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60 Years Later: Wishes Coming True?

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"In those countries where income taxes are lower than in the United States, the ability to defer the payment of U.S. tax by retaining income in the subsidiary companies provides a tax advantage for companies operating through overseas subsidiaries that is not available to companies operating solely in the United States…

The undesirability of continuing deferral is underscored where deferral has served as a shelter for tax escape through the unjustifiable use of tax havens such as Switzerland. Recently more and more enterprises organized abroad by American firms have arranged their corporate structures–aided by artificial arrangements between parent and subsidiary regarding intercompany pricing, the transfer of patent licensing rights, the shifting of management fees, and similar practices which maximize the accumulation of profits in the tax haven–so as to exploit the multiplicity of foreign tax systems and international agreements in order to reduce sharply or eliminate completely their tax liabilities both at home and abroad…

If we are seeking to curb tax havens, if we recognize that the stimulus of tax deferral is no longer needed for investment in the developed countries, and if we are to emphasize investment in this country in order to stimulate our economy and our plant modernization, as well as ease our balance of payments deficit, we can no longer afford existing tax treatment of foreign income… This proposal will maintain United States investment in the developed countries at the level justified by market forces. American enterprise abroad will continue to compete with foreign firms…

At the same time, I recommend that tax deferral be continued for income from investment in the developing economies. The free world has a strong obligation to assist in the development of these economies, and private investment has an important contribution to make. Continued income tax deferral for these areas will be helpful in this respect. In addition, the proposed elimination of income tax deferral on United States earnings in industrialized countries should enhance the relative attraction of investment in the less developed countries.

On the other hand, I recommend elimination of the "tax haven" device anywhere in the world, even in the underdeveloped countries, through the elimination of tax deferral privileges for those forms of activities, such as trading, licensing, insurance and others, that typically seek out tax haven methods of operation. There is no valid reason to permit their remaining untaxed regardless *of the country in which they are located".*

Yesterday it was exactly 60 years that US President John F. Kennedy pronounced these words in his *Special Message to the Congress on Taxation*. It was 20 April 1961. The fact that there is so much excitement, confusion and debate in the tax world after the unveiling of the Made in America Tax Plan is evidence that the job is not done yet.

As there is quite a lot happening these weeks and sometimes it is hard to keep pace, I thought it could be useful to summarise 1. how we got here, 2. what's happening now, and 3. what to watch out for in the near future.

Needless to mention it, I have been out of touch on these issues for a while now, and this is my very personal take.

1. How did we get here?

Progress over time and BEPS

True, progress has been made in these 60 years, and most of it in the last 10. It was 2011 when for the first time complex tax planning structures were made known to the wider world by **journalists** interested in tax justice and **fairness**. The Double-Irish Dutch Sandwich and so-called Stateless income became widely known and hotly debated. Anger at these practices fuelled with the worst financial crisis ever and hence there was that strong push to put an end to these practices. This BEPS Project was launched at the level of the OECD and G20 in **2013** and for the surprise of most observers it delivered new rules and standards in **October 2015**. These were then implemented via domestic laws, directives in the EU and a **multilateral instrumen**t to amend bilateral tax treaties, with an ongoing peer review process on the most important items to check that the commitments made are respected by all jurisdictions. Country-by-Country reporting, an idea originally floated by NGOs, became reality and so did the measures to stop treaty abuse, to prevent hybrid mismatches that make taxable income disappear, the put an end to harmful tax competition and to tighten-up the transfer pricing guidelines.

The Tax Cuts and Jobs Act

In 2017, almost out of the blue, the Trump Administration passed a major tax reform. In a nutshell, the Trump reform reduced the corporate income tax rate from 35% to 21% and shifted to a quasi-territorial tax system safeguarded by GILTI (Global Intangible Low-Taxed Income) and new rules on hybrids, as well as aided by FDII (Foreign Derived Intangible Income). Basically, the use of "check-the-box" rules to avoid the application of CFC rules (introduced in 1962 after the famous message) was over. GILTI provided that income in excess of a 10% return on tangible assets of a foreign operation be taxed upfront at a reduced rate. In other words, this is a super-CFC with a minimum tax on foreign income: if the foreign income is subject to at least around 13,125% abroad, then no extra tax in the US, with computation on a worldwide basis. FDII is instead a "sort of patent box" under which income from export of products and services by U.S. corporations in excess of a deemed return of 10% on tangible assets is taxed at a reduced rate. Noticeable was also the BEAT (Base Erosion and Anti-Abuse Tax) to prevent US base erosion, and a number of temporary measures such as the repatriation tax to be paid on undistributed foreign earnings up to 2017 and immediate expensing (until 2023) of cost for acquisition of qualified property, without having to wait for depreciation/amortization. More is **here**.

