TAX CHALLENGES ARISING FROM THE DIGITALISATION OF THE ECONOMY

ECONOMIC ANALYSIS & IMPACT ASSESSMENT

OECD Parliamentary Network

25 February 2020, OECD Conference Centre, Paris

INTRODUCTION

Introduction

Preliminary results of the Economic Analysis & Impact Assessment

PURPOSE

This analysis is undertaken to inform key decisions to be taken by Inclusive Framework members in negotiations underway at the OECD

ASSUMPTIONS

in this preliminary analysis are illustrative and do not pre-judge decisions of the IF

HIGH-LEVEL RESULTS

at the level of country groups (e.g. low-, middle- and high-income)

UPDATED RESULTS

as further decisions are taken by the IF on the design and parameters of the reform

Overall impact on global tax revenues would be significant

The combined effect of Pillars 1 & 2 would lead to a significant increase in global tax revenues

- Estimated global net revenue gain up to **4% of global CIT revenues** or **USD 100 billion annually**, depending on reform design
- The **revenue gains are broadly similar across high, middle and low-income economies**, as a share of corporate tax revenues
- The reforms are expected to lead to **a significant reduction in profit shifting**

Failure to reach a consensus-based solution would lead to further unilateral measures and greater uncertainty

APPROACH & CAVEATS

Approach to assess reform impact

Flexible analysis framework

To inform ongoing discussions on Pillar 1 and Pillar 2 design and parameters

Broad geographic and company coverage

With more than 200 jurisdictions (all members of the Inclusive Framework and a large number of developing countries) and more than 27,000 MNE groups

Combining data from a range of sources

Firm-level data wherever possible, combined with aggregate data

Extensive interactions with stakeholders

including delegates from Inclusive Framework jurisdictions and other key stakeholders

Main caveats

Results will depend on Pillar 1 & Pillar 2 design, which is still to be decided by the Inclusive Framework

- Further revisions will be made to reflect future design decisions
- Current estimates assume that Pillar 1 is not a “safe harbour” regime

Underlying data have limitations

- Due to gaps in coverage and time lags and the methodology inevitably involves simplifying assumptions

Refinements are still ongoing to improve data quality, in cooperation with Inclusive Framework members

