

Key features: Pillar One and Pillar Two

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).

In this briefing, we look at the key features of Pillar One and Pillar Two as outlined in the Blueprints and highlight some of the main issues.

Pillar One	Pillar Two
<ul style="list-style-type: none"> Amount A - new taxing right Amount B - fixed remuneration of baseline marketing and distribution activities Tax Certainty - dispute prevention and resolution mechanisms 	<ul style="list-style-type: none"> GloBE Rules - income inclusion rule and undertaxed payments rule Subject to Tax Rule

Pillar One

Pillar One seeks to reform existing profit allocation and nexus rules. It envisages the creation of a new taxing right not constrained by physical presence and the re-allocation of a portion of in-scope multinational enterprises' (MNE) residual profits to market/user jurisdictions.

The Pillar One Blueprint outlines a three-part 'unified' approach:

- Amount A: the new taxing right for market/user jurisdictions over a share of residual profit associated with activities carried on by in-scope businesses in that jurisdiction
- Amount B: fixed remuneration for certain baseline routine marketing or distribution functions performed by related-party companies in a manner that is aligned with the arm's length principle, and
- Tax Certainty: processes to improve

tax certainty through effective dispute prevention and resolution mechanisms, including a mandatory binding dispute prevention and resolution procedure in relation to Amount A disputes.

Pillar One has generated significant debate across member jurisdictions given its broad scope and would represent a radical overhaul to the current corporate tax system, which is largely focussed on the taxation of companies where they are physically located. Indeed some members, notably the United States, have called for Pillar One to apply on an optional 'safe harbour' basis, whereby an MNE could elect on a global basis to be subject to Pillar One.

Pillar One aims to remove the highly distortive unilateral digital services taxes introduced in recent years in countries such as the UK and France, and would offer a more uniform and harmonious approach to the taxation of digital businesses by preventing further uncoordinated tax measures.

Pillar Two

Pillar Two aims to ensure that all large internationally operating businesses pay at least a minimum level of tax, regardless of where they are headquartered or the jurisdictions they operate in.

It envisages the introduction of a global minimum effective rate of tax (**ETR**) for large MNEs, which would essentially allow the jurisdiction of the ultimate parent entity (**UPE**) of the MNE to charge a top-up amount of tax to ensure that the MNE pays an as-of-yet undetermined minimum ETR.

The Pillar Two Blueprint details two primary rules to achieve this outcome:

- **GloBE Rules:** these are comprised of the income inclusion rule (**IIR**), a switch-over rule (**SOR**), and the undertaxed payments rule (**UTPR**).

The IIR is based on traditional controlled foreign company (**CFC**) rule principles and would trigger inclusion of income at the level of the UPE where the income of a controlled foreign entity is taxed at below the ETR.

The IIR is complemented by a SOR, which removes treaty obstacles where necessary by allowing a jurisdiction to override the exemption method prescribed in the relevant double taxation treaty to apply the IIR to the profits of a permanent establishment.

The UTPR acts as a 'backstop' to the IIR and addresses inversion risks that might otherwise arise by providing a mechanism to collect any remaining top-up tax in relation to foreign profits that are not in scope of an applicable IIR.

- **Subject to tax rule (STTR):** a treaty-based rule that seeks to restore taxing rights to the source jurisdiction and deny treaty benefits for certain deductible intragroup payments made to shift profits to no or low tax jurisdictions.

The STTR allows the source jurisdiction to impose an additional top-up tax on covered payments up to the agreed minimum rate. Any top-up tax imposed under the STTR would be taken into account in determining the ETR for purposes of the IIR and the UTPR.

Like Pillar One, Pillar Two has generated much debate given its scope is much broader than typical CFC rules as it applies to all the subsidiaries in an MNE group and applies equally to both low-tax passive income and low-tax active income.

However, the Pillar Two Blueprint confirms that the US GILTI regime may, subject to coordination in certain respects, be treated as a qualifying IIR for the purposes of the GloBE Rules. Indeed, the OECD/G20 Inclusive Framework expressly recognises that an agreement on the co-existence of the GILTI regime and the GloBE Rules would need to form part of the political agreement on Pillar Two.

Public consultation: the open issues

The public consultation on the Blueprints closed on 14 December 2020. In conjunction with the release of the Blueprints, the OECD/G20 Inclusive Framework issued a public consultation document in which it invited comments on a range of particular aspects of the Blueprints. Recognising that there are still significant hurdles that must be overcome before agreement is reached, the [public consultation document](#) acknowledges that there are a number of open issues on key features of Pillar One that can only be resolved through political agreement. While the same could arguably also be said for Pillar Two, the public consultation on that pillar is more focussed on technical aspects of the proposal rather than potential political sticking points.

We've highlighted some of the main issues likely to preoccupy stakeholders below and will explore these topics and other key areas of interest in greater depth in subsequent briefings.

