Executive Summary

This report analyses the economic and tax revenue implications of the Pillar One and Pillar Two proposals currently being discussed by the OECD/G20 Inclusive Framework on BEPS (Inclusive Framework) as part of its work to address the tax challenges arising from the digitalisation of the economy. These proposals are described in the Pillar One and Pillar Two Blueprint reports (OECD, 2020[1]; OECD, 2020[2]).

A number of the design elements and parameters of Pillar One and Pillar Two will be the subject of future decisions by the Inclusive Framework. The 'ex ante' assessment in this report, which has been carried out by the OECD Secretariat, relies on a number of illustrative assumptions on proposal design and parameters, without prejudice to the final decisions of the Inclusive Framework.

The assessment in this report relies on the best data available to the OECD Secretariat across a wide range of jurisdictions, combining firm-level and more aggregate data sources, including the newly published anonymised and aggregated Country-by-Country Report (CbCR) data. Extensive work has been undertaken to ensure the highest possible level of data quality. Nevertheless, the underlying data have several limitations and the assessment relies on a number of simplifying assumptions on the proposals and the potential reactions of multinational enterprises (MNEs) and governments. In particular, the underlying data pre-date important recent developments, most notably the 2017 US tax reform, implementation of some aspects of the OECD/G20 Base Erosion and Profit Shifting (BEPS) package and the COVID-19 crisis.

Effect of the proposals on tax revenues

Pillar One and Pillar Two could increase global corporate income tax (CIT) revenues by about USD 50-80 billion per year. Taking into account the combined effect of these reforms and the US GILTI regime, the total effect could represent USD 60-100 billion per year or up to around 4% of global CIT revenues. The exact gains could differ from these 'ex ante' estimates as they would depend on the final design and parameters of Pillar One and Pillar Two, the extent of their implementation, the nature and scale of reactions by MNEs and governments, and future economic developments. Global gains would primarily come from Pillar Two:

- Pillar One would involve a significant change to the way taxing rights are allocated among jurisdictions, as taxing rights on about USD 100 billion of profit could be reallocated to market jurisdictions under the Pillar One rules. This would lead to a modest increase in global tax revenues. On average, low, middle and high income economies would all benefit from revenue gains, while 'investment hubs' would tend to lose tax revenues.
- Pillar Two would yield a significant increase in CIT revenues across low, middle and high income economies. It would significantly reduce the incentives for MNEs to shift profits to low-tax jurisdictions, which would generate revenue gains in addition to the direct gains collected through the minimum tax itself.
- The combined revenue gains from both pillars are estimated to be broadly similar – as a share of current CIT revenues – across low, middle and high income jurisdictions.

Effect of the proposals on investment and economic growth

A consensus-based multilateral solution involving Pillar One and Pillar Two would lead to a more favourable environment for investment and economic growth than would likely be the case in the absence of an agreement by the Inclusive Framework:

- Pillar One and Pillar Two would lead to a relatively small increase in the average (post-tax) investment costs of MNEs. The ensuing negative effect on global investment is estimated to be very small, as the proposals would mostly affect highly profitable MNEs whose investment is less sensitive to taxes. The impact of the proposals is expected to fall predominantly on highly-profitable MNEs in digitalised and intangible-intensive sectors in the case of Pillar One and on MNEs engaging in profit shifting in the case of Pillar Two. Overall, the negative effect on global GDP stemming from the expected increase in tax revenues associated with the proposals is estimated to be less than 0.1% in the long term.
- Pillar One and Pillar Two would support global investment and growth through less quantifiable but nonetheless significant channels, which may partly or even fully offset this small negative effect. In particular, the proposals aim to increase tax certainty and could enhance the efficiency of global capital allocation by increasing the importance of non-tax factors (e.g. infrastructure, education levels or labour costs) in investment decisions. To some extent, they would also reduce the need to raise revenues by implementing other (potentially more distortive) tax measures in the constrained post-COVID-19 budget environment. Finally, the proposals could result in additional compliance and administration costs for MNEs and governments. The extent of these costs is difficult to assess and would depend on the final design of the proposals.
- In contrast, the absence of a consensus-based solution would likely lead to a proliferation of uncoordinated and unilateral tax measures (e.g. digital services taxes) and an increase in damaging tax and trade disputes. This would undermine tax certainty and investment and also result in additional compliance and administration costs. The magnitude of the negative consequences would depend on the extent, design and scope of these unilateral measures, and the scale of any ensuing trade retaliation. In the “worst-case” scenario, these disputes could reduce global GDP by more than 1%.

Implications of the COVID-19 crisis

The full impact of the COVID-19 crisis remains highly uncertain at this stage, but a few likely implications for the impact assessment of Pillar One and Pillar Two already stand out:

- The COVID-19 crisis is likely to reduce the expected revenue gains from Pillar One and Pillar Two at least in the short run as the crisis weighs on the profitability of many MNEs, even though some digital-intensive MNEs have managed to sustain or enhance their profitability since the beginning of the crisis.
- The crisis has accelerated the trend towards the digitalisation of the economy, further increasing the prominence of the tax challenges arising from digitalisation and the need to address them. Accelerating digitalisation will also increase the relative importance of automated digital services (ADS) in the envisaged scope of Pillar One.
- Accelerated digitalisation, increased pressures on public finances after the crisis, and growing public dissatisfaction with tax planning by MNEs are all likely to reinforce the likelihood of unilateral tax measures if a consensus-based solution cannot be secured by the Inclusive Framework. The likely ensuing tax and trade disputes would undermine investment and economic growth at a time when the global economy is at its most fragile due to the COVID-19 crisis. They would compound the negative effect of the crisis and hinder the recovery prospects.

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