Tax Policy Alert
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US pause on OECD digitalization project raises likelihood of increased unilateral actions and trade war

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In brief

The road to a global agreement on changes to the international tax framework has become more uncertain following the US Treasury's decision to pause some of its participation in the OECD negotiations. There were always numerous challenges – both political and technical – standing in the way of reaching multilateral consensus by the end of 2020 on the reallocation of global profit in the digitalizing economy. However, the US Treasury's decision and the responses of several EU countries have decreased the likelihood of success this year and increased the chance of significantly exacerbating global trade and tax tensions.

In detail

In a 12 June letter to the finance ministers of France, Italy, Spain, and the United Kingdom, US Treasury Secretary Steven Mnuchin informed those countries that talks at the OECD's Inclusive Framework on the Pillar 1 Unified Approach had reached an 'impasse,' since these four countries had rejected a safe harbor approach. Subsequently, US Treasury clarified in a public statement that it was seeking a 'pause' in the OECD discussions so that the United States and other countries could focus on responding to economic issues arising from the COVID-19 pandemic.

The OECD responded by declaring its intent to maintain its present schedule "to offer all members of the Inclusive Framework a place in the design of a multilateral approach." The OECD expressed the hope that members would continue negotiating a solution to avoid heightened trade tensions that would negatively affect the "economy, jobs, and confidence." Meanwhile, France called the US Treasury letter a 'provocation' and vowed that its digital taxes would remain in place. France also said that it would restart collection of digital taxes, absent a global agreement by the end of the year. The EU Commissioner responsible for economy also stated that the European Union would move ahead with a digital tax proposal in 2021 if no deal emerged, while expressing preference for a global agreement.

Note that the US Treasury's decision, while significant, is a call for a pause, not an end to the negotiations. While Secretary Mnuchin's letter has not been released publicly, we understand that it does not dismiss the possibility of agreement later in the year (although the compressed timeline makes this less likely). The US Treasury also expressed support for the Pillar 2 process, which has more political support than Pillar 1. That would give it a greater chance of reaching agreement by year end, if other governments are willing to allow Pillar 2 to proceed without agreement on Pillar 1. Moreover, the United States' support for Pillar 2 likely depends on acceptance of GILTI as qualifying under the new rules. It remains to be seen whether other countries' position will change following the US Treasury's decision to pause on Pillar 1. The United States has also been very clear (including in related Congressional testimony by US Trade Representative Lighthizer) that countries must not pursue discriminatory unilateral actions, such as Digital Services Taxes, pending an Inclusive Framework agreement, and that it will forcefully pursue sanctions against those countries that move forward with such actions.

Yet the statements from France and the European Union indicate that countries are unlikely to stop considering or implementing unilateral actions, despite the retaliatory steps announced by the US Trade Representative. More countries that have been waiting on the sidelines may begin the process of enacting their own measures targeting digital activities. This could lead to greatly increased trade tensions if the USTR Section 301 investigations are not dissuasive and thus result in significant retaliatory tariffs. As economies begin recovering from COVID-19 shutdowns and businesses rebuild their exports, the likelihood of retaliatory tariffs on US-produced goods (and services) also carries the threat of increasing dissension within the business community.

The takeaway

Given that the United States has indicated that ultimately it still wants to achieve a global deal through the OECD, the technical work likely will continue, even as agreement this year looks less likely. This will provide continued opportunity for the business community to feed into the OECD technical process. It is uncertain how other countries and the European Commission will react and whether Pillars 1 and 2 will continue to be viewed as a single package.

Let's talk

For a deeper discussion of how this issue might affect your business, please contact:

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