OECD floats extended freeze on new digital services taxes as work on Pillar One implementation continues

International negotiators of new tax rules through the OECD this week provided hope that most new digital services taxes (DSTs) could be kept on ice for an extra year or two while jurisdictions around the world continue to work towards implementing an agreement to reallocate taxing rights, known as Pillar One. The July 11 outcome statement also highlighted the "significant progress made" by the 140-plus countries engaged in the project and provided an update on some much-anticipated documents that are expected to be released soon—but noted that there are still some items to be resolved before the latter can occur.

Buying time for Pillar One

The proliferation in 2018 and 2019 of proposed and implemented DSTs and similar unilateral measures that tended to heavily impact large US-based multinational corporations, especially in the technology space, was one of the key drivers of US involvement in the OECD project. 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 provision was included in the agreement the Biden administration signed in October 2021 and was key to alleviating escalating tensions—and the imposition of retaliatory tariffs—between the US and several of its trading partners, including the UK and France.

The OECD Inclusive Framework's member countries have since made steadier progress on Pillar Two of the agreement, which creates a global minimum tax, than on Pillar One—in part because Pillar Two's comparatively simple rules can be unilaterally implemented by any country while Pillar One requires far more of a global consensus and adoption. With the end of 2023 in sight, it is clear that there is still significant work to be done on Pillar One, but the threat of new DSTs coming into effect could chill the cooperation needed to secure consensus.

With that in mind, the OECD announcement this week noted that the 138 signatories on the outcome statement will 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 multilateral convention (MLC) before the end of 2023. This condition would appear to indicate that the negotiators expect the US to sign the MLC, given that more than 40 percent of in-scope companies reportedly are headquartered in the US. While the prospect of Congress agreeing to implementation of Pillar One in the foreseeable future is dim, the Biden administration could still sign the MLC and then push for legislative approval.

This week's outcome statement also provides for the possibility of a further one-year extension of the moratorium, through the end of 2025, if member countries agree that "sufficient progress has been made by [the end of 2024] towards the entry into force of the MLC."

Canada moving ahead with unilateral DST

Among just five Inclusive Framework countries that did not sign on to this week's statement was Canada, which has indicated plans to begin enforcing its DST in 2024.

"Canada does not disagree with the substance of the multilateral treaty that has been negotiated; indeed, we support it fully," Canadian Finance Minister Chrystia Freeland said July 12. "However, without any firm and binding multilateral timeline to implement Pillar One, Canada cannot support the extended standstill."

More to come

The text of an MLC to support the implementation of Pillar One's Amount A (which 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) is expected to be published and opened for signature in the second half of this year.

A public consultation document on Amount B (which aims to simplify and streamline the application of the arm's length principle to in-country baseline marketing and distribution activities) is scheduled to be published the week of July 17, with a goal of incorporating the new rules into the OECD transfer pricing guidelines by January 2024.

The Inclusive Framework has agreed on a model treaty article and associated commentary related to the "subject to tax" rule (which will apply a type of withholding tax on related-party interest, royalties, and some other intragroup payments), and this is also scheduled to be published in the week of July 17, with a multilateral instrument released and open for signature October 2.

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