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.
- Broader tax challenges identified in BEPS Action 1 Report 2015 and later reemphasised in Interim Report of 2018.
- 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/20 INCLUSIVE FRAMEWORK

- 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.

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TIMELINE OF EVENTS

- 2013 G20 endorsed work by OECD on BEPS Action Plans
- 2015 Final BEPS Action Reports released with options for addressing tax challenges arising from digitalisation.
- 2018 Interim Report released with further analysis on tax challenges on digital economy.
- 2019 policy note released proposing a 2-pillar approach as foundation for a consensus-based solution.
- Jan 2020 IF adopted outline of a unified approach on pillar 1, and a progress note on pillar 2
- Oct 2020 IF released blueprint reports on pillar 1 and pillar 2:
- 2021 New building blocks on Pillar 1&2 blueprints introduced
- July 2021 Building Blocks Published detailing on key components of the 2 pillar solution
- Oct 2021 IF published final statement with implementation plan on the 2 pillar solution.
- GloBE Model rules published 20 December 2021
- Progress report on Amount A released July 2022
- Dec 2022 Last public consultation document released on building blocks

Two Pillared Approach

- ✓ 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

- Review Nexus and profit allocations rules

Pillar 2

- Level the playing field– global minimum tax

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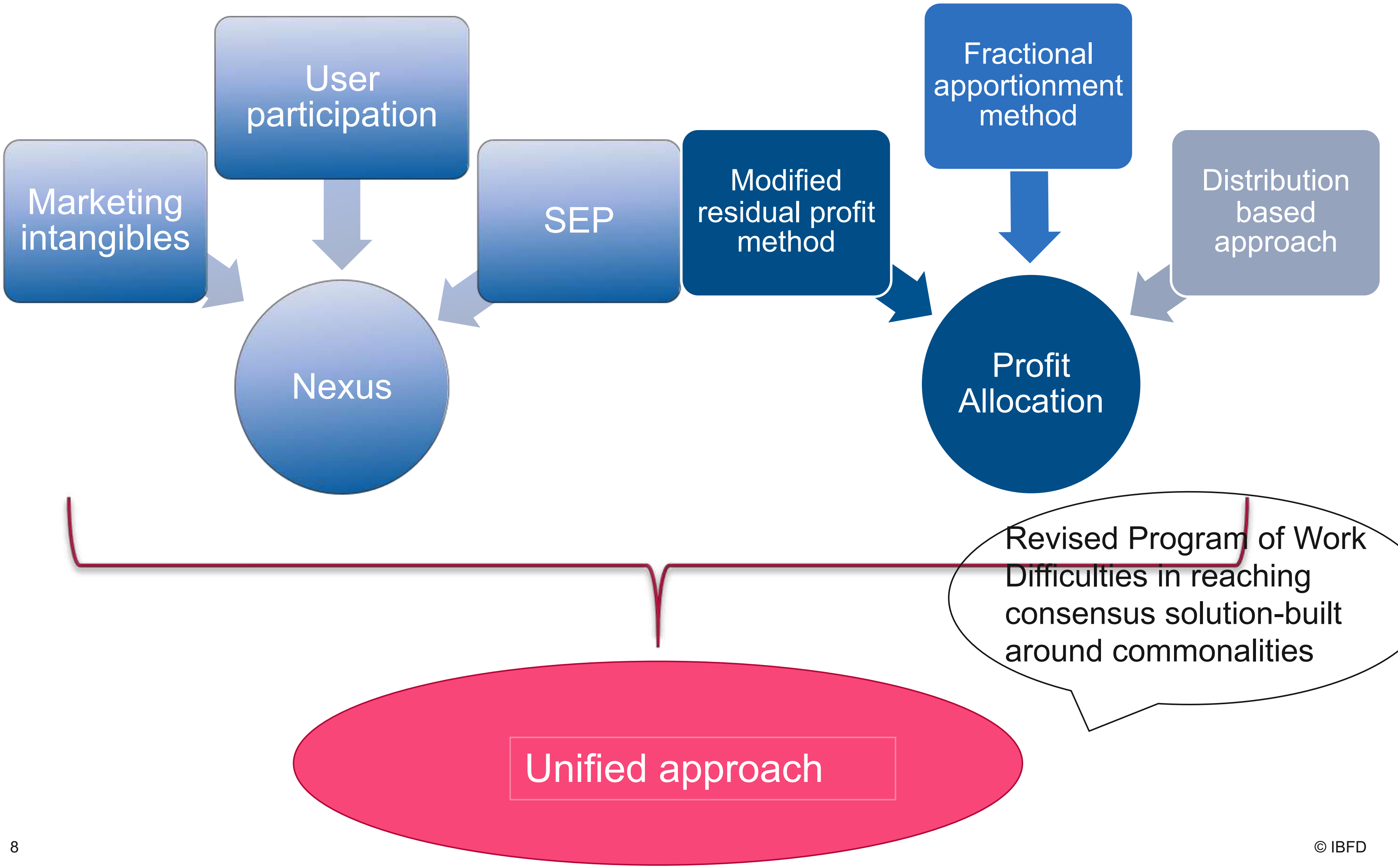
Pillar 1 proposals



