



# Italian-German International Tax Seminar

## Pillar One

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# Digitalization of the Economy

- Digital transformation has had deep economic and societal impacts resulting in significant changes.
- At the center of the debate is whether international income tax rules, developed in a "brick-and-mortar" economic environment more than a century ago, remain fit for purpose in the modern global economy.
- The fundamental elements of the global tax system which determines where taxes should be paid ("nexus" rules based on physical presence) and what portion of profits should be taxed ("profit allocation" rules based on the arm's length principle)

# Digitalization of the Economy

- Three important phenomena facilitated by digitalization
  - scale without mass
  - reliance on intangible assets
  - the centrality of data

pose serious challenges to elements of the foundations of the global tax system

# Digitalization of the Economy

## Challenges for tax authorities:

- Intangible assets continuously erode the need for physical proximity to target markets. This continuously challenges the effectiveness of existing profit allocation and nexus rules to distribute taxing rights on income generated from cross-border activities in a way that is acceptable to all countries, small and large, developed and developing (the so-called allocation of taxing right issue).
- New technologies have facilitated tax avoidance through the shifting of profits by multinational enterprises (MNEs) to low or no tax jurisdictions.

# Possible solutions

## International solution to tackle the challenge:

- A comprehensive consensus-based solution that deals with the allocation of taxing rights.
- The aim is to secure and sustain the international income tax system and increase tax equity amongst traditional and digital businesses
- In case a multilateral solution is not achieved: would lead to a patchwork of unilateral actions. Some jurisdictions introduced Digital Services Taxes (DSTs)

# OECD BEPS Project

OECD G20 Base Erosion and Profit Shifting Project (BEPS)

OECD figures: BEPS practices cost countries 100 to 240 billion in lost revenue annually which is an equivalent to 4-10 % of the global corporate tax revenue

In the OECD/G20 Inclusive Framework on BEPS over 135 countries and jurisdictions are implementing 15 Actions to tackle tax avoidance, improve the coherence of international tax rules, ensure a more transparent environment and address **the tax challenges arising from the digitalisation of the economy.**

# From OECD BEPS Project to Pillar One

- The BEPS Action Plan was developed by the OECD Committee on Fiscal Affairs (CFA) and endorsed by the G20 Leaders in September 2013. Adoption of a 15-point Action Plan to address BEPS
  - Task Force on the Digital Economy (TFDE), was established in September 2013 to develop a report identifying issues raised by the digital economy
  - Work on BEPS project was finished in 2015 with all 15 actions completed.
- BEPS Action Plan 1 – Addressing the Tax Challenges of the Digital Economy

# Way of the discussions at OECD level

- BEPS Action Plan 1 – Addressing the Tax Challenges of the Digital Economy
- The Action 1 Report identified a number of BEPS-related challenges presented by the digital economy, as well as broader tax challenges.
  - Also important “*Because the digital economy is increasingly becoming the economy itself, it would be difficult, if not impossible, to ring-fence the digital economy from the rest of the economy for tax purposes.*”
  - The report concluded that work on the issues associated with the digital economy should be continued.



# Way of the discussions at OECD level

Further steps on the way to a solution:

- 2018: Interim Report
- 2019: Policy Report: The Inclusive Framework agreed a Policy Note in January 2019 that grouped the proposals into two pillars – one of nexus and profit allocation and another on ensuring a minimum level of taxation
- 2019: Public Consultation for a “Unified Approach” under Pillar One

# Way of the discussions at OECD level

## Elements of the Unified Approach:

- Amount A – a share of deemed residual profit<sup>6</sup> allocated to market jurisdictions using a formulaic approach, i.e. the new taxing right;
- Amount B – a fixed remuneration for baseline marketing and distribution functions that take place in the market jurisdiction; and
- Amount C – binding and effective dispute prevention and resolution mechanisms

# Way of the discussions at OECD level

- 2020: Statement of by the OECD/G20 Inclusive Framework on BEPS on the Two-Pillar Approach to Address the Tax Challenges Arising from the Digitalisation of the Economy
- Key elements Pillar One:
  - Scope: Businesses in scope and nexus

## Automated Digital Services

Businesses s that generate revenue from the provision of automated digital services that are provided on a standardized basis to a large population of customers or users across multiple jurisdictions

# Way of the discussions at OECD level

Examples:

→ Online search engines, social media platforms, online market places, online gaming etc.

