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ECONOMIC ANALYSIS AND IMPACT ASSESSMENT OF THE PILLAR 1 & 2 PROPOSALS

On 13 February 2020, the OECD published a (first) economic analysis / impact assessment of the (combined) Pillar 1 & 2 proposals ("the proposals").

Background
The OECD recently published the proposals for a so-called "two pillar solution" to the tax challenges arising from the digitalization of the economy. These proposals, which are currently under negotiation, include a set-up for a fundamental tax reform.

Pillar 1
The pillar 1 proposal aims to complement the arm's-length principle with a formula-based solution for market jurisdictions and leave the existing transfer pricing rules in place. This means that the proposal would be a second layer on top of the existing transfer pricing regime. In principle, the formula-based solution exists of new rules stating:

- Where tax should be paid ("new nexus" rules); and
- On what portion of profits, they should be taxed ("profit allocation" rules).

The new nexus rule does not depend on physical presence but is largely based on (the level of) sales in a jurisdiction. The profit allocation rule is based on a formula rather than the transfer pricing regime.

Pillar 2
The pillar 2 proposal introduces a (global) minimum tax rate. This minimum tax could be applied either on global MNE profit level or on jurisdiction profit level. Pillar 2 would operate as a "top-up" tax which gives countries the right to "tax back" profit that is currently taxed below the minimum rate.

Impact assessment
The OECD has now published high-level results of the preliminary insights of the potential impact of the proposals. The main purpose of this impact assessment is to provide information to the OECD/G20's Inclusive Framework ("the Framework") that can be used in the negotiation process of the proposals. The OECD emphasizes that the results of this assessment are based on illustrative assumptions which do not pre-judge future decisions in the negotiation process of the proposals.
The results of the impact assessment are presented at the level of country groups (i.e. low-, middle- and high income) and can be summarized as follows:

- Combined effect of Pillar 1 & 2 is estimated to result in an annual increase of global tax revenues of 4 percent (i.e. USD 100 billion);
- The revenue gains are broadly similar across the country groups;
- However, on average, low- and middle income countries would gain relatively more than high-income countries;

- "Investment hubs" are expected to lose (some) tax revenues;
- More than half of the reallocated profit derives from 100 MNE groups; and
- The reform due to Pillar 1 & 2 is expected to result in a "significant" reduction in profit shifting.

Timeframe

As part of the ongoing work of the Framework on BEPS, a "Programme of Work" ("PoW") has been published in May 2019. The efforts following the PoW resulted in the publication of the public consultation documents Pillar 1 and Pillar 2 in October and November 2019 respectively. By publishing these documents, the OECD invited the public to provide comments on the proposed tax reform. One of the parties which provided comments is WTS Global. WTS' comments in this matter can be assessed here for Pillar 1 and here for Pillar 2.

Based on the comments provided by the public, the Framework published a statement relating to the proposals on January 31, 2020. In this publication, the Framework provided new insights into the proposals. Furthermore, it provided clarity on the remaining technical and political issues which should be resolved.

Last week, the OECD held a webcast which illustrated and explained the impact analysis performed. In this webcast, the OECD furthermore indicated that another impact assessment will be published by the end of March 2020. This second impact assessment will focus on the economic growth and investment aspects. Both impact assessments will be used by the Framework during 2020 in the negotiation process to reach a consensus based long term solution to the tax challenges arising from the digitalization of the economy, by the end of 2020. Part of this negotiation process is the Framework's meeting in July 2020 in Berlin. In this meeting, a political agreement will be pursued on the detailed design of the proposals. An overview of the complete timeline of the negotiation process, as prepared by the Framework, is provided below.

Framework's Timeline