Potential strategic reactions of MNEs & governments

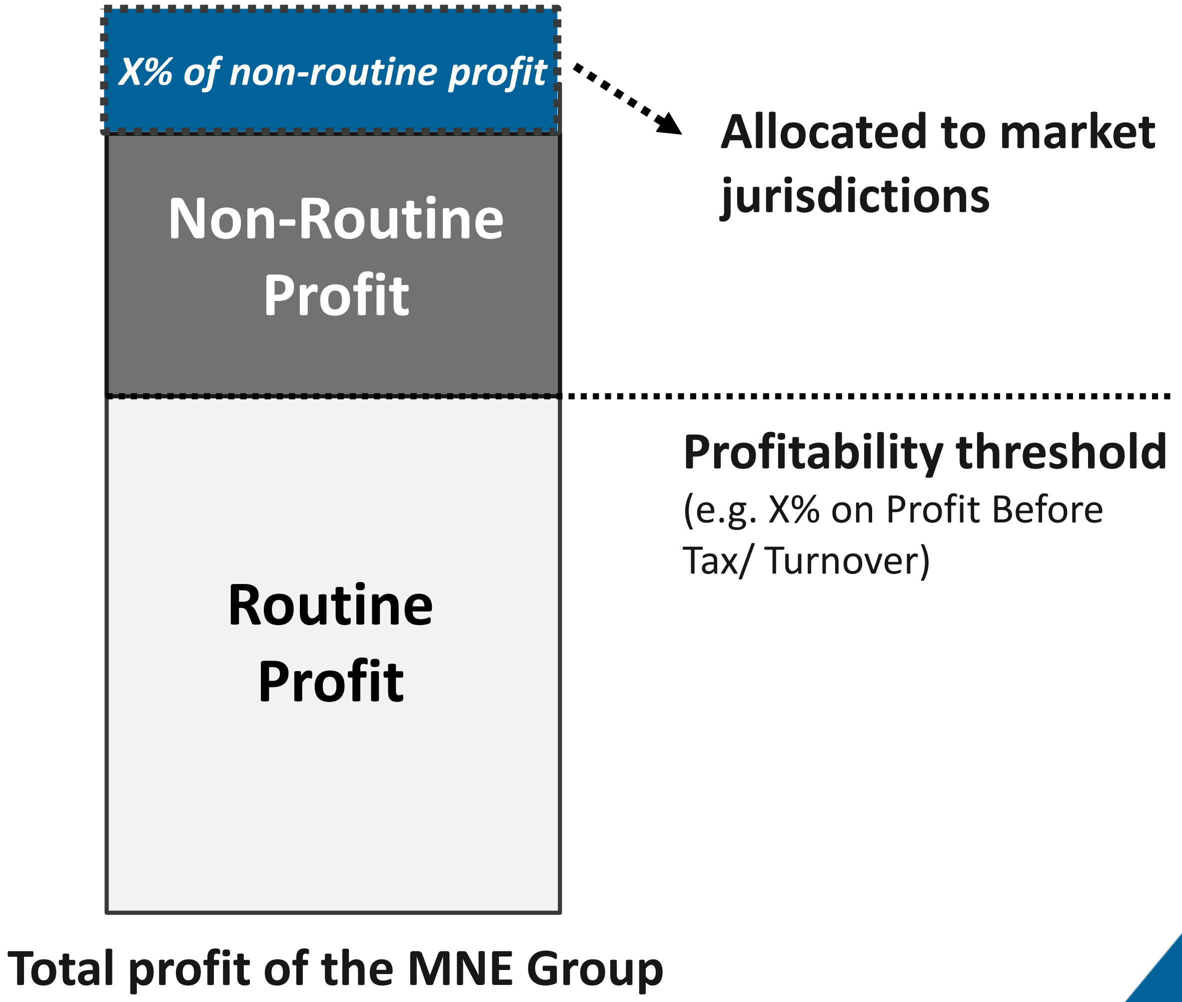
- For Pillar 2, some of these reactions have been modelled in the assessment
- These reactions are difficult to anticipate with certainty

