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INSIGHT: Subtle Shifts Seen in the OECD/Inclusive Framework's Program of Work on Digitalization

BY JEFFERSON VANDERWOLK

The OECD's Inclusive Framework on BEPS published its detailed program of work on digitalization in late May 2019.

The work plan, which has since been approved by the G20 leaders, has two ''pillars.'' Pillar One involves both allocation of a multinational's profits—giving additional taxing rights to market jurisdictions by reallocating profits in favor of the sales end of the value chain—and tax nexus, allowing countries to impose income tax on remote sellers' profits allocated to the country, regardless of physical presence. Pillar Two calls for a global minimum tax involving both residence-country taxation under an inclusion rule (such as a controlled foreign corporations regime) and source-country taxation under an anti-base erosion rule that would deny deductions or impose withholding tax in respect of certain outbound payments.

At a conference in Munich on June 28, 2019, sponsored by the Federation of German Industries (BDI), the OECD's Business and Industry Advisory Committee (BIAC), and the OECD itself, the keynote address was given by Pascal Saint-Amans, the director of the OECD Centre for Tax Policy and Administration. He spoke for over 45 minutes about the status of the program of work in the light of developments since its publication in late May.

A number of his remarks indicated that some of the lines drawn in the program document, and in its predecessors, namely the Policy Note issued in late January 2019 and the consultation document issued two weeks later, are being redrawn.

First, he said more than once that the new nexus test under Pillar One might be based on sales alone, with other factors ''possibly'' being taken into account. This differs from what is said in the program document, which states that the work on the new nexus rule will include:

''evaluation and development of indicators of an MNE group's remote but sustained and significant involvement in the economy of a market jurisdiction. This would require:

a. a sustained local revenue threshold (both monetary and temporal); and

b. a range of additional indicators which, in combination with sustained local revenues, would be taken to demonstrate *a link beyond mere selling* between those revenues and the MNE's interaction with the economy of a jurisdiction.'' (emphasis added)

Regarding profit allocation, Saint-Amans said that the formula to be agreed upon might also be ''sales-based.'' It is not clear what this means. All of the possible approaches to allocation described in the program document—modified residual profit split, fractional apportionment, and a distribution-based approach—involve an analysis of factors other than sales, such as costs, assets, or users of the seller's products or services.

Second, it appears that consensus among the 130 members of the Inclusive Framework will not be required in order for a proposed solution to be recommended to the G20 next year. It has always been tacitly understood that such a large number of sovereign nations will not all agree on the details of a new policy on taxing multinational corporate profits. Saint-Amans admitted as much, saying that consensus would be needed among ''significant'' countries, and that all groups of countries that are similar economically (e.g., smaller developed open economies) would need to be on board. Presumably this means that a group might have a minority of dissenting countries and still be considered to

be in support of the ''consensus'' solution. Cynics can be forgiven for doubting the genuineness of the repeated assertions that the members of the Inclusive Framework do their policy work ''on an equal footing.''

Of potential significance is the fact that Saint-Amans made no mention, in the course of his lengthy remarks, of the design scoping limitations that, according to the program document, would be explored with regard to Pillar One. Specifically, the program document states that the work on scope will include ''an evaluation of rules that could focus the scope of the [new] rules on businesses that are *of a type to which the rules should apply*.'' (emphasis added) Saint-Amans did, however, note that the final report on BEPS Action 1 (Tax Challenges of the Digital Economy) said that the digital economy cannot be ring-fenced, suggesting, perhaps, that any scope limitations will be minor.

He also did not mention the portion of the work program devoted to economic analysis and impact assessment of the Pillar One and Pillar Two proposals as well as the implementation of the BEPS Project recommendations. Rather, the focus appears to be on finding political agreement on the basic outlines of a mechanism to allocate more profits to market jurisdictions and allow those jurisdictions to impose corporate income tax on such profits regardless of whether the taxpayer is physically present in the jurisdiction.

With respect to Pillar Two, Martin Kreienbaum of the German Ministry of Finance spoke in an interview format with Professor Wolfgang Schoen of Munich's Max Planck Institute for Tax Law and Public Finance. He said, surprisingly, that it was possible that the anti-base erosion rule would apply to payments to unrelated parties as well as payments to related parties resident outside the jurisdiction of the payor. The program document, in contrast, clearly indicates that only related-party payments would be within the scope of the proposed anti-base erosion rule.

Multinationals would be wise to monitor the public statements of tax policy officials during the coming months, as the contours of the proposals under both Pillar One and Pillar Two appear to be evolving. The program of work presented to the G20 leaders in June may already be out of date in some respects, as noted above.

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