

OECD Pillars 1 and 2 History in the Making or Building a Doomed Temple?

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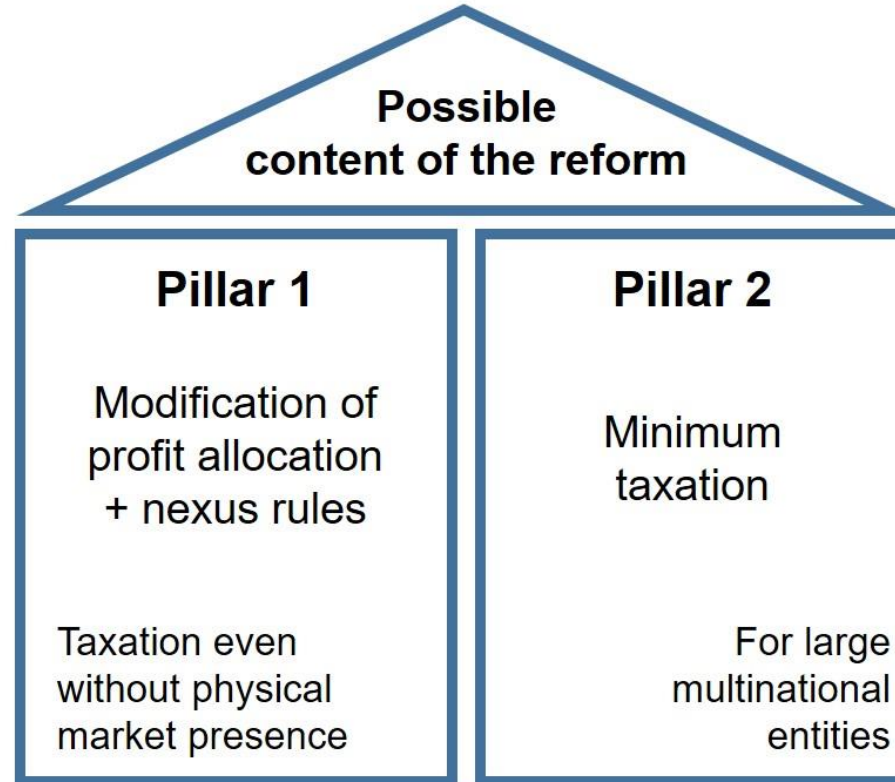
1. Introduction

- The OECD Pillar 1 and 2 reform aims to adapt taxation to new digital developments. It stems from the BEPS project.
- OECD/G20 Inclusive Framework 139 (!) countries were involved in the process.
- The purpose of the reform is to avoid a proliferation of national unilateral measures and therefore ensure legal certainty.
- Large international companies as well as the whole digitalised international economy are to be affected.
- The OECD reform proposes a 2 pillar-system and a global minimum tax rate of 15%. 130 (now 134) out of 140 States accepted the reform.

1. Introduction

- Pillar 1 provides a shift of taxing rights to market/user jurisdictions, without regard to physical presence :
 - Companies with more than EUR 20 billion in annual turnover and a profit margin of >10% will have to pay taxes on some of their profits in the market area.
- Pillar 2 provides for a minimum tax rate of at least 15% for companies operating internationally with more than EUR 750 million in annual turnover.

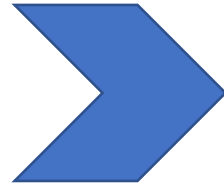
1. Introduction



Source :
https://www.sif.admin.ch/sif/en/home/finanzmarktpolitik/digit_finanzsektor/best_digit_wirtschaft.html

1. Introduction

1. Work related to the OECD BEPS Program – 2015 and 2018 final report (G20)



2. Related work of the EU :

- 21.09.2017 : EU communication for digital economy
- 21.03.2018 : 2 draft guidelines
 - Taxation of companies with important digital presence;
 - Common system of tax on digital services



3. Unilateral measures of some States



4. 20.04.2021 – UN introduces section 12B of its DTA.

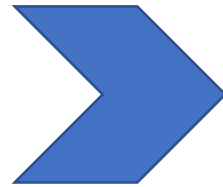


5. 01.07.2021 – OECD Pillars reform and minimal tax rate of 15% accepted by 130 States

1. Introduction

What next ?

1. 08.10.2021 – OECD/IF hopes to reach final agreement and issue implementation plan



2. 12-13.10.2021 – G20 Finance Ministers to endorse



3. 2021-2022 – Technical work drafting statutory and treaty text ?



