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INSIGHT: What to Expect in 2020 From the OECD on Pillars One and Two

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The actions of the Organization for Economic Cooperation and Development's (OECD's) Inclusive Framework on Base Erosion and Profit Shifting (BEPS) over the past 11 months have ensured that 2019 will be remembered by international tax professionals as a truly historic year.

Let's do a quick high-level recap. In January, a so-called ''policy note'' was issued that set forth a two-part plan for the Inclusive Framework's work on the tax challenges of the digitalizing economy: The first part, Pillar One, would address tax nexus and profit allocation issues by departing from established principles of physical presence and arm's-length pricing, while the second part, Pillar Two, would focus on the design of a global minimum tax regime that could be implemented by all of the Inclusive Framework's member countries. A public discussion draft followed in February. Stakeholder comments were published in March. The Inclusive Framework then published its detailed program of work on digitalization in May, and the two-pillar program was approved by the G20 leaders in June.

During the summer, the OECD Secretariat drafted a proposed ''unified approach'' to the nexus and profit allocation issues of Pillar One. This proposal was unveiled in October, in a public consultation paper. Over 400 stakeholder comments were submitted within a three-week comment period. During that period, in early November, a public consultation paper on aspects of Pillar Two was issued, with a similarly short comment period.

(Sidebar: Also during the summer, the French government enacted a digital services tax that affects mostly U.S.-based multinational groups. The U.S. Trade Representative immediately announced that he would consider retaliatory action in the form of tariffs on French imports into the U.S. At the G7 meeting in Biarritz in late August, U.S. President Donald Trump and French President Emmanuel Macron announced that they had made a deal: If the OECD-led multilateral work produced a consensus solution, France would refund what it had collected from digital services tax [DST] payers, and the U.S. would hold off on considering retaliatory tariffs for at least 90 days.)

Following a public consultation meeting in Paris on Pillar One in late November, the viability of the proposed unified approach was thrown into doubt when, in early December, U.S. Treasury Secretary Steven Mnuchin sent a letter to the OECD secretary-general expressing misgivings about the proposal's mandatory departures from established international tax principles and stating that the U.S. would prefer a ''safe-harbor approach'' (meaning an elective approach) to new nexus and profit allocation rules. At about the same time, the U.S. Trade Representative announced that he was restarting his consideration of retaliatory tariffs on French goods. French Finance Minister Bruno Le Maire expressed outrage, and the OECD secretary-general invited Secretary Mnuchin to a meeting in Paris with himself and Monsieur Le Maire. Mnuchin said he might be able to do it in January.

Finally, a public consultation meeting on aspects of Pillar Two was held in Paris in December.

What can we expect during the next twelve months?

First and foremost, the political negotiations over Pillar One issues will continue. The U.S. will need to explain to the rest of the Inclusive Framework what exactly it has in mind and why it makes sense to allow taxpayers to choose whether or not they wish to be subject to the new rules (whatever they may ultimately be) on nexus and allocation of profits. Countries such as France will want to ensure that the Pillar One agree-

ment covers multinationals that are subject to their domestic DST laws; otherwise, those countries will not agree to repeal their DSTs, which is one of the primary goals of the Inclusive Framework's project. The negotiations will not take place in public, but as in any political process, one can expect a certain amount of strategic leaking of selected information.

The discussions will most likely go on for several months, into the second half of 2020. Even if some type of agreement is reached on the optionality issue, a host of other important design issues will need to be dealt with. These include the scope of the new nexus and allocation rules, the determination of the profits to be reallocated to market jurisdictions, the method of identifying the jurisdictions from which those profits will be taken, and, perhaps most importantly, the mandatory binding dispute resolution processes that will be agreed to. In addition, many developing countries will insist that the Pillar One regime include new rules requiring local reporting of a fixed taxable return on routine distribution activities (Amount B, in the proposed unified approach).

Second, the parallel work stream focused on Pillar Two will also continue; however, contrary to expectations that no political negotiations on the design of the global minimum tax regime would be needed beyond finding agreement on the minimum rate, it appears likely that the Inclusive Framework will have to grapple with differences of opinion on how the proposed income-inclusion and undertaxed-payments rules should interact. Developing countries want the undertaxed-payments rule to take precedence, whereas developed countries will favor making the income-inclusion rule the primary one. This fundamental question will need to be resolved somehow if the Pillar Two work is to mean anything other than an exploration of the different types of anti-base erosion measures that countries are free to adopt if they wish.

As with Pillar One, many important design features in Pillar Two are currently unfinished, so there will be plenty of technical work to do after the necessary political accord is reached. At some point during the first half of 2020 it is likely that a public consultation paper will be issued, requesting comments on issues relating to the undertaxed-payments rule and perhaps other elements of Pillar Two as well. Multinationals will be well advised to engage with policy makers on these issues. Many of the comments made by business representatives on the 2019 consultation papers appear to have been influential. The OECD, which in the past did its tax policy work without the benefit of much input from the multinational business community, has become more interested in listening to taxpayers' suggestions.

Third, we can expect to see more unilateral DSTs being proposed or enacted during 2020. The U.K., Spain, and Italy have DSTs ready to go; Canada is looking at a DST; and even U.S. presidential candidates are floating DST-like ideas. The Trump administration will most likely react as it did to the French DST in 2019, but many observers believe that the U.S. would have difficulty justifying the imposition of retaliatory tariffs on most, if not all, of its major trading partners simply because of DSTs. This activity will maintain the importance of the Inclusive Framework's efforts to find a solution that will include explicit agreement to refrain from imposing unilateral DSTs.

Will that solution be found and agreed to by the end of 2020? As the great 20th century American philosopher Yogi Berra once said, ''It's tough to make predictions—especially about the future.'' I'll go out on a limb and say that I expect to be writing in December 2020 about whether or not the solution will be found in 2021.

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