

OECD/G20 Inclusive Framework on BEPS



Addressing the Tax Challenges Arising from the Digitalisation of the Economy

HIGHLIGHTS, OCTOBER 2020



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Overview

The COVID-19 pandemic continues its course, resulting in global and sustained economic fallouts. Since the start of the COVID-19 pandemic, the OECD has monitored closely the tax and fiscal policy responses of countries and jurisdictions. Tax policy should prioritise supporting health systems and recovery above all and then be adapted in view of social and economic transformations that include but are not limited to COVID-19. Beyond domestic measures, as governments are adopting recovery plans to restore growth, the issue of international taxation and co-operation remains a priority.

One pressing issue – which has been a priority of the international community for several years – is to reform the international tax system to address the tax challenges arising from the digitalisation of the economy, restore stability to the international tax framework and avoid the risk of further uncoordinated, unilateral tax measures which could trigger trade sanctions. The COVID-19 crisis has exacerbated these tax challenges even further by accelerating the digitalisation of the economy, increasing pressures on public finances and decreasing public tolerance for profitable multinational enterprises (MNEs) not paying their fair share of taxes.

In July 2020, the OECD/G20 Inclusive Framework on BEPS was mandated to produce reports on the Blueprints of Pillar One and Pillar Two by the October G20 Finance Ministers meeting with a view to reaching consensus by year end. Pillar One is focused on nexus and profit allocation whereas Pillar Two is focused on a global minimum tax intended to address remaining base erosion and profit shifting (BEPS) issues. Despite the unprecedented times, the G20/OECD Inclusive Framework, which consists of 137 member jurisdictions, has worked tirelessly to deliver the reports on the blueprints of the two-pillar solution to these direct tax challenges. Since February 2020, the Steering Group and the Working Parties of the G20/OECD Inclusive Framework have carried out almost 70 days of mostly virtual meetings to advance the technical work.

On 9 October 2020, the OECD/G20 Inclusive Framework finalised a package consisting of a Cover Statement and the Reports on the Blueprints of Pillar One and Pillar Two

for public release. This package reflects convergent views on a number of key policy features, principles and parameters of both Pillars, identifies remaining political and technical issues where differences of views remain to be bridged, and next steps. **The 137 members of the OECD/G20 Inclusive Framework recognised the Blueprint on Pillar One as a “solid foundation for future agreement”** that would adhere to the concept of net taxation of income, avoid double taxation and be as simple and administrable as possible”, and that **the report on the Blueprint on Pillar Two is “a solid basis for a systemic solution that would address remaining base erosion and profit shifting (BEPS) challenges”**.

In addition, as decided in the May 2019 Programme of Work¹, the OECD Secretariat released its report, *Tax Challenges Arising From Digitalisation: Economic Impact Assessment*, which analyses the economic and tax revenue implications of both Pillars, as set out in the blueprints. Pillar One and Pillar Two could increase global corporate income tax (CIT) revenues by about USD 60-100 billion per year or up to around 4% of global CIT revenues taking into account the combined effect of these reforms and of the US GILTI regime.

Thus, while at this point the conditions for a political agreement have not yet been achieved, the Inclusive Framework now has a sound and solid basis for a future agreement to which it remains committed. Given, how far the architecture of each Pillar has advanced, political agreement could and should be reached soon.

1. <https://www.oecd.org/tax/beeps/programme-of-work-to-develop-a-consensus-solution-to-the-tax-challenges-arising-from-the-digitalisation-of-the-economy.htm>

Meanwhile, the OECD/G20 Inclusive Framework decided on 9 October 2020 to use the reports on the blueprints as a basis for seeking stakeholder input.

These inputs will inform the ongoing work of the OECD/G20 Inclusive Framework, which has also agreed to continue working to resolve the remaining issues quickly with a view to bringing the process to a successful conclusion by mid-2021.

Reaching a solution to the tax challenges arising from digitalisation will only be achieved with strong leadership and unequivocal political support and involvement.

The work on tackling **other tax challenges arising from the digitalisation** of the economy is also progressing.

- As new technologies derived from digitalisation have emerged, they raise novel tax challenges that must be addressed as well. In this respect, **the OECD/G20 Inclusive Framework adopted in October 2020 the report, *Taxing Virtual Currencies: An Overview of Tax Treatments and Emerging Tax Policy Issues***. With coverage of over 50 jurisdictions, including all G20 and OECD members, this report is the first comprehensive analysis of the existing approaches and key policy gaps across the main categories of taxes for such a large group of countries.
- Progress is being made in updating the Common Reporting Standard for the automatic exchange of information to extend its coverage to crypto assets. The update of the standard should be completed in 2021.

