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TAX

OECD Global Minimum Taxation Rules and IP Regimes

5 MIN READ

The OECD Pillar Two Blueprint published on 12 October 2020 is aimed at addressing challenges relating to the taxation of the digital economy.

Curiously, the Pillar Two Blueprint appears to conflict with the position taken by the OECD in 2015 with respect to its final report on BEPS Action 5 and the use of special IP tax regimes, which recognised the importance of R&D as a key driver of growth.

A main element of Pillar Two is the global anti-base-erosion (**GLOBE**) measure, designed to ensure that multinational enterprises (MNEs) are subject to a minimum effective tax rate in each county in which they operate.

GLOBE rules

The GLOBE rules propose to introduce supplementary tax liabilities where a MNE's effective tax rate (**ETR**) in a given jurisdiction falls below a certain threshold. The OECD has recommended that the GLOBE rules only apply to MNEs with consolidated revenue in excess €750 million per year. That is the same threshold as the OECD transfer pricing county by country reporting rules. Simply put, it is proposed that the ETR will be calculated by dividing an MNE's 'covered taxes' by its income (subject to any allowable adjustments). For these purposes, covered taxes is broadly defined and means all taxes imposed on income or profits. If the ETR in a particular jurisdiction is below to minimum tax rate, a top-up tax equal to the shortfall is applied to the MNE's adjusted income in the relevant jurisdiction.

The GLOBE rules account for some tax incentives such as immediate expensing and accelerated depreciation of assets as well as government grants and tax credits. The Pillar Two Blueprint proposes options to prevent these incentives being nullified. However, the Pillar Two Blueprint does not make provision for substance-based IP regimes such as those that comply with BEPS Action 5. It appears that substance based IP tax incentive regimes may be negatively affected by the implementation of the GLOBE rules as currently proposed. This may have implications for R&D activity and innovation generally.

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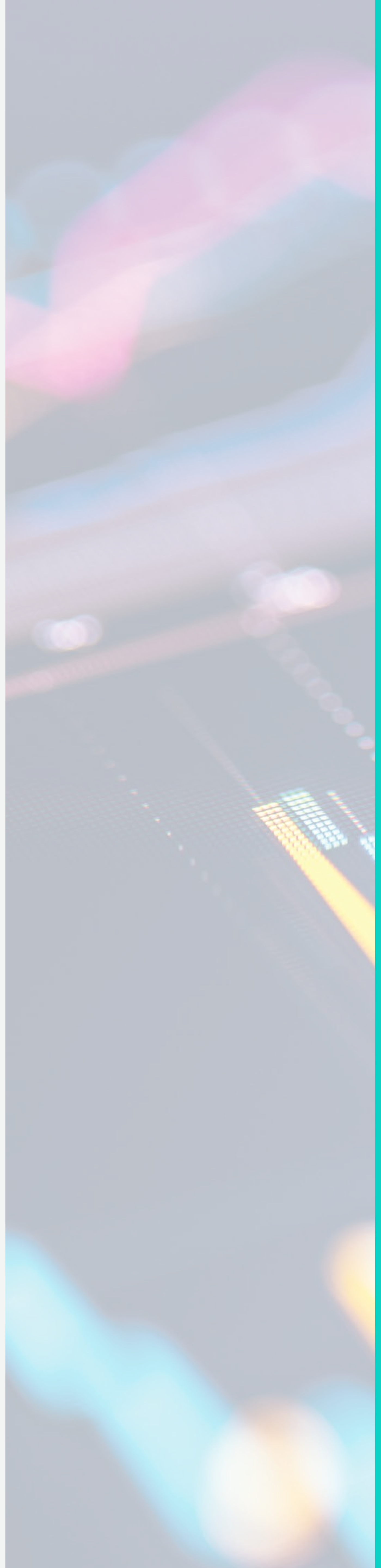

IP regimes

The OECD published its final report on Action 5, relating to the use of specified IP tax regimes, in October 2015. This report prescribes conditions for non-harmful, substance based, IP regimes. In the report, the OECD acknowledged that well-structured IP regimes are important drivers of innovation, growth and employment. Action 5 permits R&D tax incentives provided that they are granted in accordance with the principles agreed by the forum on harmful tax practices and is focussed on the nexus approach. This requires that R&D activities related to IP must have been undertaken in the country providing the incentive in order for it to be allowable.

Having such IP regimes that foster innovation by incentivising R&D ultimately leads to an increase in economic activity and as a result, increased tax revenue. In an Irish context, non-harmful R&D tax incentive regimes are particularly important, given the prevalence of multinational pharmaceutical companies performing R&D in Ireland. An example of an Irish BEPS Action 5 compliant R&D tax incentive is the knowledge development box (**KDB**) corporation tax relief. It was introduced in the Finance Act 2015 and recently extended through to 2023 by the Finance Act 2020.

Broadly speaking, the KDB is a regime for the taxation of income which arises from patents and copyrighted software. It is available to companies that carry out R&D in Ireland leading to the creation of copyrighted software or patents. A company that qualifies for the regime will be entitled to a deduction equal to 50% of its qualifying profits in computing the profits of its specified trade. Such profits are therefore taxed at an effective rate of 6.25% (50% of the 12.5% corporation tax rate).

The application of this preferential rate should decrease the amount of covered taxes for the purposes of the GLOBE rules which would in turn reduce the MNE's ETR. This may trigger an additional tax liability if the ETR falls below the specified minimum rate as a result of the relief. A consequence is that intended incentives from the KBD regime (as well as similar regimes in other EU and OECD signatory countries) could be fully or partially eliminated by the GLOBE rules.

Conclusion

The importance of R&D in the context of the pharmaceutical industry has been brought into sharp focus by the COVID-19 pandemic and the successful development of several vaccines to prevent the virus throughout the course of 2020. The GLOBE rules will be of significant concern to MNEs in the pharmaceutical industry as well as other R&D intensive industries and could possibly negatively affect R&D activity generally due to increased costs.

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