Overview of the OECD Two-pillar Solution to Taxation of the Digitalised Economy

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Outline

- The problem
- History of the solution development
- Where are we now.
Introduction

- Dissatisfaction with existing rules allocation taxing rights.
- Rules developed as far back as the 1920’s.
- Pre-digital economy issue e.g PE Exemptions and international shipping, exploration, insurance and other specialised businesses.
- Issues with unilateral measures introduced by countries.
Major Issues identified

- Shortcomings of nexus and profit attribution i.e. physical presence and ALP
- Limitations of BEPS 1.0 on taxing rights issue
- Value creation from user participation
- Race to the bottom to attract investment.
OECD/G20 Inclusive Framework promised to address some of the legitimate grievances of the developing world regarding the systemic shortcomings in the current rules and deliver fairer and more coherent outcomes from cross-border trade and investment.
<table>
<thead>
<tr>
<th>Year</th>
<th>Event</th>
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<tbody>
<tr>
<td>2013</td>
<td>G20 endorsed work by OECD on BEPS Action Plans</td>
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<td>2015</td>
<td>Final BEPS Action Report release with options for addressing tax challenges arising from digitalisation.</td>
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<td>2018</td>
<td>Interim Report released with further analysis on tax challenges on digital economy.</td>
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<td>Jan 2020</td>
<td>IF adopted outline of a unified approach on pillar 1, and a progress note on pillar 2</td>
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<td>2021</td>
<td>New building blocks on Pillar 1 &amp; 2 blueprints introduced</td>
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<td>Oct 2020</td>
<td>IF released blueprints on pillar 1 and pillar 2:</td>
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<td>July 2021</td>
<td>Building Blocks Published detailing on key components of the 2 pillar solution</td>
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<td>Oct 2021</td>
<td>IF published final statement with implementation plan on the 2 pillar solution.</td>
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<td>Dec 2021</td>
<td>GloBE Model rules published 20 Decem ber 2021</td>
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<td>Dec 2022</td>
<td>Last public consultation document released on building blocks</td>
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Two Pillared Approach

- Pillar 1
  - Review Nexus and profit allocation rules

- Pillar 2
  - Level the playing field—global minimum tax

- 2019 policy note – “without prejudice basis”
- Grouped into two pillars
- Released public consultation document seeking input on approach
- Program of work released on architecture
Pillar 1 proposals

Marketing intangibles

User participation

SEP

Modified residual profit method

Fractional apportionment method

Distribution based approach

Nexus

Profit Allocation

Unified approach

Revised Program of Work
Difficulties in reaching consensus solution built around commonalities
Pillar 1

**Amount A**
Global reallocation of portion of residual profits

**Amount B**
Fixed remuneration for baseline Marketing & Dist using ALP-standard application of TNMM

**Amount C**
Additional profit above Amount B and tax certainty

- Promises a pool of over USD 500 billion of global residual profits and about USD 100 to 150 billion reallocated profits
- Blueprint released in October 2020
- Public consultation (January 2021) - criticised for being too complicated
- New Amount A structure and building blocks.
From 2021 Amount A has evolved to comprehensive scoping.

Seeks to reallocate 25% of residual profits of highly profitable companies to market jurisdictions by allocating of taxing rights based on a new special –purpose nexus rules based on market based criteria of sales with revenue sourcing rules looking at the location of the final consumer.

It is not a holistic reform- overlay to existing rules
(1) Qualifying Domestic Minimum Top Up Tax (QDMTT)

(2) Income Inclusion Rule (IIR)

(3) Undertaxed Payments Rule (UTPR)

STTR (Subject to Tax Rule)

Switch-Over Rule

GloBE rules

Treaty rules

(common approach) 15%

9%

Implemented through an MLI
-Interest, royalties and some services
-materiality threshold and low-return exclusion

is a backstop rule that ensures that TOP UP TAX is collected in cases where it is not collected under the IIR.
Top-up tax may be imposed by jurisdictions if effective tax rate (ETR) falls below 15% on a jurisdictional basis.

A lower ETR may be allowed based on a “substance” carve out (i.e. % of tangible asset and payroll costs).

Increased CIT revenues from application of IIR in UPE jurisdiction and source of payment jurisdiction under UTPR and STTR- assures USD 135 billion to 180 billion of global CIT revenues from the global minimum tax.

Expected Behaviours:

- do nothing
- Reduction in profit shifting to low/no tax jurisdictions (investment hubs).
- Increase of ETR in some low-tax jurisdictions by restructuring tax incentive regime.
Potential impact on incentives

What are the options?

- Do nothing (but other jurisdictions will tax)
- Implement QDMTT (simplication measure)
- Implement IIR and/or UTPR (adopt model rules)
- Review incentives

Careful consideration

Make the cost-benefit analysis
Review country tax incentives

Criticism for the ATAF Secretariat has already published a Suggested Approach for Drafting Domestic Minimum Top-Up Tax Legislation
Summary: GloBE Rules set threshold and discourage some (not beneficial) tax incentives

- **Substance**: less impact on MNEs with substance in a jurisdiction (SBIE)
- No impact on tax incentives that allow faster recovery of cost of tangible assets (accelerated depreciation)
- Less impact on incentives narrowly targeted (specific income or expense categories) (blending of income within a jurisdiction)
- Possible less/no impact on cash grants (subsidies) and refundable tax credits (QRTC)
Pillar One - Where are we?

- 2020: Blueprint Pillar One: Tax Challenges Arising from Digitalisation
- 2021: October Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy
- 2022: July Progress Report on Amount A
- 2022: October Progress Report on the Administration and Tax Certainty Aspects of Pillar 1
- 2022: December Consultation Document on Amount B
- 2022: December Consultation Document on withdrawal and standstill of DST
- 2023: February release of Agreed Administrative Guidance will ensure co-ordinated outcome
Not a holistic reform of existing standards- is it sustainable in rapidly digitalising world?

- Reduced covered entities- from 2300 MNEs to below 100 (scope threshold, single profitability, averaging mechanism)

- Reduced size of Amount A- reallocation of 25% of profits above 10%, safe-habour for routine profits based on ALP with no regards to original issue of new business models. (carry forward of losses including pre-regime losses, recognition of WHTs and MDSH.

- Out of scope companies not subject to tax using new nexus’ because of withdrawal and standstill of unilateral measures (treaty override on those allowed)

- Too complex.
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Thank You!