

1 Overview of main findings

1.1. Introduction

1. The international corporate tax system faces growing challenges. While the OECD/G20 Base Erosion and Profit Shifting (BEPS) project represented an unprecedented multilateral effort to tackle profit shifting, many questions over the allocation of taxing rights remain unresolved. Digitalisation and globalisation have highlighted certain vulnerabilities in the existing framework, which allocates taxing rights principally on the basis of physical presence. In addition to this, some BEPS issues remain. In this context, an increasing number of jurisdictions are taking uncoordinated and unilateral actions, contributing to an increase in tax and trade disputes and growing tax uncertainty. The COVID-19 crisis is exacerbating these tensions by accelerating the digitalisation of the economy and increasing pressures on public finances. The fact that many firms have benefitted from direct or indirect government support during the crisis is also likely to intensify public dissatisfaction with tax avoidance by multinational enterprises (MNEs).

2. Against this backdrop, the OECD/G20 Inclusive Framework on BEPS (Inclusive Framework), which consists of 137 member jurisdictions, is discussing proposals for a consensus-based reform of the international tax rules to address the tax challenges arising from the digitalisation of the economy. The proposals, which are described in the Pillar One and Pillar Two Blueprint reports (OECD, 2020^[1]; OECD, 2020^[2]), fall under two pillars, which are briefly presented in Box 1.1. As part of the Programme of Work approved by the Inclusive Framework in May 2019 (OECD/G20 Inclusive Framework on BEPS, 2019^[3]) and endorsed by the G20 Finance Ministers and Leaders in June 2019, the OECD Secretariat was mandated to carry out an economic analysis and impact assessment of the proposals. The aim of this report is to provide this 'ex ante' assessment.

Box 1.1. Overview of the proposals to address the tax challenges arising from digitalisation

Pillar One seeks to adapt the international tax system to new business models through a coherent and concurrent review of the profit allocation and nexus rules. It intends to expand the taxing rights of market jurisdictions (which, for some business models, is the jurisdiction where the user is located) where there is an active and sustained participation of a business in the economy of that jurisdiction through activities in, or remotely directed at, that jurisdiction. Pillar One also aims to significantly improve tax certainty by introducing innovative dispute prevention and resolution mechanisms. The key elements of Pillar One can be grouped into three components:

- A new taxing right for market jurisdictions over a share of residual profit calculated at an MNE group (or segment) level (Amount A).
- A fixed return for defined baseline marketing and distribution activities taking place physically in a market jurisdiction, in line with the arm's length principle (Amount B).
- Improved tax certainty processes to improve tax certainty through innovative dispute prevention and dispute resolution mechanisms (Tax certainty component).

Pillar Two addresses remaining BEPS challenges and is designed to ensure that large internationally operating businesses pay a minimum level of tax regardless of where they are headquartered or the jurisdictions they operate in. It does so via a number of interlocking rules that seek to (i) ensure minimum taxation while avoiding double taxation or taxation where there is no economic profit, (ii) cope with different tax system designs by jurisdictions as well as different operating models by businesses, (iii) ensure transparency and a level playing field, and (iv) minimise administrative and compliance costs.

- The principal mechanism to achieve this outcome is the **income inclusion rule** (IIR) together with the **undertaxed payments rule** (UTPR) acting as a backstop (together, the “GloBE rules”). The operation of the IIR is, in some respects, based on traditional controlled foreign company (CFC) rule principles and triggers an inclusion at the level of the shareholder where the income of a controlled foreign entity is taxed at below the effective minimum tax rate. It is complemented by a **switch-over rule** (SOR) that removes treaty obstacles from its application to certain branch structures and applies where an income tax treaty otherwise obligates a contracting state to use the exemption method. The UTPR is a secondary rule and only applies where a Constituent Entity is not already subject to an IIR. The UTPR is nevertheless a key part of the rule set as it serves as a back-stop to the IIR, ensures a level playing field and addresses inversion risks that might otherwise arise.
- The **subject to tax rule** (STTR) complements these rules. It is a treaty-based rule that targets risks to source countries posed by BEPS structures relating to intragroup payments that take advantage of low nominal rates of taxation in the other contracting jurisdiction (that is the jurisdiction of the payee).

3. A number of design elements and parameters of Pillar One and Pillar Two will be the subject of future decisions by the Inclusive Framework. For the purpose of the ‘ex ante’ impact assessment in this report, a number of illustrative assumptions on proposal design and parameters have been made, without prejudice to the final decisions of the Inclusive Framework. This report presents results for a range of illustrative parameters for both Pillar One and Pillar Two in order to inform the ongoing discussions of the Inclusive Framework around the design of the proposals.

4. The geographic scope of the analysis in this report is very wide, as it covers more than 200 jurisdictions, including all 137 members of the Inclusive Framework. The analysis is based on wide-ranging and thorough data analysis, as well as insights from the economic literature. It has benefitted from extensive interactions with representatives of Inclusive Framework jurisdictions, as well as exchanges with academics, civil society and business representatives and other international organisations. As is the case for any economic analysis, the methodology relies on a number of simplifying assumptions, for example on the design of the proposals and the way MNEs and governments may react to their implementation.

5. The analysis mobilises a wide array of data sources that are combined in a consistent analytical framework. This comprises firm-level data, including the financial accounts of most of the large MNE groups worldwide, as well as a wide range of aggregate data sources, including the anonymised and aggregated Country-by-Country Report (CbCR) statistics collected as part of the implementation of the BEPS package and published by the OECD for the first time in July 2020 (OECD, 2020^[4]). Nevertheless, the data underlying the analysis have limitations in terms of coverage, consistency and timeliness. In particular, the data focus primarily on 2016-17 and therefore pre-date some significant recent developments, including the implementation of various measures under the OECD/G20 BEPS project, the 2017 US tax reform (US Tax Cuts and Jobs Act) and most importantly the COVID-19 crisis. The potential implications of the COVID-19 crisis for the impact of the proposals are discussed in the final section of this chapter.

6. The report focuses primarily on the impact of the proposals on tax revenues, MNE investment and economic activity. This chapter (Chapter 1) summarises the main findings of the analysis at a high level.