## Consumer-facing businesses

→ covers businesses that generate revenue from the sale of goods and services of a type commonly sold to consumers, i.e. individuals that are purchasing items for personal use and not for commercial or professional purposes

→ Out of scope: extractives and financial services industries

# Way of the discussions at OECD level

→ Considered Thresholds: similar to CbCR (750 Mio. Euro) to reduce administrative burden

→ Nexus

The generation of in-scope revenue in a market jurisdiction over a period of years would be the primary evidence of a significant and sustained engagement. The revenue threshold would be commensurate with the size of a market, with an absolute minimum amount to be determined.

- Quantum of Amount A

# Way of the discussions at OECD level

## → Tax base

The calculation of Amount A will be based on a measure of profit derived from the consolidated group financial accounts.

The calculation of Amount A is based on a formula designed to identify the portion of the residual profits that is to be allocated to eligible market jurisdictions, as Amount A applies only to the portion of profit exceeding a certain level of profitability.

## → Allocation Key

## → Elimination of double taxation

# Way of the discussions at OECD level

- Tax certainty
  - Securing tax certainty is an essential element of the unified approach and is a fundamental part of the design of Pillar One
  - A new framework for dispute prevention and resolution for Amount A
  - Tax certainty and dispute prevention and resolution for Amounts B and C

# Way of the discussions at OECD level

- 2021: Statement on a Two-Pillar Solution to Address the Tax Challenges Arising From the Digitalisation of the Economy (July)

## → Scope

In-scope companies are the multinational enterprises (MNEs) with global turnover above 20 billion euros and profitability above 10% (i.e. profit before tax/revenue) with the turnover threshold to be reduced to 10 billion EUR.

Extractives and Regulated Financial Services are excluded.



# Way of the discussions at OECD level

## → Nexus

Nexus rule permitting allocation of Amount A to a market jurisdiction when the in-scope MNE derives at least 1 million euros in revenue from that jurisdiction. For smaller jurisdictions with GDP lower than 40 billion euros, the nexus will be set at 250 000 euros.

## → Quantum

For in-scope MNEs, between 20-30% of residual profit defined as profit in excess of 10% of revenue will be allocated to market jurisdictions with nexus using a revenue-based allocation key.

# Way of the discussions at OECD level

→ Revenue Sourcing

→ Tax base determination

The relevant measure of profit or loss of the in-scope MNE will be determined by reference to financial accounting income

→ Segmentation

Segmentation will occur only in exceptional circumstances where, based on the segments disclosed in the financial accounts, a segment meets the scope rules.

# Way of the discussions at OECD level

→ Marketing and distribution safe harbor

Where the residual profits of an in-scope MNE are already taxed in a market jurisdiction, a marketing and distribution profits safe harbour will cap the residual profits allocated to the market jurisdiction through Amount A.

→ Elimination of double taxation

Double taxation of profit allocated to market jurisdictions will be relieved using either the exemption or credit method.

# Way of the discussions at OECD level

- Tax certainty
  - In-scope MNEs will benefit from dispute prevention and resolution mechanisms, which will avoid double taxation for Amount A in a mandatory and binding manner.
  - Disputes on whether issues may relate to Amount A will be solved in a mandatory and binding manner, without delaying the substantive dispute prevention and resolution mechanism.

