

## Background to OECD Pillar One and Pillar Two proposals

The matter of directly addressing the tax challenges of the digitalised economy was effectively parked in the course of the OECD's base erosion and profit shifting (BEPS) project. Work on the matter is now being taken up again.

On 12 October 2020, the OECD published its reports on the 'Blueprints' for its two-pillar proposal to address both the tax challenges arising from the digitalisation of the economy and the remaining challenges of the BEPS project (the [Pillar One Blueprint](#) and [Pillar Two Blueprint](#), together the Blueprints). Here, we take a look at the background to the Blueprints and to the OECD's two-pillar approach.

The Blueprints acknowledge that agreement has not yet been reached on the measures but the texts reflect the 'convergent views' of the 137 member jurisdictions of the OECD/G20 Inclusive Framework (OECD/G20 IF) and are designed as a foundation for future agreement.

The Blueprints contain detailed commentary and guidance on the proposals under Pillar One and Pillar Two. Public consultation on the Blueprints closed on 14 December 2020. A virtual hearing will take place in January 2021.

While the current timeframe is to reach a successful conclusion on the proposals by mid-2021, uncertainty remains regarding the position the US will take in the negotiations, in particular due to the change in the US administration.

### At a glance: the Blueprints

#### Pillar One Blueprint

In broad terms, the aim of Pillar One is to allocate a greater amount of certain profits of certain multinational enterprises (MNE) to market or end user countries. It proposes to achieve this through the introduction of new tax rules that would effectively provide for taxation in those countries without the need for the relevant MNE to have a physical presence in the country concerned.

At the moment the scope of the proposed rules is intended to cover certain digitalised businesses and consumer facing groups with cross-border activity.

Key features and principles emanating from the Pillar One Blueprint are:

- the creation of a new taxing right no longer requiring physical presence of an MNE in a particular country
- any new rules should be based on net basis taxation (as opposed to being taxed on gross receipts), should avoid double taxation and should be as simple as possible in terms of both administration and compliance. The Pillar One Blueprint expressly notes that 'it is expected that any consensus-based agreement must include a commitment by members of the Inclusive Framework to implement this agreement and at the same time to withdraw unilateral actions (i.e. unilateral digital services taxes (DSTs)), and not adopt such unilateral actions in the future', and
- tax certainty processes should be improved through enhanced dispute prevention and resolution tools.

A number of policy issues remain open including the precise scope of Pillar One, the quantum of relevant thresholds and the operation of enhanced tax certainty processes. Further

technical work is required in relation to segmentation of the tax base for certain in-scope MNEs and the administration of the new rules.

### Pillar Two Blueprint

Broadly, Pillar Two is aimed at ensuring that certain large multinational groups pay a minimum level of tax regardless as to where the relevant MNE profits arise.

The key aspects under the Pillar Two Blueprint are:

- the introduction of a global minimum effective rate of taxation for large businesses operating internationally to ensure minimum a minimum level of taxation regardless of where a business is headquartered or tax resident, while avoiding double taxation or taxation where there is no economic profit
- the new measures should address the challenges arising from BEPS structures, ensure transparency and create a level playing field for businesses, and
- administrative and compliance costs should be minimised through relying on existing frameworks where possible (e.g. leveraging off current BEPS Action 13 Country by Country Reporting rules, thresholds and definitions).

Important issues remain outstanding, including the level at which the minimum effective tax rate (**ETR**) should be set, the scope of application of the rules and potential carve-outs for a fixed return from substantive activities, and the development of new (multilateral) dispute prevention and resolution processes.

In addition, further technical work is required in relation to the ETR calculation and the co-existence of the Pillar Two global anti-base erosion rules (GloBE Rules) and the Global Intangible Low-Taxed Income (**GILTI**) regime in the United States.

### Background: the Two Pillar approach

The two-pillar approach stems from the 2015 OECD/G20 IF Final BEPS Action Reports. The BEPS Action 1 Report focussed on the tax challenges arising from the digitalisation of the economy and has remained a top priority for the OECD/G20 IF ever since. Following an interim report published in March 2018 which recognised the need for a global solution, in January 2019 the OECD/G20 IF issued a policy note which advocated a two-pillar approach as the basis for a consensus solution to the tax challenges arising from digitalisation.

Pillar One focussed on the allocation of taxing rights between jurisdictions and considered various proposals for new profit allocation and nexus rules, while Pillar Two focussed on the remaining BEPS issues and in particular the 'continued risk of profit shifting to entities subject to no or very low taxation'.

Although the two proposals are distinct, the OECD noted that they intersect, as the 'remaining BEPS issues' addressed under Pillar Two are 'exacerbated by digitisation'. Therefore, the OECD championed a two-pillar approach, with each pillar having a reinforcing effect for the other.

A programme of work on the two pillars was adopted in May 2019 and a public consultation held from October–December 2019. The outcome of this public consultation comprised an outline of the so-called 'unified approach' (unifying Amounts A and B) under Pillar One, which was released in January 2020, together with a progress note on Pillar Two.

In July 2020, the G20 mandated the OECD Inclusive Framework to produce reports on the blueprints of Pillar One and Pillar Two prior to the meeting of the G20 Finance Ministers in October 2020. The Blueprints were approved by the Inclusive Framework on 8-9 October 2020 and on 12 October 2020 the Blueprints were released by the OECD Secretariat for public consultation, which closed on 14 December 2020.



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