The following chapters present more detailed results and analyses, covering a wide range of potential Pillar One and Pillar Two parameters. These chapters also contain a full description of the data and methodology underlying the analyses, as well as a wide range of robustness checks carried out on the data and the results. More specifically, Chapters 2 and 3 focus on the tax revenue effects of Pillar One and Pillar Two respectively. Chapter 4 discusses the effect of both pillars on investment and economic activity. Finally, Chapter 5 describes the construction of the data “matrices” underpinning the estimates presented in the other chapters.

1.2. Effect of the proposals on tax revenues

7. The effect of the proposals on tax revenues will depend on the final design and parameter choices to be agreed by the Inclusive Framework. Under an illustrative set of design and parameter assumptions, the combined effect of Pillar One and Pillar Two on global corporate income tax (CIT) revenues could increase global CIT revenues by 1.9% to 3.2%, or about USD 50-80 billion per year (Table 1.1).¹

8. These estimates assume illustratively – while no decision has been taken by the Inclusive Framework at this time – that the US Global Intangible Low Tax Income (GILTI) regime would ‘co-exist’ with Pillar Two and US MNEs would not be subject to the income inclusion rule (IIR) under Pillar Two. As a result, Pillar Two revenue gains in Table 1.1 do not include potential gains related to the application of Pillar Two by US MNEs, which are assumed to remain subject to the GILTI regime. Taking into account the combined revenue gains of both pillars and the US GILTI regime,² the total effect could represent about USD 60-100 billion per year or up to 4% of global CIT revenues.

1.2.1. Global tax revenue effects of Pillar One

9. Pillar One seeks to adapt the international corporate tax system to the digital age through significant changes to the rules applicable to business profits to ensure that the allocation of taxing rights on business profits is no longer exclusively determined by reference to physical presence. It intends to expand the taxing rights of market jurisdictions (which, for some business models, is the jurisdiction where the user is located)³ where there is a significant and sustained participation of a business in the economy of that jurisdiction, either physically or remotely. It also aims to improve tax certainty by introducing improved dispute prevention and resolution mechanisms.

10. The key elements of Pillar One can be grouped into three components: a new taxing right for market jurisdictions over a share of residual profit (i.e. profit in excess of a certain profitability threshold percentage) calculated at an MNE group level based on a formulaic approach (Amount A); a fixed return for defined baseline marketing and distribution activities taking place physically in a market jurisdiction (Amount B); and improved tax certainty processes through innovative dispute prevention and dispute resolution mechanisms (Tax certainty component).

Table 1.1. Overview of global tax revenue effects from the proposals

Estimates based on illustrative assumptions on the design and parameters of Pillar One and Pillar Two

Estimated global tax revenue gains		In % of global CIT revenues	In USD billion
Pillar One		0.2%-0.5%	5-12
Pillar Two	Direct revenue gains	0.9%-1.7%	23-42
	Additional gains from reduced profit shifting	0.8%-1.1%	19-28
	Total Pillar Two	1.7%-2.8%	42-70
Total Pillar One and Pillar Two		1.9%-3.2%	47-81
US GILTI regime		0.4%-0.8%	9-21
Total, including GILTI		2.3%-4.0%	56-102

Note: The estimates in this table are based on the following illustrative assumptions. Pillar One, for which only Amount A is modelled, is assumed to focus on Automated Digital Services (ADS) and Consumer Facing Businesses (CFB), with a global revenue threshold of EUR 750 million, a profitability threshold percentage of 10% (based on the ratio of profit before tax to turnover), a reallocation percentage of 20% and a nexus revenue threshold of EUR 1 million for ADS and EUR 3 million for CFB. Pillar Two is assumed to involve a 12.5% minimum tax rate with jurisdictional blending and a 10% combined carve-out on payroll and depreciation expenses. The US GILTI regime is illustratively assumed to 'co-exist' with Pillar Two. Therefore, US MNEs (which are subject to the GILTI regime) are excluded from the Pillar Two gains in this table. Revenues from GILTI are included in this table based on estimates from the US Joint Committee on Taxation. MNEs are assumed to reduce their profit shifting intensity in reaction to Pillar Two introduction, resulting in additional tax revenue gains. The interaction between Pillar One and Pillar Two is taken into account in this table. Estimates are presented as ranges to reflect uncertainty around the underlying data and modelling. See Chapters 2 and 3 for more details.

Source: OECD Secretariat calculations, and estimates from the US Joint Committee on Taxation for GILTI.

11. Amount A would lead to a reallocation of a portion of the tax base of in-scope MNE groups from jurisdictions where the residual profit of MNE groups is currently located, to market jurisdictions. Not all MNE groups would be subject to this reallocation, as it is assumed that it would only apply to relatively large and profitable MNE groups (i.e. MNE groups with revenues above a certain global revenue threshold, and profitability above the profitability threshold percentage). Although subject to political agreement, for present purposes this work has proceeded on the basis of the technical proposals to define the in-scope activities as Automated Digital Services (ADS) and Consumer Facing Businesses (CFB). By design, the impact of Amount A would fall primarily on large and profitable MNE groups in the digital-oriented and intangible intensive sectors.

12. Based on illustrative assumptions on Amount A parameters (including the profitability threshold to define residual profit), the residual profit of the MNE groups that would be in scope of Amount A could represent about USD 500 billion, of which a percentage to be decided by the Inclusive Framework would be reallocated to market jurisdictions.⁴ Assuming illustratively that this reallocation percentage would be 20%, this would imply that taxing rights over about USD 100 billion of profit would be reallocated to market jurisdictions as a result of Amount A. The existing transfer pricing rules would continue to determine the allocation of taxing rights for other MNE profits (i.e. the profits of out-of-scope MNEs and the non-residual profits of MNEs as well as the share of their residual profits not reallocated under Amount A, which is 80% in this illustrative example).

13. On average, corporate tax rates are relatively higher in the market jurisdictions where residual profit would be reallocated under Amount A than in the jurisdictions where it is currently located. Indeed, a substantial share of residual profit is currently located in relatively low-tax jurisdictions. This implies that the reallocation occurring under Amount A would generate a net revenue gain at the global level. The magnitude of this overall revenue gain would be relatively modest (e.g. up to 0.5% of global CIT revenues under the assumptions in Table 1.1) reflecting that only a percentage of the residual profit of the MNEs in scope would be reallocated, and that not all reallocated profit would face a higher tax rate in market jurisdictions than the tax rate it faces where it is currently located.

