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Comments on the OECD/G20 tax agreement arising from digitalisation

# A Minimal Agreement on the Minimum Tax Rate – Is the International Reform Agenda up to Speed?

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**Table of contents**

Executive summary ... 1
A minimal agreement on a minimum tax rate ... 2
Shifting profits of Big Tech, Big Pharma and Big (luxury) Brands ... 2
Assessing the outcome ... 3
In the long run: is international tax reform keeping pace with globalisation? ... 3

## Executive summary

On 8 October 2021 the signatory countries of the OECD/G20 Inclusive Framework on Base erosion and profit shifting (BEPS) adopted a revised version of its roadmap for global tax reform ("Statement on a Two-Pillar Solution to Address the Tax Challenges Arising From the Digitalisation of the Economy"). Compared to the preliminary version of July 2021, not enough progress was achieved in building an operational and detailed agreement for the effective implementation of the Framework. Rather than raising the bar, the final agreement merely reached a minimum common denominator – particularly regarding the global minimum tax rate under Pillar 2 of the negotiation process, which is set at 15%, the minimum envisaged level according to the preliminary version. By all means, this is inadequate if the intent is to put an end to the tax race to the bottom.

The change to corporate tax rules, which falls under Pillar 1, is left to the margin (compared to the BEPS 15 agreement). It will however specifically target large Big Tech, Big Pharma and Big (luxury) Brands companies. With just 25% of profits reallocated above the 10% threshold, this is a limited reform that is at risk of not compensating for the loss of revenues stemming from the repeal of the DSTs. Unlike DSTs however, the proposed shift in corporate taxation rights may be less easy to pass on to consumers or workers.

Assessing the true impact of the agreement is even more difficult because of the lack of publicly available data on corporate profits. The assessment also depends on what the expectations are. Clearly, the October agreement did not mark the expected historical outcome that will lead to a

systemic change of the global corporate tax landscape. On the contrary, it seems to target specific tax challenges in developed countries only, not those in developing countries.

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 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 (21.9%) and with a very limited number of carve outs and exemptions. Clearly, a 15% rate is far too low to stop the tax race to the bottom.

The most fundamental concern, however, is whether the pace of the international tax reform, which started in 2009 following the global financial crisis, is keeping up with the rapid acceleration of globalisation and digitalisation that is shaping our economy. Unless additional measures are taken, particularly for developing countries, the October agreement could result being too little, too late. It could even become counterproductive, should it "lock-in" some of outcomes, such as the 15% minimum rate, with no possibility for raising the bar and the rate in the future.

## A minimal agreement on a minimum tax rate

Pillar 2 establishes a secure right for governments to (i) tax back undertaxed overseas profits up to a minimum tax rate and (ii) deny certain category of deductions for payments. The rules would apply to profits that are taxed below a global minimum effective tax rate and would affect MNEs with a EUR 750M turnover.

What was left pending from the negotiations in July 2021 was: (i) the precise minimum tax rate (with an "at least 15%" provisional bottom floor); (ii) the scope for "carveouts" (deductions that can apply to accommodate certain forms of tax incentives for foreign investments); and (iii) the "subject-to-tax rule", particularly helpful for developing countries as an instrument to tax back MNEs' profits on debt interest and royalties, which otherwise are deemed tax free as part of existing bilateral tax treaties.

In the end, the parties settled at 15% effective tax rate – the minimum level foreseen in July. This is inadequate if the intent is to put an end to the tax race to the bottom, even considering the level is set at the *effective* rate. According to OECD figures, the average effective corporate tax rate is 21.9% for OECD countries, 17.4% for OECD-based "investment hubs", and it ranges between 18.8% and 30.1% for the BRICS economies. The agreement also suggests that through multiple forms of carve outs – which are increased in size compared to the July agreement - some governments will be able to bypass the minimum tax floor.

