



Trade Union  
Advisory Committee  
to the OECD  
*Commission  
syndicale consultative  
auprès de l'OCDE*

## **Comments on the OECD Impact Assessment of the Tax Reform Proposals to Address Digitalisation**

Paris, this version 6 November 2020

### **Overview & key findings**

On 12 October 2020, the OECD released two blueprints for international tax reform, which are the results of a 3-year long negotiation process of its Inclusive Framework on Base Erosion and Profit Shifting (BEPS), a forum gathering OECD economies, non-OECD G20 economies and over 70 other countries, set up at the request of the G20 following the 2015 BEPS agreements. The blueprints have not been finalised and agreed because of a lack of consensus. The final agreement is now postponed to mid-2021.

The release of the two blueprints was accompanied by an economic impact assessment prepared by the OECD Secretariat. The +280-page long report assesses the impact of both Pillar I & II through different angles and under different parameters of the blueprints. Some of the key findings are listed below.

Quantitative impact on corporate income tax (CIT) revenues:

- The OECD's latest baseline scenario includes a global minimum corporate income tax of 12.5% and excess profits ("residual profits") set as above 10% of turnover. It would increase global CIT by USD 50-80 billion per year (+1.9% to +3.2% increase). Alternative scenarios (including a higher global minimum rate) would generate USD88-158bn.
- In addition to increasing CIT globally, the reform would also reallocate circa USD100bn CIT to "market jurisdictions" (where users and consumers of digital services are located).
- The report does not disclose country-specific impact assessments. Regrouped in broad categories, it appears that both high-income and high-tax countries would be net beneficiaries in terms of CIT revenues. Middle- and lower-income countries would also benefit but to a lesser extent. For "Investment hubs" (defined as countries which FDI stock exceeds 150% of GDP), including 5 OECD countries, the picture is less clear, but the potential loss would appear to be very modest (at about 0.1% of GDP).
- Lowering or even eliminating the EUR750m turnover threshold below which businesses are exempted from the new rules would have little effect. This might

be indicative of the top heavy concentration of excess profits in few corporate hands.

- Ensuring harmful tax incentives to attract FDI, including “patent boxes”, are properly covered by the reform would boost the impact on CIT revenues.
- The reform would generate a very modest increase in the effective taxation rate of firms (i.e. statutory taxation at the net of tax incentives and special regimes): just +0.3 percentage point on top of the 24% global effective average tax rate.

Qualitative impact on market structure and competition:

- By reducing the tax differentials between MNEs and non-MNEs, the reform would ensure better level playing field and help address market concentration issues;
- By reducing tax differentials between countries, the reform would lower the intensity of tax competition. Conversely, it would increase “the importance of non-tax factors (e.g. infrastructure, education levels or labour costs) in investment decisions”.
- Among the stakeholders of the firm, workers are the prime candidates to take on the cost of the tax increase through additional wage compression, alongside shareholders (lower dividend payouts) and consumers (higher prices). However data and literature are scarce on the topic. The report suggests that the impact on workers could be mitigated (MNEs with high profit margins are less affected by tax increases in their business decisions on investment locations or employment/wage levels; and in conditions of quasi-monopoly, such as the case of digital MNEs, companies have more manoeuvre to raise final consumers’ prices in order to mitigate increased tax costs).

Questions about the methodology:

- The calculations are based on a number of assumptions, including interaction between the components of the reform, the expected reaction by MNEs closing down their aggressive tax planning schemes and reaction by some governments, raising their effective tax rates.
- The data that are used for the purpose of the impact assessment are 3 to 4 year old (data for 2016-2017). On the scale of the current digitalisation process, this is equivalent to a full decade. At the same time, the COVID-19 crisis is accelerating the digitalisation process and the market power of large digital businesses.
- To make the case of the reforms, the OECD offers dramatic figures in case of a no-deal in 2021 and the multiplications of bilateral digital services taxes. The implicit message to governments is clear: reach a deal sooner rather than later, or it is a catastrophic scenario that will be in the making.

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## **About the reform proposals**

The proposed new rules would have a twin objective:

- to target large and highly profitable MNEs that benefit from the current gap between tax rules (designed for brick and mortar businesses) and the disruptive business model of the digital economy (Pillar I); and
- to resolve the old issue of harmful tax competition by creating a defensive legal framework allowing government to set a minimum taxation benchmark for MNEs through a global minimum tax rate (Pillar II).