14. The effect of the other components of Pillar One (Amount B and the Tax certainty component) is more difficult to quantify due to data limitations (e.g. lack of sufficient data on the nature of MNE activities at the MNE entity level, and lack of transaction-level data) and methodological challenges. As a result, quantitative estimates of Pillar One in this report focus exclusively on Amount A. While the effect of Amount B and the Tax certainty component will depend on their design and scope, their impact on global tax revenues is generally expected to be small. This reflects the fact that these proposals seek to support the existing transfer pricing system and prevent tax disputes, in contrast to Amount A, which establishes a new taxing right.

15. Amount B would set a fixed return for defined baseline distribution and marketing functions of MNEs taking place physically in market jurisdictions. Amount B is expected to reduce administration costs for governments and increase tax certainty for taxpayers, and may be of particular benefit to jurisdictions with low administrative capacity. Where the fixed return for baseline and marketing functions exceeds current returns taxable in market jurisdictions, Amount B would contribute to additional revenues in those jurisdictions. A number of jurisdictions with low administrative capacity assess that this is likely to be the case in their jurisdiction, as a result of the challenges they face applying the existing transfer pricing rules effectively. However, at the global level, the revenue effect of Amount B is likely to be modest, as it does not provide market jurisdictions with a new taxing right, but is merely designed to simplify the administration of the current transfer pricing system.

1.2.2. Global tax revenue effects of Pillar Two

16. The various components of Pillar Two would ensure a minimum level of tax on MNE profit. The GloBE rules (i.e. the income inclusion rule (IIR) and the undertaxed payments rule (UTPR), see Box 1.1) would operate as a ‘top-up’ on existing taxes to ensure that the effective tax rate on MNE profit that would otherwise be taxed below an agreed minimum rate is brought up to this minimum rate, which has to be decided by the Inclusive Framework. A variety of minimum rates have illustratively been explored in the analysis. The results in Table 1.1 above assume illustratively a 12.5% minimum rate. Results for other rates are presented in Chapter 3.

17. The Inclusive Framework also has to decide on a number of Pillar Two design features, including the degree of ‘blending’ (i.e. the level of aggregation at which the effective tax rate test would be applied). Two main options are considered: jurisdictional blending (i.e. blending the income and covered taxes of all entities from an MNE group in a jurisdiction) or global blending (i.e. blending all foreign income and covered taxes of an MNE group). While no decision has been taken by the Inclusive Framework yet, the results in this report are illustratively based on jurisdictional blending.⁵

18. Another design question that the Inclusive Framework has to decide upon relates to the existence and design of a formulaic substance-based carve-out. Such a carve-out would exclude a fixed return for substantive activities within a jurisdiction from the scope of the GloBE rules. This fixed return could be defined as a certain percentage of expenses on payroll and depreciation of tangible assets. For example, the results in Table 1.1 assume illustratively a 10% carve-out on payroll and depreciation of tangible assets. The analysis in this report considers a range of potential options regarding formulaic substance-based

carve-outs and suggests that their effect on global Pillar Two revenue gains would be relatively small under the assumptions considered.⁶

19. The analysis suggests that the global revenue gains from Pillar Two could be significant. The impact of Pillar Two would fall on MNEs with low-taxed profits, including due to profit shifting behaviour. The exact size of the tax revenue gains would depend on the design of Pillar Two and the agreed minimum tax rate. In addition to direct revenue gains collected through the Pillar Two minimum tax provisions (e.g. the income inclusion rule or the undertaxed payments rule), Pillar Two is expected to generate indirect tax revenue gains by reducing MNE profit shifting.

20. Indeed, Pillar Two would reduce the differences in effective tax rates across jurisdictions, which are one of the main drivers of profit shifting. Reducing these tax rate differentials would reduce MNEs' incentives to shift profit to low-tax jurisdictions. This would likely lead MNEs to reassess their profit shifting strategies, and some MNEs would likely consider that the gains of certain profit shifting schemes would no longer be worth the costs (e.g. financial and advisory costs of the schemes, reputational costs, etc.). The exact scale of the reduction in profit shifting and location of profits in a post Pillar Two world are difficult to anticipate with certainty as profit shifting schemes are very complex and firm-specific. Nevertheless, the reduction of profit shifting is expected to contribute significantly to the global revenue gains from Pillar Two.

1.2.3. Interaction of Pillar One and Pillar Two

21. The effects of Pillar One and Pillar Two would interact, in the sense that the joint implementation of the two pillars would have a slightly different effect from the effect resulting from the two pillars considered in isolation. Assuming that the minimum tax in Pillar Two would be applied after the reallocation involved by Pillar One, the analysis in this report suggests that the interaction between the two pillars would reduce the overall revenue gains compared to a hypothetical situation where there would be no interaction between the pillars. However, this interaction effect would be quantitatively small under the assumptions on Pillar One and Pillar Two considered in this report.

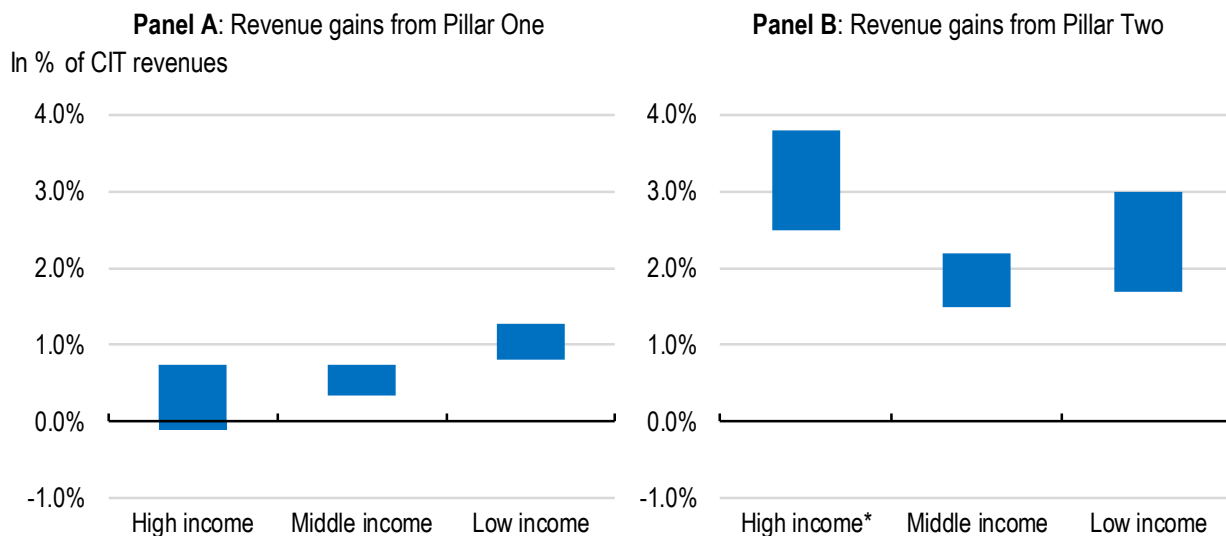
1.2.4. Revenue effects of Pillar One and Pillar Two by jurisdiction groups

