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OECD Statement on Pillars One and Two Leaves Many Questions Unanswered

BY JEFFERSON VANDERWOLK

The OECD/G20 Inclusive Framework on BEPS moved its global tax policy process another step forward on Oct. 8, 2021, when the group issued a revised statement outlining the Pillar One and Pillar Two plans that have been in development for almost three years. The statement has two parts. The first part is a five-page summary that is identical to the group's statement of July 1, 2021, save for a handful of changes. The second part is a three-page discussion of the group's vision for the implementation of the new tax rules once they have been finally determined.

In brief, the changes from the July 1 statement are limited to the following:

- An averaging mechanism (unspecified) will be used to determine the 20 billion euros ($23.1 billion) revenue threshold and the 10% profit margin threshold regarding the scope of the Amount A rules.
- The quantum of an MNE's excess profits to be reallocated as Amount A will be 25%.
- Certain countries with very few MAP cases will be allowed to use an elective binding dispute resolution process rather than the mandatory binding dispute resolution process that other countries must use.
- The rollback of digital services taxes and other relevant unilateral measures has been slightly clarified. New taxes of this kind cannot be enacted after Oct. 8, 2021, and the taxes must be repealed with respect to all companies, not just those within the scope of the Amount A rules.

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- On Pillar Two, the global minimum tax rate will be 15% (note that this is an effective rate, not a nominal rate).
- Certain MNEs will not be subject to the undertaxed payment rule for the first five years after meeting the 750 million euros ($866 million) revenue threshold if their foreign tangible assets do not exceed 50 million euros ($57.7 million) and they operate in no more than five foreign countries.
- The substance-based carve-out of income from the Pillar Two rules will exempt, in the first year, 8% of the carrying value of tangible assets and 10% of payroll. These percentages will decline by 0.2% each year for the next five years, and by 0.4% (for tangible assets) and 0.8% (for payroll) each year for the subsequent five years, after which the exemption will be 5% of both tangible assets and payroll.
- A de minimis carveout will exclude profits from countries where the MNE has less than 10 million euros ($11.6 million) of revenue and less than 1 million euros of profits.
- The minimum rate of tax for the purposes of the subject to tax rule will be 9%.

Another change from July is that the October statement has the support of 136 of the 140 jurisdictions in the Inclusive Framework. The three EU member states that were previously holding out—Estonia, Hungary, and Ireland—decided to join the majority after certain changes were made to address their concerns about the global minimum tax. This may allow the EU to implement the new rules in due course fairly smoothly, unless Cyprus, an EU member state that is not in the Inclusive Framework, obstructs the EU-wide implementation process. The non-participation of the four dissenters in the Inclusive Framework—Kenya, Nigeria,

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Pakistan, and Sri Lanka—does not appear to be likely to cause any significant problem with the near-global rollout of the plans, and therefore their refusal to agree will not stop the process.

The U.S. might ultimately face implementation problems due to the apparent need for Senate approval, on a bipartisan basis, of a new multilateral tax convention that would override the existing bilateral tax treaties of the signatory countries in certain respects. Even if the Biden administration and the Democratic leadership in Congress were able to devise a method of implementing the new rules without any Republican support, it is not clear that all Democrats in Congress would support implementation if the deal appeared to be a revenue loser for the U.S.

The October statement leaves many important questions unanswered, including:

- How will revenue be sourced to a particular market country?
- How will financial statement information be adjusted to determine the tax base for purposes of the Pillar One and Pillar Two rules?
- Which group entities will be treated as giving up the profits that are reallocated as Amount A, and how will the surrendered amounts be determined?
- Will the U.S. GILTI regime be considered a good Income Inclusion Rule for Amount A purposes if it is not amended to be exactly like the OECD's future model rule?
- What will the promised Amount A safe harbor for marketing and distribution activities look like?
- What are the definitions of ''extractives'' and ''regulated financial services'' for purposes of the scope of the Amount A rules?
- What will the Amount B rules on marketing and distribution be?
- How will the undertaxed payment rule and the subject to tax rule work, exactly? What kinds of administrative simplifications for Pillar Two will be available? How will the dispute resolution mechanism work in practice?

As noted, the statement says that existing digital services taxes (DSTs) and ''other relevant similar measures'' must be repealed, and new ones cannot be enacted from now on. The timing of the repeal commitment is not entirely clear, however. The statement asserts only that ''the modality for the removal'' of the taxes ''will be appropriately coordinated.'' The statement refers to a planned multilateral convention for the implementation of the Amount A nexus and reallocation rules, and says that the specific unilateral measures that must be repealed will be listed in that document.

The three-page implementation plan at the end of the statement suggests that we should expect to see draft model rules and commentary for the global minimum tax regime by the end of next month, i.e. November 2021, and draft model provisions relating to the subject to tax rule by mid-2022. In addition, a mid-2022 deadline is provided for the signing of the contemplated multilateral convention on the Amount A regime, with a view to bringing the new rules into effect around the world in 2023. Time will tell whether these ambitious implementation goals can be achieved.

Finally, consultation with stakeholders on the development of the new rules is promised, but no specific commitment is given in this regard.

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