**The OECD/G20 Inclusive Framework's Two-Pillar Solution**

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On the 8th of October 2021, 136 countries from the OECD/G20 Inclusive Framework released a statement (October Statement) announcing their agreement for a "Two-Pillar Solution". The agreement notionally addresses the tax challenges arising from the digitalisation of the economy, but, in effect, it aims at a broader and more significant reform of the international business tax system. The October Statement only adds marginally to a statement released on the 1st of July 2021 (July Statement) which has been agreed by 134 countries, and is thus less meaningful. But it is yet another step in a process of reform that has been going on for the best part of a decade and has gained momentum over the past few months, first with the US Treasury's "Made in America Tax Plan" of 7th of April and then with the G7 agreement of the 5th of June. Several challenges remain ahead, despite the progress.

The basic structure of the constituent parts of the Two-Pillar *Solution*[1] are well known. Pillar 1 – the Unified Approach – allocates some taxing rights to market countries, defined as countries where goods or services are used or consumed. It is meant to "ensure a fairer distribution of profits and taxing rights among countries with respect to the largest MNEs".[2] Pillar 2 - the Global anti-Base Erosion Rules (GloBE) - is a global minimum tax that is meant to address remaining profit shifting opportunities and tax competition. A brochure released by the OECD to accompany the October Statement (Brochure)[3] now explains that Pillar 2 does not aim at eliminating tax competition but merely sets "multilaterally agreed limitations on it."[4] The Brochure's reference to "*unhealthy* tax competition"[5] will have drawn a few smiles from seasoned readers.

Many, this writer included, will question various aspects of the agreement and whether it will be implemented successfully. Three points should be kept in mind when doing so. First, an agreement that went this far and was agreed by this many countries seemed highly improbable to many even only three years ago or so. The OECD has done tremendous technical and diplomatic work to bring us to this point, and it would be churlish not to recognise its achievement. Second, the agreement is a product of political compromise. The reform process was not directed at designing the "ideal" improvements to the system, let alone an "ideal" tax system, whatever that may be. It was directed at proposing reforms that a large group of countries with diverse and even conflicting interests could agree on. Of course, this does not mean that one should refrain from criticising the political ambition of

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1 Is the use of the term "Solution" politically astute, a sign of confidence, or a hostage to fortune?

2 OECD/G20 Base Erosion and Profit Shifting Project, "Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy", October 2021, page 4. This document is available at https://www.oecd.org/tax/beps/brochure-two-pillar-solution-to-address-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-october-2021.pdf

3 Ibid.

4 Ibid. page 4.

5 Ibid. page 3 (emphasis added).

the reform, the reform itself, and how agreement was achieved. Third, one can be critical of the reform - or aspects of it - while being positive about the novel directions of travel it takes, including the allocation to the market and the move away from the Arm's Length Principle (ALP). As Richard Collier and Michael Devereux have observed:

> "The current developments involving a new partial allocation of revenues by reference to the market or demand side (rather than as exclusively based on the supply or production side as under the existing system) are the first serious multilateral steps in a paradigm shift relating to the global income allocation system. It is not just the ALP-based rules of transfer pricing and PE profit attribution that are being modified here. The new approach also partially reshapes the existing nexus concept of Article 5 of the OECD Model Tax Treaty, meaning the shift in thinking is fundamental to the existing international tax system as a whole." [6]

The reform agreed is indeed open to several lines of criticism. There is much that can and will be said about the substantive content of the agreement, not least its lack of principle and complexity (two ills which already characterise the existing system). But there is also much to be said about the politics surrounding the agreement. EU Commissioner Gentiloni – and others - hailed "this triumph for multilateralism",[7] but four members of the Inclusive Framework (Kenya, Nigeria, Pakistan and Sri Lanka) have not joined the agreement, and others joined reluctantly. Although countries participate on "an equal footing" in the Inclusive Framework, some countries, unsurprisingly, are more equal than others. This affects powerful countries, which had to wait for the US's green light before moving forward at different points. But it particularly affects less powerful countries which, it is suggested, were leaned on to join the agreement, or, in practice, were given little choice. Representatives from some of these countries have spoken out publicly to this effect, including the Argentine Economy Minister Martin Guzman who said that the proposals forced developing countries to choose between "something bad and something worse".[8] The attention devoted to developing countries in the Brochure may be telling. At points, one does feel that it doth emphasise some points too much, for example when it insists that "[d]eveloping countries (particularly those in Africa, and with the support of the African Tax Administration Forum (ATAF)) have had a significant influence on the agreement."[9] We have seen illuminating research into the politics and mechanics of international tax reform over

6 Richard Collier and Michael Devereux, "On why it really was such a big deal", Oxford University Centre for Business Taxation Blog, 2 July 2021. This bog is available here: [https://oxfordtax.sbs.ox.ac.uk/article/on-why-it-really-is-such-a-big-deal](https://oxfordtax.sbs.ox.ac.uk/article/on-why-it-really-is-such-a-big-deal). The move towards a destination basis of taxation was advocated in Michael Devereux, Alan Auerbach, Michael Keen, Paul Oosterhuis,Wolfgang Schön, and John Vella, *Taxing Profit in a Global Economy*, Oxford University Press, (2021).