- **The implementation of the OECD's standards for the effective collection of VAT on online sales of goods, services and digital products (included in the 2015 BEPS Action 1 report) have continued to influence VAT reform in a growing number of countries worldwide.** Work on guidance for the VAT treatment of the sharing and gig economy, including on the role of sharing and gig economy platforms in facilitating VAT compliance, is on track for delivery by the end of 2020. Almost 65 jurisdictions have implemented these standards while over 40 additional jurisdictions are implementing these standards or are considering doing so. Among those, three jurisdictions have promoted a VAT/digital solution while abandoning their plans for a digital services tax (DSTs) based on turnover. The implementation of these standards is yielding impressive results. For example, the European Union reported EUR 14.8 billion of VAT revenues collected from these measures in the first four years of their operation.
- Once implemented, the model reporting rules² for digital platforms facilitating transactions in the sharing and gig economy, approved on 30 June 2020, will constitute an efficient tool to ensure digital platforms report to tax authorities the identity of sellers active on the platform, as well as details on the transactions they have concluded.

2. OECD (2020), *Model Rules for Reporting by Platform Operators with respect to Sellers in the Sharing and Gig Economy*, OECD, Paris. www.oecd.org/tax/exchange-of-tax-information/model-rules-for-reporting-by-platform-operators-with-respect-to-sellers-in-the-sharing-and-gig-economy.htm



Cover Statement by the OECD/G20 Inclusive Framework on BEPS on Pillar One and Pillar Two Blueprints

As approved by the Inclusive Framework at its meeting on 8-9 October 2020

Digital transformation spurs innovation, generates efficiencies, and improves services while boosting more inclusive and sustainable growth and enhancing well-being. At the same time, the breadth and speed of this change introduces challenges in many policy areas, including taxation. Reforming the international tax system to address the tax challenges arising from the digitalisation of the economy, restore stability to the international tax framework and prevent further uncoordinated unilateral tax measures has therefore been a priority of the international community for several years, with commitments to deliver a consensus-based solution by the end of 2020.

The current context of the COVID-19 pandemic makes the need for a solution even more compelling than when it was first considered. Governments have responded through increased spending on healthcare and by providing unprecedented levels of financial support to both businesses and workers to cushion them from the economic blow of this crisis. However, the time will come when governments will need to focus on putting their finances back on a fair and sustainable footing.

A consensus-based solution comprised of two pillars (Pillar One focused on nexus and profit allocation whereas Pillar Two is focused on a global minimum tax intended to address remaining BEPS issues) can not only play an important role to ensure fairness and equity in our tax systems and fortify the international tax framework in the face of new and changing business models; it can also help put government finances back on a sustainable footing. The public pressure on governments to ensure that large, internationally operating, and profitable businesses pay their fair share and do so in the right place under new international tax rules has increased as a result of the current COVID-19 pandemic. At the same time, a consensus-based solution could provide businesses with much needed tax certainty in order to aid economic recovery.

Against this background, despite their differences, and the COVID-19 pandemic, which has had an impact on the work, the members of the Inclusive Framework (IF) have made substantial progress towards building consensus. The IF is releasing today a package consisting of the Reports on the Blueprints of Pillar One and Pillar Two, which reflects convergent views on a number of key policy features, principles and parameters of both Pillars, and identifies remaining political and technical issues where differences of views remain to be bridged, and next steps.

We approve the Report on the Blueprint of Pillar One for public release. It is designed to deliver a sustainable taxation framework reflective of today's digitalising economy, with the potential to achieve a fairer and more efficient allocation of taxing rights. The Blueprint reflects the extensive technical work that has been done. Though no agreement has been reached, the Blueprint nevertheless provides a solid foundation for a future agreement that would adhere to the concept of net taxation of income, avoid double taxation and be as simple and administrable as possible. The Blueprint offers a solid basis for future agreement and reflects that:

- in an increasingly digital age, in-scope businesses are able to generate profits through participation in a significant/ active and sustained way in the economic life of a jurisdiction, beyond the mere conclusion of sales, with or without the benefit of local physical presence and this would be reflected in the design of nexus rules while being mindful of compliance considerations;
- the solution would follow the policy rationale set out above and allocate a portion of residual profit of in-scope businesses to market/user jurisdictions ("Amount A");
- the solution would be targeted and build in thresholds so that it minimises compliance costs for taxpayers and keeps the administration of the new rules manageable for tax administrations;
- Amount A would be computed using consolidated financial accounts as the starting point, contain a limited number of book-to-tax adjustments and ensure that losses are appropriately taken into account;
- in determining the tax base, segmentation would be required to appropriately target the new taxing right in certain cases, but with broad safe-harbour or exemption rules from segmentation to reduce complexity and minimise burdens for tax administrations and taxpayers alike;
- the solution would contain effective means to eliminate double taxation in a multilateral setting;
- the work on Amount B will be advanced, (a fixed rate of return on base-line marketing and distribution activities intended to approximate results determined under the arm's length principle) recognising its potentially significant benefits including for tax administrations with limited capacity as well as its challenges;
- the Pillar One solution would contain a new multilateral tax certainty process with respect to Amount A, recognising the importance of using simplified and co-ordinated administrative procedures with respect to the administration of Amount A;
- a new multilateral convention would be developed to implement the solution, recognising that it would offer the best and most efficient way of implementing Pillar One.

