

# OECD releases Blueprints on Pillar One and Pillar Two, Updated Economic Analysis

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## In brief

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On 12 October, the OECD released a series of documents regarding the ongoing work of the OECD/G20 Inclusive Framework (IF). Key takeaways from the Blueprints and related documents include:

- The Inclusive Framework has agreed to continue discussions on the Pillar One and Pillar Two frameworks with a view to reaching political agreement by mid-2021.
- The Blueprints show that technical progress has been made on agreeing to the intermediate architecture of the plans.
- Significant elements of both Pillar frameworks remain to be resolved, such as the scope of Amount A and reallocation rate under Pillar One, and the minimum tax rate and 'whitelisting' of deemed compliant regimes under Pillar Two.
- The updated economic impact analysis states that reallocated profits to market jurisdictions could reach up to USD 100 billion each year under Pillar One, and new revenues raised under Pillar Two (combined with the effects of global intangible low-taxed income (GILTI) and Pillar One) could be in the range of USD 60-100 billion annually.
- The US position in the negotiations remains uncertain with the upcoming national presidential election expected to clarify how the US might proceed in 2021.
- The Blueprints are the subject of a public consultation seeking stakeholder input running from 12 October - 14 December, with a virtual hearing to take place in January 2021.

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## In detail

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### Background

The OECD/G20 IF has been working to address tax issues arising from the challenges of the digitalising economy since the initial recommendations of the OECD's Base Erosion and Profit Shifting (BEPS) work. In 2019, the OECD Secretariat suggested a two-pillar approach that the IF has adopted as the basis for a work program. A stated goal of the Pillar One proposal is to allocate a greater share of (residual) profits to market/user jurisdictions by moving away from the traditional arm's length principle (ALP) approach in certain respects and creating a standalone nexus rule without reference to physical presence. The current scope is intended to cover both highly digitalized businesses as well as consumer-facing companies with cross-border activity. The Pillar Two goal is expressed as addressing remaining BEPS challenges by ensuring large companies pay a minimum level of tax on income regardless of where it arises.

The documents released by the IF on 12 October include the following.

### IF Cover Statement

The IF has published Blueprints for [Pillar One](#) and [Pillar Two](#) and agreed to “swiftly address the remaining issues with a view to bringing the process to a successful conclusion by mid-2021.” Although no agreement has been reached on the Blueprints, the reports provide a “solid foundation for a future agreement” and reflect “convergent views on a number of key policy features, principles, and parameters of both Pillars, and identifies remaining political and technical issues where differences of views remain to be bridged, and next steps.”

Pillar One would “adhere to the concept of net taxation of income, avoid double taxation and be as simple and administrable as possible.” On Pillar Two, the framework would allow for a “right to ‘tax back’ where other jurisdictions have not exercised their primary taxing rights, or the payment is otherwise subject to low levels of effective taxation.”

### Pillar One Blueprint

The [Pillar One Blueprint](#) recognises three core components, each with subsidiary building blocks:

- *Amount A*: a new taxing right for market jurisdictions with a share of a multinational entity's (MNE's) residual profit being reallocated;
- *Amount B*: a fixed return for certain baseline marketing and distribution activities taking place physically in a market jurisdiction (with the outcomes consistent with the arm's length principle);
- *Processes to improve tax certainty* through effective dispute prevention and resolution mechanisms.

The Pillar One Blueprint contains several key design features of the new taxing right under Amount A:

- A **revenue threshold** (potentially phased in to the €750 million CbCR annual gross revenue level) to minimize compliance costs and provide manageable administration;
- **Scoping rules** that focus on businesses able to profit from significant and sustained interactions with customers in a market jurisdiction (covering automated digital services (ADS) and certain consumer-facing (CF) businesses);
- A new **nexus rule** that identifies Amount A market jurisdictions to receive potential profit reallocations, along with sourcing rules and a profit reallocation key;
- A **loss carryforward regime** to ensure only economic profit is reached, with an earn-out mechanism to offset past losses against future profits;
- Potential **safe harbors** to reflect situations where residual profits are already allocated relying on existing ALP-based rules, thus avoiding double-counting issues;
- **Elimination of double taxation** by identify paying entities in order to equitably apportion Amount A tax relief among market countries;

- Proposed implementation of a **simplified administrative process** for necessary filing burdens and payment of Amount A taxes.

For Amount B, the Blueprint suggests a standard remuneration for activities involving distributors that buy from related parties and sell to unrelated parties and have a routine distributor functionality profile; the determined amounts are intended to approximate results reached in accordance with the ALP. With regard to improving tax certainty processes, a review panel mechanism is envisioned to prevent disputes about aspects of the Amount A framework, and other potential mandatory binding tools are being considered for disputes beyond Amount A.

The Pillar One Blueprint recognizes that a number of open issues remain for political decision, including:

- **Scope of Amount A:** the activities proposed to be covered by the definitions of 'automated digital services' and 'consumer-facing' businesses;
- **Profit amount reallocated:** how much to allocate to market jurisdictions based on thresholds and percentages;
- **Scope of Amount B:** identifying in-scope activities of baseline distributors and potential use of a pilot program;
- **Extent of tax certainty:** the review process and use of determination panels for Amount A, as well as the use and scope of mandatory binding dispute resolution beyond Amount A.