7 "Statement by Commissioner Gentiloni on the G20's endorsement of the agreement on international taxation reform", 13 October 2021. This statement is available at https://ec.europa.eu/commission/presscorner/detail/en/STATEMENT_21_5247

8 "Developing countries get short shrift in global tax deal – Argentina", Reuters, 7 October 2021.

9 Footnote 2, supra, page 18.

the past few years,[10] and this process will undoubtedly provide fecund ground for further research into these issues.

As noted above, the October Statement adds marginally to the July Statement. Perhaps the most practically significant development is the addition of Ireland, Estonia, and Hungary to the list of signatories.[11] All EU member states have now joined the agreement thus freeing the way for the pillars to be implemented through EU directives. [12] Leaving aside other factors that may militate in favour or against such a move, this could reduce the probability that the European Court of Justice finds Pillar 2 incompatible with the fundamental freedoms. A few important issues have also been pinned down in the October Statement. Having considered a range of 20-30% in the July Statement, the October Statement settled on 25% of the residual profit of companies within scope to be allocated to market countries under Pillar 1. The minimum rate for the GloBE rules and the Subject to Tax Rules are fixed at 15% and 9% respectively in the October Statement, while they were "at least" 15%, and 7.5-9% in the July Statement. The October Statement also introduced an exclusion for the Undertaxed Payment Rule for MNEs in the initial phase of their international activity, extended the transition period for the substance-based carve out under Pillar 2 to 10 years from 5, and provided some more detail on the phasing out of this period as well as on the de minimis exclusion. An ambitious implementation plan was also released in October. Work is expected to move faster on Pillar 2 than it is on Pillar 1. Model rules on Pillar 2 are expected in November 2021, while the next steps for Pillar 1, including text for a Multilateral Convention, are expected in "early" 2022. Implementation of the two pillars is set for 2023. Pillar Two should be brought into law in 2022, to be effective in 2023, with the Undertaxed Payment Rule coming into effect in 2024.

But the October Statement offers no updates on some thorny issues, and from the outside it is hard to know how much progress has been made on them. Two examples of high political sensitivity can be given here. The first concerns "surrendering entities" under Pillar 1.[13] Pillar 1 essentially takes as a starting point profit as allocated to different countries under the existing system. It then allocates part of that profit to market countries. The difficult question is which countries that currently enjoy taxing rights under the existing system are to give them up in favour of market countries. More technically, the question is which entities are to provide relief for the tax paid on profit in the market countries. The October Statement simply repeats the line found in the July Statement on this point: "The entity (or entities) that will bear the tax liability will be drawn from those that earn residual profit." This does not take us very far. A second example is the mandatory and binding dispute resolution process for Pillar 1, on which there still is scant detail.[14]

10 See for example Yariv Brauner, "Tax Treaty Negotiations: Myth and Reality", (2020), Working Paper available at https://ssrn.com/abstract=3722607, and Rasmus Corlin Christensen, Martin Hearson and Tovony Randriamanalina, "At the Table, Off the Menu? Assessing the Participation of Lower-Income Countries in Global Tax Negotiations", ICTD Working Paper 115. This paper is available at https://opendocs.ids.ac.uk/opendocs/bitstream/handle/20.500.12413/15853/ICTD_WP115.pdf

11 130 signed up the July 1 agreement on July 1. By 31 August 134 countries had signed up. Pakistan did not sign the October agreement.

12 At the time of writing the EU Commission intends publishing a proposal for a directive implementing Pillar 2 by the end of the calendar year. "EU will propose a Pillar 2 Directive by Year end", *Tax Notes*, COMPLETE REFERENCE.

13 On this difficult issue see Richard Collier, Michael Devereux, and John Vella, 'Comparing Proposals to Tax Some Profit in the Market Country', (2021) *World Tax Journal,* Vol. 13, No. 3, 405-439.