Pillar I sets revised corporate income tax rules to reallocate a portion of the excess profits (defined by the OECD Guidelines on Transfer Pricing as “residual profits”) of large international digitalised businesses to “market jurisdictions” where users and consumers of digital services are located. The purpose is to address the disruptive business model of the digital economy that allows businesses to sell or raise revenues without physical presence. Above a certain level of profits (defined as “routine profits”), the excess “residual” profits are measured and a share of it (10%, 20% or 30%, subject to negotiations) are then reallocated to market jurisdictions based on a formula.

Businesses covered include:

- Automated Digital Services (ADS) incl. search engines, social networks, other platforms & e-commerce, games & IT software and services;
- Consumer Facing Businesses (CFB) including internet retailers, digital media, IT devices & Telecom; and
- Business with a minimum threshold of EUR750 million in annual turnover.

Pillar II introduces a tool for governments to tax back in-country made profits by businesses with foreign fiscal residence at a globally defined minimum tax level. In part, the proposal is an extension of the rules set for “controlled foreign corporations” in the 2015 BEPS agreement. Businesses legally located overseas but which economically should be subject to taxation at home, would be taxed for an amount equivalent to the difference between the tax level overseas and a global minimum tax rate. The key parameter, yet to be determined, is the level of the minimum tax rate, but not only. The scope also matters, whether harmful tax incentives for FDI and “innovation” (i.e. patent

boxes) are covered or not. Unlike Pillar I, Pillar II is a generic reform, and not aiming specifically at digital or digitalised businesses.

Pillar II would apply to all 137 countries of the Inclusive Framework, except the United States which has its own “GILTI” regime.

The release of the two blueprints was accompanied by an economic impact assessment report prepared by the OECD Secretariat<sup>1</sup>. The +280-page long report assesses the impact of both Pillar I & II through different angles and under different parameters of the blueprints. What follows are comments on the content of the report.

### **Impact on CIT revenues**

The executive summary states that, combined, Pillar I & II could increase global corporate income tax revenues by about USD 50-80 billion per year, (+1.9% to 3.2% increase), reaching USD 60-100 billion when the separate US GILTI regime is added. As shown in the table further below, much of the increase would come from the minimum tax framework of Pillar II. Pillar I would generate a much small amount globally, given that its goal on a country by country basis is to reallocate rather than increase CIT levels.

The figures presented in the executive summary are based on a number of assumptions and hypotheses made by the OECD Secretariat. The agreed October blueprints are unfinished products and a number of parameters of both Pillar I & II have yet to be set through negotiations in 2021, including:

- For Pillar I: the threshold above which profits are treated as excess / residual profits: the OECD’s baseline scenario is 10% profit before tax, but it should not be set in stone (other scenarios include 8%, 15%, 20%). Once that is set, the share of the excess profits that are reallocated to market jurisdictions shall be defined: the baseline scenario suggests 20%, again to be discussed;
- For Pillar II: the minimum effective taxation level is set at a baseline 12.5%, but could be well revised at political negotiations level.

### *Overall impact under different scenarios*

The table below compiles the revenue estimates found both in the executive summary (baseline scenario) and in the report (including other scenarios). By shifting from the OECD’s baseline scenario of 12.5% minimum taxation to 17.5%, the expected revenue gains would increase from circa USD42-70bn to USD59-98bn. When combined with Pillar I and the US GILTI regime (both unchanged), the total revenue would reach USD73-131bn (15% minimum) and USD88-158bn (17.5%) respectively.

Global tax revenue gains	In % of global CIT		In USD bn	
	Lower	Upper	Lower	Upper
<b>Pillar One</b>	<b>0.2</b>	<b>0.5</b>	<b>5</b>	<b>12</b>
<b>Pillar II (12.5% scenario)</b>	<b>1.7</b>	<b>2.8</b>	<b>42</b>	<b>70</b>
<b>Total Pillar I &amp; II (12.5%)</b>	<b>1.9</b>	<b>3.2</b>	<b>47</b>	<b>81</b>
<b>US GILTI regime</b>	<b>0.4</b>	<b>0.8</b>	<b>9</b>	<b>21</b>
<b>Total incl. US GILTI (12.5%)</b>	<b>2.3</b>	<b>4.0</b>	<b>56</b>	<b>102</b>
Pillar II (15%)	2.4	3.9	59	98
Pillar II (17.5%)	3.0	5.0	74	125
Total Pillar I & II (15%)	2.6	4.4	64	110
Total Pillar I & II (17.5%)	3.2	5.5	79	137
Total Pillar I & II (15%) + GILTI	3.0	5.2	73	131
Total Pillar I & II (17.5%) + GILTI	3.6	6.3	88	158