22. On average, it is estimated that low, middle and high income jurisdictions would all benefit from revenue gains as a result of the proposals (Figure 1.1). Gains would be relatively small under Pillar One and larger under Pillar Two. 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.

23. Estimated revenue gains from Pillar One tend to be larger – as a share of current CIT revenues – among low and middle income jurisdictions than high income ones, reflecting that relatively low amounts of residual profit are currently located in low and middle income jurisdictions, which implies that they would gain unambiguously from the reallocation occurring under Pillar One.⁷ These results focus exclusively on Amount A, though depending on its ultimate design, some lower income jurisdictions, particularly those with low capacity tax administrations, may also see revenue gains from Amount B. This reflects the fact that these jurisdictions report that they face challenges applying the existing transfer pricing rules effectively, with some MNEs reporting low or negative returns for baseline marketing and distribution activities in their jurisdiction.

Figure 1.1. Estimated effect of the proposals on tax revenues, by jurisdiction groups

Estimates based on illustrative assumptions on the design and parameters of Pillar One and Pillar Two



* Excluding the United States (given illustrative assumption that the US GILTI would co-exist with Pillar Two)

Note: The estimates in this figure are based on the following illustrative assumptions. Pillar One is assumed to focus on Automated Digital Services (ADS) and Consumer Facing Businesses (CFB), with a global revenue threshold of EUR 750 million, a profitability threshold percentage of 10% (based on the ratio of profit before tax to turnover), a reallocation percentage of 20% and a nexus revenue threshold of EUR 1 million for ADS and EUR 3 million for CFB. Pillar Two is assumed to involve a 12.5% minimum tax rate with jurisdictional blending and a 10% combined carve-out on payroll and depreciation expenses. The US GILTI regime is assumed to 'co-exist' with Pillar Two. As a result, the United States is not included in Panel B to ensure greater comparability of results (but it is included in Panel A). Pillar Two estimates take into account the interaction with Pillar One and include gains from a reduction in the profit shifting intensity of MNEs resulting from Pillar Two introduction. Estimates are presented as ranges to reflect uncertainty around the underlying data and modelling. Groups of jurisdictions (high, middle and low income) are based on the World Bank classification. Investment hubs (defined as jurisdictions with a total inward FDI position above 150% of GDP) are not included in this figure. See Chapters 2 and 3 for more details.

Source: OECD Secretariat.

24. Revenue gains from Pillar Two are estimated to be significant across all income groups presented in Figure 1.1. The estimated gains tend to be relatively larger among high income jurisdictions, reflecting that gains from the income inclusion rule would accrue to the jurisdiction of ultimate parent of MNE groups, which are often high income jurisdictions. Still, lower income jurisdictions could benefit from significant gains as a result of the reduction in MNE profit shifting expected to result from Pillar Two. The subject to tax rule, which has not been modelled in this analysis due to data limitations, could also support revenues in low and middle income jurisdictions by allowing the source jurisdiction to apply a top-up tax to an agreed minimum rate to certain related-party payments that are subject to low nominal rates of tax in the residence jurisdiction.

25. Furthermore, Pillar Two would put a floor on the competition to attract MNE activities through special tax incentives (e.g. tax holidays), which could bring additional revenue gains to lower income jurisdictions. Indeed, these jurisdictions often have a weak bargaining position vis-à-vis investing MNEs, which can lead them to offer very low tax rates to these MNEs. Pillar Two could enable these jurisdictions to impose at least the minimum rate. The potential resulting gains are not included in the estimates in Figure 1.1.

26. Results for investment hubs⁸ are omitted from Figure 1.1 as they generally involve a higher degree of uncertainty than other results and because investment hubs are a relatively heterogeneous group of

jurisdictions. These results are presented in Chapter 2 (for Pillar One) and Chapter 3 (for Pillar Two). In general, investment hubs would tend to lose tax base from Pillar One. The magnitude of the resulting tax revenue loss would depend on the effective tax rate on the residual profit of MNEs that is currently located in their jurisdiction. As this rate is sometimes zero, some investment hubs would lose tax base but not tax revenue. Pillar Two, by reducing MNE profit shifting, would lead many investment hubs to lose tax base (as they would tend to receive less shifted profit after the introduction of Pillar Two).

27. Still, many investment hubs may gain a substantial amount of tax revenues from Pillar Two, especially if they decide to increase the effective tax rate on profit in their jurisdiction when this rate is currently below the minimum rate. The scale of this potential reaction by some governments is difficult to anticipate, as it will depend on a number of strategic considerations and may be influenced by the exact design of Pillar Two. This question is further discussed in Chapter 3, which also presents the potential implications of stylised scenarios on the effect of such tax rate increases on revenue gains across jurisdiction groups.

1.2.5. Revenue effects of Pillar One and Pillar Two at the jurisdiction level

28. Jurisdiction-level revenue estimates of Pillar One and Pillar Two were shared by the OECD Secretariat on a confidential and bilateral basis with most Inclusive Framework members. The OECD Secretariat has provided estimates to more than 115 jurisdictions at their request. After extensive consultation with members of the Inclusive Framework, there was no consensus over whether or not jurisdiction-specific estimates should be publicly released as part of the economic impact assessment. In view of this lack of consensus, no jurisdiction-specific estimates are included in this report. As jurisdiction-specific estimates have only been shared with Inclusive Framework members on a confidential and bilateral basis, each jurisdiction has received estimates for its jurisdiction only.