REVENUE EFFECTS
PILLAR 1

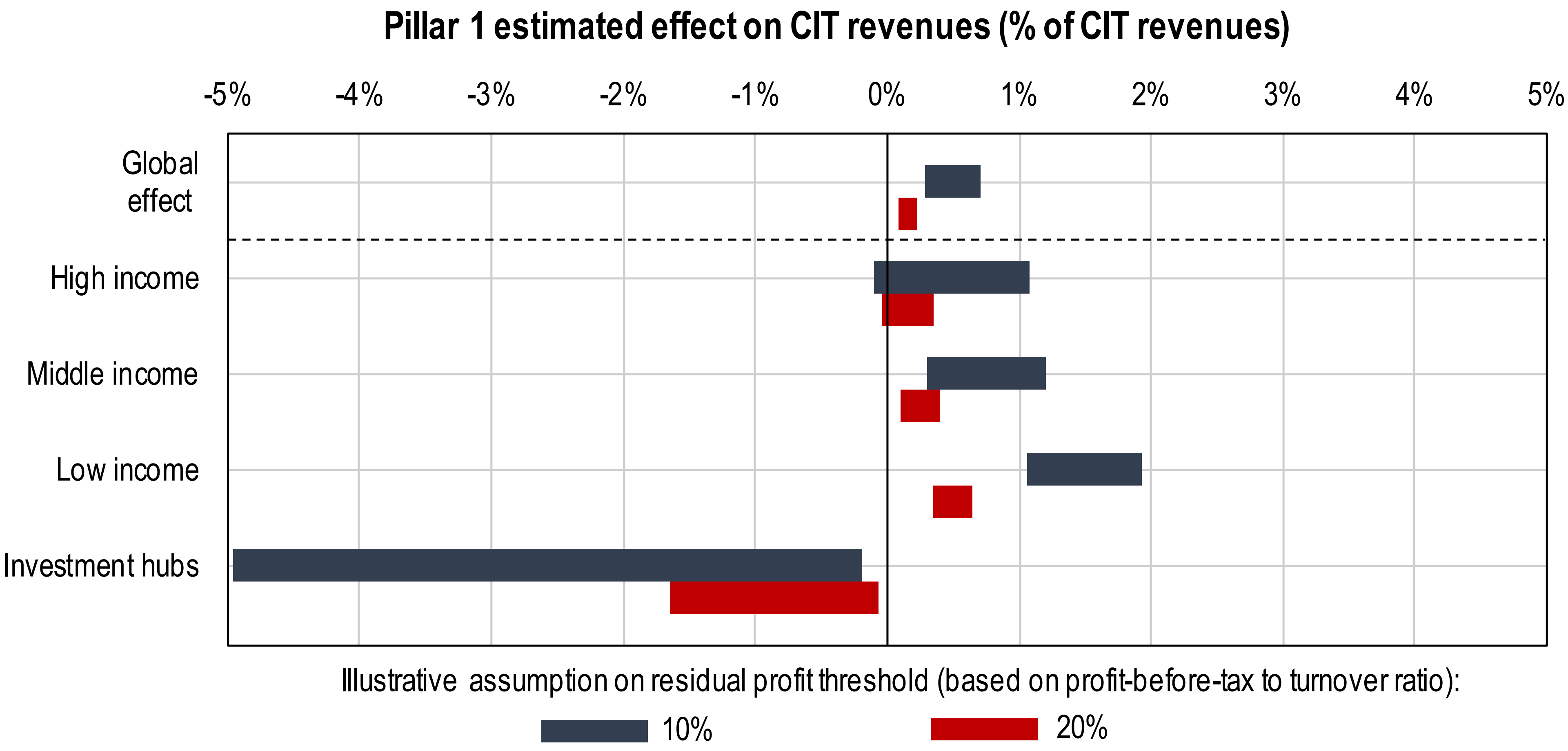
Pillar 1 changes the way countries carve up the ‘tax pie’

Pillar 1: Amount A

- **Substantial reallocation of taxing rights** across jurisdictions
- **Going beyond physical presence** to determine taxing rights
- **Considers MNE groups as a whole** rather than entity-by-entity
- **Allocates some tax base to market jurisdictions based on a formula**



Most jurisdictions gain tax revenues, except investment hubs



Note: Illustrative scenarios of Pillar 1 (Amount A only), where residual profit is defined with a 10% or 20% threshold on profit-before-tax to turnover, assuming a 20% reallocation of residual profit to market jurisdictions, with commodities and financial sectors excluded from scope. High, middle and low income jurisdictions are defined based on the World Bank classification. Investment hubs are jurisdictions with inward FDI above 150% of GDP.

In addition to reallocating taxing rights, Pillar 1 would slightly increase tax revenues

