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OECD Digitalization Project: Now Is the Time for Business to Engage

BY JEFFERSON VANDERWOLK

The OECD's Inclusive Framework on BEPS announced on Oct. 12, 2020 that it will pursue its work plan on the tax challenges of digitalization until at least the middle of 2021 and probably beyond. The work plan, which was reconfirmed by the G20 finance ministers on Oct. 14, 2020, has two distinct parts or ''pillars''. Pillar One calls for the creation of a new taxing right involving reallocation of part of a multinational's profits to market countries, and expanded taxing powers for those countries at the expense of countries where production occurs. Pillar Two is a global minimum tax proposal for large multinationals.

Two ''blueprints'' of the pillars were published on 12 Oct. 2020, each more than 200 pages in length. The 137 members of the Inclusive Framework have not yet agreed on all elements of the plans; hence the need to continue discussing them in 2021.

The stakes for multinational businesses are high. In particular, Pillar Two would create an elaborate new system of tax rules applicable to all multinationals with annual global sales revenue in excess of a stated threshold (750 million euros in the current draft blueprint). These rules would aim to ensure that a certain minimum effective tax rate was paid on all of the group's global income. The minimum effective rate has not yet been agreed upon, but many believe that it will be at least 12.5%.

Even if this new regime did not result in a significant increase in tax payable by a given multinational group, the cost of simply determining how the Pillar Two rules apply to the group's operations and entities everywhere that it does business would be substantial, and painful. Pillar One would add another complex set of rules for groups within the scope of its allocation rules, plus additional new rules for the taxation of marketing and distribution activities in all industries. The business community has every reason to be concerned about the outcome of this process, and to do whatever is possible to try to influence the outcome.

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An additional risk factor for businesses operating in Europe is the possibility of new tax measures to be initiated by the European Commission. EU officials have repeatedly stated that, if an agreement is not reached by the Inclusive Framework, the EU will move on its own to propose within the first half of 2021 rules similar to the Pillar One and Pillar Two proposals for all EU member states. In addition, France has announced its intention to reinstate its digital services tax by year end 2020, a move that could deepen existing transatlantic trade tensions.

A further tax risk for multinational business lies in Africa. Recently, the African Tax Administration Forum (ATAF) published a policy paper titled ''Suggested Approach to Drafting Digital Services Tax Legislation,'' encouraging African countries to consider proceeding unilaterally with such taxes, regardless of the multilateral Inclusive Framework process. Kenya has already passed one and other African countries may follow its lead.

The messaging from all of these organizations—the OECD/Inclusive Framework, the EU, and ATAF—reflects the increasingly political nature of the international tax policy discussion. The OECD documents make reference to multinationals' ''fair share'' of taxes, a common phrase in political campaigns but not one that is expected from an international organization dedicated to encouraging cross-border trade and investment. Both EU and ATAF officials have claimed, with-

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out citing supporting evidence, that digital multinationals currently pay less than non-digital businesses and therefore should be targeted by new digital services taxes. The fact that online services have proven to be an extremely important feature of the global economy during the past several months is cited, oddly, as a reason for taxing them more heavily, on the assumption that digital businesses are making large profits as a result.

This is odd because, under normal tax policy principles, heavier taxation should be aimed at activities that cause harm to society, e.g. through environmental degradation or harm to human health. In contrast, as the OECD itself puts it, ''digital transformation spurs innovation, generates efficiencies, and improves services while boosting more inclusive and sustainable growth and enhancing well-being.''

Another aspect of the Pillar One and Pillar Two proposals, as presented in the recent launch of the draft blueprints, that departs from the OECD's earlier policies, yet is now being expressly acknowledged, is that the proposals are as much about how much tax should be paid as about where tax should be paid. In the BEPS project, the OECD and G20 clearly avoided any recommendations about tax rates, either nominal or effective. Rather, the goal of the project was to ensure that the reporting of taxable profits in a jurisdiction was aligned with the amount of business substance that the taxpayer had in that jurisdiction. Now, with respect to Pillar Two in particular, we are told that a global minimum tax regime is needed ''to address remaining BEPS challenges.'' No explanation is given regarding the fact that a low effective tax rate per se was never identified as a BEPS challenge in the list of 15 actions required to address BEPS challenges.

The next step in the Inclusive Framework's process is a public consultation on the blueprints. A consultation document was issued along with the draft blueprints, requesting written comments on a number of issues that remain to be discussed by the Framework's members. Comments may also address other aspects of the proposals.

The comment period will last from mid-October until Dec. 14, 2020, and a public consultation meeting will take place in January 2021. Companies and business groups would be well advised to take advantage of the opportunity to submit written comments and speak at the meeting.

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