The Inclusive Framework on BEPS continues the work

Meanwhile the unfinished work on BEPS continued in the **Inclusive Framework** that today counts 139 members. The most relevant unfinished items of the BEPS Project regarded the challenges raised by the digital economy, which went beyond mere tax avoidance and had to do with which countries should levy tax rather than whether tax should be levied; as well as the work on Controlled Foreign Companies Rules which did not bite as many had wanted, chiefly because of EU constraints for a number of countries and possibly because also that part had in effect to do with which country should levy tax.

The EU Proposal for a Digital Services Tax

Also based on the Action 1 Report on the Digital Economy, the EU put out a **draft directive** for the introduction of a Digital Services Tax in March 2018. Basically, a levy on turnover derived from digital services. for which users' contributions and network effects are more pronounced. These are online advertising, data trasfers and platforms' intermediation fee. However, this was presented as an interim tax "to ensure that those activities which are currently not effectively taxed would begin to generate immediate revenues for Member States". It would then be repealed when a comprehensive reform has been implemented and has inbuilt mechanisms to alleviate the possibility of double taxation. Comprehensive reform that could eventually be integrated into the scope of the CCCTB (Common Consolidated Corporate Tax Base).

Domestic Digital Services Taxes

At the same time, a number of countries around the world decided to go ahead in their domestic law to introduce a tax that would capture the value created by the activities of users monetised via different business strategies. Only in Europe, the **list of countries** is starting to become rather long and it includes: Austria, France, Hungary, Italy, Poland, Spain, Turkey, and the United Kingdom which have implemented a DST; Belgium, the Czech Republic, and Slovakia that have published proposals to enact a DST; and Latvia, Norway, and Slovenia that have either officially announced or shown intentions to implement such a tax.

Negotiations continue

The US considered that Digital Services Taxes were unfairly targeting US businesses and hence discriminatory. It threatened tariffs in response, so the issue from a tax one became also a trade one. Further, in a letter to the OECD dated December 2019 it signalled that any new approach for taxing multinational businesses under development at the level of the OECD-G20 Inclusive Framework would only work as a safe harbour. In addition, it was ensured that any discussion on minimum taxes would safeguard the US approach with GILTI.

The **Pillar 1** and **Pillar 2** Blueprints were published in October 2020: basically stuck in a limbo, waiting for the results of the US elections. There were many aspects on which decisions had to be taken. But here chapeau to all those in the Inclusive Framework that have relentlessly continued to work on these technical aspects, bringing forward proposals and hammering some very complex challenges. It is thanks to them if today there is hope that results may arrive in a reasonable timeframe.

2. Where exactly are we today?

Developments in Washington DC

Elections took place, the new team is in, the **Made in America Tax Plan** was unveiled by the US Treasury on 7 April 2021. Around the same time, Democratic Senators Wyden (Chair of the Finance Committee), Brown, and Warner issued a Document on similar issues (**Overhauling the International Taxation**) and with similar inclinations, although with some divergences in certain important details.

In a nutshell, the Made in America Tax Plan provides for an increase in the corporate income tax rate from 21% to 28%. Second, it amends GILTI in a way that would (i) increase the minimum tax rate on foreign income to 21% (3/4 statutory rate); (ii) ensure that the calculation is done per-country rather than overall hence stopping blending techniques between high and low tax countries; (iii) eliminates the exemption for a deemed return on fixed assets (currently 10%). The proposal would also revamp the BEAT, which will become SHIELD and will include tightening of the anti-inversion rules, and will deny deductions for payments made to related parties subject to a low-effective rate. The idea is to make the Minimum Tax global via the OECD/G20 work and hence the links not only in relation to Pillar 2 but also Pillar 1 and via the application of the SHIELD only to payments to resident of countries that do not have minimum taxes. In that respect, the minimum rate would be defined multilaterally but pending that, the US will use 21%. In addition, the US also plans to abolish the FDII and put the resources on incentives for the input rather than the output of research and innovation. Finally, it provides for a second minimum tax of 15% on book income for the largest corporations; the assumption here is that if you signal big profits to investors then at least you should pay 15% tax on them. Clearly, it will have to be seen how incentives that the government itself has introduced would have to be taken into account. Last but least, it signals the need for additional resources to the IRS in order to be able to enforce effectively tax laws.

