

International corporate tax reform could support global tax revenues

Category: Digitalisation

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Recent economic analysis suggests that a proposed solution to the tax challenges arising from the digitalisation of the economy under negotiation at the OECD would have a significant positive impact on global tax revenues.

The analysis puts the combined effect of the two-pillar solution under discussion at up to 4% of global corporate income tax (CIT) revenues, or USD 100 billion annually. The revenue gains are broadly similar across high, middle and low-income economies, as a share of corporate tax revenues.

The analysis was released just weeks after the international community reaffirmed its commitment to reach a consensus-based long-term solution to the tax challenges arising from the digitalisation of the economy, and to continue working toward an agreement by the end of 2020, according to a Statement by the OECD/G20 Inclusive Framework on BEPS.

The Inclusive Framework on BEPS, which brings together 137 countries and jurisdictions on an equal footing for multilateral negotiation of international tax rules, decided during its January 29-30 meeting to move ahead with a two-pillar negotiation to address the tax challenges of digitalisation.

Participants agreed to pursue the negotiation of new rules on where tax should be paid (“nexus” rules) and on what portion of profits they should be taxed (“profit allocation” rules), on the basis of a “Unified Approach” under Pillar One. The aim is to ensure that multinational enterprises (MNEs) conducting sustained and significant business in places where they may not have a physical presence can be taxed in such jurisdictions. They also decided to continue discussions on Pillar Two, which aims to address remaining base erosion and profit shifting (BEPS) issues and ensure that international businesses pay a minimum level of tax.

The economic analysis and impact assessment of the Pillar One and Pillar Two proposals is being undertaken to inform key decisions on the design and parameters of the tax reform to be agreed by Inclusive Framework members as part of the negotiations underway at the OECD. The analysis covers data from more than 200 jurisdictions, including all members of the Inclusive Framework, and more than 27,000 MNE groups. Assumptions in the preliminary analysis are illustrative, and do not pre-judge decisions to be taken by the Inclusive Framework.

The analysis shows that the Pillar One reform – designed to re-allocate some taxing rights to market jurisdictions, regardless of physical presence – would also bring a small tax revenue gain for most jurisdictions. Under Pillar One, low and middle-income economies are expected to gain relatively more revenue than advanced economies, with investment hubs experiencing some loss in tax revenues. More than half of the profit re-allocated would come from 100 large MNE groups.

The analysis shows that Pillar Two could raise a significant amount of additional tax revenues. By reducing the tax rate differentials between jurisdictions, the reform is expected to lead to a significant reduction in profit shifting by MNEs. This will be important for developing economies as they tend to be more adversely affected by profit shifting than high-

income economies.

The overall direct effect on investment costs is expected to be small in most countries, as the reforms target firms with high levels of profitability and low effective tax rates. The reforms would also reduce the influence of corporate taxes on investment location decisions. In addition, failure to reach a consensus-based solution would likely lead to further unilateral measures and greater uncertainty.

References

OECD Webcast presentation of the preliminary results of the Economic analysis and impact assessment of potential reforms to address the tax challenges arising from the digitalisation of the economy (February 2020):
www.oecd.org/tax/beps/webcast-economic-analysis-impact-assessment-february-2020.htm.

OECD Secretary General Tax Report to G20 Finance Ministers and Central Bank Governors (February 2020):
<http://www.oecd.org/ctp/oecd-secretary-general-tax-report-g20-finance-ministers-riyadh-saudi-arabia-february-2020.pdf>

Statement by the OECD/G20 Inclusive Framework on BEPS on the Two-Pillar Approach to Address the Tax Challenges Arising from the Digitalisation of the Economy (January 2020):
<http://www.oecd.org/tax/beps/statement-by-the-oecd-g20-inclusive-framework-on-beps-january-2020.pdf>