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Hot Tax Topics for Multinational Groups in the United States, the European Union, and Beyond

Richard Sultman, Vania Petrella, Anne-Sophie Coustel, Jens Hafemann, Gianluca Russo, and Jason R. Factor*

In this article, the authors review a number of current tax issues of interest to multinational companies in the United States, the European Union, and elsewhere.

Impact of "Pillar Two" Global Minimum Taxation

The push for global tax reform continues to have a significant impact on large multinational groups. Since broad international consensus was reached through the Organisation for Economic Co-operation and Development (OECD) in 2021 on the principles of a "two-pillar solution" to tax challenges arising from the digitalization of the world economy, many of the countries that support the plan (of which there are now over 140) have rushed through legislation to implement the second pillar (a global minimum rate of effective taxation). Many of the new "Pillar Two" rules will accordingly apply for the first time this year, and companies should be sure they understand both the overall global impact and how local nuances create differences between jurisdictions.

Pillar Two aims at ensuring that large multinationals pay a minimum 15 percent effective tax on their worldwide income (as determined on a jurisdiction by jurisdiction basis), wherever they are headquartered or have their business operations. The rules will apply to multinational groups with €750 million or more in consolidated revenues, although not sovereign, nonprofit, or charitable entities, or pension, investment, and real estate funds. There is also an exclusion for international shipping income. Other limitations include a de minimis exclusion for jurisdictions where revenues and profits are low, and a substance carve out that excludes certain

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amounts of income based on the carrying value of tangible assets and payroll.

The main tool to achieve the minimum tax is a global anti-base erosion regime consisting of two components: an income inclusion rule (IIR) and an undertaxed payments rule (UTPR). The objective is for in-scope multinational groups to pay a top-up tax on the difference between the minimum 15 percent tax rate and their effective tax rate per jurisdiction, if lower. The IIR will generally charge the top-up tax in the jurisdiction of the ultimate parent company. The UTPR would function as a backstop if IIR rules do not pick up all of the group's low-taxed income—it would require adjustments (for example, by imposing new taxes or by denying deductions) to increase tax levels in subsidiary jurisdictions.

In many cases, these two rules will be supplemented by a locally enacted qualified domestic minimum top-up tax (QDMTT). A QDMTT is a domestic minimum tax that applies to local constituent entities of in-scope multinational groups, topping up local taxes to the globally agreed minimum effective 15 percent. The attraction of a QDMTT to a local jurisdiction is that it should allow that jurisdiction (rather than the parent company jurisdiction or another group company jurisdiction) to collect the relevant top-up tax in relation to the otherwise low-taxed local income.

Regarding implementation, a Pillar Two Directive required Member States of the European Union to transpose the global minimum tax rules into domestic law by December 31, 2023, with the IIR being effective on or after December 31, 2023, and the UTPR becoming effective on or after December 31, 2024. Most EU countries (including France, Germany, and Italy) enacted their implementing legislation within that time frame, as did the United Kingdom. France, Germany, Italy, and the United Kingdom also all enacted a QDMTT. Many other countries outside the European Union and the United Kingdom (including Australia, Canada, and Japan) have either enacted Pillar Two legislation or are in the process of enacting their legislation. Whether all the local rules will fit together remains to be seen, and many practical impacts of the new regime will continue to unfold in 2024 and beyond. Consequences could be significant—ranging from increases in tax (the OECD most recently estimated an increase in annual worldwide corporate income tax revenue of between $155 billion and $192 billion) and tax compliance, to commercial considerations and risk allocation for M&A transactions.

Certain major jurisdictions, like the United States and China, have not introduced their legislation, even though they signed up to Pillar Two. Particular challenges present themselves in the United States. The Biden administration has been one of the most forceful proponents of Pillar Two but 2021 ended with a failure to get Congress to enact the Build Back Better Act, which would have brought U.S. tax law into compliance with Pillar Two. Thus, the United States still applies international tax rules (known as Global Intangible Low-Taxed Income and Base Erosion and Anti-Abuse Tax) that are not in line with Pillar Two's IIR and UTPR. The practical implications of this mismatch remain unclear, but could result in U.S. multinationals being taxed multiple times on the same income, tax compliance burdens, and the need for structural changes or other tax planning to mitigate potential adverse effects.