## Shifting profits of Big Tech, Big Pharma and Big (luxury) Brands

Pillar 1 aims at revising corporate tax rules to account for the disruptive business models of big tech companies and other companies relying on data and brands. The agreement only applies to MNEs with a turnover above EUR 20 bn (a threshold that could be lowered to EUR 10 bn after 7 years from the implementation, i.e. earliest in 2030). The change in corporate tax rules is marginal, but it will specifically target large companies form the digital and the telecommunication sector (the GAFAM of course, but also more traditional companies such as Samsung), luxury (such as LVMH) and pharmaceutical groups. The agreement maintains the 2015 transfer pricing rules in place – but it adds a new condition: profits that exceed the 10%

threshold (in between 20% and 30%) would be shifted to jurisdictions where consumers and sales are located.  Importantly, Pillar 1 comes with a condition: the removal of all existing Digital Service Taxes.

The central issue that was left pending over the summer was the precise amount to relocate to market jurisdictions, in between 20% and 30%. In the end, countries settled at 25%.  The overall limited ambition is of concern. A central question is whether the agreement will compensate for the loss of revenues arising from the repeal of existing DSTs that a dozen of countries have introduced already. On a positive note, the reform would aim directly at corporate income taxation, which as a cost is more difficult to transfer on to workers and consumers, unlike a DST.

## Assessing the outcome

Assessing the true impact of the agreement is difficult because of a lack of publicly available data on corporate profits. This lack of data is partly due to the rejection by the OECD and the G20 in 2015 to include the possibility of public country-by-country reporting for MNEs

Whilst the October agreement might be considered a historic initiative in the current state of multilateralism, it is clearly not the historical landmark agreement needed to ensure a systemic and transformative change of the global corporate tax landscape. To the contrary, it seems to aim specifically at addressing tax challenges arising in developed countries – not those of developing countries.

For instance, a Pillar 2 minimum tax rate of 15% should raise additional tax revenues in the range of USD150bn (OECD estimate). However, within that estimate much of the positive impact will be limited to OECD economies with little or no gain for developing ones. Tax reforms under Pillar 1 were in fact not intended to 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. There too, OECD countries with a large base of consumers of digital services, brands and pharma products should be the main beneficiaries. For developing countries, the limited proportion of the reallocation (25%) further reduces the prospect of additional revenues.

A final assessment will of course depend on implementation of the agreement. Whereas a template model legislation could be ready for Pillar 2 by December 2021, Pillar 1 requires some form of a “multilateral instrument” to change current treaty rules which will take time to deliver, at best by mid-2022. The fragile state of multilateralism at large and the political situation in some countries, and at the US Congress, do not give strong assurance that implementation will happen in smooth manner to say the least.

## In the long run: is international tax reform keeping pace with globalisation?

At face value, the October agreement is better than the status quo and no agreement at all. In addition, it is of course hoped but remains to be seen, whether the agreement on Pillar 2 in particular will reduce intensity in tax competition between countries and raise additional revenues as envisioned.

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. The TUAC worked and lobbied for an effective global minimum corporate income tax rate 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.

On Pillar 1, the TUAC had repeatedly expressed concerns about a complex and unstable scope. As such, the TUAC has been calling for a far more ambitious reform of corporate taxation beyond the 2015 BEPS agreement and a shift to global excess profit taxation.

The October 2021 agreement is comparable to the 2015 BEPS Agreement, and before that the 2009 G20 London summit initiative on tax transparency. The more fundamental concern however, is whether the pace of the international tax reform process as led by the G20 and hosted by the OECD, which started in 2009 following the global financial crisis, is keeping up with the rapid transformation of the economy through accelerated globalisation and digitalisation.

Unless additional measures are taken, particularly for developing countries, the agreement could prove to be too little, too late, if not counterproductive by fixing the tax rate at 15% with no possibility for raising the rate in the future, and more broadly preventing countries from introducing otherwise legitimate Digital service taxes on their own.