29. Jurisdiction-specific results were shared in the form of revenue estimation ‘tools’. These tools provide jurisdictions with the ability to consider the estimated impact on tax revenues in their jurisdiction of a range of potential Pillar One and Pillar Two parameters (e.g. profitability threshold percentage under Pillar One, minimum tax rate under Pillar Two, etc.) in order to inform the discussions of the Inclusive Framework. Preliminary versions of the Pillar One and Pillar Two tools were shared respectively in October 2019 and February 2020. Refined and updated tools were later shared in June and July 2020, taking into account progress in the design of the proposals, refinements in the underlying data and methodology and feedback from Inclusive Framework jurisdiction officials on the earlier tools and results.

1.3. Effect of the proposals on investment and economic activity

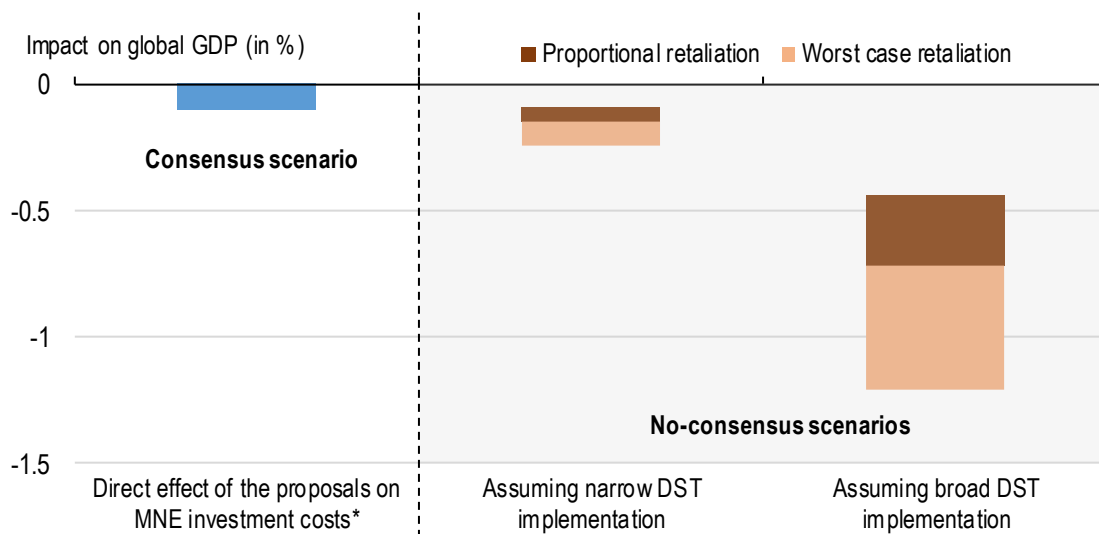
30. The proposals would affect MNE investment, innovation and economic activity through a range of channels. The most direct channel is that, by raising additional tax revenues, the proposals would increase (after-tax) investment costs for the MNEs affected. This would likely have a negative effect on investment and activity, but the magnitude of this effect is estimated to be relatively small: less than 0.1% of GDP in the medium to long term (further details are included in Chapter 4).

31. This small negative effect may be partly or even fully offset by the positive effect from other less quantifiable but nonetheless significant channels. In particular, the proposals aim to increase tax certainty, would affect compliance and administration costs in various ways, may enhance the efficiency of global capital allocation, and would reduce the need to raise revenues by implementing other (potentially more distortive) tax measures, as further discussed below.

32. For the purposes of this analysis, the consensus scenario involving the adoption of Pillar One and Pillar Two by the Inclusive Framework assumes the withdrawal of existing digital services taxes (DSTs) as well as a commitment to refrain from introducing such measures in the future. In contrast, the absence of

a consensus-based solution would likely see the proliferation of uncoordinated and unilateral tax measures (including DSTs) continue, which would likely result in an increase in damaging tax and trade disputes. This would undermine tax certainty and investment, with negative effects on global GDP that could far exceed the direct effect of the reform on investment costs, especially in a scenario involving widespread adoption of DSTs and a “worst-case” (i.e. five-time) trade retaliation factor (Figure 1.2).

Figure 1.2. Estimated effect on global GDP in stylised scenarios



* The proposals would also have positive impacts on GDP through indirect channels (e.g. increased tax certainty, reduced need to increase other distortive taxes) which are not quantified in this figure.

Note: The estimate in the consensus scenario only takes into account the direct effect of the proposals on MNE after-tax investment costs and its implications on MNE investment and ultimately GDP. The range reflects uncertainty on the tax sensitivity of the affected MNEs as well as uncertainty about whether lower investment in a jurisdiction where after-tax investment costs are increased would result in higher investment in other jurisdictions (where some of the investment may be relocated) or not. In the no-consensus situation, two cases are considered: (i) a narrow digital services tax (DST) implementation, where jurisdictions currently subject to Section 301 investigation by the United States introduce a DST, the United States retaliates with tariffs and these jurisdictions counter-retaliate also with tariffs; and (ii) a broad DST implementation, where all jurisdictions except the United States, China and Hong Kong (China) introduce a DST and reactions similar to the previous case ensue. In each case, the uncertainty ranges correspond to the range of outcomes between scenarios with 3% to 5% DST rates and 1-time (i.e. “proportional”) to 5-time (i.e. “worst case”) trade retaliation factors. See Chapter 4 for more details.

Source: OECD Secretariat.

1.3.1. Direct effect of the proposals on investment costs

33. By raising additional tax revenues on the profit of certain MNEs, the proposals would likely increase the effective tax rate on their investment, and therefore after-tax investment costs. Under illustrative assumptions on the parameters of Pillar One and Pillar Two, it is estimated that the effective *average* tax rate (EATR, i.e. the *average* tax rate on the profit derived from a new investment project) on a typical investment project by an MNE would be increased by around 0.3 percentage points on average. The effective *marginal* tax rate (EMTR, i.e. the tax rate on the profit derived from a *marginal* increase in the scale of an existing investment project) would be increased by around 1.3 percentage points on average (see Chapter 4 and Hanappi and González Cabral (2020^[5])). These estimated increases are relatively small compared to the current average level of EATRs and EMTRs on MNE investments (about 24% and 25%, respectively). The increases would primarily come from Pillar Two, consistent with the finding that Pillar Two would have larger effects on tax revenues than Pillar One.