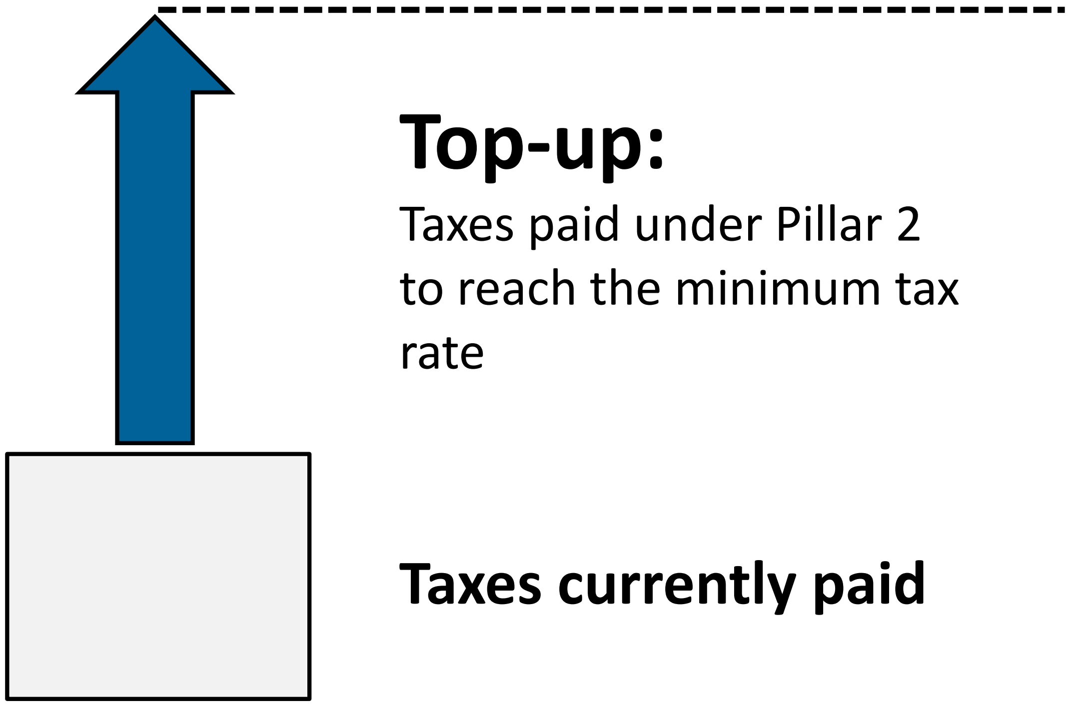
- **Global tax revenues would slightly increase** as some taxing rights shift from low-tax jurisdictions to higher-tax jurisdictions
- **Most economies** would experience a **small tax revenue gain**
- On average, **low and middle-income economies would gain relatively more revenue than advanced economies**
- **Investment hubs** would experience **some loss in tax revenues**
- **More than half of the profit reallocated** comes from **100 MNE groups**

