Trade Union
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Comments on the OECD/G20 tax agreement arising from digitalisation

Global Tax Reform Process Kept Alive

Paris, 2 July 2021

Executive summary

On 1 July 2021, the OECD-hosted and G20-mandated "Inclusive Framework" on Base erosion and profit shifting (BEPS) adopted a historic roadmap for a substantial reform of corporate tax rules, to address the undertaxation of large businesses and curb the global tax competition race to the bottom. "Pillar 1" of the roadmap is set to reallocate parts of the profits of MNEs to consumer's jurisdictions – 20-30% of profits above 10% profitability – to account for the digitalisation of the economy. "Pillar 2" is set to introduce the secure right for government to "tax back" overseas profits based on a minimum tax rate.

According to the OECD, thanks to the reached agreement taxing rights on more than USD 100 bn of profit are expected to be reallocated to market jurisdictions each year, while the 15% global minimum corporate income tax rate under Pillar 2 will generate an estimated USD 150 bn annually in additional global tax revenues.

While the broad direction is welcome, further efforts are required for it to become an actionable agreement, and much needs to be done to raise its scale and ambition. The text agreed on 1 July indeed does not amount to a final and definitive agreement, and rather to a roadmap. Much remains to be agreed on before the scheduled final agreement in October 2021.

With regard to pillar 1, the unknowns, among others, include the precise proportion of profits to be allocated (20%?, 30%?). There is also uncertainty around compatibility of any future digital tax initiatives with the agreement. This is a serious matter for the EU which intends to implement without delay a new EU-wide DST to fund its Covid-19 recovery fund and does not intend to be tied by the OECD/G20 process.

With regard to pillar 2, a number of issues remain also, in particular the scope of the carveouts and the extent to which tax incentives for FDI will be impacted. How the US Congress will approach pillar 2, and how it plays out with the expected revision of the US 'GILTI' regime is another source of concern.

At the outset it is difficult to judge who will be the winners and losers of the July statement. This is due to the complexity of the deal – and the uncertainty as to how the two pillars will interact. But there is another and simple reason: the lack of publicly available data on corporate profits. For developing countries, the limited scope and ambition of both pillars (Just 15% tax rate for pillar 2, a mere 20-30% reallocation of profits for pillar 1) suggest that the agreement is very much self-serving for OECD and G7 economies.

For TUAC, the priority so far has been the achievement of a robust and ambitious agreement on a Pillar 2 global minimum tax floor, leaving countries with more time to reflect on an appropriate design for Pillar 1 if needed. Clearly, a 15% rate is far too low to reverse the tax race to the bottom. For trade unions, a global minimum tax rate should be at 25%.

Regarding pillar 1, the question remains whether the agreement will effectively address the issue of MNEs' under-taxation. The July text is a step in the right direction, but it could also result being too little, too late, if not even counterproductive, leading to poor outcomes while preventing countries to introduce otherwise legitimate Digital service taxes on their own.

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A roadmap, not a definitive agreement

The G7 Finance meeting in June had already signalled support for many elements of the roadmap, including a global minimum tax rate of "at least 15%". Yet, ensuring an equivalent agreement by the 139 members of the Inclusive Framework (IF) was not a given. Several countries, including China, Eastern European countries and low tax jurisdictions, reportedly were fairly reluctant to the agreement and particularly to the global minimum tax floor. On the opposite end, some developing and emerging countries, led by Nigeria and Argentina, were denouncing the lack of ambition of the agreement, seen as self-serving for the G7 and for most OECD economies.

No full consensus was found when the IF met on 30 June - 1 July at the OECD, but a near consensus was reached: 130 of the 139 countries of the IF signed on to a 5-page set of principles, the "Statement on a Two-Pillar Solution to Address the Tax Challenges Arising From the Digitalisation of the Economy". Nine countries holding out reflect the broad range of views and objections: Ireland, Hungary and Estonia (firmly opposed to the "Pillar 2" minimum floor agreement), and on the other end of the spectrum is Nigeria (objecting to the lack of consideration for developing countries). Switzerland formally approved the deal but was then quick to set redlines and conditions on the next steps.