34. This small increase in investment costs would likely have a relatively small effect on global business investment. This is because the firms most affected by the additional investment costs would be relatively large and highly profitable MNEs. These firms are estimated to be less sensitive to corporate taxes in their investment decisions than less profitable firms, as discussed further in Chapter 4 and Millot et al. (2020^[6]). For example, firms belonging to MNE groups with a profitability rate above 10% are found to be about half as sensitive to taxes as those in groups with a profitability between 0% and 10%. This lower sensitivity may reflect that more profitable firms face fewer financing constraints, and also that they are more likely to benefit from economic ‘rents’ (e.g. related to market power).⁹ Taxes on rents are generally thought to affect firm investment less than taxes on ‘normal’ profits.

35. As a result, the negative impact on economic activity of this increase in investment costs is estimated to be very modest: less than 0.1% of GDP over the medium to long term. This impact could be even less negative to the extent that some MNE groups that reduce investment in jurisdictions where investment costs have increased may reallocate this investment to other jurisdictions.

36. Indeed, the proposals would encourage some relocation of investment, as investment costs would increase relatively more in jurisdictions that currently offer low effective tax rates (e.g. below the potential minimum rate under Pillar Two). This could affect investment in these jurisdictions significantly, with potential knock-on effects on the CIT tax base and other tax bases (e.g. personal income tax), although this negative effect on investment could be reduced if Pillar Two includes a formulaic substance-based carve-out that excludes a fixed return for substantive activities from the scope of the GloBE rules. In contrast, jurisdictions with tax rates above the minimum rate would face no significant investment loss and may even benefit from higher investment.

37. All in all, by reducing differences in effective tax rates across jurisdictions, the proposals would tend to increase the relative importance of non-tax factors, such as infrastructure, education levels or labour costs, in the investment location decisions of MNEs. This would generally contribute to a more efficient global allocation of investment, in the sense that investment would be more likely to be located where it is the most economically productive, rather than in the jurisdictions that provide the most favourable corporate tax treatment.

1.3.2. Other effects of the proposals on investment and economic activity

38. Beyond their direct effect on investment costs, the proposals would affect economies through several other channels. One important channel is that, by increasing tax revenues, the proposals would reduce, at least to some extent, the need for governments to rely on other (potentially more distortive) tax measures or cuts in government spending to restore public finances after the COVID-19 crisis. As such, the proposals would also support domestic resource mobilisation in developing economies.

39. The proposals would increase global tax revenues through their direct effect (discussed in the revenue section above) and they could further support tax revenues in the longer term by reducing the intensity of corporate tax competition between jurisdictions. This is because the introduction of a minimum tax rate would limit possibilities for governments to use very low statutory corporate tax rates or very generous preferential regimes to attract MNE activity and profit. Indeed, the introduction of a minimum tax rate would lift the floor on the effective corporate tax rate paid by MNEs to an agreed minimum level. The full implications of this on governments’ future tax rate and base setting behaviour are hard to anticipate with certainty and will depend on future circumstances. Nevertheless, in the context of the post-COVID-crisis constrained budgetary environment, this could have the effect of slowing or even halting some of the aggressive tax competition that has taken place over the past decades.

40. A potential downside of curtailing the ability of governments to offer very low tax rates is that it may, to some extent, reduce their ability to use tax incentives to pursue specific policy objectives, such as promoting innovative activities or economic development (e.g. via investment tax incentives or tax

incentives for R&D). Under the Pillar One and Pillar Two design and parameters illustratively considered in this report, governments would retain a relatively wide margin to use the corporate tax system to pursue these goals, especially if Pillar Two includes a formulaic substance-based carve-out, as such a carve-out would make it easier to offer low rates to activities involving economic substance. In addition, as discussed further in Chapter 4, the efficiency of these preferential schemes is not always well-established. Finally, governments would continue to have a range of other policy tools at their disposal to support their policy objectives, meaning that they could likely adapt their mix of policy instruments if necessary without significantly undermining their ability to pursue these objectives. As a result, it seems unlikely that the reform would have detrimental effects on innovation or economic development via this channel.

41. Another important question is the potential impact of the proposals on compliance costs for MNEs and administration costs for governments. This impact is difficult to assess comprehensively at this stage, as it will depend on the exact design of the proposals and, in particular, on the extent to which the Inclusive Framework adopts simplification measures in the architecture of the proposals.

42. The new tax provisions under both pillars will increase tax filing requirements, which will have a cost for MNEs and governments (e.g. in terms of time spent and need to adapt existing procedures and IT systems). However, this cost will be moderated by the fact that smaller and less profitable MNEs would be out of the scope of the proposals, and the extent to which efficient design options, such as a centralised and simplified administration system, are to be included in the final design of the proposals. In addition, certain provisions of Pillar One (Amount B and the Tax certainty component) would reduce compliance and administrative costs by simplifying the tax treatment of certain business functions, and preventing tax disputes. It is also important to emphasise that, if a consensus-based solution cannot be secured, compliance costs for businesses would likely increase, as a proliferation of unilateral tax measures would likely give rise to a more fragmented and less consistent international tax system, as well as more frequent tax and trade disputes.

43. The economic impact of the proposals will also depend on who bears the economic ‘incidence’ of the additional taxes. In theory, the cost of additional taxes can ultimately fall on MNE shareholders (in the form of lower dividends), workers (in the form of lower wages) or consumers (in the form of higher prices). In practice, the incidence may be split between these three categories in proportions depending on the specific situation of each firm, as further discussed in Chapter 4.

44. Finally, the proposals may also affect competition dynamics among firms. By increasing taxes on large, profitable and profit-shifting MNEs, the proposals would likely contribute to a more even tax playing field between these MNEs and other MNEs (e.g. smaller MNEs that do not shift profits) as well as non-MNE firms. This could contribute to mitigating current trends towards greater market concentration, especially in digital markets, that risk undermining consumer welfare, investment and innovation. Indeed, preliminary evidence suggests that profit shifting MNEs use tax savings to crowd out other firms.

