties participating in the Multilateral Convention ("**MLC**") will be required to remove all digital services taxes and other relevant similar measures.

Pillar Two

Pillar Two will consist of an Income Inclusion Rule ("**IIR**"); an Undertaxed Payment Rule ("**UTPR**"), together referred to as the Global anti-Base Erosion (GloBE) rules; and a treaty-based rule permitting limited source taxation on certain related party payments. The UTPR serves, in part, as a backstop to the IIR, reducing incentives for tax-driven inversions by providing a mechanism for making an adjustment in respect of any remaining top-up tax in relation to profits of a Constituent Entity that is not in scope of an applicable IIR.

Both rules will refer to the same minimum effective tax rate of 15% on all
MNEs with annual revenue over EUR 750 million.

A further key element of Pillar Two is the requirement of all jurisdictions with a nominal corporate income tax rate below 9% to interest, royalties and other specific payments to implement the Subject to Tax Rule ("**STTR**"), which is a top-up withholding tax, into their bilateral treaties when it is requested by either party, so that their tax treaties cannot be abused.

Implementation

Pillar One	Pillar Two
Early 2022 – Text of a Multilateral Convention (MLC) and Explanatory Statement to implement Amount A of Pillar One	November 2021 – Model rules to define scope and mechanics for the GloBE rules
Early 2022 – Model rules for domestic legislation	November 2021 – Model treaty provision to give

necessary for the implementation of Pillar One	effect to the subject to tax rule
Mid 2022 – High-level signing ceremony for the Multilateral Convention	Mid 2022 – Multilateral Instrument (MLI) for implementation of the STTR in relevant bilateral treaties
End 2022 –Finalisation of work on Amount B for Pillar One	End 2022 – Implementation framework to facilitate co-ordinated implementation of the GloBE rules
2023 – Implementation of the Two-Pillar Solution	

Dates taken from www.oecd.org.

Gibraltar Development

As from the financial year commencing 20 July 2021, Gibraltar's corporation tax rate was increased from 10% to 12.5%. During the budget speech, Chief Minister Fabian Picardo explained that if the global minimum rate mandated a minimum rate of 15% across the globe, then such change would be less troublesome if an interim rate of 12.5% was adopted. However, given that the 15% taxation rate will apply only to those businesses with a revenue exceeding EUR 750 million, it is unlikely that this will affect many Gibraltar businesses.

For any queries pertaining to the above, or should you require any assistance in determining the implication of the rules for your business, our team of experts are happy to offer their assistance. Email Stuart Dalmedo at stuart.dalmedo@isolas.gi for more information.

Legal Disclaimer

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