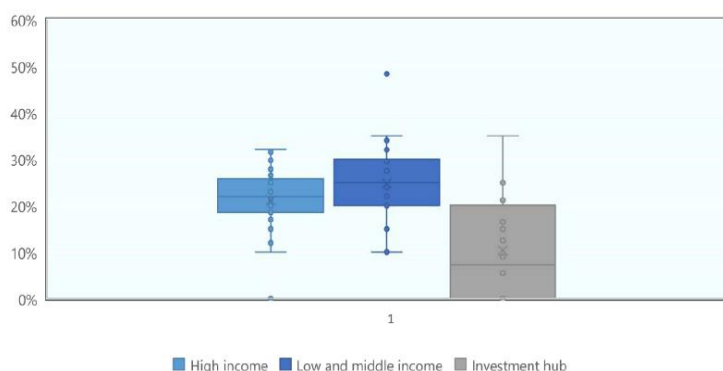
In bold, the OECD baseline scenario

### *Pillar II: minimum tax levels and scope*

The revenues estimates are set within lower and upper boundaries because negotiations over the final package are not over. Two key parameters are still to be determined: the minimum tax rate and the scope of taxation, whether or not it will address aggressive tax incentives to attract FDI.

The OECD Secretariat’s baseline scenario includes a minimum tax rate of 12.5%, which is broadly in line with the statutory CIT rate of many low taxing “investment hubs” (see below). Yet the report also shows that the average statutory rate for high-income countries (which includes the vast majorities of OECD economies) is rather in the range of 20-25%, up to 25-30% for middle and low income economies.

Figure 4.12. Distribution of statutory CIT rates by income group



Source: OECD impact assessment report

Even the effective tax rate (i.e. the statutory CIT at the net of the tax incentives and caveats offered by jurisdictions to support domestic businesses and attract FDI) is much higher than 12.5% for key countries of the OECD and of the Inclusive framework. It is 21.9% for OECD countries on average, 17.4% for OECD-based “investment hubs”, and it ranges between 18.8% and 30.1% for the BRICS economies. Even Singapore has a higher rate than the baseline scenario.

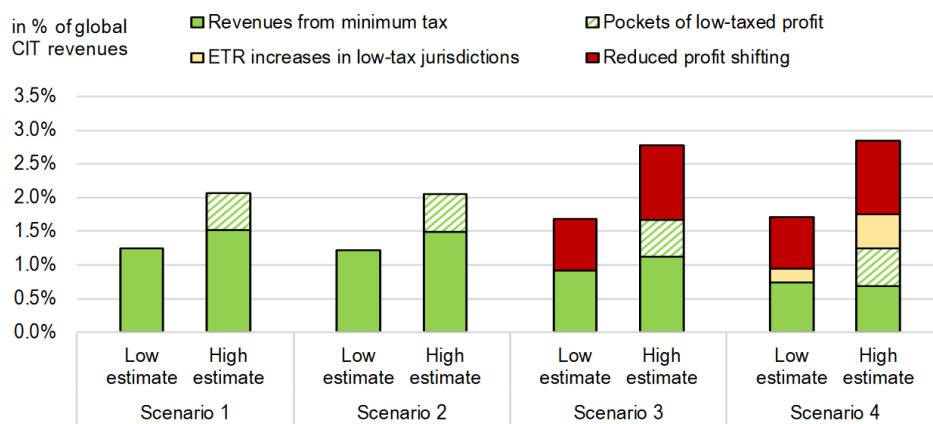
Average effective tax rate	
OECD wide	21.9
OECD investment hubs	17.4
Brazil	30.1
Hong Kong, China	15.2
China	23.5
India	45.7
Indonesia	22.3
Singapore	16.3
South Africa	27.1
Russia	18.8

Source: OECD database

Regarding tax incentives, the report offers different estimates depending on the ability of Pillar II to tax back businesses benefiting from harmful “patent boxes” and other specific low-tax regimes that are common to many OECD countries. In the report these regimes are renamed “Pockets of low taxed profits [in high tax jurisdictions]”. The full inclusion of these scheme would make a substantial difference to the overall impact of the reforms, accounting for +0.5% increase in global CIT revenues, or +USD12bn, out of a total of +2.8% overall increase for Pillar II.