1.3.3. Impacts on the global economy in case no consensus is reached

45. The expected effects of the proposals must be compared to the implications of a counterfactual scenario where a multilateral consensus-based solution cannot be secured. The exact nature of this counterfactual scenario is uncertain, but it seems likely that it would not look like the status quo. Indeed, recent years have seen a proliferation of tax and trade disputes, as a number of jurisdictions have taken unilateral action to address the tax challenges arising from the digitalisation of the economy (e.g. by introducing DSTs or similar measures). In particular, this has led to the United States announcing retaliatory tariffs on about USD 1.3 billion of French goods under section 301 of the US Trade Act and to launch several additional section 301 investigations in June 2020.

46. Tax and trade disputes are likely to intensify further if a multilateral consensus-based solution is not agreed. Indeed, in addition to those jurisdictions that have already announced DSTs, a number of

jurisdictions considering DSTs have announced that they will refrain from introducing them if a multilateral, consensus-based solution can be secured. If no agreement is reached, they would likely proceed with introducing DSTs and an escalation of DST-related trade tensions would follow. Several recent surveys confirm that tax uncertainty is a key concern of MNEs and that the perception of uncertainty has been increasing in recent years. A consensus-based solution, which for the purposes of this report assumes the withdrawal of existing DSTs as well as a commitment to refrain from introducing such measures in the future, is expected to provide greater tax certainty than the counterfactual scenario where no multilateral agreement can be secured.

47. A proliferation of DSTs would generate economic inefficiencies. As DSTs are not designed as taxes on corporate profits, but are typically designed more like taxes on turnover, DSTs are more likely to give rise to instances of double taxation. In addition, contrary to profit-based taxes, DSTs would also affect loss-making firms, which could be damaging in the context of a significant economic downturn like the current COVID-19 crisis.

48. These inefficiencies, combined with growing tax uncertainty and the likelihood of further tax and trade disputes, would undermine investment and economic activity. The magnitude of these adverse effects would notably depend on the number of jurisdictions introducing DSTs, the design and rate of these DSTs, and the scale of the tariff retaliation and potential subsequent tariff counter-retaliation by jurisdictions targeted by tariffs. Under stylised scenarios with ‘narrow’ DST implementation (i.e. only focusing on jurisdictions currently under section 301 investigation by the United States), it is estimated that the negative effect on global GDP could reach -0.1% to -0.2%. In scenarios with broader DST implementation, the negative effect on global GDP could reach -0.4% to -1.2%. The upper end of these ranges corresponds to scenarios with proportional trade retaliation, while their lower end corresponds to worst-case scenarios with trade retaliation factors going up to five times beyond proportional. In most of these scenarios, the negative effect on GDP would be significantly larger than the direct effect of Pillar One and Pillar Two on investment costs (see Figure 1.2 above).

1.4. Conclusion and main prospects in the context of the COVID-19 crisis

49. Overall, the analysis suggests that a consensus-based multilateral solution involving Pillar One and Pillar Two would bring significant tax revenue gains to most jurisdictions. In addition, it would lead to a more favourable environment for investment and growth than would likely be the case in the absence of an agreement by members of the Inclusive Framework, while its effects on compliance and administrative costs would depend on the exact design of Pillar One and Pillar Two.

50. More broadly, the analysis suggests that a multilateral consensus-based solution involving Pillar One and Pillar Two could provide a series of key benefits to the international tax system. It would adapt the international corporate tax system to the digital age by ensuring that the allocation of taxing rights on business profits is no longer exclusively determined by reference to physical presence. It would support a more level playing field between highly digitalised and intangible intensive MNEs and other firms, and also enhance the efficiency of global capital allocation. The proposals would likely increase tax certainty, particularly when compared to the unilateral tax measures and escalating tax and trade disputes that would likely result in the absence of a consensus-based solution. The proposals would reduce profit shifting and place a floor on tax competition, which would support the ongoing revenue needs of governments, particularly as they seek to rebuild their economies after the COVID-19 crisis. Finally, the proposals would support the long-term sustainability of the system as the importance of digitalisation and intangibles are likely to intensify further in the coming decades.

51. The full implications of the COVID-19 crisis remain uncertain at this stage. The impact assessment in this report is based on pre-crisis data. Its key messages are likely to remain valid in the post-crisis environment, with nuances discussed in Box 1.2 below. Looking ahead, the COVID-19 crisis will likely

make it even more pressing to address the tax challenges arising from the digitalisation of the economy, for three main reasons:

- i. The crisis is accelerating the digitalisation of the economy, making the tax challenges from digitalisation even more acute.
- ii. The crisis will lead to a sharp deterioration of public finances in most countries, which will raise questions about how to support tax revenues once the post-crisis recovery is firmly on track.
- iii. As many firms are receiving government support during the crisis and many members of society will be asked to make additional contributions and sacrifices to the collective efforts in the context of the crisis, there is likely to be even less tolerance of aggressive tax planning by MNEs than before the crisis.

52. All this suggests that, in the absence of a consensus-based solution, uncoordinated and unilateral tax measures would become even more likely than in the pre-crisis environment. In turn, the negative effects of the ensuing tax and trade disputes would undermine investment and activity at a moment when the global economy is at its most fragile due to the crisis, which could compound the negative effects of the crisis and hinder the recovery prospects.

Box 1.2. Implications of the COVID-19 crisis for the impact of the proposals

The COVID-19 crisis will affect firms, economies and governments in ways that could modify the expected impact of the proposals, primarily in the short term, but also in the longer term. The full impact of the COVID-19 crisis remains highly uncertain at this stage, but a few likely implications already stand out.

In the short term, the economic crisis is having a strong negative effect on the profitability of most MNEs, reflecting declining consumer demand as well as difficulties with production (e.g. locked-down workers, restrictions on travel, supply chain disruptions). There are some exceptions, including highly-digitalised MNEs that are benefitting from the increasing reliance on digital technologies.

Overall, lower MNE profitability will reduce the amount of residual profit available for reallocation under Pillar One, as fewer MNEs will have profitability above the profitability threshold percentage. It would also reduce the global amount of low-taxed profit and the expected revenue gains under Pillar Two. These effects should largely dissipate over time, as economies and MNE profits recover from the crisis. The timing of the recovery in expected revenue gains from the Pillar One and Pillar Two proposals will depend on the shape and speed of the economic recovery. It will also depend on the design of potential loss carry-forward provisions under both pillars, as MNEs experiencing losses during the crisis could make use of these provisions to offset tax liabilities in the future.