We will now focus on resolving the remaining political and technical issues, including issues around scope, quantum, the choice between mandatory and safe harbour implementation, and aspects of the new tax certainty procedures with respect to Amount A, and the scope and form of new and enhanced tax certainty procedures for issues beyond Amount A.

We also approve the Report on the Blueprint of Pillar Two for public release. It provides a solid basis for a systemic solution that would address remaining base erosion and profit shifting (BEPS) challenges and sets out rules that would provide jurisdictions with a right to “tax back” where other jurisdictions have not exercised their primary taxing rights, or the payment is otherwise subject to low levels of effective taxation. These rules would ensure that all large internationally operating businesses pay at least a minimum level of tax. We acknowledge that jurisdictions are free to determine their own tax systems, including whether they have a corporate income tax and the level of their tax rates, but also consider the right of other jurisdictions to apply an internationally agreed Pillar Two regime where income is taxed below an agreed minimum rate. Though no agreement has been reached, the Blueprint provides a solid basis for future agreement on:

- the Income Inclusion Rule (IIR), the Undertaxed Payments Rule (UTPR), the Subject to Tax Rule (STTR), the rule order, the calculation of the effective tax rate and the allocation of the top-up tax for the IIR and the UTPR, including the tax base, the definition of covered taxes, mechanisms to address volatility, and the substance carve-out;
- the IIR and UTPR as a common approach, including an acceptance of the right of all members of the IF to implement them as part of an agreed Pillar Two regime. It would nevertheless be recognised and accepted that there may be members that are not in a position to implement these rules. However, all those implementing them would apply them consistently with the agreed Pillar Two vis-à-vis all other jurisdictions (including groups headquartered therein) that also join this consensus. Furthermore, given the importance that a large number of IF members, particularly developing countries, attach to an STTR, we recognise that an STTR would be an integral part of a consensus solution on Pillar Two;
- the basis on which the United States’ Global Intangible Low Taxed Income Regime (GILTI) would be treated as a Pillar Two compliant income inclusion rule as set out in the Report on the Blueprint on Pillar Two;
- the development of model legislation, standard documentation and guidance, designing a multilateral review process if necessary and exploring the use of a multilateral convention, which could include the key aspects of Pillar Two.

We welcome stakeholder input into this process on both pillars, in particular on administration and simplification rules, which would help inform the further development of the consensus-based solution.

NEXT STEPS

We agree to swiftly address the remaining issues with a view to bringing the process to a successful conclusion by mid-2021 and to resolve technical issues, develop model draft legislation, guidelines, and international rules and processes as necessary to enable jurisdictions to implement a consensus-based solution.

Pillar One Blueprint

INTRODUCTION

Digital transformation spurs innovation, generates efficiencies, and improves services while boosting more inclusive and sustainable growth and enhancing well-being. At the same time, the breadth and speed of this change introduces challenges in many policy areas, including taxation. Reforming the international tax system to address the tax challenges arising from the digitalisation of the economy has therefore been a priority of the international community for several years, with commitments to deliver a consensus-based solution by the end of 2020.

These tax challenges were first identified as one of the main areas of focus of the OECD/G20 Base Erosion and Profit Shifting (BEPS) Project, leading to the 2015 BEPS Action 1 Report (the Action 1 Report).¹ The Action 1 Report found that the whole economy was digitalising and, as a result, it would be difficult, if not impossible, to ring-fence the digital economy. In March 2018, the Inclusive Framework, working through its Task Force on the Digital Economy (TFDE), issued *Tax Challenges Arising from Digitalisation – Interim Report 2018* (the Interim Report)² which recognised the need for a global solution.

Since then, the 137 members of the Inclusive Framework have worked on a global solution based on a two pillar approach.³ Pillar One is focused on new nexus and profit allocation rules to ensure that, in an increasingly digital age, the allocation of taxing rights with respect to business profits is no longer exclusively circumscribed by reference to physical presence. Globalisation and digitalisation have challenged fundamental features of the international income tax system, such as the traditional notions of permanent establishment and the arm's length principle (ALP), and brought to the fore the need for higher levels of enhanced tax certainty through more extensive multilateral tax co-operation. These transformational developments have taken place against a background of increasing public attention on the taxation of highly digitalised global businesses, which has in turn reinforced the political pressure and imperative to address the issue.

