Bloomberg Tax

bloombergindustry.com

INSIGHT: The OECD's Draft Blueprints For Pillars 1 and 2—Rube Goldberg Lives On

BY JEFFERSON VANDERWOLK

In the world of international tax policy, we now have two new Rube Goldberg machines: the OECD's draft ''blueprints'' for Pillars 1 and 2 of the program of work undertaken by the OECD-led, 137-member Inclusive Framework on Base Erosion and Profit Shifting.

The Merriam-Webster Dictionary defines a Rube Goldberg machine as an invention that ''accomplishes by complex means what seemingly could be done simply.'' The concept is named after the American cartoonist Rube Goldberg, who devised delightfully silly contraptions.

Unfortunately, the OECD's draft blueprints are not delightfully silly cartoons, but rather depressingly mind-numbing reports that are hundreds of pages long. The hardworking and talented staff of the OECD Centre for Tax Policy and Administration should not be blamed for the length and complexity—they receive their marching orders from superiors who answer in turn to political masters in different countries with different tax policy priorities. In a multilateral process, the technicians will be asked to come up with proposals that have a chance of being acceptable to everyone, and it should not be surprising if the resulting proposals involve contortions and complications.

As many readers will know, the Pillar 1 blueprint relates to the reallocation of non-routine multinational business profits in favor of market countries, while the Pillar 2 blueprint is for a global minimum tax regime to ensure that a certain level of income tax is paid, somewhere, on all of a multinational's profits each year.

The drafts, which have not been made public but have leaked out, will be considered by the Inclusive Framework (IF) during the next few weeks. The expectation is that the IF will adopt them without substantial changes (but perhaps ''without prejudice'' and with significant reservations) and send them to the G-20 finance ministers in mid-October of this year.

Each of the draft blueprints outlines proposals that are lengthy and complicated, raising a plethora of interpretive issues that taxpayers, tax administrators, and courts would be forced to grapple with if the proposals were ever enacted into law. The sheer volume of detail may inhibit a sharper focus on the key political/policy issues that must be resolved before achieving consensus. The draft blueprints leave many issues open for future resolution, creating the possibility—some would say the likelihood—that countries will ultimately enact a variety of laws that are based on the architecture of the blueprints but that differ in important ways.

The draft blueprints are like Rube Goldberg machines in that they are not only incredibly complex but also seem to be far more complex than necessary to achieve their goals (although the goals themselves have never been clearly defined).

One of the goals of Pillar 1 is to ensure that a given country is able to tax nonresident businesses that derive a substantial amount of revenue, via online transactions, from customers located in that country despite having no offices or other physical presence in the country. As the OECD's final report on BEPS Action 1 pointed out back in 2015, one way to achieve this goal is simply to subject the relevant transactions to consumption tax. This is a straightforward solution to the perceived problem, and has already been implemented in many jurisdictions, with cooperation from business. Notably, the U.S. Supreme Court in the Wayfair case acknowledged the right of the U.S. states to impose lo-

cal sales tax (as opposed to income tax) on internet sales to in-state buyers by nonresident sellers having no physical presence in the state.

The Pillar 1 blueprint, in contrast, relates only to corporate income tax. It would give market countries an expanded right to tax certain nonresident businesses (that have not obtained political carve-outs) by providing for a formulaic reallocation of a portion of the nonroutine global profits of a multinational group among the countries where the group has customers (or nonpaying users of the group's services, in the case of groups that make their money through the sale of advertising space). This reallocation does not appear to be based on any principle of income taxation. Rather, it is explicitly acknowledged to be a purely political matter, to be dealt with through negotiations between competing sovereign powers, each of which is primarily interested in maximizing its economic strength and carving out its national champions.

The goal of Pillar 2 is to make sure that multinational businesses are subject to a certain level of income tax on all of their profits each year. Leaving aside the important question of whether this goal is sensible or realistic in a world of sovereign nations, one might well ask: why does this need to be complicated? A simple approach could have just three steps: (1) an annual computation, using a commonly agreed methodology, of a group's global effective tax rate (before taking loss carryforwards or carrybacks into account); (2) a comparison of that rate with the agreed minimum rate; and (3) if the group's rate is too low, a commensurate topping up of the tax payable by the group, allocated pro rata among the countries where the group pays tax.

Instead, the draft Pillar 2 blueprint fills 252 pages with an extensive array of proposed rules, including some that could disrupt the existing financial reporting standards that enable our connected economies, but the draft is far from complete. Indeed, even the proposed minimum rate is left blank, due to the fact that the entire exercise is political in nature, rather than being grounded in principle.

The Rube Goldberg-like complexity of the blueprints is a problem, not only because the proposed rules would create a massive administrative burden for all involved, but also because the complexity serves to mask the fact that the blueprints are not founded on neutral principles. The Inclusive Framework process is clearly being driven by politics, pure and simple.

Recognizing this fact, it is worth remembering that politics is the art of compromise, and that one of the things that many countries want is simpler tax rules that encourage rather than discourage investment, economic growth, and employment. Certainly, the taxpayers—i.e., multinational businesses—want clearer, more consistent, and more stable tax rules around the world. Governments do, too. Given the nature of net income taxation, a certain amount of complexity may be unavoidable. But Rube Goldberg machines are not what is wanted, or needed.

This column does not necessarily reflect the opinion of The Bureau of National Affairs, Inc. or its owners.

Author Information

Jeff VanderWolk is a partner at Squire Patton Boggs (US) LLP in Washington.