

The Reform of the International Tax System: State of Affairs

The top priority on the international tax agenda right now is reforming the international tax system to address the challenges arising from the digitalization of the economy. The need for international co-ordination to resolve the tax challenges of digitalization and restore stability to the international tax framework is greater than ever, as the Coronavirus diseases 2019 (COVID-19) pandemic has accelerated digitalization, public finances are increasingly strained and tolerance for tax avoidance by multinational companies in the current environment is nil.

Despite the challenges posed by COVID-19 since early 2020, the nearly 140 member countries and jurisdictions of the OECD/G20 Inclusive Framework have continued to develop the agreed two-pillar approach that could form the basis for a multilateral, consensus-based solution. Pillar One seeks to adapt the international tax system to new business models through a coherent and concurrent review of the profit allocation and nexus rules. It intends to expand the taxing rights of market jurisdictions where there is an active and sustained participation of a business in the economy of that jurisdiction through activities in, or remotely directed at, that jurisdiction. Pillar One also aims to significantly improve tax certainty by introducing innovative dispute prevention and resolution mechanisms. Pillar Two would introduce global anti-base erosion rules to ensure a minimum level of effective taxation to address remaining BEPS concerns. To this end, Pillar Two would provide jurisdictions with 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.

On 9 October 2020, the OECD/G20 Inclusive Framework on BEPS (Inclusive Framework) approved a package comprising a Cover Statement, the Report on the Pillar One Blueprint and the Report on the Pillar Two Blueprint, which 'reflect convergent views on a number of key policy features, principles and parameters of both Pillars, identifies remaining political and technical issues where differences of views remain to be bridged, and next steps'. It was agreed by the Inclusive Framework that the Pillar One Blueprint was a 'solid basis for future agreement' and the Pillar Two Blueprint was also a solid basis 'for a systematic solution that would address remaining BEPS challenges'. It was also agreed by the Inclusive

Framework to 'swiftly address the remaining issues with a view to bringing the process to a successful conclusion by mid-2021 and to resolve technical issues, develop model draft legislation, guidelines, and international rules and processes as necessary to enable jurisdictions to implement a consensus based solution'.

The G20 has long recognized the importance of resolving the tax challenges arising from digitalization, and the Blueprints of Pillar One and Pillar Two were welcomed by G20 Leaders in November 2020. G20 Leaders mandated that a solution be delivered by the middle of this year, urging the Inclusive Framework 'to address the remaining issues with a view to reaching a global and consensus-based solution by mid-2021'.

The possibility for such a solution appears to be even further within reach given the new political dynamics surrounding the negotiations. At the February G20 Finance Ministers' meeting, US Secretary of the Treasury Janet Yellen announced that the United States is no longer advocating its 'safe harbour' proposal for Pillar One. This new position has provided a fillip to the negotiations, and the news was welcomed by many fellow G20 Finance Ministers. The G20 Finance Ministers' press release noted the discussions, stating that the Finance Ministers' meeting 'focused on the urgent need to reform the current system to respond to the new challenges posed by globalization and the digitalization of the economy. In this regard, the G20 will endeavour to achieve a global and consensus-based solution by mid-2021'.

In light of these developments, there is reason to be cautiously optimistic that the remaining technical and political challenges can be overcome by mid-2021. Progress has already been made on addressing many of the issues that were identified during the OECD's recent public consultation on both pillars. The public consultation was carried out from October to December 2021. In total, over 200 submissions were received totalling around 3,500 pages of comments.

With respect to Pillar One, written commentators and participants in the January 2021 public consultation meeting expressed strong support for an international consensus solution and for the removal of unilateral measures, such as digital services taxes. Some concerns were noted regarding uncertainty about policy objectives and principles, and there

were numerous calls for greater simplification to reduce complexity and compliance costs. Furthermore, there was a convergence among many commentators on the technical parts of a number of the Amount A building blocks. To recap, these building blocks under Amount A include scope, nexus, revenue sourcing, tax base determination, profit allocation, and the elimination of double taxation. Separately, NGOs considered the proposed reforms to be too narrow, in particular the amount of profits to be redistributed.

With respect to Pillar Two, stakeholders participating in the public consultation expressed support for the basic design of the effective tax rate calculation as well as support for the rule order as proposed. Further support was expressed for mechanisms to address timing differences, and there was a renewed call for re-considering the use of deferred tax accounting. Strong support was also given to the development of simplification options but some stakeholders expressed concerns about its design and consistency of its application. Stakeholders also expressed concerns surrounding additional complexity in application of the split-ownership and the undertaxed payments rule, while others raised concerns about the design of the subject to tax rules and the limitations on its scope. General support was also expressed for the US's GILTI (Global Intangible Low-Taxed Income) co-existence and mechanisms to address sandwich structures.

Clearly, there are still many moving pieces, but the pieces of this tax puzzle are starting to come together. The Inclusive Framework continues to build upon the invaluable input received from stakeholders to further refine and simplify the Pillar One and Pillar Two proposals, with the objective of reaching political agreement in mid-2021, as

mandated by the G20. An Inclusive Framework Steering Group meeting was held in early March 2021, where further progress was made and the new US delegate to the group was welcomed.

Delegates understand that the absence of a consensus-based solution would likely lead to a further proliferation of uncoordinated and unilateral tax measures (e.g., digital services taxes) and an increase in damaging tax and trade disputes. Already, over thirty countries/jurisdictions have introduced some type of unilateral measure. These unilateral measures undermine tax certainty and investment and result in additional compliance and administration costs. Our own OECD impact assessment estimates the negative impact on growth from these measures would be up to 1% (EUR 800 billion). Before COVID-19, global GDP growth was expected to be 2.9% in 2020. It is now estimated to have fallen by 4.5% in 2020. In this context, the global economy needs greater tax certainty, via revamped international tax rules, not tax chaos.

While the timeline to deliver a solution is no doubt tight between now and the 9–10 July G20 Finance Ministers meeting scheduled to take place in Venice, Italy, there is reason to remain sanguine if high level political support for resolving the remaining technical differences continues unabated. The bridges of Venice's canals are within sight, and if Inclusive Framework members continue to work diligently and in good faith, a solution should be in hand before we reach the Rialto.

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