The crisis is accelerating the trend towards the digitalisation of the economy. This will increase the relative importance of automated digital services (ADS) in the overall scope of Pillar One, as envisaged in this report. In 2016, ADS represented about one-fifth of the residual profit of MNEs in the envisaged scope of Pillar One. This share was already on a fast-growing trajectory before the crisis. For example, the residual profit of the top 10 MNEs in ADS sectors was 30% higher in 2019 than 2016. In addition, given that MNEs with a heavy reliance on intangible assets and with highly-digitalised business models generally have more possibilities to shift profits to low-tax jurisdictions than other MNEs, accelerating digitalisation could also increase the revenue effects of Pillar Two.

Finally, the crisis may bring or accelerate other structural economic changes, including potential changes in the sectoral structure of economies, the organisation of global value chains and the competition dynamics among firms. The nature and magnitude of these changes is difficult to anticipate with certainty, but they could also have implications for the long-term impact of the proposals.

References

- Hanappi, T. and A. González Cabral (2020), “The impact of the pillar one and pillar two proposals on MNE’s investment costs : An analysis using forward-looking effective tax rates”, *OECD Taxation Working Papers*, No. 50, OECD Publishing, Paris, <https://dx.doi.org/10.1787/b0876dcf-en>. [5]
- Millot, V. et al. (2020), “Corporate Taxation and Investment of Multinational Firms: Evidence from Firm-Level Data”, *OECD Taxation Working Papers*, No. 51, OECD Publishing, Paris, <https://dx.doi.org/10.1787/9c6f9f2e-en>. [6]
- OECD (2020), *Corporate Tax Statistics*, OECD Publishing, Paris, <https://www.oecd.org/tax/beps/corporate-tax-statistics-database.htm>. [4]
- OECD (2020), *Tax Challenges Arising from Digitalisation – Report on Pillar One Blueprint: Inclusive Framework on BEPS*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, <https://dx.doi.org/10.1787/beba0634-en>. [1]
- OECD (2020), *Tax Challenges Arising from Digitalisation – Report on Pillar Two Blueprint: Inclusive Framework on BEPS*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, <https://dx.doi.org/10.1787/abb4c3d1-en>. [2]
- OECD/G20 Inclusive Framework on BEPS (2019), *Programme of Work to Develop a Consensus Solution to the Tax Challenges Arising from the Digitalisation of the Economy*, OECD/G20 Inclusive Framework on BEPS, <https://www.oecd.org/tax/beps/programme-of-work-to-develop-a-consensus-solution-to-the-tax-challenges-arising-from-the-digitalisation-of-the-economy.pdf>. [3]

Notes

¹ Global CIT revenues are estimated to represent about USD 2.5 trillion in 2019. This is based on OECD and IMF data on CIT revenues in 2016 (the year with best geographic coverage of CIT revenues, with more than 120 jurisdictions covered), extrapolations based on the median ratio of CIT revenues to GDP (i.e. 2.7%) in jurisdictions not covered in OECD or IMF data, and World Bank data on nominal global GDP growth between 2016 and 2019 (assuming a constant ratio of global CIT revenues to global GDP).

² Gains from the US GILTI regime are based on *ex ante* estimates from the US Joint Committee on Taxation. See Chapter 3 for more details.

³ For the purpose of this paper, user/market jurisdictions (henceforth “market jurisdictions”) are jurisdictions where an MNE group sells its products or services or, in the case of highly digitalised businesses, provides services to users or solicits and collects data or content contributions from them.

⁴ This USD 500 billion estimate assumes illustratively that the MNE groups in scope of Amount A would be those with revenues above a global revenue threshold of EUR 750 million, profitability above a profitability threshold percentage of 10% (based on the ratio of profit before tax to turnover) and activities in ADS and CFB. Estimates based on other potential assumptions on the parameters of Amount A are presented in Chapter 2.

⁵ Global blending, which is more difficult to model with the available data, would bring less revenues than jurisdictional blending for a given level of minimum tax rate, as it would allow MNEs to use high-taxed profit in certain jurisdictions to 'offset' low-taxed profit in other jurisdictions.

⁶ In particular, it is illustratively assumed in this report that an MNE group that claims the benefit of the carve-out would be required to make a corresponding and proportional adjustment to the covered taxes for the calculation of the ETR. The alternative option (i.e. not making a corresponding and proportional adjustment to the covered taxes) would be difficult to model with the available data. See Chapter 3 for more details.

⁷ High income jurisdictions are likely to see higher amounts of residual profit allocated to them under Amount A, but they already have taxing rights over some residual profit of in-scope MNE groups, and will see their taxing rights over these profits reduced where they are reallocated to other jurisdictions under Amount A. Hence, the overall revenue gains from Amount A are estimated to be on average lower for high income jurisdictions than for low and middle income jurisdictions.

⁸ In this report, investment hubs are defined as jurisdictions with a total inward FDI position above 150% of GDP. Many of them have relatively low statutory and/or effective tax rates on corporate profit. The jurisdiction groups considered in this report (i.e. high, middle and low income jurisdictions) exclude investment hubs.

⁹ The lower sensitivity may also relate to tax planning behaviour, which is expected to be reduced by the proposals.



From:
**Tax Challenges Arising from Digitalisation –
Economic Impact Assessment**
Inclusive Framework on BEPS

Access the complete publication at:
<https://doi.org/10.1787/0e3cc2d4-en>

Please cite this chapter as:

OECD (2020), “Overview of main findings”, in *Tax Challenges Arising from Digitalisation – Economic Impact Assessment: Inclusive Framework on BEPS*, OECD Publishing, Paris.

DOI: <https://doi.org/10.1787/00a77eb4-en>

This work is published under the responsibility of the Secretary-General of the OECD. The opinions expressed and arguments employed herein do not necessarily reflect the official views of OECD member countries.

This document, as well as any data and map included herein, are without prejudice to the status of or sovereignty over any territory, to the delimitation of international frontiers and boundaries and to the name of any territory, city or area. Extracts from publications may be subject to additional disclaimers, which are set out in the complete version of the publication, available at the link provided.

The use of this work, whether digital or print, is governed by the Terms and Conditions to be found at <http://www.oecd.org/termsandconditions>.