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US International Tax Alert

OECD Pillar One Amount A: Digital services taxes and other relevant similar measures

Overview

The OECD released on December 20, 2022 a consultation document that includes draft multilateral convention provisions on the removal of digital services taxes and other relevant similar measures under Pillar One. Comments on the consultation draft are invited by January 20, 2023.

Background

On December 20, 2022, the OECD published a consultation document (the "DST Consultation Document") including draft multilateral convention (MLC) provisions on the removal of digital services taxes (DSTs) and other relevant similar measures. Comments on the consultation draft are invited by January 20, 2023.

The removal of DSTs and other relevant similar measures was a key component of the October 2021 political agreement among over 135 members of the Inclusive Framework (IF) embodied in the Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalization of the Economy. The statement explained that Amount A of Pillar One has been developed as part of the solution for addressing the tax challenges arising from the digitalization of the economy. Amount A introduces a new taxing right to be embodied in a MLC over a portion of the profit of large and highly profitable enterprises for jurisdictions in which goods or services are supplied or consumers are located.

The October 2021 Statement specifically provided that "[t]he Multilateral Convention (MLC) 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 DST Consultation Document's draft MLC provisions consist of two articles that are relevant for determining which DSTs and other similar measures must be abandoned, the first of which calls for the removal of all existing unilateral measures identified in an accompanying Annex A to the MLC. The definitive list of measures in Annex A will be agreed upon by the OECD/IF Task Force on the Digital Economy as part of the continued negotiation of the MLC and is not part of the public consultation.

The second article sets forth criteria for identifying "digital services taxes and other similar measures" on an ongoing basis and defines them as a tax which meets all three of the following conditions:

- The application of the tax is determined by reference to the location of customers or users, or other similar market-based criteria;
- Such tax either:
    1. Is applicable by its terms solely to persons that are "non-residents," i.e., not residents of that jurisdiction (party to the MLC); or are primarily owned, directly or indirectly, by non-residents of that jurisdiction ("foreign-owned businesses"); or
    2. Is applicable in practice exclusively or almost exclusively to non-residents or foreign-owned businesses as a result of the application of revenue thresholds, exemptions for taxpayers subject to domestic corporate income tax in that jurisdiction, or restrictions of scope that ensure that substantially all residents (other than foreign-owned businesses) supplying comparable goods or services are exempt from its application; and
- Such tax is not treated as an income tax under the domestic law of the jurisdiction or is otherwise treated by that jurisdiction as outside the scope of any agreements (other than this Convention) that are in force between that jurisdiction and one or more other jurisdictions for the avoidance of double taxation with respect to taxes on income.

DSTs or relevant similar measures do not include VAT or other similar taxes on consumption, taxes imposed on a per-unit or per-transaction basis rather than on an ad valorem basis, or anti-avoidance rules in relation to permanent establishments. Of particular note, the term "digital services tax and other similar measures" does not include "a rule that addresses artificial structuring to avoid traditional permanent establishment or similar domestic law nexus requirements that are based on physical presence (including both direct physical presence and the physical presence and activity of an agent)." This carveout would seem to take the UK "diverted profits tax" outside the scope of "other relevant similar measures."

Countries that impose a defined DST or other similar measure, or that do not withdraw a tax listed within annex A, will not receive Amount A tax allocations of taxable profit, even where they are market countries and otherwise would be entitled to them.

The DST Consultation Document identifies several areas where further work is required. Of great interest to US MNEs that operate in the digital space, the DST Consultation Document notes that "[c]onsideration will be given to clarifying how this clause [relating to scope limitations that favor residents] applies when the relevant jurisdiction does not have residents supplying comparable goods and services, making it difficult to evaluate whether restrictions of scope ensure that a measure will apply to foreign-owned companies rather than residents." Terms like "exclusively or almost exclusively" and "substantially all" in this same provision are also identified as subject to "ongoing work."

Businesses that are impacted by digital services taxes will want to consider whether to supply comments to the OECD/IF by the January 20, 2023 deadline.

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