### Pillar Two Blueprint

The Pillar Two Blueprint discusses several mechanisms envisioned to establish a global framework of minimum taxation.

- The **income inclusion rule** (IIR) operates as a top-up tax when income of controlled foreign entities are taxed below an effective minimum tax rate.
- The **switch-over rule** (SoR) complements the IIR by removing treaty obstacles in situations where a jurisdiction uses an exemption method that could frustrate the application of a top-up tax to branch structures.
- The **undertaxed payments rule** (UTPR) serves as a backstop to the IIR through application to certain constituent entities; the top-up tax computation is the same as under the IIR.
- The **subject-to-tax rule** (STTR) would help source countries protect their tax base by denying treaty benefits for deductible intra-group payments made to jurisdictions with low or no taxation.

The IIR and UTPR (collectively, 'GloBE'), would apply to companies with more than €750 million in annual gross revenues. The financial accounts of the parent entity are used to calculate the tax base and an effective tax rate (ETR) after taking into account covered taxes (broadly of an income nature; a digital services tax (DST) is not a covered tax). The GloBE provisions contemplate allowing recognized losses when computing the tax rate and providing for a formulaic substance carve-out to exclude certain fixed returns. In a next step the ETR per jurisdiction is determined. In recognition of administrative considerations and need for simplicity, the Blueprint raises a number of potential design choices, including:

- Reliance on CbCR thresholds and definitions;
- A list of excluded entities (such as investment entities, pension funds, nonprofit organizations, etc.);
- Only 'limited' book-to-tax adjustments and reliance on entity level information;
- Timing difference simplifications, and
- Rule ordering.

The Pillar Two Blueprint recognizes that a number of open issues remain for political decision, including:

- The need for some co-existence mechanism of the GloBE rules with the US GILTI regime;
- The amount of the minimum rate;
- Whether calculation of ETR should occur on an aggregate or jurisdictional level.

#### Analysis of economic impacts and investment effects

The OECD released a [new report](#) addressing the anticipated effects that the Pillar One and Pillar Two proposals might have on countries' tax revenues and economic investment. The report relies on a combination of firm-level and aggregate data sources, including CbCR data, and predicated its Pillar One modeling using a 20% residual profit allocation key while using a 12.5% minimum tax rate for Pillar Two. The reforms are cast as leading to a much more favourable environment than scenarios which assume the proliferation of unilateral DSTs and increased trade tensions if there were no consensus. Pillar One might result in approximately USD 100 billion per year of profit reallocated to market jurisdictions. Taking into account the combined effect of the Pillar One/Two proposals (USD 47-81 billion) and the US GILTI regime (USD 9-21 billion), the total effect could represent USD 56-102 billion per year of new revenues (or up to around 4% of global CIT revenues). The exact revenue gains, of course, would depend on the final design and parameters of the two pillars, the method of implementation, and the behavioral response by MNEs and governments.

Under Pillar One, it is expected that low, middle and high-income economies would all benefit from revenue gains, while 'investment hubs' would tend to lose tax revenues. Pillar Two is anticipated to result in a significant increase in corporate income tax revenues across low, middle and high-income economies.

Regarding the potential investment effects, the report argues that Pillar One and Pillar Two could lead to a relatively small increase in the average post-tax investment costs of MNEs. The OECD report estimates only a small negative effect on global investment based on its belief that the proposed pillars would mostly affect highly profitable MNEs whose investment is less sensitive to taxes. The report further states that the impact is expected to "fall predominantly on highly-profitable MNEs in digitalized and intangible intensive sectors in the case of Pillar One and on MNEs engaging in profit shifting in the case of Pillar Two." Overall, the OECD predicts that the negative effect on global GDP stemming from the expected increase in tax revenues associated with Pillar One and Pillar Two is estimated to be less than 0.1%.

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### The takeaway

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The Blueprints will be discussed at the 14-15 October virtual G20 Finance Ministers' Meeting. Based on the documents sent to the G20, the Finance Ministers will likely offer an extension of time to negotiate a consensus political agreement until some time in 2021. The Pillar One and Pillar Two Blueprints will be subject to a public consultation to run from 12 October through 14 December, with a virtual consultation to take place in January 2021.

#### See also:

- [The OECD's Pillar One Blueprint](#)
- [The OECD's Pillar Two Blueprint](#)
- OECD publication: [Tax Challenges Arising from Digitalisation – Economic Impact Assessment](#)
- OECD publication: [OECD Secretary-General tax report to G20 Finance Ministers and Central Bank Governors](#)
- OECD press release: [OECD/G20 Inclusive Framework on BEPS invites public input on the Reports on Pillar One and Pillar Two Blueprints](#)
- OECD report: [Taxing Virtual Currencies: An Overview of Tax Treatments and Emerging Tax Policy Issues](#)

- OECD press release: [International community renews commitment to address tax challenges from digitalisation of the economy](#)
- [OECD Tax Talks Webcast](#)

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## Let's talk

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