4. 2022 - Implementation : enacting laws and ratifying treaty ?



5. 2023 – Entry into force ?

2. Pillar 1 – Overview and key elements

A. Overview :

- Scope : MNEs with global revenue > EUR 20 billion turnover and profit margin >10%. → Less than 100 companies worldwide.
- New *nexus* rule : revenue > EUR 1 million (or 250K for small economies)
- New reallocation rule of profit : 20-30% residual profit (Amount A)
- Tax certainty : mandatory & binding mechanism for Amount A related issues, possibly elective for developing countries.
- The realization of Pillar 1 requires a multilateral agreement.

2. Pillar 1 – Overview and key elements

B. New *nexus* rule :

- This new rule would apply if a company has significant and sustained participation in the economy of a market jurisdiction.
- The Amount A will be allocated to the places where the company reaches an amount of EUR 1 million of revenue.
- In countries in which the GDP is inferior to EUR 40 billion, this EUR 1 million limit is lowered to EUR 250K.
- Its only purpose is to determine whether a jurisdiction qualifies for the Amount A allocation.

2. Pillar 1 – Overview and key elements

C. New reallocation rule :

There are 3 different amounts :

1. Amount A : a new taxing right for market jurisdictions with a share of MNEs residual profit – 20-30% of residual profit. Expected to come into force in January 2023.
2. Amount B : a fixed return for certain baseline marketing and distribution activities taking place physically in a market jurisdiction → work deferred to 2022.
3. Amount C : dispute resolution mechanism – July 2021 agreement is unclear about this point.

3. Pillar 2 – Overview and key elements

A. Overview

- GloBE (Global anti-Base-Erosion) rules introduce an additional tax on the difference between the local effective rate and the minimum rate of 15%.
- 4 component parts of the GloBE proposal :
 1. Income inclusion rule - **IIR**
 2. Undertaxed payments rule - **UTPR**
 3. Switch-over rule - **SOR**
 4. Subject to tax rule - **STTR**



Source : <https://www.oecd.org/tax/beps/public-consultation-document-global-anti-base-erosion-proposal-pillar-two.pdf.pdf>, p. 8.

