TAX CHALLENGES ARISING FROM THE DIGITALISATION OF THE ECONOMY

ECONOMIC ANALYSIS & IMPACT ASSESSMENT

Tax Justice Network Virtual Conference
Wednesday, 11 December 2019

David Bradbury
Head of the Tax Policy and Statistics Division
OECD's Centre for Tax Policy and Administration

OECD
BETTER POLICIES FOR BETTER LIVES

Proposals to develop a consensus solution to the tax challenges arising from digitalisation

- **Programme of Work** adopted by the OECD/G20 Inclusive Framework on BEPS in May 2019 and endorsed by the G20 in June 2019, with two pillars:

PILLAR 1

Focuses on the allocation of taxing rights

- “Unified approach” proposed by the Secretariat in October 2019, involving a significant re-allocation of taxing rights
- Allocation of a share of MNE groups’ “residual” profit to market countries and new rules taking into account digital presence

PILLAR 2

Focuses on remaining BEPS issues

- Global anti-base erosion (GloBE) that would ensure that profit is taxed at a minimum effective rate
- Top-up on current effective tax to a fixed rate to be set once key design elements of the proposal are finalised

Revenue implications: approach and main caveats

- **Flexible analysis framework** as the detail of proposals are under discussion
- **Broad geographic and company coverage** (more than 200 jurisdictions, more than 27,000 MNE groups)
- **Revenue estimation tool** (Pillar 1) sent bilaterally to countries in October 2019
- **Main caveats:**
  - **Estimates are "static"** and do not take into account the potential strategic reactions of MNEs and governments
  - **Many reform parameters are the subject of ongoing discussions**
  - **The underlying data have limitations**, due to gaps in coverage and conceptual differences between sources
  - **Underlying data on profit and its location are from 2016** and do not take into account recent events (e.g. US tax reform)
  - **Refinements are still ongoing** to improve data quality, including via interactions with countries

→ Results should be interpreted as broad orders of magnitude, rather than precise point estimates

REVENUE IMPLICATIONS FOR PILLAR 1

Revenue implications: Overview

Key Objective

- Initial results gauge the overall direction and magnitude of the impact of the proposals
- Secretariat has assessed the proposals under a range of different design and parameter scenarios
- Design and parameter choices are not intended to pre-judge decisions that are still to be taken by the IF
- Compare to a counterfactual scenario of increased unilateral measures, tax uncertainty and continued tax planning by MNEs

Broad geographic and company coverage

- More than 200 jurisdictions
- Based on firm-level data covering more than 25,000 MNE groups, including major digital MNEs, complemented with aggregate data

Main caveats

- Estimates should be considered as broad orders of magnitude, due to data limitations, and the preliminary nature of the proposals

Pillar 1 revenue effects: methodology and data

Tax revenue change for Country A = **Global residual profit allocated** × (**Country A Share of MNE sales** − **Country A Share of residual profit**) × **Country A Corporate tax rate**

Global residual profit is computed based on the accounts of more than 27,000 MNE groups. A fraction of global residual profit is assumed to be allocated to markets (e.g. 20%)

Key data sources: Orbis, Worldscope and other sources

Countries receive residual profit in proportion to MNE sales in the country (including digital sales)

Key data source: OECD Analytical Activities of Multinational Enterprises (AMNE) Database

Countries relieve residual profit in proportion to the amount of residual profit located in the country (illustrative assumption)

Key data sources: Country-by-Country Reports (CbCR) data, Orbis, AMNE, National Accounts and FDI data

The corporate tax rate is applied to the change in tax base (note: the rate can differ between received and relieved profit)

Key data source: OECD Tax Statistics

- The is a simplified illustration of the analysis, which draws upon a range of data sources, including publicly available sources such as the recently-released Analytical AMNE database, OECD FDI statistics and OECD Tax Statistics

Pillar 1 revenue effects: summary of main insights

- **Modest global net tax revenue gain**
- **Low and middle income economies tend to gain more** than advanced economies
  - They have a smaller share of residual profits compared to developed countries and investment hubs
  - This suggests that on balance they gain tax base
  - They also have higher statutory CIT rates, so the tax base they gain they tax at higher rates
  - This is partially dependent on the treatment of the commodities & extractives sectors
- **Investment hubs tend to experience significant losses in tax base,** and to a lesser extent in tax revenues
- **MNEs in digital-oriented and intangible-intensive sectors would be significantly impacted**