Accordingly, the text agreed on 1 July does not amount to a final and definitive agreement, and rather to a roadmap. The official process, which started in 2016, dates back to the 1998 OECD report entitled "Harmful Tax Competition: An Emerging Global Issue", and of course the 2015 BEPS Agreement. The 1 July 2021 text leaves a number of crucial matters for further negotiations before a clear final agreement at the G20 Finance meeting in October 2021 can be reached. Also, the commitment by the members of the IF to the roadmap is still to be tested, as well as the willingness of the US Congress that could block the agreement, despite the leading and positive role of the Biden Administration.

A minimum tax rate ("pillar 2")

In line with past proposals and the recent G7 finance ministers´ meeting, the statement under "Pillar 2" establishes a secure right for governments to apply new "Global anti-Base Erosion" Rules (GloBE). The rules consist of (i) a right to tax back undertaxed overseas profits that economically should be taxed ("income inclusion rule") and (ii) a right to deny certain category of deductions for payments that are taxed under the minimum tax rate ("undertaxed payments rule").

The rules would apply to profits that are taxed below a global minimum effective tax rate of "at least" 15% and would affect MNEs with a EUR 750M turnover on a country-by-country basis (to limit tax arbitrage). Workers' pension funds, regulated investment funds and all government entities are exempted, as well as shipping companies.

Importantly, the GloBe rules are introduced on a voluntary basis (OECD's "common approach") which has the benefit of avoiding burdensome (and politically risky) routes of treaties and conventions. Signing countries can renounce to their right to the GloBe rules (i.e. not taxing back). On the other hand, they cannot prevent other countries from exercising that right and from "taxing back" MNEs located within their jurisdictions.

Much of the negotiations revolved around the possibility for "carveouts" concerning the minimum floor of 15%, i.e. deductions that can apply on the ground of economic substance. In the end, a carveout of 7.5% (and 5% after 5 years of implementation) of the workforce cost and of tangible assets, can be deducted from the profits to the taxed back. The carveouts were a key demand from countries such as China and several Eastern European countries that rely on strong FDI incentives.

While Pillar 2 can be implemented without treaty changes, there is one exception. The "subject-to-tax rule", which would allow countries, mainly developing countries, to tax back at a 7.5 to 9 % rate MNEs profits on debt interest and royalties, among others, which would be otherwise tax free as part of existing bilateral tax treaties.

Reallocation of profits ("pillar 1")

Pillar 1 introduces new rules specifying in which jurisdiction corporate profits should be declared. The agreement maintains the 2015 transfer pricing rules in place –, but it adds a new condition: for profits above 10%, in between 20% and 30% of the global profits of an MNE would be shifted to jurisdictions where consumers and sales are located. These new rules would be introduced specifically in response to the disruptive business models arising from digitalisation and the difficulty to correctly measure tax revenues generated by data and branding.

The agreement would apply to all MNEs marking a turnover above EUR 20 bn (a threshold that could be lowered to EUR10bn after 7 years of implementation, i.e. at best in 2030). Extractives are excluded from the deal, as well as the entire financial sector (its exclusion was not a given last week). The digital and the telecommunication sector would represent at least half of the MNEs covered by the agreement – the GAFAM of course, but also Samsung. The two other sectors that would be primarily concerned are luxury goods (particularly LVMH) and the pharmaceutical groups.

The agreement on Pillar 1 comes with a condition: the removal of all existing Digital Service Taxes and similar measures on all companies.

What is still left for negotiations

Much remains to be agreed on before the July 2021 statement turns into an actionable agreement with sufficient legislative and treaty guidance for implementation.

With regard to Pillar 1, the unknowns, among others, include the precise proportion of profits to be allocated (20%?, 30%?). There is also uncertainty around compatibility of any future digital tax initiatives with the agreement. In the July statement, countries agree to repeal existing DST (including the French and the UK DSTs) in exchange for the implementation of Pillar 1. But nothing is said about how future DSTs should be designed to ensure compatibility. This is a serious matter for the EU, which intends to implement without delay a new EU-wide DST to fund its Covid-19 recovery fund and does not intend to be tied by delays in the OECD/G20 process. On process, Pillar 1 will also be demanding because, unlike Pillar 2, it requires a Multilateral Treaty to change current treaty rules.

With regard to Pillar 2, a number of issues remain, in particular the scope of the carveouts and the extent to which tax incentives for FDI will be affected. impacted. The process should also be facilitated by the fact that Pillar 2 would require changes in domestic legislations only with no multilateral negotiations on a new convention needed – with the exception of the subject to tax rule. The major uncertainty lies also with the separate process for revised the US 'GILTI' tax regime, and how political forces at the US Congress will approach the pillar 2 agreement.