Finally it should also be noted that Pillar II estimates are calculated based on complex chain reaction of scenarios by the OECD Secretariat:

- Step 1: measuring the impact at face value, other things equal;
- Step 2: interaction with implementation of Pillar I;
- Step 3: reaction by MNEs that close down their aggressive tax planning schemes; and
- Step 4: reaction by single governments, raising their effective tax rate.



### *Pillar I: reallocation of excess (“residual”) profits*

As already mentioned, the main effect of Pillar I is to reallocate CIT rather than generate new CIT. Overall the OECD estimates excess profits of the digitalised economy to amount to USD 500 billion. The executive summary’s baseline scenario concludes that Pillar I would “imply that taxing rights over about USD 100 billion of profit [i.e. 20% of the USD500bn] would be reallocated to market jurisdictions”. The baseline scenario is:

- excess / residual profits are deemed above 10% (hence, a business delivering 9.9% annual profits on its total turnover would be exempted by the new tax regime);
- a reallocation of 20% of the excess / residual profit to market jurisdictions depending on where business activity takes place (hence 80% of the excess profits are treated as they were in the past);
- a coverage limited to companies with a turnover of EUR750 million or more (in line with the 2015 country-by-country reporting framework ).

As with Pillar II, the report includes other estimates for alternative scenarios, as shown in the table below. Compared with the baseline scenario (10% profitability & EUR750m turnover threshold leading to USD 494 billion in excess profits, of which 20% are reallocated, that is USD 98.8 billion), lowering the profit threshold to 8% results in excess profits to USD 603 billion, of which USD 120 billion are reallocated (20% reallocation ratio) or USD 180 billion (30% reallocation).

Excess profit threshold	ADS		CFB		ADS+CFB	
	8%	10%	8%	10%	8%	10%
All MNEs		83		433		513
<b>+EUR750m MNEs</b>	90	<b>81</b>	513	<b>413</b>	603	<b>494</b>
+EUR5bn MNEs		74		341		415
reallocation 10%	9	8.1	51.3	41.3	60.3	49.4
<b>reallocation 20%</b>	18	<b>16.2</b>	102.6	<b>82.6</b>	120.6	<b>98.8</b>
reallocation 30%	27	24.3	153.9	123.9	180.9	148.2

In bold, the OECD baseline scenario

Two other key findings stand out:

- In a fairly counter-intuitive way, the OECD estimates that lowering the turnover threshold below EUR750m would have little effect. The absence of any threshold would not substantially increase the amount of taxing rights (from USD 494 billion to USD 513 billion, or just +3.8% increase of the total). This is explained by the heavy concentration of excess profits in few top corporations;
- A major part of the reallocation would take place in the more “traditional” part of the digital economy, i.e. the “consumer facing businesses”, accounting for 83-85% of the total, while fully digitalised businesses (the “ADS”, including the GAFAs) would contribute a mere 15-17% of the total. This may be misleading. The data that are used for the purpose of the impact assessment are 3 to 4 year old (2016-2017) which, on the scale of the current digitalisation process might be equivalent to a full decade. ADS and the GAFAs reportedly have seen their excess profits increased by 30% since then.

### *Country-level impact*

The report does not disclose country-by-country impact estimates. The OECD Secretariat did deliver such estimates to each country, but they were kept confidential at the request of single governments. The only country-specific estimate that was disclosed publicly is

the one for the Netherlands, in a legal communication of the government to the Dutch Parliament. Instead, the OECD report offers broad estimates per income groups:

- high income, including majority of OECD countries;
- middle income, including OECD’s Colombia, Mexico, Turkey;
- low income; and
- “investment hubs”, including OECD’s Hungary, Ireland, Luxembourg, Netherlands, and Switzerland.

The “investment hub” group includes a mixed bag of countries for which the domestic stock of FDI exceeds 150% of GDP. In addition to the above OECD countries, the group includes: Anguilla, Bermuda, Hong Kong, Bahamas, Liberia, Barbados, Marshall Islands, British Virgin Islands, Gibraltar, Guernsey, Mauritius, Malta, Cyprus, Cayman Islands, Isle of Man, Mozambique, Turks and Caicos Islands, Jersey and Singapore.

