Pillar One treaty process will spill over into next year, Yellen says

Treasury Secretary Janet Yellen said this week that the US will not be in a position to sign a multilateral treaty implementing Pillar One of the OECD-led global tax reform process in 2023—a development that could lead to the imposition of new digital services taxes (DSTs) when an existing moratorium on those levies expires at the end of this year.

The OECD, which has for several years spearheaded the global tax project involving more than 140 countries, on October 11 released a draft of the multilateral tax treaty it proposes for implementing what is known as "Amount A" of Pillar One. This element of the agreement would establish a taxing right for market jurisdictions with respect to a defined portion of the residual profits of the largest and most profitable multinational businesses—in short, increasing taxing rights for jurisdictions in which the companies have users and customers. The treaty is not yet open for signatures, and there are notes throughout the document identifying areas where negotiating countries are still trying to reach agreement.
URL: https://www.oecd.org/tax/beps/multilateral-convention-to-implement-amount-a-of-pillar-one.htm

'Some matters that are important to the US . . .'

Speaking to reporters after a meeting with EU finance ministers in Luxembourg October 16, Secretary Yellen stated that "much of the treaty has been agreed to," but she cautioned—without elaborating—that there are "some matters that are important to the US and other countries that . . . must be resolved before the treaty can be signed." Getting those issues resolved, she said, means the treaty process "will take into next year."

Yellen also noted that the Treasury Department is awaiting comments on the draft treaty from US stakeholders. (Treasury released the draft to the public on October 11. Written comments are due December 11, and must be submitted electronically to: OTP_Pillar1MLC@treasury.gov.)

"It's critically important for a treaty of this level of importance and complexity to show it to the American public, to Congress, to the business community," she said.

Global consensus elusive

Pillar One will need broad global consensus to become reality, and in the US it will need sufficient support in the Senate for the proposed treaty to be ratified—support that currently does not seem to exist. Senate Finance Committee ranking member Mike Crapo, R-Idaho, and other Republicans on the taxwriting panel, for example, have been particularly concerned about the revenue impact of Pillar One on US companies—and the US fisc generally—and have criticized the Treasury Department for not providing Congress more detailed estimates.
URL: https://www.finance.senate.gov/ranking-members-news/crapo-congress-still-in-the-dark-on-oecd-pillar-one-global-tax-deal-impact-on-us

And there are other hurdles around the globe: some of the large developing countries at the table, including Brazil, Colombia, and India, are at odds with corporations over the treatment of withholding taxes and the marketing and distribution safe harbor as currently drafted.

These challenges, along with other technical disputes, loom over the fate of Pillar One. OECD tax director Manal Corwin recently told reporters that countries are actively trying to resolve their differences on technical issues.

Implications for DST moratorium

Secretary Yellen's announcement that the US will not sign the treaty this year raises questions about the possible re-emergence in 2024 of unilateral digital services taxes that would largely fall on US-based tech companies. The prospect of new global tax rules that would bring an end to DSTs, which began to proliferate in 2019, was a key motivation for the US to engage in the OECD project in the first place. With taxing jurisdictions from around the globe at the negotiating table and willing to discuss base erosion and profit shifting, reallocation of taxing rights, and a global minimum tax, the US was able to secure a pause on new DSTs through 2023 (or until a new Pillar One multilateral convention came into force, if that occurred sooner).

This past July, with the work on Pillar One running behind schedule, 138 of the 143 negotiating countries released a statement agreeing to extend the current moratorium on DSTs and other similar relevant taxes through 2024, with one important condition: at least 30 jurisdictions accounting for at least 60 percent of the ultimate parent entities of in-scope businesses must sign the treaty before the end of 2023. This condition would appear to indicate that the negotiators expect the US to be one of the signers, given that more than 40 percent of in-scope companies reportedly are headquartered in the US.

If the US is not prepared to sign the treaty this year, as Yellen now has indicated, the odds will greatly increase that the freeze on DSTs will lapse at the end of 2023 (or 2024) unless negotiating countries reach a new agreement to extend it.

Canada's DST still moving forward

Among the five countries that did *not* agree to the July statement extending the DST moratorium was Canada, which has insisted it will move ahead with its plans to impose a DST beginning January 1, 2024, because there is no "firm and binding multilateral timeline to implement Pillar One."

Canada's DST is a 3 percent tax on the revenue large businesses earn from online marketplaces, social media platforms, the sale and licensing of user data, and online ads. Unless Canada backs down before next January 1, it will begin collecting the tax retroactive to January 1, 2022.

A spokesperson for Canadian Finance Minister Chrystia Freeland made clear this week that the plan to implement the new DST remains on track, saying in a statement released October 16 that "[t]he Canadian government has been clear for several years that it would move forward with its own digital services tax if a global agreement [on Pillar One] is not reached. And we are committed to protecting Canada's national economic interest."

For their part, Senate Finance Committee Chair Ron Wyden, D-Ore., and ranking member Crapo recently sent a letter to US Trade Representative (USTR) Katherine Tai insisting that she "make clear [to the Canadian government] that [the USTR's] office will immediately respond using available trade tools upon Canada's enactment of any DST." The senators added that USTR would have their "full support" in adopting retaliatory trade measures. (The comments from Wyden and Crapo on Canada's DST echo those of House Ways and Means Committee members. For prior coverage, see *Tax News & Views*, Vol. 24, No. 31, Sep. 22, 2023.)
URL: https://www.finance.senate.gov/imo/media/doc/20231010wydencrapolettertoustroncanadadst.pdf
URL: https://dhub.deloitte.com/Newsletters/Tax/2023/TNV/230922_4.html

Tai, US ambassador to Canada David Cohen, and Treasury official Michael Plowgian have all publicly called on Canada to maintain the current DST moratorium while OECD work continues, and Treasury Secretary Yellen has reportedly engaged directly with her Canadian counterpart on the issue. However, with Canada signaling it plans to impose its tax as scheduled, it is not clear whether the administration will be willing take retaliatory measures that could escalate the dispute.

— Michael DeHoff and Storme Sixeas
Tax Policy Group
Deloitte Tax LLP