Winners and losers

At the outset it is difficult to judge who will be the winners and losers of the July statement. This is of course due to the complexity of the deal – and the uncertainty as to how the two pillars will interact. But there is another and simple reason: the lack of publicly available data on corporate profits. In 2015 the OECD and the G20 rejected the possibility of public country-by-country reporting for MNEs that, precisely, will be covered by the current statement. We have now to pay the price of inaction in 2015.

Globally, a Pillar 2 at 15% should raise additional tax revenues in the range of USD150bn (OECD estimate). But within that, much of the positive impact will be concentrated among OECD economies, with much less gains for developing ones. Both Nigeria and Argentina have been vocal about the low rate (15%). For the Nigerian tax negotiator, Mathew Gbonjubola, it "would not do much to countries in Africa and it is likely to continue to promote (tax) base erosion for African countries"[i].

Unlike Pillar 2, tax reforms under Pillar 1 would not raise new revenues, but rather reallocate tax revenues to jurisdictions where sales occur and consumers are located. The OECD estimates a "shift" of USD98.8bn, annually. Presumably, OECD countries with a large consumer base and little presence of large digitalised business and business models relying on digital intangibles and branding should be winners (and by opposition, countries with narrow consumer markets, but will a large presence of digitalised businesses would be losers). However, a reliable and consistent estimate and impact assessment are currently not available. To give an example:

according to one estimate the US would lose up several USD bn in revenues, while according to another estimate, the impact would be revenue neutral. The impact is all the more uncertain for countries who would have to repeal existing DSTs. For France, the net gain (i.e. revenues from pillar 2, minus the repeal of the French DST) would generate USD900m; for the UK one estimate finds a gain, another shows a loss of £254m.

For developing countries, the limited proportion of the reallocation (20%, at best 30%) is grossly inadequate, and explains why the agreement appears very much self-serving for OECD and G7 economies.

While reliable estimates and impact assessments are scarce, there is of course the presumption that low-tax jurisdictions and jurisdictions that are familiar with aggressive and harmful tax practices will be directly impacted, which explains the explicit opposition of Ireland, as well as the mixed positions of Switzerland.

The creation of a minimum tax floor will also impact on how tax incentives scheme are designed to attract FDI. As mentioned above, China and many Eastern European countries are reportedly reluctant to lend support to the July statement, because it would disrupt existing tax arrangements to attract FDI, including through export processing zones.

Trade union perspective

For TUAC, the priority so far has been the achievement of a robust and ambitious agreement on a Pillar 2 global minimum tax floor, leaving countries with more time to reflect on an appropriate design for Pillar 1 if needed. An effective global minimum corporate income tax rate should sit within the OECD's average effective tax rates (20-25%) and with a very limited number of carve outs and exemptions. Clearly, a 15% rate is far too low to reverse the tax race to the bottom. For trade unions, a global minimum tax rate should be at 25%.

On Pillar 1, TUAC had repeatedly expressed concerns about a complex and unstable scope, calling for a shift to global excess profit taxation and arguing that a refocus on profitability would bring a much welcome diversion from scoping issues. The July statement has the great merit of simplification and clarity, in line with the US Biden Administration proposal. The question remains whether the agreement will effectively address the issue of MNEs' under-taxation. It is a step in the right direction, but it could also result being too little, too late, if not even counterproductive, leading to poor outcomes while preventing countries to introduce otherwise legitimate Digital service taxes on their own.

On the longer term, the prospect of a reduced intensity in tax competition between countries as envisioned by Pillar 2, is much welcome – although the pace of the reform process that started at the OECD in 1998 is far too slow. In parallel, other forms of regulatory competition than tax competition need attention. Reduction in tax competition could well increase "the importance of non-tax factors (e.g. infrastructure, education levels or labour costs) in investment decisions" as the OECD stated in its impact assessment in October 2020. And there, among the stakeholders of the firm, workers are well known to be the prime candidates to take on the cost of the tax increase through additional wage compression, followed by shareholders (lower dividend payouts) and consumers (higher prices).

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[i] Developing Countries Refuse To Endorse G7 Corporation Tax Rate, Forbes, 30-06-2021