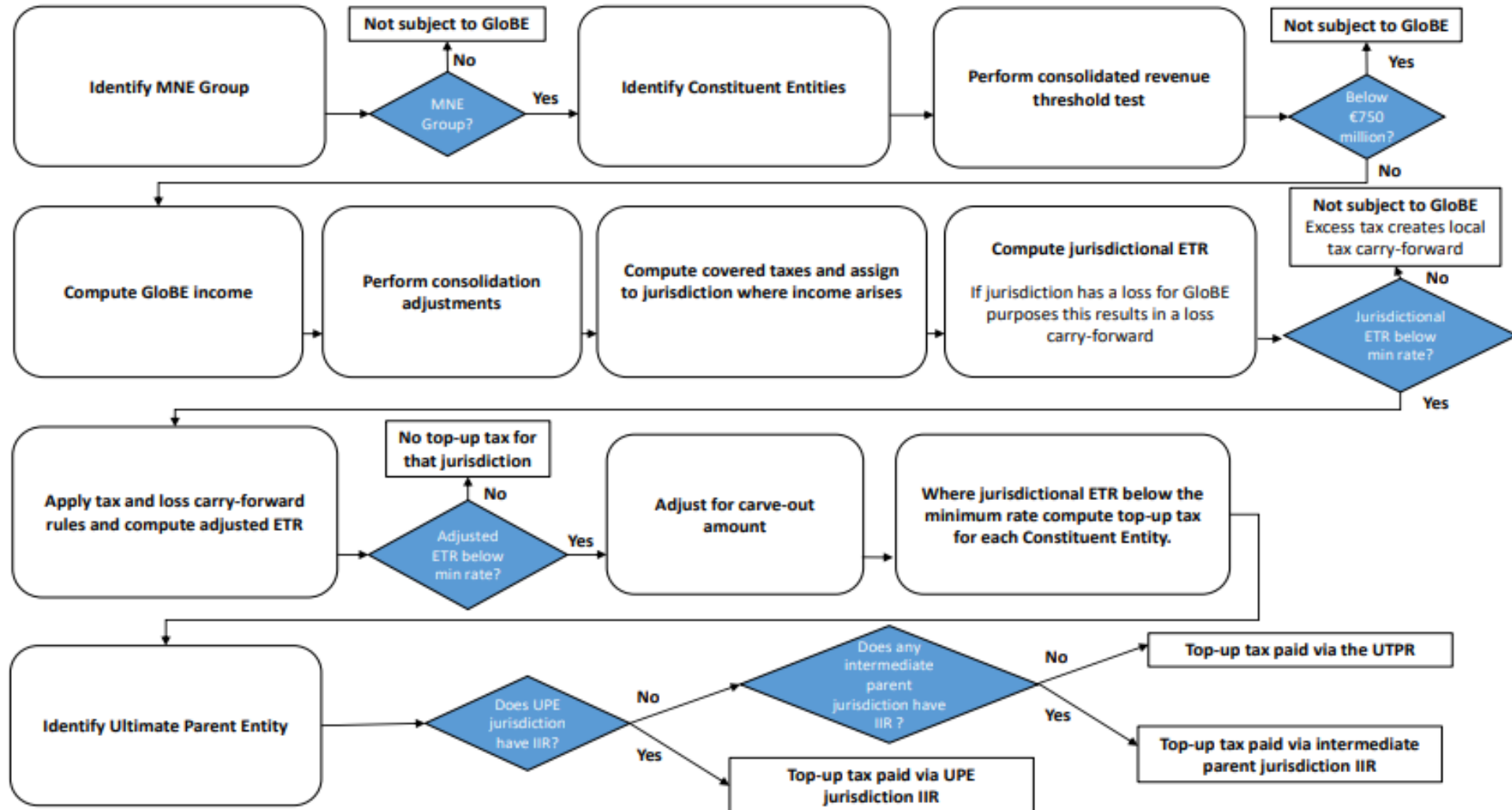
3. Pillar 2 – Overview and key elements

B. How does it work ? :

- Pillar 2 consists of :
 - Two interlocking domestic rules which together compose the GloBE rules :
 - i. IIR : imposes top-up tax on a parent entity
 - ii. UTPR : ensures low-tax income of MNE group members is taxed at minimum ETR (of at least 15%)
 - Treaty rule : STTR allows source taxation on related party payments taxed in recipient country at below minimum nominal rate (of 7.5% - 9%)
- Scope : GloBE rules apply to MNEs with > EUR 750 million revenue
- ETR Calculation : CbC, based on financial accounting income

Flow Diagram

40. The flow diagram below is intended to provide a high-level overview of the process steps for applying the GloBE rules to wholly-owned Constituent Entities of an MNE Group.



4. Impact on companies

- Companies might be subject to two corporate tax systems living in parallel.
- Swiss view : MNEs will have to pay more taxes, which in the short-term results in higher tax receipts, but inhibits the company's ability to innovate and leads to less investment meaning weaker national growth, fewer jobs and lower tax receipts in the long term.
- A select group of companies would have to pay tax both in domicile country and many market jurisdictions.

5. Impact on Switzerland

- Switzerland has been very active in the negotiations of the BEPS project and the OECD Pillars 1 and 2.
- Switzerland signed the July 2021 Agreement with major reservations, in particular that *“the interests of small, innovative countries are to be taken into account in the final rules”* and national legislative procedures to be respected (Referendum)
- Regarding Pillar 1, only a few large Swiss companies are concerned, e.g. Roche, Novartis and Holcim.
- Regarding Pillar 2, around 200 Swiss companies are concerned and several hundred Swiss subsidiaries of foreign groups
- Long legislative process, possible referendum in sight.

6. Complexity and major hurdles

- Pillar 1 – most of the roughly 100 companies concerned are US ...
- Will the Biden Administration continue to support this ? And will it be able to win a vote in Congress or the Senate (Treaty) ?
- Pillar 2 – 15% ETR, defined how ? And more importantly, what about the tax base ? Harmonized tax base as well ?
- Will countries abolish their Digital Services Taxes ? E.g. France GAFA tax, UK DPT, Australia MAAL ? What about sovereignty ?
- What will the EU do after this ? Escalate like after BEPS ? ATAD 4 ? Or rather dust off the CCCTB ?
- In a historic move 134 countries agreed on the principles, but will they now agree on the details as well ?

7. Conclusion

- International tax system appropriate to its time.
- Historical milestone : global minimum tax rate never accepted before.
- No final decision yet – OECD agreement only reflects interim status.
- Pillar 1 : more than USD 100 billion expected to be reallocated to market jurisdictions per year.
- Pillar 2 : global minimum rate of 15% estimated to generate around USD 150 billion in additional global tax revenues per year.
- History in the Making or Building a Doomed Temple ?

My personal view ...



Questions ?