Revenue estimation tool and country outreach

- **We have developed a jurisdiction-specific revenue estimation tool** to help jurisdictions to evaluate the revenue impacts of Pillar 1
  - **Tool has been sent to IF member jurisdictions** to help them understand the impact of the proposals and various design considerations
  - Technical support for IF members with **a demonstration of how to use the tool**
  - Special efforts to engage in **bilateral outreach to developing countries** to ensure that they understand results for their country
- **Bilateral engagement on data and methodology**
- **Ongoing engagement to refine the results,** through quality checking and data verification

REVENUE IMPLICATIONS FOR PILLAR 2

Pillar 2 revenue effects: global results and summary of main insights

- **Global net tax revenue gains of Pillar 2 may be significantly higher than for Pillar 1,** but depend heavily on design and rate of minimum tax
- **The distribution of gains across countries** will depend on the detailed design of rules, as well as MNE and government behavioural responses
- **The additional tax burden from Pillar 2 would fall on MNEs engaging in tax planning activities**, mainly in the digital-oriented, financial and real estate sectors
- **Pillar 2 will reduce countries' incentives to offer tax incentives** (tax holidays and other tax incentives) that result in windfall gains for MNEs
- **Pillar 2 should also level the playing field for countries** that feel that they have to offer these tax incentives to compete with their neighbours

Pillar 2 Revenue Effects: Behavioural Responses

- **Behavioural responses are expected to be more significant in the case of jurisdiction blending**
- **MNEs:**
  - Pillar 2 will reduce tax rate differentials between countries; reducing incentives to shift profits to low- and zero-tax jurisdictions
  - Revenue gains are expected to be larger in jurisdictions with ETRs above the minimum tax rate
- **Governments:**
  - Some jurisdictions with low- or zero-statutory tax rates may increase their rates
  - Some jurisdictions may increase ETRs by curtailing or removing tax incentives and through increased use of anti-avoidance measures
- **Longer term reactions**
  - Real investment decisions will be driven more by non-tax factors, such as workforce skills or quality of institutions and infrastructure

CONCLUSION

Overall key messages: Pillars 1 and 2

- **Combined revenue impact of Pillars 1 & 2 would lead to a significant increase in global tax revenues as well as a redistribution of taxing rights to market jurisdictions**

- **Pillar 2 would have a larger impact on global tax revenues than Pillar 1**. We are currently modelling the interactions between the two Pillars

- **Tax revenue gains accrue to most jurisdictions** (except investment hubs)

- **There are complementarities between Pillar 1 and Pillar 2,** as the sectors and firms affected have some overlap, but there are also differences

- **The reform would strengthen the impact of real economic factors** on the scale and location of investment decisions

Impact on developing countries

- **Developing countries tend to gain from Pillar 1**
  - Their share of global sales is higher than their share of global residual profit
  - Ensuring commodities are out of scope has an important impact for developing countries
- **Amount B is expected to be beneficial for developing countries**
- **Developing countries rely more on CIT revenues, so increased CIT revenues represent a larger gain as a proportion of total tax**
- **Developing countries tend to be more affected by BEPS, and thus may benefit proportionately more from Pillar 2**
- **There tends to be a greater reliance on the use of poorly-designed** (inefficient and ineffective) **tax incentives in developing countries**
- While economic analysis is less precise due to data quality issues, the work the OECD has done presents as comprehensive picture as is possible

Ongoing work

Ongoing work on Pillar 1 revenue effects

- Refine results as key decisions are taken on the parameters, scope and operation of the Unified Approach
- Consideration of Amount B

Ongoing work on Pillar 2 revenue effects

- Incorporate different scenarios based on different behavioural responses
- Development of jurisdiction-specific tool and results
- Refine as decisions are taken on design

Other ongoing work

- Consideration of the interactions between Pillars 1 and 2
- Ongoing work on investments impacts
- Goal to release elements of the economic analysis in early 2020

Contact details

David Bradbury

Head of the Tax Policy and Statistics Division
Centre for Tax Policy and Administration

2, rue André Pascal - 75775 Paris Cedex 16
Tel: +33 1 45 24 15 97 – Fax: +33 1 44 30 63 51

David.Bradbury@oecd.org || www.oecd.org/tax