# Way of the discussions at OECD level

- Amount B
  - The application of the arm's length principle to in-country baseline marketing and distribution activities will be simplified and streamlined
- Unilateral Measures
  - Appropriate coordination between the application of the new international tax rules and the removal of all Digital Service Taxes and other relevant similar measures on all companies

# Way of the discussions at OECD level

- Transposition of the rules

The Statement provided that Amount A, under which a share of residual profit would be allocated to market jurisdictions using a formulary approach applied at the level of an MNE group (or segment), would be delivered through a multilateral instrument

# Way of the discussions at OECD level

- 2021: Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy (October 2021)

Confirmation on the elements of Pillar One, and more detailed rules on Unilateral Measures

“The Multilateral Convention (MLC) will require all parties to remove all Digital Services Taxes and other relevant similar measures with respect to all companies, and to commit not to introduce such measures in the future. No newly enacted Digital Services Taxes or other relevant similar measures will be imposed on any company from 8 October 2021 and until the earlier of 31 December 2023 or the coming into force of the MLC. The modality for the removal of existing Digital Services Taxes and other relevant similar measures will be appropriately coordinated.”

# Way of the discussions at OECD level

- Statement contained a Detailed Implementation Plan, confirming that Amount A would be implemented through a Multilateral Convention (“MLC”, or “Convention”) and, where necessary, correlative changes to domestic law
- The MLC would introduce a multilateral framework for all jurisdictions that join, regardless of whether a tax treaty currently exists between those jurisdictions.
- Where a tax treaty exists between parties to the MLC, that tax treaty will remain in force and continue to govern cross-border taxation outside Amount A, but the MLC would address inconsistencies with existing tax treaties to the extent necessary to give effect to the solution with respect to Amount A.



# Way of the discussions at OECD level

- 2022: Several Public Consultations on every building block of the MLC for Amount A
- 2023: Outcome State of 11 July and the delivery of a draft of the MLC, some issues still open

Important content regarding Pillar One – Amount A

→ Members (not all!) have agreed to refrain from imposing newly enacted DSTs or relevant similar measures, as defined in the MLC, on any company between 1 January 2024 and 31 December 2024.

# Way of the discussions at OECD level

- To prevent delay of the ratification of the MLC, and subject to at least 30 jurisdictions accounting for at least 60 percent of the Ultimate Parent Entities (UPEs) of in-scope MNEs signing the MLC before the end of 2023, Members (not all!) have agreed to refrain from imposing newly enacted DSTs or relevant similar measures, as defined in the MLC, on any company between 1 January 2024 and 31 December 2024.
- Entry into force was planned for 31 December 2025.

# Way of the discussions at OECD level

- Amount B
  - Provides a framework for the simplified and streamlined application of the arm's length principle to in-country baseline marketing and distribution activities
  - Amount B is a critical component of the broader agreement on Pillar One
  - To ensure the appropriateness of the scope and pricing framework, further work must be done.
  - The content of the final Amount B report will be incorporated into the OECD Transfer Pricing Guidelines by January 2024.

# Way of the discussions at OECD level

- Next steps:
  - Remaining issues must be solved
  - Signing of the MLC by participating jurisdictions
  - Ratification of the text of the MLC by the jurisdictions

# Key elements of the MLC

The content of the MLC is as follows:

- Part I: General (Application and general rule)
- Part II: Definitions (General definitions and Covered Group)
- Part III: Allocation and taxation of profits
- Part IV: Elimination of double taxation
- Part V: Administration and certainty
- Part VI: Treatment of specific measures enacted by parties

# Key elements of the MLC

The content of the MLC is as follows:

- Part VII: Final provisions
- Annex A: List of existing measures subject to removal
- Annex B to G: Supplementary provisions to articles and chapters
- Annex H: Review process and early clarification on Digital Services Taxes and relevant similar measures
- Annex I: Points attributed to jurisdictions for the purpose of certain provisions

# Key elements of the MLC / ES

The content of the MLC is as follows:

→ Appendix regarding the approach for the application of the MLC to non-state jurisdictions

## Explanatory Statement

The October 2021 Statement provided that the MLC would be supplemented by an Explanatory Statement that would describe the purpose and operation of the Amount A rules and processes.

# Key elements of the MLC / ES

- Next steps:
  - Remaining issues must be solved
  - Signing of the MLC by participating jurisdictions
  - Ratification of the text of the MLC by the jurisdictions



# Pillar One

**Thank you for your attention !**

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