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

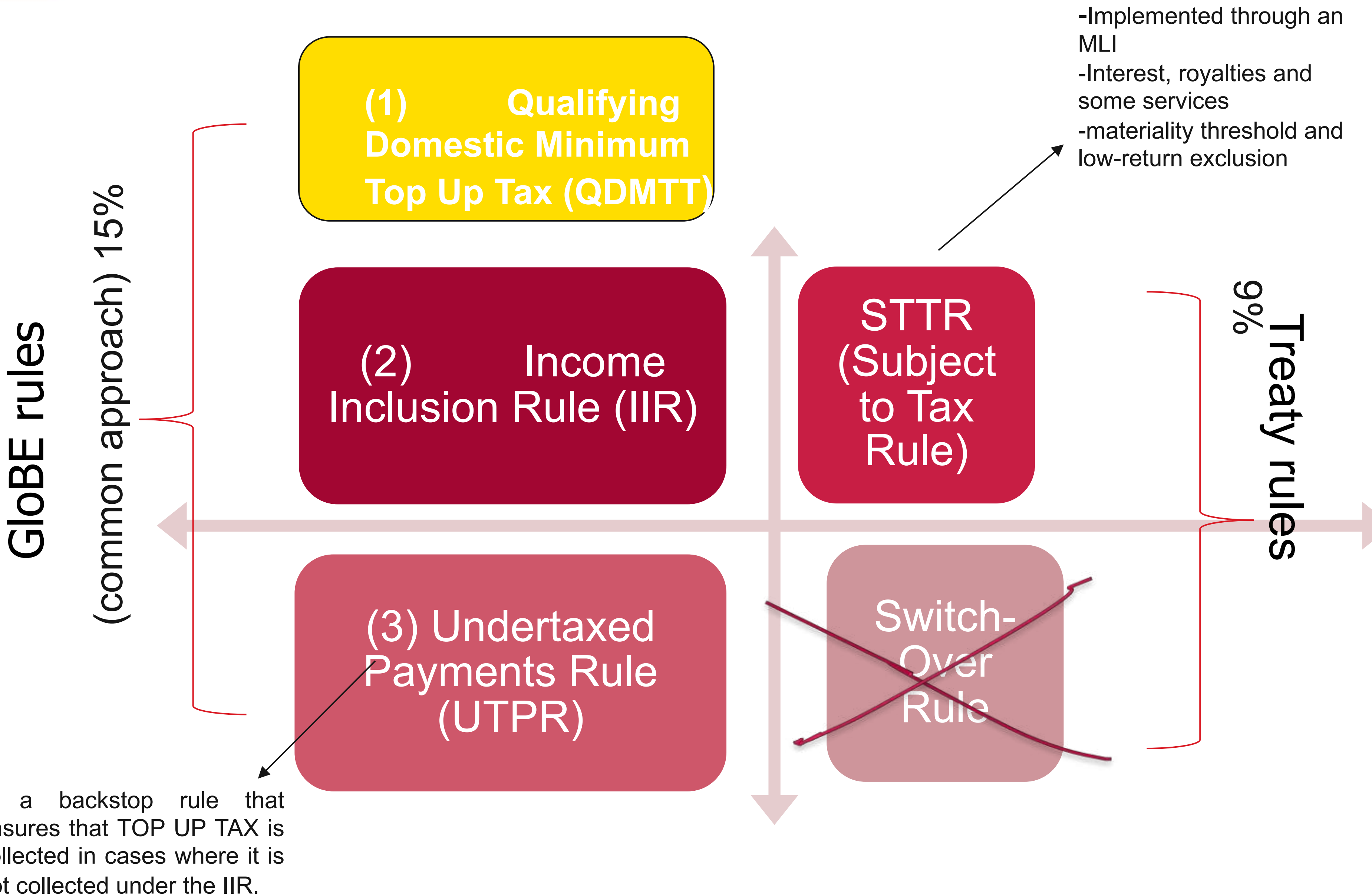
Amount C
Additional profit above Amount B and tax certainty

- 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.

Current design of Pillar 1 Amount A

- 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

Pillar 2 proposals



Pillar 2 Operation

- 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.

What should countries be doing?

- 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

Pillar 2 – Globe Rules effect on Tax Incentives

- **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**

Major criticism of Pillar 1

- 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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