The final component to note about Pillar Two is the subject to tax rule (STTR). The STTR is a new double tax treaty rule that will allow developing countries to deny treaty benefits in respect of interest, royalties, and certain other payments that are subject to corporate income tax at below nine percent in the recipient country, in effect creating a right to tax the difference. A model treaty provision to give effect to the STTR was published by the OECD in October 2023 for those countries that choose to implement it.

Large multinational groups should consult with their tax counsel for further details on Pillar Two as well as on Pillar One (a slower-moving OECD proposal for the reallocation of taxable income of large multinational businesses to customer jurisdictions, even if the business has no or minimal physical presence there).

International Cross-Border Tax Audits

In 2023, tax authorities continued the trend of conducting large-scale tax audits and cross-border proceedings across Europe, relying on broader access to information and new technological tools.

Exchange of Information/Anti-Avoidance Rules

The provisions of a new EU Directive referred to as "DAC7" impose new tax disclosure obligations on online platform operators (i.e., entities that contract with sellers to make an online marketplace available). DAC7 targets transactions implemented through online platforms and seeks to ensure efficient tracking of such transactions by requiring the platform operators to disclose personal and trade details of platform members (such as their name, country of residence, and identification number, if any). DAC7 became effective as of January 1, 2023. The first assessment of the findings under DAC7 should be available in the course of 2024 after tax authorities have processed the first batch of disclosures. Similar rules came into effect in the United Kingdom from January 1, 2024.

The Council of the European Union also adopted a "DAC8" Directive in October 2023, supplementing DAC7 and targeting transactions relating to crypto assets (not only including crypto currencies but also certain other tokens). This new Directive is expected to enter force as of January 1, 2026.

On top of these legislative advances, tax authorities have also benefited from more effective exchange of information between EU (and non-EU) countries. In addition to sharing of information, international tax collaborations have also taken the form of joint procedures in which local and foreign tax authorities have worked together to investigate cross-border tax planning schemes and arrangements. In some cases, this has led to foreign tax agents assisting in dawn raids launched by local authorities. Companies should expect this kind of cross-border cooperation to be more prevalent going forward.

Not all EU-level tax initiatives are having similar levels of success. The proposal for a third Anti-Tax Avoidance Directive, which was intended to combat the use of "shell" companies, still lacks consensus among Member States. The Business in Europe: Framework for Income Taxation proposal, which contemplates the introduction of a common system to compute the tax base of corporate groups across the European Union, is also facing difficulties.

Use of AI Tools for Data Processing

Tax authorities have made significant investments in AI tools in order to better analyze the voluminous amount of information obtained through the operation of automatic exchange of information rules, and to identify transactions for further investigation.

Dedicated teams specializing in data mining have been set up by tax authorities. As a result of such efforts, in certain jurisdictions, the targeting of tax audits has become predominantly driven by information obtained and processed through data mining. This can be expected to have a significant impact on future tax audit and reassessment trends.

The strengthening of tax enforcement in the European Union has also been coupled with more severe legal responses, including ad hoc penalties aimed at tackling specific behaviors (such as the enabling of tax evasion), and a wider criminalization of certain tax reassessments (such as reassessments following a failure to disclose facts, or the provision of misleading information, in relation to beneficial owners of income or gains).

Partnerships and Collaboration Between Taxpayers and Tax Authorities

Counterbalancing more severe audit and enforcement policies, several initiatives have been taken by tax authorities across Europe to offer more legal certainty to taxpayers. While each of these initiatives are country specific, there is a general trend toward a more collaborative approach with compliant taxpayers.

The most elaborate versions of such initiatives take the form of partnerships entered into by taxpayers and tax authorities. Under such partnerships, taxpayers that have demonstrated past compliance with tax rules and that commit to be transparent with the tax authorities on an ongoing basis may benefit from more direct access to the tax authorities, allowing them, in certain circumstances and under certain conditions, to discuss in advance with the tax authorities uncertain tax positions and agree on a reporting position that is protected from challenge.

Although these kinds of partnerships have generally been designed for larger groups, some jurisdictions have also implemented simplified versions for the benefit of small or medium-sized entities.

Lighter-touch versions of these initiatives provide benefits for cooperative taxpayers that include reinforcement of taxpayers' rights and the introduction of new remediation processes to correct mistakes or omissions.

Note

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