

G7 Finance Ministers back international tax reform (Pillar One and Pillar Two), including introducing a global minimum tax of at least 15%

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In this Update

- G7 Finance Ministers, including Minister Chrystia Freeland from Canada, commit to the principal design elements for Pillar One and Pillar Two.
- New taxing rights under Pillar One are proposed to be allocated to market jurisdictions (where customers are located) on at least 20% of profit exceeding a 10% margin for the “largest and most profitable multinational enterprises”.
- Appropriate coordination is to be provided between the application of the new international tax rules under Pillar One and the removal of all digital services taxes (DSTs), and other similar measures, on all companies (although Minister Freeland separately noted that Canada intends to proceed with plans to introduce a 3% DST effective January 1, 2022 as an interim measure).
- Global minimum tax rate under Pillar Two to be at least 15% on a country by country basis.
- This proposal will be advanced at the July meeting of the G20/OECD Inclusive Framework (comprising 139 countries). While the G7 agreement is important to the potential success of that meeting, many technical issues remain. In addition, developing countries may not be satisfied with the approach to Pillar One if it does not result in comparable tax revenue to DSTs, and countries like Ireland will likely resist any minimum tax rate in excess of 12.5% under Pillar Two.

G7 Finance Ministers Communique

On June 5, 2021, the Finance Ministers from the G7 group of leading economies – consisting of Canada, France, Germany, Italy, Japan, the United Kingdom, the United States and the European Union – released a [communique](#) committing to the principal design elements for the OECD’s two pillar approach for international tax reform. This includes a commitment to introduce a global minimum tax of at least 15% on a country by country basis.

Canada has been an active participant in the multi-year G20/OECD Inclusive Framework on Base Erosion and Profit Shifting (BEPS) project, which targets tax-planning strategies that shift profits to low tax jurisdictions. The BEPS reports released in 2015 were aimed at improving the coherence, substance and transparency of the international tax system. For more details on the BEPS reports, see our [BEPS Action Plan Summary](#). However, many countries' governments remained unsatisfied with the results of the BEPS project, and the OECD introduced a two-pillar approach to international tax reform in 2019 to address the digital economy (Pillar One) and unresolved BEPS issues (Pillar Two).

First, BEPS did not address the allocation of taxing rights between residence states and market or source states. This is what Pillar One is intended to address through granting more taxing rights to market jurisdictions where multinational corporations are providing digital and certain other consumer facing services to consumers.

Second, while BEPS focused on avoiding "stateless income", it did not address the ability for MNEs to add economic substance to investment hubs and other low tax jurisdictions. This is what Pillar Two is intended to address through the introduction of a global minimum tax with a substance-based carve-out for a fixed return on payroll costs and tangible assets.

For more details on the OECD's two-pillar approach to international tax reform, please see our [Osler Update](#) and [submission](#) to the OECD on the blueprint reports on Pillar One and Pillar Two.

Pillar One

With respect to the Pillar One proposals, the G7 Finance Ministers committed to allocating new taxing rights to market jurisdictions (where customers are located) on at least 20% of profit exceeding a 10% margin for the "largest and most profitable multinational enterprises". It is unclear at this stage whether the tax would be limited to only about 100 MNEs (as proposed by the United States) or whether it would apply more broadly to a larger number of companies.

While Pillar One is intended to replace the Canadian digital services tax (DST) announced in Budget 2021, Minister Freeland confirmed that Canada still intends to proceed with plans to introduce a 3% DST on revenue in excess of \$20 million from digital services that rely on the engagement, data and content contributions of Canadian users effective January 1, 2022, noting that the G7 countries committed to repeal such measures once the Pillar One proposals are in place. In this regard, the G7 Finance Ministers communique states: "We will provide for appropriate coordination between the application of the new international tax rules and the removal of all Digital Services Taxes, and other relevant similar measures, on all companies."

Budget 2021 states that the DST will apply as of January 1, 2022 "until an acceptable multilateral approach comes into effect" for the relevant businesses. Even if the G7 proposal is adopted by the G20/OECD Inclusive Framework in 2021, it could still be several years before such an approach is considered to "come into effect" – particularly since countries like the United States may encounter difficulties in passing the requisite legislation and tax treaty amendments domestically. For more details on the 3% DST proposed in Budget 2021, please see our [Osler Update](#) on Budget 2021.

Pillar Two

With respect to the Pillar Two proposals, the G7 Finance Ministers committed to introducing

a global minimum tax at a rate of at least 15% on a country by country basis. The country-by-country approach could restrict the ability of MNEs from being able to mix or blend income that is taxed at a higher rate in one country with income that is taxed at a lower rate in another country.

The Pillar Two proposals contemplate a top up to a minimum tax rate. If a MNE is not subject to the agreed upon minimum rate in a particular state, then another state would get the right to raise that tax to top it up to the minimum rate. According to the OECD, that right would generally be given to the jurisdiction where the MNE is headquartered.

Next Steps

The announcement from the G7 Finance Ministers follows numerous setbacks including political differences, technical design considerations and the COVID-19 pandemic. While many technical issues remain outstanding, the G20/OECD will be looking to find agreement among the G20/OECD Inclusive Framework (consisting of 139 countries) with a strategic meeting scheduled from June 30-July 1, 2021 in Paris. Key milestones to watch going forward also include the G20 meeting scheduled for July 9-10, 2021, and October 29-31, 2021.

If a consensus is reached in 2021, this could then start a years-long process of adopting new rules through domestic legislation and changes to tax treaties.

For more information on these international tax proposals, please contact any member of our [National Tax Group](#).