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INSIGHT: Next Steps in the OECD/Inclusive Framework's Digitalization Project



BY JEFFERSON VANDERWOLK

The OECD's Inclusive Framework on BEPS is continuing with its program of work on the tax challenges of digitalization. The work plan, which was published in May this year and approved by the G20 leaders in June, has two distinct parts known to the international tax community as Pillar One and Pillar Two (readers steeped in the works of Dr. Seuss may be reminded of the havoc-wreaking Thing One and Thing Two of "The Cat in the Hat").

Pillar One calls for the creation of a new taxing right involving reallocation of part of a multinational's profits to market countries, plus local income taxation of the allocated amount, regardless of whether the multinational has a local physical presence or agent. Pillar Two is a global minimum tax proposal that includes residence-country taxation via an inclusion rule (such as the U.S. GILTI regime) and source-country taxation under an anti-base erosion rule that would deny deductions or impose withholding tax in respect of outbound payments to a low-taxed recipient.

Pascal Saint-Amans, the director of the Organization for Economic Cooperation and Development (OECD) Center for Tax Policy and Administration, has said in recent press interviews that the next step in the process will be the issuance of a public consultation document in early October. This follows a summer spent working behind the scenes on a unified approach to the Pillar One issues. The consultation document is expected to outline the proposed unified approach and ask for comments on a number of issues raised by the proposal. It will most likely also discuss the status of the work on Pillar Two and request comments on issues related to it.

The comment period is expected to be limited to no more than six weeks, as a public consultation meeting

has been scheduled at the OECD Conference Center in Paris for a date in late November. Companies and business groups wishing to submit written comments and speak at the meeting need to start thinking about what questions are likely to be asked and what input will be most helpful.

Regarding Pillar One, several important issues were flagged in comments by OECD officials and government representatives from the U.S., Singapore, and Colombia during a panel session at the IFA Congress in London on Sept. 11, 2019. One issue is the scope of the new taxing right: will it apply to all multinational businesses, or only a subset? It was suggested during the IFA panel that only "consumer-facing" businesses should be in scope, but no details were given as to the exact contours of that phrase. It was also suggested that only large businesses with unusually high profit margins should be affected by the new rules. Those concepts may be the subject of specific requests for comment in the upcoming consultation document.

Another issue being considered is whether to apply the new rules to controlled groups in their entirety or to particular business lines within a corporate group. A related question is whether, and how, consolidated financial accounting information can be used in determining relevant numerical thresholds such as revenue and operating profit margins.

The Inclusive Framework's steering group is aiming to develop a formula-based method of determining the amount of market-linked profit to be allocated among the jurisdictions where a multinational business has customers or other users of its products or services. Therefore, the consultation document is likely to ask for input on what the elements of the formula should be, and how they should be weighted. Local sales revenue is expected to be one factor in any allocation formula,

but other factors, such as expenditure on marketing targeted toward a country, may also be suggested. Comments may also be requested on how to determine the market country in which particular sales revenue is derived, given the variety of different structures used by different multinationals to sell their products and services around the world.

In addition, the consultation paper will probably ask for input on how to determine which entities in a controlled group should be treated as having earned the reallocated profits for tax purposes, and which entities in the group should be viewed as “surrendering” the reallocated profits.

Regarding the Pillar Two minimum tax regime, the speakers at the IFA panel in London indicated that policymakers were leaning toward using single, globally consistent effective tax rate test to determine what is low-taxed and what is not. This raises difficult questions about which rules should be used to compute the relevant tax base, and whether the effective rate calculation should be done on a country-by-country basis or a foreign-pooling basis that blends the income earned and taxes paid in all of the different countries where a group does business. Input will most likely be requested on this.

Another set of Pillar Two issues that the consultation document will probably ask about relate to the coordi-

nation of the income-inclusion rule (which results in tax in the group’s home country) with the base-eroding payments rule (which results in tax in source countries). Policymakers who believe that their country’s tax base is being improperly eroded by multinational groups resident elsewhere are unlikely to support the idea of giving primacy to the income-inclusion rule. The coordination of these rules is an important issue that, up to now, has received little attention in public discussions of the OECD’s work.

Finally, it is likely that the consultation document will highlight the need for effective mechanisms to prevent double taxation and to resolve any double taxation problems that do arise as a result of these new rules (both Pillar One and Pillar Two rules). Stakeholders will most likely be asked for input on what works in practice, what doesn’t work, and what could be effective approaches going forward. Tax treaty changes will need to be considered in this context, along with the use of administrative practices such as transfer pricing safe harbors and multilateral advanced pricing agreements.

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