REVENUE EFFECTS PILLAR 2

Pillar 2 would operate as a minimum tax rate

Pillar 2: GloBE

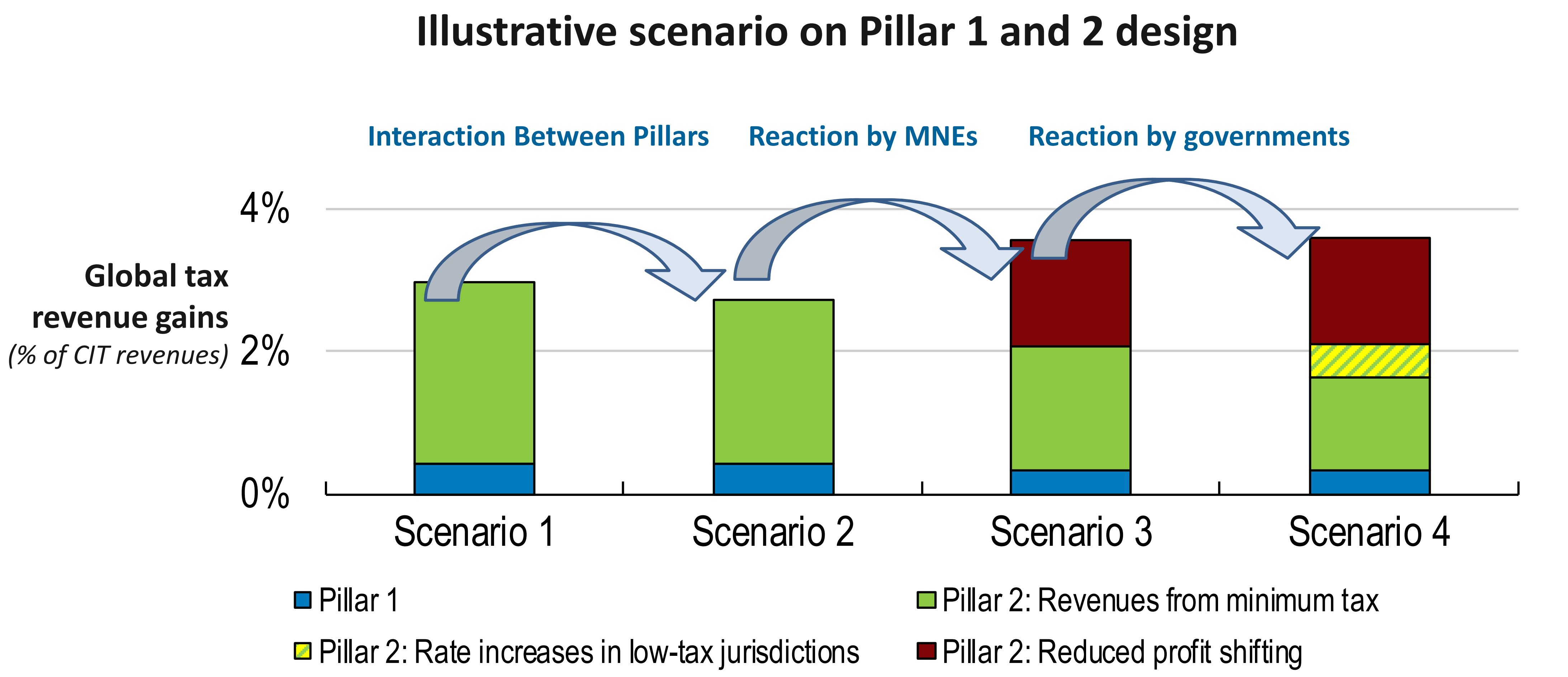
- **GloBE gives countries the right to ‘tax back’ profit** that is currently taxed below the minimum rate
- **It would operate as a ‘top-up’ tax,** up to the minimum rate
- It could be applied either on **global MNE profit or jurisdiction-by-jurisdiction**



Main stylised scenarios on strategic reactions of MNEs & governments

Scenario 1	=	Static scenario (no behavioural reaction)		
Scenario 2	=	Scenario 1	+	Interaction with Pillar 1
Scenario 3	=	Scenario 2	+	MNEs reduce their profit shifting intensity
Scenario 4 Higher degree of uncertainty	=	Scenario 3	+	Some low-tax jurisdictions increase their CIT rate

Global tax revenue gains could be up to 4% of global CIT revenues



Note: Pillar 1 (Amount A only) estimates are based on an illustrative scenario where residual profit is defined with a 10% threshold on profit-before-tax to turnover, assuming a 20% reallocation of residual profit to market jurisdictions, with commodities and financial sectors excluded from scope. Pillar 2 estimates are based on an illustrative scenario with jurisdiction blending and a 12.5% minimum tax rate.