Pillar One

Scope of Amount A

Under the Pillar One Blueprint, MNEs that satisfy both the activity test and the threshold tests, would be within scope of Amount A, unless they come within one of the carve-outs.

Activities within scope of the activity test are:

- automated digital services (**ADS**) (e.g. online advertising services, sale or other alienation of user data, online search engines, etc.) and

- ii. consumer facing businesses (CFB) (i.e. “businesses that generate revenue from the sale of goods and services of a type commonly sold to consumers, including those selling indirectly through intermediaries and by way of franchising and licensing”). One of the most contentious and politically sensitive aspects of Pillar One is its broad scope of application, in particular the wide-ranging definition of CFBs.

Nexus Rule

Whether an MNE group satisfies the Amount A nexus test will depend on the nature of the activity that it carries on (i.e. ADS or CFB).

For ADSs, the primary consideration will be whether a prescribed market revenue threshold test is met, potentially supplemented by a temporal requirement (e.g. that the market revenue threshold contain a temporal requirement of more than one year).

For CFBs however, comments are invited on appropriate additional “plus factors” that denote an engagement with the market beyond the mere conclusion of sales, which would be required before a sufficient nexus is established to bring the MNE within scope of Amount A. Given the broad definition of CFBs, member jurisdictions may seek to narrow its scope by enumerating a strict list of “plus factors” to curtail the potential impact of Amount A.

Pillar Two

GILTI Co-Existence

As noted above, the Pillar Two Blueprint expressly recognises that an agreement on the co-existence of the GILTI regime and the GloBE Rules would need to form part of the political agreement on Pillar Two. The United States will be keen to ensure its GILTI regime is regarded as a qualifying IIR for the purposes of Pillar Two with as few amendments to its existing regime as is possible.

Agreement on this point will undoubtedly necessitate both political negotiations and an analysis of the technical implications. In this regard, the public consultation document invites comments on any other technical implications of the GILTI co-existence beyond those already identified in the Pillar Two Blueprint.

Calculating the ETR under the GloBE Rules

The GloBE ETR is determined by dividing the amount of “covered taxes” by the amount of income as determined under the GloBE Rules. The Pillar Two Blueprint explores the concept of “covered taxes” in considerable detail, but it is on the tax base (i.e. the denominator in the ETR formula calculation) that the public consultation focuses.

The starting point in calculating the tax base is the financial accounts prepared under the same accounting standard that is used by the parent of the MNE to prepare its consolidated financial statements. A number of adjustments are then made to the profits reflected in the accounts. The public consultation document invites comments on the suggested adjustments including, for example, the treatment of dividends and gains from disposition of stock in a corporation, the treatment of reorganisations under Pillar Two, and rules to adjust for accelerated depreciation.

The complexity and technical considerations inherent in calculating the GloBE ETR is indicative of the difficult matters that remain to be resolved before agreement is finally reached on the proposals.

Looking ahead: implementation

Considerable work will need to be undertaken before agreement is reached on the proposals, but if and when all relevant stakeholders arrive at a conclusion, member jurisdictions must then turn to implementing the measures. From a practical perspective, implementation will require amendments to both domestic legislation and to existing bilateral double taxation treaties.

For instance, the Pillar One Blueprint recognises that effective implementation will require amendments at a domestic level in order to:

- create a domestic taxing right consistent with the design of Amount A
- provide for the relief of double taxation where a resident entity is identified as a taxpayer liable to tax under Amount A
- incorporate procedures for administering the new taxing right as well as relief from double taxation, and

- facilitate the tax certainty (prevention and dispute resolution) processes envisaged under Pillar One.

From an international law perspective, the Pillar One Blueprint suggests that a new multilateral convention be developed in order to remove obstacles under existing bilateral double taxation treaties to the implementation of Pillar One and to do so in a way that ensures consistency and certainty in the application and operation of Amount A.

Similarly, the Pillar Two Blueprint explains that successful implementation of Pillar Two would require legislative amendments at both domestic and international level. For instance, the IIR and UTPR would require amendments to domestic law, while both the STTR and SOR would require changes to existing bilateral double taxation treaties.

The Pillar Two Blueprint notes these latter amendments could be achieved most effectively by either adopting the rules under the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS (the existing MLI) or by way of a new multilateral convention.

It is unclear, at this stage, whether action might be taken at supranational level in order to coordinate the timing of the implementation of the necessary measures. For example, could a directive be adopted at EU level requiring Member States to transpose the relevant provisions into domestic law by a certain date, as under the EU Anti-Tax Avoidance Directive? Therefore, while the Blueprints do indeed lay a solid foundation for future agreement on the two-pillar approach, the path ahead remains far from certain.

You can contact any member of the [A&L Goodbody Tax team](#) for further information.

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