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Global Tax Alert

OECD hosts webcast on preliminary impact assessment and economic analysis of BEPS 2.0 project proposals

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Executive summary

On 13 February 2020, the Organisation for Economic Co-operation and Development (OECD) Secretariat hosted a webcast to discuss some of the preliminary results of its economic analysis and impact assessment of the international tax changes being considered in the ongoing project on addressing the tax challenges of the digital economy (the BEPS 2.0 project). The OECD webcast was held just weeks after the jurisdictions participating in the BEPS 2.0 project through the OECD/G20 Inclusive Framework on BEPS reaffirmed their commitment to reach agreement on a consensus-based long-term solution by the end of 2020.[1]

The analytical work being done by the OECD Secretariat and discussed during the webcast focuses on the impact of the BEPS 2.0 proposals on the tax revenue of countries and not on the tax liabilities of multinational enterprises (MNEs). The work is intended to inform the decisions to be made by the Inclusive Framework jurisdictions in the negotiations underway at the OECD with respect to the technical and policy details of the proposed solution. The OECD's preliminary analysis is based on data from more than 200 jurisdictions, including all members of the Inclusive Framework, and from more than 27,000 MNE groups.

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Based on the preliminary analysis, the OECD Secretariat expects the combined effect of Pillars One and Two to lead to a significant increase in global tax revenues overall. The OECD noted during the webcast that these preliminary results are based on assumptions and simplifications with respect to the proposals under consideration, which is not intended to pre-judge the design decisions to be made by the Inclusive Framework.

The OECD Secretariat noted that the analysis will be updated as the work on the BEPS 2.0 project progresses and further decisions are made by the Inclusive Framework on the specific international tax changes that will be included in the consensus-based solution. They also indicated that work was ongoing on a more detailed analysis to be concluded by the end of March.

Detailed discussion

Background

In May 2019, the OECD released the "Programme of Work to Develop a Consensus Solution to the Tax Challenges Arising from the Digitalisation of the Economy" (the Workplan).[2] The Workplan is divided into two pillars:

- Pillar One addresses the allocation of taxing rights between jurisdictions and considers various proposals for new profit allocation and nexus rules.
- Pillar Two is the "GloBE" proposal involving the development of a coordinated set of global minimum tax rules.

The OECD released a public consultation document on an OECD Secretariat proposal for a "unified approach" under Pillar One on 9 October 2019,[3] which was discussed at a consultation session on 21-22 November 2019.[4] The OECD released a consultation document on design aspects relating to the GloBE proposal on 8 November 2019,[5] which was discussed at a consultation session on 9 December 2019.[6]

On 31 January 2020, the OECD released a Statement reporting that the members of the Inclusive Framework reaffirmed their commitment to reach an agreement on a consensus-based solution by the end of 2020.[7] Attached to the Statement are an outline of the architecture and a revised workplan for Pillar One and a progress update on Pillar Two.

Webcast summary

On 13 February 2020, the OECD Secretariat hosted a webcast to provide a summary of the preliminary results of its analysis of the impact on countries' tax revenues of the proposals being developed under the BEPS 2.0 project. These preliminary results were presented to the participating jurisdictions at the Inclusive Framework meeting on 29-30 January 2020.

The Secretariat indicated that the assumptions used for modelling purposes should not be viewed as pre-judging the decisions to be made by the Inclusive Framework jurisdictions as the proposals are further developed. For purposes of the analysis, the Secretariat grouped countries into "high-income," "middle-income," "low-income" and "investment hubs" – by reference of gross domestic product (GDP) per capita of each country – and provided results at the level of such country groups. No results at a country-specific level were provided on the webcast. The data sources used for the analysis include aggregate data from country-by-country reporting, the OECD Analytical Activities of Multinational Enterprises (AMNE) database, foreign direct investment (FDI) data, and national accounts. The Secretariat indicated that wherever possible, they used firm-level information, and combined this with aggregate data.

Overall, the OECD Secretariat expects the combined effect of Pillars One and Two to be a significant increase in global tax revenues. Depending on the specific design choices that are made, the Secretariat's analysis estimated that the global net revenue gain may be up to 4% of global corporate income tax revenues, or US$100 billion annually. As a share of corporate tax revenues, the Secretariat's estimates of the revenue gains are broadly similar across the groups of high, middle and low-income countries. The Secretariat did not provide any information on the estimated impact on the revenue impacts for investment hubs.

The OECD Secretariat noted that the proposals under consideration are expected to lead to a significant reduction in profit shifting. They also expressed the view that a failure to reach a consensus-based solution would lead to further unilateral measures and greater tax uncertainty.

