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INSIGHT: OECD/Inclusive Framework—Pillar 1 Impasse Puts the Spotlight on Pillar 2

BY JEFFERSON VANDERWOLK

On June 12, 2020, Secretary of the Treasury Stephen Mnuchin wrote a two-page letter to the finance ministers of France, Italy, Spain, and the United Kingdom, stating that negotiations on Pillar 1 of the OECD/ Inclusive Framework's program of work on the tax challenges of digitalization were ''at an impasse'' and calling for a pause in the discussion of Pillar 1 issues. As many readers will know, Pillar 1 relates to proposals to enlarge the taxing rights of market jurisdictions with respect to the profits of multinational corporations making sales to customers in those jurisdictions.

Mnuchin was responding to the four finance ministers' ''joint proposal for a phased implementation of Pillar 1'' rules. Although the details of that proposal have not been made public, observers understand that the proposal involved a first-phase set of rules that would have applied only to large multinationals that provide ''automated digital services.'' A disproportionate number of such companies are based in the U.SSecretary Mnuchin pointed out that the US has consistently opposed proposals to impose heavier taxes on digital businesses and is adhering to that position in rejecting the Europeans' proposed phase-in of Pillar 1 rules.

He also referred to the likelihood of ''appropriate commensurate measures'' by the US against countries that adopt unilateral digital services taxes, such as those enacted in France, Italy, Spain, and the U.K. The U.S. Trade Representative (USTR) investigated the French tax last year and recommended the imposition of tariffs on certain imports of French goods into the U.S. Earlier this month, the USTR announced new investigations involving taxes in a number of other countries.

Mnuchin's letter was strongly criticized by the French finance minister, Bruno Le Maire, who called it a ''provocation'' and asserted that France would collect its digital services tax from American companies regardless of the threatened retaliation. The reaction of the OECD Secretary-General, Angel Gurria, was more muted. He avoided any specific reference to either Mnuchin's letter or Pillar 1 and said simply that all member countries of the Inclusive Framework should continue to be engaged in working on the tax challenges of digitalization.

The multilateral talks are in fact continuing, but it seems safe to say that Pillar 1 will not be on the agenda for at least the next few months, unless the Europeans come up with a new proposal that does not target digital services. What will move up to the top of the agenda is Pillar 2, also known as the global anti-base erosion (GloBE) proposal. Mnuchin's letter noted that the U.S ''fully supports'' the goal of reaching agreement on Pillar 2 before the end of this year.

Pillar 2 has a peculiar history. Unlike the various approaches to the tax challenges of digitalization that resulted in the current Pillar 1 proposals, Pillar 2 does not attempt to reallocate taxing rights over multinational business profits in favor of market jurisdictions, nor does it have anything to do with digitalized business models. It is, rather, a global minimum tax proposal, along the lines of the U.S.'s global intangible low-taxed income (GILTI) rules, but with an added dimension involving minimum taxation in source countries for outbound deductible payments to low-taxed affiliates offshore.

Pillar 2 was introduced into the Inclusive Framework's discussions on tax and digitalization in mid-2018 by France and Germany. At the time, two alternative approaches were being discussed. One, championed by the UK, took a narrow view of the digitalization issues and would have limited the Pillar 1 rules to social media, online marketplaces, and sales of data. The other, led by the U.S., was much broader, encompassing profits attributable to marketing intangibles of multinationals in all industries. The French and German governments, which were (and still are) under political pressure to do something about perceived multinational corporate tax avoidance above and beyond what had already been done in the BEPS Project, added the GloBE proposal to the Inclusive Framework's to-do list, saying that it was necessary to ensure that base erosion and profit shifting could not continue.

Pillar 2 was enshrined in the Inclusive Framework's program of work on digitalization in 2019, along with Pillar 1. The latter has received most of the attention of stakeholders up to now, as it involves radical departures from well-established norms of international taxation, and it also had (in 2019) alternative approaches that needed to be reconciled. Pillar 2, on the other hand, has generated relatively little discussion among stakeholders. One reason for this is that stakeholders have been given little in the way of detailed information on the proposed Pillar 2 regime. Only one public consultation has been held on Pillar 2 issues, and it was both rushed (just before the 2019 end-of-year holidays) and limited in scope. More recently, the OECD has devoted very little time in its Tax Talks webcasts to the ongoing work on Pillar 2. We are told that progress is being made but that many issues remain unresolved.

Now that the current Pillar 1 proposal is off the table, one wonders whether Pillar 2 will become the sole focus of the multilateral tax policy project. The U.S. has signaled its willingness to make an agreement on Pillar 2 alone, and presumably the French and the Germans would also be willing. An agreement on Pillar 2 would be hailed as an achievement of multilateralism, but would do nothing to resolve the conflict between the U.S. and countries that have enacted digital services taxes. Perhaps this will be the most that the Inclusive Framework can achieve.

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