The United Nations goes its way

The United Nation issued its Draft Proposal on Taxation of Automated Digital Services, a new Article to be included in the UN Model Tax Convention which is sometimes used in negotiations of bilateral tax treaties with developing countries (art. 12B). This is being discussed at the 22nd session of the **Committee of Experts on International Cooperation in Tax Matters**. Fundamentally, the new provision would allow the country where the payor is located to levy a withholding tax on payments such as Online advertising services, Sale or other alienation of user data, Online search engines, Online intermediation platform services, Social media platforms, Digital content services, Online gaming, Cloud computing services, Standardized online teaching services. Going its own way does not seem to bring it too far. Even if included in the UN Model, it would have to be negotiated and included in bilateral tax treaties. Give me a call when that happens.

Bruxelles consults

At the same time, on 12 April 2021 the EU Commission closed its consultation on the introduction of a Digital Levy. Importantly, the digital levy is one of the new sources of own financing of the EU for purposes of repaying the Recovery and Resilience Fund. In fact, in its conclusions of 21 July 2020 the European Council tasked the Commission with putting forward proposals for additional own resources. The digital levy is one of them. According to the Commission, the initiative will help address the issue of fair taxation related to the digitalisation of the economy and, at the same time, is intended to not interfere with the ongoing work at the G20 and OECD level on a reform of the international corporate tax framework. Commission officials have **aired** the intention to go ahead with its proposal for a digital levy which it does not seen in contradiction with the OECD-G20 process. The draft is expected for the second half of 2021.

The IMF on excess profits

To complete the picture, the IMF **signalled** that in time of pandemic it would make sense to levy an additional tax on those who benefitted the most from it, and that can show a significant amount of excess profits (or super-profits). In this case, the concept of excess profits does not necessarily have the same meaning as under OECD work. It is more related to the difference between profits made in past years without COVID-19 and those made during the pandemic.

Bringing it all together

On 8 April 2021 the US sent its position paper to countries in the inclusive framework signalling the interconnections between the Made in America Tax Plan and discussions at the level of the OECD/G20. The link between the US Proposal and the discussions at the OECD/G20 is evident. According to the widely leaked slides that the US government sent to the other countries in the inclusive Framework, the idea is to move away from applying the new rules of Pillar 1 only to Automated Digital Services and Consumer-Facing Businesses. It would instead include in scope all companies above a certain turnover, with a certain profit margin. This avoids the problem of having to segment business lines and is considered to be useful in identifying those MNE groups that are the most intangible-driven, most profitable, and have the highest profit-shifting potential. The US considers that Pillar 2 cannot be fully successful absent a stable multilateral international tax architecture and that the proposal on Pillar 1 provides the opportunity to stabilize the architecture, which includes (i) addressing the proliferation of unilateral measures, and (ii) a new tax certainty framework which provides for binding, non-optional dispute prevention and resolution process, along the lines of what included in the Pillar 2 blueprint.

3. Areas of attention

Obviously, this is just the beginning of another interesting time for tax-interested folks. Whether it is “the beginning of a new era” or “more of the same” will have to be seen.

Certainly, hopes are sky-high. At the moment, I see three areas of attention.

