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Corporate Tax 2022

Introduction

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INTRODUCTION

Contributed by:** Steve Edge, **Slaughter and May

Corporate Tax 2022 – Global Outlook

The last version of this introduction focused very much on the pandemic and what economic and tax measures might emerge from it as countries tried to repair the damage to their economies. Those are still, of course, issues of the day, but their importance is varying from country to country depending on how and where the pandemic has affected them individually.

The very sad recent events in Ukraine have added another dimension.

OECD Pillars One and Two, however, spare no one. Every country will have some important decisions to take in the coming months.

Again, the OECD is to be congratulated on the work it is doing in bringing governments, taxpayers and their advisers together to thrash out the principles and address the detailed implementation aspect.

Pillar One

Pillar One has made great strides – though not necessarily in the direction that it was originally heading.

The original plan was that Pillar One would satisfy the popular and political demand to have a tax on digital sales. Many then hoped that an OECD-sponsored global solution would stop individual countries coming up with their own uncoordinated solution, which would surely lead to uncertainty and complexity. In short, chaos.

When a digital tax through Pillar One was originally imposed, many members of the tax world said that things would surely be easier if the OECD simply put out a list of the companies it wanted to tax rather than trying to define digital sales that were in scope and out of scope in an inevitably complex way. They have had their wish, because Pillar One now effectively constitutes an additional tax on foreign sales for the world's top multinationals.

Those who, for many years, have been pushing for a destination-based tax system (reasoning no profit without a sale) have also had a partial victory. Pillar One taxes are thus to be collected in the jurisdictions in which sales are made. Some have said that this constitutes one of the best ways of giving aid to developing countries, which often have large consumer markets. Tax at the point of sale thus suits them and recognises their importance in the supply chain. But it has also been said that imposing taxes on profits at a local level in excess of those that are actually being made (or would be made) by an independent distributor is not principled or philosophically justified. The arm's-length standard should continue to apply, they say. The only profits that should be taxed locally are those that are being generated by local activity rather than IP owned offshore. This is obviously not the direction in which Pillar One has eventually gone.

Part of the answer to those who are protesting that this is an unprincipled shift of tax base is that Pillar One effectively recognises that multinational companies are, in fact, making profits locally by deriving value from their brand or other IP in the jurisdiction concerned. What they are effectively being taxed on is a marketing intangible that they have created in jurisdictions in which their products are recognised and sold in volume. Pillar One thus now goes well beyond the digital sales area.

Those who were previously complaining about US companies largely being the target of digital

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taxation proposals will no doubt have noticed that the US is also a very big consumer market. For the US and other countries where multinationals are based, there will thus be swings and roundabouts as profits are allocated out and then back in.

The conclusion at this stage is that Pillar One seems likely to be broadly revenue neutral (maybe even revenue positive) for the US. (If, on the sales side, digital taxes are passed on to consumers, then the damage to multinationals caught by the new provisions will be further reduced for the multinational itself. Passing digital taxes on to consumers will also go some way towards levelling the playing field between non-digital suppliers paying full local taxes and sales outlet costs and digital suppliers, which have a completely different cost structure.)

Digital taxation has always been a highly political matter in the US and it appears that is likely to manifest itself in a failure to get Pillar One approved during this presidency. The implications of this are discussed below.

Pillar Two

Pillar Two may have started life as an attempt to capture low or untaxed profits in a jurisdiction where factually or economically they did not "belong" but things have moved on here, too. If that was indeed the target, it could have been said that parent jurisdiction controlled foreign corporation (CFC) and transfer pricing rules (both part of the original BEPS Actions) should have made Pillar Two unnecessary. Equally, an exemption (as there is in the UK CFC rules) for profits that were actually generated by substance located in a particular jurisdiction would have greatly reduced the scope and effect of Pillar Two.

But again the agenda has moved – the OECD now admits that Pillar Two is trying to moderate global tax competition by ensuring that nobody competes at a corporate tax rate level below 15%. This has obviously caused considerable difficulty for countries such as Ireland (whose low corporate tax rate strategy has had real success in leading very significant business operations to make Ireland their choice), though eventually Ireland was persuaded to sign up and will wait anxiously to see what impact that has on new investment.