Pillar I would generate a very marginal overall increase in CIT, but it would have a substantial impact at country level because of the reallocation of excess profits between countries – an impact that would in fact be more pronounced than Pillar II for several countries, as shown in the tables below. Other findings include:

- Much of the reallocation would take place between high-income countries, the overall increase for that (broad) group would be limited;
- Middle-income and, particularly, low-income countries would benefit from higher increases more than high income countries. As the report explains, this is because the former do not host excess profits in the first place. In fact the OECD report estimates that low income countries host “zero” excess profits, hence any percentage increase would be infinitively superior than for high-income economies;
- The impact for “investment hubs” is less easy to determine, with a far broader range of estimates; and
- High tax jurisdictions (i.e. statutory CIT rates above 30%, mainly high and low income countries) would be the main beneficiaries of Pillar I, while countries with a CIT rate below 30% would overall be negatively impacted.

For Pillar II, the clear and main beneficiaries are the high-income countries. Middle- and low-income countries would also benefit, but to a lesser extent. Regarding the “investment hubs”, the range of estimates is so wide that it is clearly inconclusive.

	<b>High income</b>	<b>Middle income</b>	<b>Low income</b>	<b>“Investment hubs”</b>
<b>Pillar I*</b>	0% to +0.7%	+0.4 to +0.7%	+0.8 to +1.2%	-0.3% to +3.9%
<b>Pillar II**</b>	+2.5 to +3.9%	+1.5 to +2.1%	+1.6 to +3%	0% to +11%
<b>Statutory CIT rate</b>	<b>&lt;10%</b>	<b>10-20%</b>	<b>20-30%</b>	<b>&gt;30%</b>
<b>Pillar I*</b>	-0.10%	-1.1% to +0.3%	-0.2% to +0.6%	+0.5% to +1.2%

\*Pillar I scenario: 12.5% minimum tax rate with jurisdictional blending and a 10% combined carve-out on payroll and depreciation expenses

\*\* Pillar II scenario: reallocation percentage of 20%, profitability threshold percentage of 10%



The impact of Pillar I & II on “investment hubs” is difficult to measure (anywhere between 0% and 4% for Pillar I, between 0% and 11% for Pillar II). Even though the group is relatively heterogeneous in its composition, the fact that the range of estimates is in positivity territory is counter-intuitive. At first sight, these countries should be net losers of the reform, and this is not the case. This might be explained by the OECD Secretariat’s complex methodology which factors in a number of chain events that are not warranted (reaction by governments and by MNEs): *“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”*.

### Other impacts

Regarding world GDP, the negative impact stemming from the expected increase in tax revenues is almost zero, estimated to be “less than 0.1% in the long term”.

The report elaborates on a number of other direct and indirect impacts, in a fairly detailed qualitative manner –understandably, given the absence of data, or when existing literature is not sufficiently conclusive. The following OECD table sums up the key findings:

<b>Fiscal space</b>	revenue increases would support public finances at large, and domestic resource mobilisation in developing countries
<b>Tax competition</b>	lower intensity of tax competition between jurisdictions, but potentially higher intensity on other non-tax factors (including labour costs)
<b>Tax incentives for “innovation” (ie. “patent boxes”)</b>	Negatively impacted, except for “substance-based” tax schemes
<b>Other tax incentives for development</b>	Increasing “bargaining position” of developing countries wanting to reduce “costly and potentially inefficient tax incentives”
<b>Compliance costs</b>	Increased cost in filing requirements
<b>Firm competition</b>	Decrease of corporate concentration thanks to level playing field between MNEs and other firms

One key OECD finding stands out and resonates, especially for trade unions: since the minimum tax principle under Pillar II is ought to reduce the tax rate differentials between countries, the reforms would increase the relevance of “non-tax factors” in the allocation of FDI: skills, labour cost, infrastructure. In other words, the countries’ race to the bottom to attract investment on the basis of diminishing corporate income tax regimes would be reduced, though not entirely. Governments instead could then turn to competition on other basis, including the comparative labour cost. This can go two ways: a virtuous positive / high road competition on skills and education and of course a negative mutually destructive low road competition on low labour standards and the downward pressure on wages that goes with it.