Main results of OECD Secretariat analysis

- **Revenue effects of Pillar One**: The analysis focuses only on Amount A of Pillar One. Using 10% and 20% thresholds for residual profit, and assuming an allocation of 20% of the residual profit to market jurisdictions,[8] the preliminary results of the analysis show that most jurisdictions would gain tax revenues – with the exception of investment hubs which would experience losses in tax revenues. The overall global tax revenue increases would be slight and would arise because some taxing rights would shift from low-tax jurisdictions to higher-tax jurisdictions. The analysis shows that, on average, low and middle-income economies would gain relatively more revenue than advanced economies. Moreover, the analysis shows that more than half of the profit that would be reallocated would come from 100 MNE groups.
- **Revenue effects of Pillar Two**: The OECD Secretariat modeled four different scenarios for Pillar Two, using 12.5% as the assumed minimum tax rate and based on the income inclusion approach and a country-by-country measurement (i.e., jurisdiction blending):
  - A minimum tax assuming no interaction with Pillar One
  - A minimum tax with interaction with Pillar One but no profit shifting behavior change by MNEs
  - A minimum tax with interaction with Pillar One and a change in profit shifting behavior by MNEs
  - A minimum tax with interaction with Pillar One, a change in profit shifting behavior and countries raising tax rates

  Based on the OECD Secretariat's analysis, the outcome of all four scenarios would be similar overall increases in tax revenues – however, the cause of the increase in tax revenue was different across the scenarios.

  The OECD Secretariat concluded that Pillar 2 would raise significant tax revenues, reduce tax rate differentials between jurisdictions and reduce the incentives for MNEs to shift profit.
- **Investment effects**: The OECD Secretariat's analysis also provides estimates of the investment impact of the proposed changes. For this purpose, the analysis compares the impact of the adoption of Pillar One and Pillar Two with a counterfactual scenario where there would be no agreement on BEPS 2.0 and there would be more unilateral actions. The analysis shows that the direct effect on investment costs is expected to be small in most countries and many MNEs would be unaffected by the proposals, which target firms with high levels of profitability and low effective tax rates. The Secretariat's analysis also concludes that reforms would reduce the influence of corporate taxes on investment location decisions.

Caveats

The OECD Secretariat acknowledged that their current analysis has limitations. In particular, as design options are decided on, revisions to the analysis will be required. Moreover, the underlying data has limitations, from gaps in coverage to time lags – and the preliminary analysis was done based on economic data from 2016. The Secretariat noted that work is still ongoing to improve data quality.

A further caveat to note is that the OECD Secretariat's modeling for Pillar Two includes possible strategic reactions of MNEs and governments, which are very difficult to anticipate with certainty.

Next steps

The ongoing work on the BEPS 2.0 project will be discussed during the G20 finance ministers and central bank governors meeting in Riyadh, Saudi Arabia, on 22-23 February.

A more detailed analysis by the OECD Secretariat on the investment and growth impacts of the proposals is expected by the end of March 2020. As the work progresses and further decisions are made by the Inclusive Framework on the design and parameters of the reform, the analysis will continue to be updated and refined.

Implications

The complex issues underlying the Pillar One and Pillar Two work will be the subject of policy and technical discussions among the Inclusive Framework jurisdictions throughout 2020. The ongoing project, with the participation of 137 jurisdictions, could lead to fundamental changes in the global international tax system under which multinational businesses operate and could have significant consequences in terms of both the overall tax liabilities of businesses and the tax revenues of countries. The OECD Secretariat's preliminary economic analysis provides some indication of the information that is being provided to participating jurisdictions as they consider their posture in the ongoing negotiations and evaluate what the proposals under development would mean in economic terms.

Companies may want to consider engaging with the OECD and policymakers at both national and multilateral levels on the business implications of these proposals.

Endnotes

1. See EY Global Tax Alert, *OECD documents on BEPS 2.0 include new details and identify issues under consideration on Pillar One and Pillar Two*, dated 7 February 2020.
2. See EY Global Tax Alert, *OECD workplan envisions global agreement on new rules for taxing multinational enterprises*, dated 3 June 2019.
3. See EY Global Tax Alert, *The OECD takes next step on BEPS 2.0 – Proposal for a "unified approach" for additional market country tax*, dated 10 October 2019.
4. See EY Global Tax Alert, *OECD hosts public consultation on proposed "unified approach" under Pillar One of BEPS 2.0 project*, dated 27 November 2019.
5. See EY Global Tax Alert, *OECD issues consultation document on technical design aspects of Pillar Two*, dated 14 November 2019.
6. See EY Global Tax Alert, *OECD hosts public consultation on global anti-base erosion (GloBE) proposal under Pillar Two of BEPS 2.0 project*, dated 13 December 2019.
7. See EY Global Tax Alert, *OECD documents on BEPS 2.0 include new details and identify issues under consideration on Pillar One and Pillar Two*, dated 7 February 2020.
8. See EY Global Tax Alert, *The OECD takes next step on BEPS 2.0 – Proposal for a "unified approach" for additional market country tax*, dated 10 October 2019 and EY Global Tax Alert, *OECD documents on BEPS 2.0 include new details and identify issues under consideration on Pillar One and Pillar Two*, dated 7 February 2020 for more details on these concepts.

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