1. **Geopolitics**. Short-term, the first thing to watch is the positions of a number of key players, namely: China, the EU, the group of least developed countries, the group of “small open economies”, and last but not least, the US Congress (many items will have to pass through it anyway). Everything is also linked to what countries with a DST will do, and whether there will be trade tariffs introduced in the US in response. *Timing is key here*. In the picture, upcoming elections in France and Germany, the US mid-term elections, and the financing of the EU Recovery Plan.
2. **Excess profits**. On the details where the devil is (so to speak), some of the relevant ones regarding Pillar 1 include: (1) the level at which the turnover threshold will be set – apparently, the US has proposed 20 Billions; (2) the profit margin threshold – to be seen also based on the mechanics of the calculation of the margin itself; (3) whether it will really apply to everyone or there will be exclusions – natural resources being a candidate, question mark on financial services; (4) the mother of all questions will be how to account for B2B transactions when sourcing and allocating a portion of the excess profits in a particular jurisdiction (imagine about components manufactured in different countries, assembled in another, stored in another, sold a distributor in another and then sold to customers in a number of them). Finally, (5) there are a number of purely procedural aspects which are complex to say the least.
3. **Minimum taxes**. As regards Pillar 2, clearly the biggest question is about the inclusion of income derived from genuine business activities on the ground (the pizzeria in Dubai or the hotel in Bermuda). Including “active income” in the scope of the minimum tax is a big move, with very interesting and potentially far-reaching consequences policy-wise. It will be interesting to see the reactions after the excitement-dust has settled, when it becomes clear that this has a direct impact on other countries tax systems and their ability to introduce tax incentives to influence economic behaviours. This is particularly relevant for developing countries that have tax free zones; as we have seen, Kennedy had already thought about that. But it is also relevant for countries that have introduced incentives such as patent boxes (whose “tax policy glory” may in any case be over now that the US has made its position on FDII clear, I cannot agree more with that), tax credits for 4.0 investments, plant renovations and other. Possibly even more relevant for policy makers is that it may well have an impact beyond corporate income tax, shifting the problem to a different field. First, harmful tax competition was tackled, with the focus on avoidance practices facilitated by countries’ tax systems; these systems were meant to attract only nominal profits without any material activity on the ground, and all the work that has been done since 1998, and fully revamped with BEPS in the last decade has closed loopholes and is now checking on countries’ implementation of their commitments, including the obligation to exchange rulings which in the past were secret. Now it is about tax competition itself:

introducing tax incentives to attract real investments and economic activity. This will be over with a biting global minimum tax. The risk is that as it is over for corporate income taxes, it shifts into property taxes, wage taxes, non-tax measures like interest-free financing, fast-track procedures and the like. Whether the fire of tax competition will be extinguished is to be seen.

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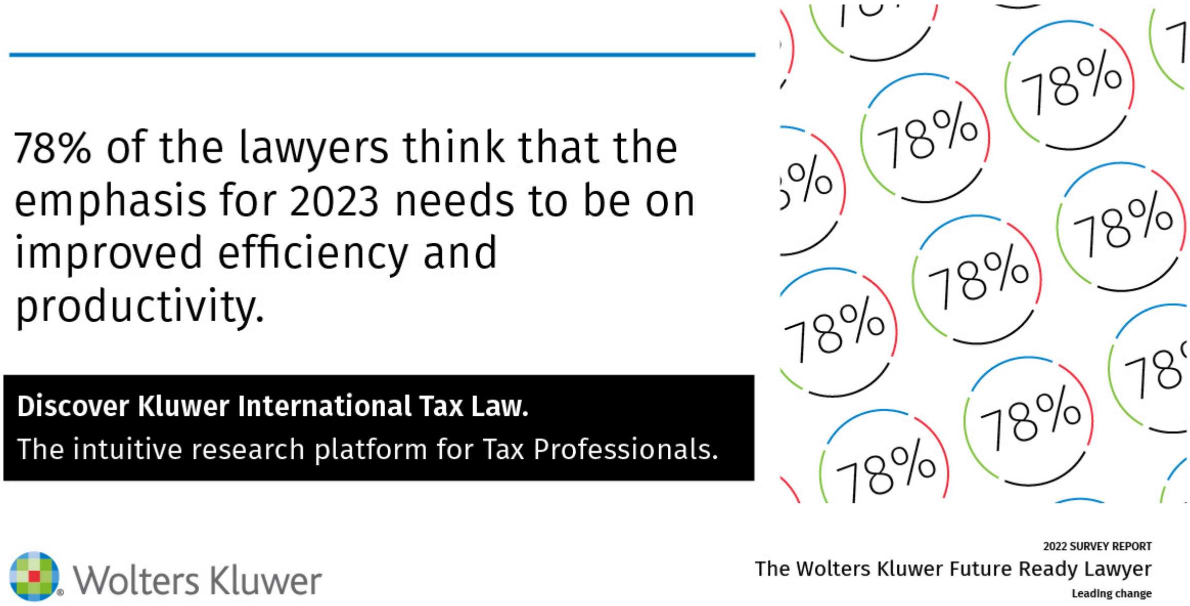

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