The European Commission has also sat up and taken notice.

The 1960 Treaty of Rome contained no provisions about legitimate tax competition between jurisdictions. That is correct at first sight – the EU is not a fiscal union.

If Pillar Two had been around in 1960, though, the question is, would the treaty negotiators have thought that there should be rules within the EU to prevent undue tax competition between member countries? VAT is, of course, moderated in that way, and I suspect that the EU architects would have said that a corporate tax rate floor made a great deal of sense. State aid in the tax area is completely different from this. Trading within the EU can only operate fairly if governments do not intervene on behalf of their national champions, etc. Market intervention can obviously take the form of a tax subsidy (special rules or a special treatment in practice) that is not universally available and distorts the market to the benefit of local companies. Tax competition, by having a generally low corporate tax rate that applies to all, is completely different from that.

The discussion in relation to what is an appropriate tax rate for those who sign up to Pillar Two is bound to be a difficult one. There are no real guidelines to follow. For now, a 15% rate still leaves scope for differences that may swing the

decision on a particular investment in favour of the jurisdiction concerned. Whether "big" countries will continue to grumble so that the rate will be moved in later years remains to be seen.

Key Role for the US

But the first task is to get Pillar Two generally accepted, which is again where the US comes in.

The US already thinks it is doing part of the job Pillar Two is intended to do through its global intangible low-taxed income (GILTI) rules. If that does not get accepted by those implementing Pillar Two, profits that the US is claiming as its own will end up being taxed elsewhere and that will not be acceptable. Double taxation could be the outcome.

Even if the GILTI debate does end up being resolved in the US's favour (as it should), the general assessment still seems to be that Pillar Two is unlikely to be implemented in the US in the short term.

So, the question is, what happens when an important country such as the US does not want to play by the same rules as everyone else?

If both Pillars One and Pillars Two are not adopted by the US:

- on Pillar One, it seems likely that the whole project will fail and countries will go back to individual digital taxes (the EU may sensibly have a single levy across its members and the UK may try to conform to that to avoid disputes with its neighbours) – as already mentioned, consumers will probably end up bearing taxes of that type rather than the multinationals that are being targeted, which may be seen as a narrowing of price differences between digital and non-digital markets; and
- Pillar Two might well go ahead in significant parts of the world – it seems quite likely it would be implemented within the EU because of its desire to moderate tax competition, while the UK has also put out a consultation.

Because of the way in which the proposals operate – having a single measure of taxable profits and looking through complex group structures – Pillar Two will be extremely complex to implement. Whether countries that have not joined at the outset may be inclined to join later is another question. Many of the teething problems may have been sorted by then. If local discontent has been dealt with, it could well be that people will join gradually over time. There seems no problem with that.

Conclusion

One thing that is very clear is that neither of these measures will lead to wide-scale redundancies in the global tax profession – there is much still to be done. For multinational companies, transfer pricing continues to be a main focus. Shifts in the tax base arising out of Pillar One or some other form of digital taxation and through the implementation of Pillar Two will not remove the need to get the group pricing arm's length if any new rules come into play.

Much is still to be done, for a few years at least.

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Slaughter and May is a leading international law firm with a worldwide corporate, commercial and financing practice. The highly experienced tax group deals with the tax aspects of all corporate, commercial and financial transactions. Alongside a wide range of tax-related services, the team advises on the structuring of the biggest and most complicated mergers and acquisitions, the development of innovative and tax-efficient structures for the full range of financing transactions, the documentation for the implementation of transactions so that the desired tax objectives are met, the tax aspects of private equity transactions and investment funds from initial investment to exit, and tax investigations and disputes from opening enquiries to litigation or settlement.

CONTRIBUTING EDITOR

Steve Edge advises on the tax aspects of private equity and public mergers, acquisitions, disposals and joint ventures, and on business and transaction structuring (including transfer pricing in all its aspects) more generally. He also advises many banks, insurance companies, hedge funds and others in the financial service sector in a wide range of areas. A large part of Steve's practice involves advising non-UK multinationals (particularly those based elsewhere in Europe and in the USA) on cross-border transactions and tax issues of various types. In that area of his practice, he works closely with other leading international tax advisers around the world.

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