There are other challenges in the process leading to the implementation of the Two-Pillar Solution. As noted above, there are questions on the compatibility of Pillar 2 with EU law.[15] The number of countries that will adopt Pillar 2 is also not yet known. The agreement is only for a "common approach", meaning that countries "are not required to adopt the GloBE rules, but, if they choose to do so, they will implement and administer the rules in a way that is consistent with the outcomes provided for under Pillar Two, including in light of model rules and guidance agreed to by the IF." Much rides on this number, as the proper functioning of Pillar 2 requires adoption by a critical mass of countries. The Multilateral Convention 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. The October Statement does not provide further information on how these measures are to be identified – a detailed definition will be finalised as part of the adoption of the Multilateral Convention and its Explanatory Statement. In the meantime, signatories to the October Statement have also agreed not to impose new DSTs or other relevant similar measures on any company until the earlier of the 31st of December 2023 or the coming into force of the Multilateral Convention.[16] It is not clear how the EU Commission's commitment to introduce an EU digital levy[17] can live alongside this part of the agreement. The deadline may have been designed to allow the US administration to put pressure on Congress to adopt Pillar 1. Given the current composition of Congress, this is one of the most significant challenges for the process going forward. One can only speculate as to what would happen if this challenge were not overcome. Pillars 1 and 2 have been presented as individual parts of a package that stand and fall together. Could the US's failure to implement Pillar 1 lead to the decoupling of the Pillars, with countries pressing ahead with Pillar 2? Some countries are known to have been more enthusiastic about Pillar 1 than they were about Pillar 2 and agreed to the latter in return for other countries' agreement to the former. But it might be too late, or futile, for those countries not to adopt the GloBE rules at that stage. DSTs are likely to proliferate in this scenario. If progress stutters and cracks in this broad coalition of countries become more prominent, countries that joined the agreement despite reservations may then start agitating more vigorously for change. But this is only one possible scenario. The road ahead may be significantly more, but also significantly less, bumpy. It is hard to tell.

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14 See, for example, the discussions in Jinyan Li, 'The Legal Challenges of Creating a Global Tax Regime with the OECD Pillar One Blueprint', 75 *Bulletin for International. Taxation* 2 (2021), Journal Articles & Opinion Pieces IBFD; and Collier, Devereux, and Vella, supra note 13.

15 See, for example, Joachim Englisch, Designing a harmonized EU-GloBE in compliance with fundamental freedoms, *EC Tax Review*, 30(3), (2021), 136-142; Luc De Broe and Mélanie Massant, "Are the OECD/G20 Pillar Two GloBE-Rules Compliant with the Fundamental Freedoms?" *EC Tax Review*, 30(3), (2021); and Michael Devereux, François Bares, Sarah Clifford, Judith Freedman, İrem Güçeri, Martin McCarthy, Martin Simmler, and John Vella, 'The OECD Global Anti-Base Erosion Proposal', *Oxford University Centre for Business Taxation* Report, (2020).

16 On the 21st of October, the US, the UK, Austria, Spain, France, and Italy released a statement regarding a compromise on a transitional approach to existing unilateral measures during the interim period before Pillar 1 is in effect. This statement is available at: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1027640/Joint_statement.pdf

17 Communication from the Commission to the European Parliament and the Council, "Business Taxation for the 21st Century", Brussels, 18.5.2021 COM(2021) 251 final. This Communication is available at: https://ec.europa.eu/taxation_customs/system/files/2021-05/communication_on_business_taxation_for_the_21st_century.pdf

If the road to reform is successfully traversed, and the two pillars implemented, will it lead to a stable international tax system that is fit for purpose for years to come? Is this too much to expect of the reform, even when it is has been hailed as "seismic"[18] and a "tax revolution"?[19] In the court of public and political opinion the agreement may be judged on its revenue effect, not least because politicians driving this reform have trumpeted its goal of ensuring that companies pay "a fair share" of tax at every turn.[20] Around USD 125 billion of profit are expected to be reallocated to market countries each year under Pillar 1. Pillar 2 is expected to raise around USD 150 billion in new tax revenues per year. Pillar 2 is also meant to stabilise the international tax system and provide increased tax certainty for taxpayers and tax administrations, but these benefits are hard to quantify, and public and political attention is likely to focus on the additional revenues raised instead. If these revenue estimates prove to be broadly correct, one does wonder whether the goal of making companies pay their "fair share" of tax will be widely judged to have been achieved and, and, if not, what impact that might have going forward. To put these revenues in context, global corporate tax revenues are currently around USD 2400 billion per year.

Politicians commenting on the July and October agreements readily resorted to hyperbole, unhelpfully raising public expectations, in particular about the revenues they will raise. If the two pillars are implemented properly by participating countries, they could have a significant impact on the international business tax system. They would certainly constitute a departure from the paradigm currently underpinning the system, and, once this breakthrough is achieved, they may even be harbingers of more extensive reform in the future. But, at this point, even the adequate implementation of the two Pillars is not a foregone conclusion. It will require political manoeuvring as well as careful thought and evaluation. Careful thought and evaluation will also be needed on the tax system that will emerge from the process. A special issue of the *British Tax Review* will be devoted to the Two-Pillar Solution in 2022 and submissions are invited - on technical issues as well as the bigger picture - that contribute in this way.

18 HM Treasury, "G7 Ministers Agree Historic Tax Deal", 5 May 2021. This news item is available at: https://www.gov.uk/government/news/g7-finance-ministers-agree-historic-global-tax-agreement

19 By EU Commission Gentiloni. See footnote 4, supra.

20 European Commission President Ursuala van der Leyen, British Chancellor of the Exchequer Rishi Sunak, American President Joe Biden, German Finance Minister Olaf Sholz, among others, have done so with abandon.