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OECD's Pillar One and the Return of the Pencil!

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There's something about OECD's Pillar One. For some years now, the world has been under the spell of a new system of taxation of companies that make profits in countries without taking root there in any way. They often operate via internet platforms, which means that the profits that are generated elsewhere cannot be taxed in those other countries. However, the OECD is unable to make progress to create a global solution for these countries. At the time of writing, only one thing is certain. And that is that the answer to whether the countries will reach an agreement is anything but certain. Two major problems play a role in this. First of all, the complex method of distributing the profits among the countries, whereby the remuneration for R&D is a particularly difficult point of discussion. And secondly, the requirement that binding arbitration must be applied in the event of a dispute. For the enthusiast: in 2020 I published an article about Pillar One in the EC Tax Journal of February (Tax and the digital economy – Will Pillar One be the solution?) In which I wondered whether the world could ever reach an agreement. I was and am not very hopeful. The tenor in politics and the media is often that "those Americans" would not want that. The Americans, however, are quite willing to push back, but they want binding arbitration to be the starting point. However, arbitration is a threat to many countries, even the non-binding ones. Many African countries view arbitration as a violation of their sovereignty. And a country like India not long ago denounced its bilateral investment treaties because it no longer wished to accept that arbitrators could play a decisive role in whether they could, in this case, retroactively adjust the rules of the game.

The discussion is therefore at an impasse. A number of European countries, but also India and Brazil, for example, no longer wish to wait and are introducing their own so-called digital services tax. The United States, the country that has to shift the most in tax revenues, feels attacked as the companies based there will now be faced with double taxation. Instead of the countries trying to get closer together, the opposite seems to be happening. The fact that Janet Yellen has reaffirmed that the United States will actively participate in the follow-up talks on Pillar One does not change this. The discussions are just stuck. The familiar thought that pulling a dead horse is pointless comes to mind the most.

But although the OECD countries believe that the UN countries are also represented by them, practice shows otherwise. How different, that was expressed as follows in the Asia-Pacific Tax Bulletin 2020, No. 3.

When NASA first started sending up astronauts, they quickly discovered that ball-point pens would

not work in zero gravity. To combat this problem, NASA scientists spent a decade and $12 billion developing a pen that writes in zero gravity, upside down, on almost any surface including glass and at temperatures ranging from below freezing to over 300 °C.

The Russians used a pencil.

What all this has to do with Pillar One is the following. While NASA ultimately managed to develop a ballpoint pen suitable for all circumstances for a hefty price tag, the OECD is unable to develop a system for all countries. And where Russia chose to work with a pencil and thereby achieve the same as NASA, a group of countries from the United Nations has managed to come up with an alternative to Pillar One that has a considerably greater chance of success. In the middle of last year, a number of countries presented a joint alternative on behalf of the UN. Just an idea in terms of solution direction? No, this concerns a concrete amendment to the UN model convention, namely the introduction of Article 12b. What have they arranged? Actually quite a lot. Section 12b attempts to tax the profits that a company realizes in another state without having a permanent establishment or a subsidiary there. This effectively becomes a new tax at source. A number of logical steps have been defined to determine the amount of the tax at source (the profit to be taxed). This method is probably not without problems. But it could certainly work. For example, it has been determined which part of the profit is the basis for this new withholding tax. These are called the "qualified profits". The source country examines the profit ratio of the recipient of the revenues or of the relevant group to which the beneficial owner belongs, and applies this ratio to the revenues in that country. The profit calculated on this basis is then multiplied by 30% to calculate the taxable amount in that source country.

All pretty complicated of course, but not impossible either. Of course, discussions will arise about this group ratio. But let that be resolved in a mutual agreement procedure. And under tax treaties, assuming that the MLI minimum standard is used, in the event that the mutual agreement procedure does not lead to an outcome, arbitration is possible in any case. Since the UN countries want to see article 12b included in their treaties, the other countries can be sympathetic to this, provided that the relevant UN country agrees to binding arbitration and then we are actually where we wanted to get.

It appears that a number of UN countries have formulated a proposal that will bring the pencil back to the international tax debate in a way that makes a multibillion-dollar ballpoint pen obsolete. All problems solved? No unfortunately. Why would the OECD want to listen to what UN countries are developing? Were we not all trained in the past with the statement that, in addition to (in my case) the Dutch standard treaty, there was also an OECD model? And yes, also a UN model. But that was not so relevant. That is always in the minds of many tax specialists all over the Western world. Also in other countries. I am therefore curious whether France, the United Kingdom, Germany, Italy but also India, are prepared to let go of their digital tax in the event that a new tax treaty can be concluded that has an Article 12b. I don't really see why these countries wouldn't want this. Or they must have a dual agenda and simply want to tackle the US tech giants. Of course, OECD suffers a loss of face. That's a shame, but unfortunately. After all, it is not ultimately about the success of OECD in redefining workable international tax rules, but about the result that the countries in which profits are generated that cannot be taxed under the current rules, will be taxed in the future. Long live the pencil!

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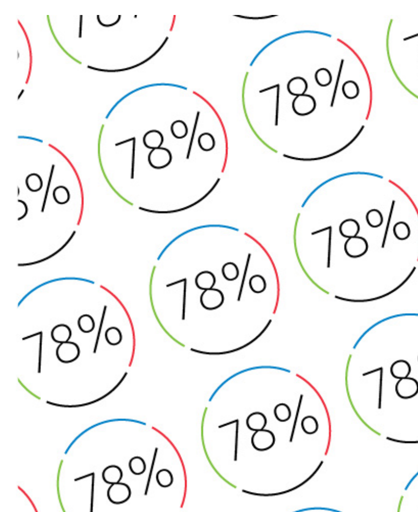

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