Following suit, European Commission publishes draft EU Directive to swiftly implement OECD 15 percent global minimum tax

Global Tax Reform Alert

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On December 22, 2021, only two days after the OECD published its model rules on the agreed Pillar 2 minimum tax, the European Commission has proposed a Directive “on ensuring a global minimum level of taxation for multinational groups in the Union.” The Directive will require all EU member states to implement the minimum tax rules accordingly.

The proposal delivers on the EU’s pledge to ensure swift and harmonized implementation of the historic international agreement on global tax reform, and to build on it so that corporate tax systems work in a fair and sound way.

In general, the Directive reflects the global OECD agreement with some adjustments which aim to guarantee conformity with EU law.

The timetable towards implementation envisaged by the Commission may raise a concern against the timetable contemplated by the OECD. The Commission proposes that the Directive be finalized by the mid-2022 and transposed into domestic law of the member states effective on 1 January 2023. The OECD envisages an explanatory Commentary to the Model Rules to be released in January or February 2022 and detailed implementation guidance to be released in late 2022 or early 2023. As a result, the EU Directive would be finalized before the final guidance from the OECD would
The proposed rules will apply to any large group, both domestic and international, including the financial sector, with combined financial revenues of more than €750 million a year, and with either a parent company or a subsidiary situated in an EU member state.

As indicated by the Commission itself, the implementation of the GloBE Model Rules in the EU could have implications for existing provisions of the EU Anti-tax Avoidance Directive (ATAD) and specifically for the Controlled Foreign Company (CFC) rules. The CFC rules implemented by the EU Member States may interact with the primary rule of Pillar 2 – the Income Inclusion Rule (IIR). According to a statement made by the Commission, it has explored how to best accommodate the interaction between the CFC rules and the IIR. The Commission concluded that it is not necessary to amend the ATAD in this regard. Moreover, the Commission is of the opinion that it is consistent with the OECD Model Rules to continue the application of the CFC rule in parallel to the GloBE Model Rules.

As to the practical application, the Directive stipulates that the ATAD CFC rules will apply first and any additional taxes paid by a parent company under a CFC regime in a given fiscal year will be taken into consideration in the GloBE Model Rules by attributing those to the relevant low-taxed entity for the purpose of computing its jurisdictional effective tax rate.

Under the Commission’s proposal, the calculation of the effective tax rate will be made by the ultimate parent entity of the group (unless the group assigns another entity) following what has been agreed upon at the international level. The effective tax rate is established per jurisdiction by dividing taxes paid by the entities in the jurisdiction by their income. If the effective tax rate for the entities in a particular jurisdiction is below 15 percent, the group must pay a top-up tax to bring its rate up to 15%.

While the scope of OECD Pillar Two is limited to multinational groups, and a parent entity subjects only its foreign subsidiaries to the income inclusion rule, the Commission’s proposal adjusts the scope of the international agreement to also include purely domestic groups.

In order to preserve sovereignty of member states, the Directive also adopts the concept of a domestic top-up tax. The domestic top-up tax allows the jurisdiction in which a low-taxed entity is resident to levy the top-up tax before application of the IIR at the level of the parent company. The domestic top-up tax is a concept that previously was not included in the original Blueprints from the OECD and jurisdictions appear to be allowed to opt into this possibility changing the ordering rule of the IIR.

The adoption of the proposal for a Directive requires unanimity by the EU member states in Council. By now, most EU member states have supported the international tax agreement hence it is expected that there will be little resistance against the proposed Directive. Additionally, the European Parliament and the European Economic and Social Committee will need to be consulted and give their opinion on the Directive as well.

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