Pillar 2 would raise significant tax revenues and reduce profit shifting

Pillar 2 would raise a significant amount of additional tax revenues

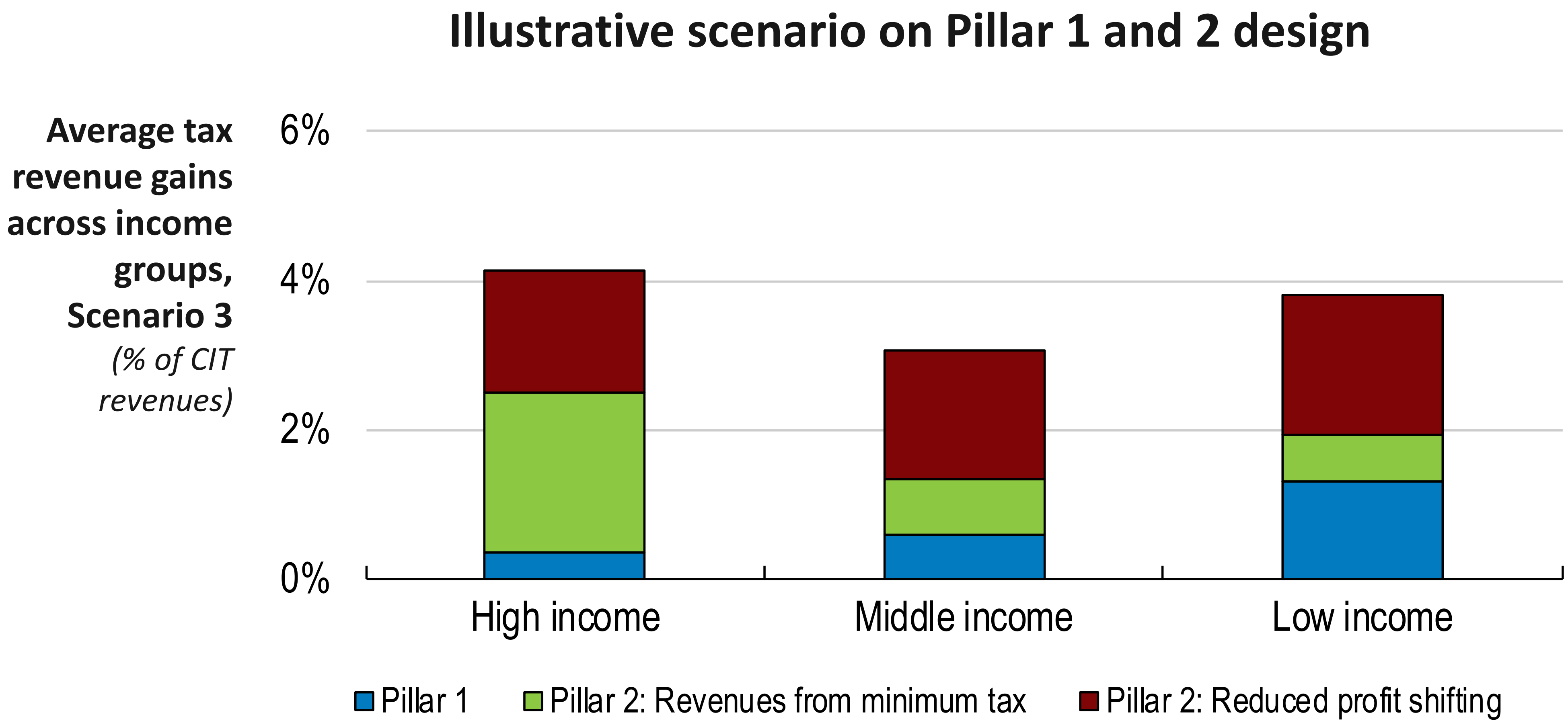
- The amount will depend on the rate and the design

The reform would reduce profit shifting

- Pillar 2 would reduce tax rate differentials between jurisdictions and reduce the incentives for MNEs to shift profit
- This will be important for developing economies as they tend to be more adversely affected by profit shifting than high-income economies

COMBINED REVENUE EFFECTS OF PILLARS 1 & 2

The revenue gains are broadly similar across income groups



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INVESTMENT EFFECTS

Investment impacts are assessed in a stylised, standard framework

Use of the Effective Tax Rates (ETR) framework

- To assess the impact of the proposals on a stylised investment project
- The methodology incorporates the profit shifting behaviour of MNEs and the underlying data is consistent with the revenue estimation

Impact of ETRs on investment may vary across firms

- A firm-level analysis is being undertaken

Assessment of the counterfactual scenario with no agreement and more unilateral measures

Small effects on investment costs, with the potential for improved tax certainty

The direct effect on investment costs is expected to be small in most countries

- **Many firms will be unaffected by the proposals**, which target firms with high levels of profitability and low effective tax rates

The reforms would reduce the influence of corporate taxes on investment location

- **Investment could be driven more** by other factors (e.g. infrastructure, education levels or labour costs)
- This could channel more investment to jurisdictions where it would be **more productive**, which would **support global growth**

The failure to achieve a consensus-based solution would lead to more unilateral measures, uncertainty and trade disputes

QUESTIONS

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