### *Tax competition*

The OECD average statutory CIT rate has declined from 32% in 2000 to 23% in 2020, and from 28% to 21% in a sample covering more than 90 developing and developed

countries. The global effective average tax rate (EATR) for the companies covered by the reforms is estimated at 24%, –marking a 6% decrease between 1999 and 2017. These downward trends reflect the fierce and harmful tax competition between countries in attracting FDI and in boosting a supply-side “competitiveness” agenda.

For the OECD, “theoretical and empirical insights suggest that the new rules will not put an end to tax competition, but they are likely to dampen the downward pressure on effective tax rates across many jurisdictions, mostly due to the reduction in ETR differentials”:

- Pillar I should help reduce competitive pressures through (i) the reallocation of profits to market jurisdictions (consumers and users are by definition less mobile than capital) and (ii) assessing corporate tax bases at the MNE group level, rather than on a separate basis for each of the entities of the MNE group (thanks to the introduction of a dose of unitary taxation in transfer pricing, by opposition to the entity-by-entity arm’s length principle); and
- Pillar II should have a bigger impact thanks to the introduction of a lower bound on the effective tax rates that governments can offer in order to attract foreign investment.

However, the presented impact on effective average tax rate (EATR) does not give much assurance about the results for tax competition. Indeed, the baseline scenario would generate a very modest increase in EATR globally: just +0.3 percentage point on the 24% global average, all of which through Pillar II (Pillar I would contribute by a nominal +0.01%). The corresponding increase for the Effective Marginal Tax Rate (EMTR) is expected at +1.4%. Regarding the impact at single country level, the report states that Pillar 2 would raise EATR by 0.3% for high income countries, 0.2% for low-middle income, and 1% for investment hubs. Similarly, the increase in EMTR would be 1.4% for high-income countries, 1.2% for low-middle income, 3.4% for investment hubs).

#### *Corporate concentration*

According to the OECD, since SMEs and non-MNEs face on average higher effective tax rates than MNEs, being often unable to benefit from aggressive tax planning schemes that are within the reach of 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”. From there the report believes that the reforms could “contribute to mitigating current trends towards greater market concentration, especially in digital markets”.

#### *Workers, shareholders and consumers*

Last but not least, the reforms would increase “the importance of non-tax factors (e.g. infrastructure, education levels or labour costs) in investment decisions”. In theory, an increase in corporate tax burden can be passed on (i.e. tax incidence) and ultimately fall on shareholders (lower dividend payouts), workers (lower wages, lower labour standards) or consumers (higher prices). Obviously, the question is how the burden is shared between the different social stakeholders. In theory, in fully open capital markets and limited labour mobility, workers are the prime candidate to take on the cost of the tax increase. But the OECD report does not take that theory at face value:

- Pillar II on the global minimum taxation has a carve out on payroll expenses;
- Due to the scarcity of disaggregated firm-level data, there is “only a few empirical papers [that] directly investigate these theoretical insights”, and that the few existing actually question the theory, suggesting that it is rather shareholders, not workers, who bear a larger share of the economic cost.
- The reform will target highly profitable businesses that are “less sensitive to taxation” and hence any change in taxation does not necessarily fall on wages, in part due to the economic rents generated by market and corporate concentration. The report offers some numbers on this aspect: “firms 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%”.
- With quasi-monopoly situation in the digital economy sector and “winner-takes-all (or winner-takes-most) dynamics”, the incidence of tax burden on consumers could be far higher than expected.

#### *Alternative scenarios and impact of COVID-19*

To make the case for the reforms, the OECD report is not shy to point to dramatic figures in case of a no-deal achieved in 2021: *“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. [...] In the “worst-case” scenario, these disputes could reduce global GDP by more than 1%”*. The message of the OECD Secretariat to governments is clear: reach a deal in 2021, otherwise it is a catastrophic scenario that will be in the making.

There is no reason to contest the validity of these estimates. It so happens that, they are themselves based on a number of complex and interrelated assumptions, and the conclusions on the role of DSTs fit well the OECD Secretariat agenda. Whilst focussing on trade disruptions, the impact assessment fails to assess the impact on the tax revenues. This is a missed opportunity to say the least, and given that the rise of in tax revenues is, precisely, the very reason of the DSTs, in spite of the possible trade sanctions, and in response to the proposed Pillar 1.

The report is also keen to highlight that the consequences of the on-going COVID-19 crisis are not taken fully on board.

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<sup>i</sup> <https://www.oecd.org/tax/beps/tax-challenges-arising-from-digitalisation-economic-impact-assessment-0e3cc2d4-en.htm>