Members of the Inclusive Framework agreed that any new rules should be based on net basis taxation, should avoid double taxation and should be as simple as possible. They stressed the importance of tax certainty and the need for improved dispute prevention and dispute resolution tools. The members are mindful of the need to ensure a level playing field among all jurisdictions: large or small, developed or developing. Also mindful of limiting compliance and administrative burdens, Inclusive Framework members agreed to make any rules as simple as the tax policy context permits, including through the exploration of simplification measures.

Following a proposal made by the Secretariat,⁴ the Inclusive Framework agreed upon an outline of the architecture of a “Unified Approach” in January 2020 as the basis for the negotiation of the Pillar One solution (the “Outline”).⁵ Since January, and in spite of the outbreak of COVID-19, all members have worked on the technical development of all the building blocks that make up Pillar One. This is a Report on the blueprint for Pillar One (the “Blueprint”). It describes, in detail, the main features of the building blocks of Pillar One and identifies the areas where political decision is needed. It shows that there has been significant progress towards a global agreement, and contains proposals to bridge remaining divergences. It recognises that further technical work will be required to finalise some aspects of Pillar One, for example to reduce complexity, improve administrability, and meet the available capacities of both developed and developing economies.

PILLAR ONE BLUEPRINT

Pillar One seeks to adapt the international income tax system to new business models through changes to the profit allocation and nexus rules applicable to business profits. Within this context, it expands the taxing rights of market jurisdictions (which, for some business models, are the jurisdictions where the users are located)⁶ where there is an active and sustained participation of a business in the economy of that jurisdiction through activities in, or remotely directed at, that jurisdiction.⁷ It also aims to significantly improve tax certainty by introducing innovative dispute prevention and resolution mechanisms. Pillar One seeks to balance the different objectives of Inclusive Framework members and result in the removal of relevant unilateral measures.

Consistent with the Outline, the key elements of Pillar One can be grouped into three components: a new taxing right for market jurisdictions over a share of residual profit calculated at an MNE group (or segment)

1. OECD (2015), *Addressing the Tax Challenges of the Digital Economy*, Action 1 – 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris.

2. OECD (2018), *Tax Challenges Arising from Digitalisation – Interim Report 2018*, Inclusive Framework on BEPS, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris.

3. *Addressing the Tax Challenges of the Digitalisation of the Economy – Policy Note*, as approved by the Inclusive Framework on BEPS on 23 January 2019, OECD 2019.

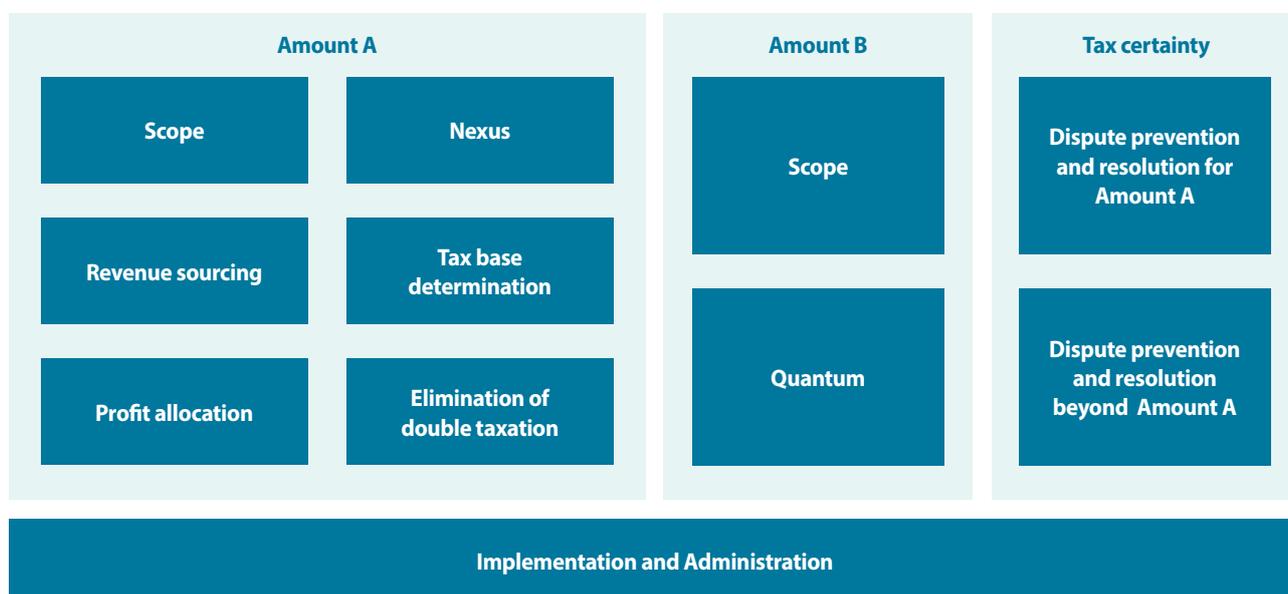
4. Public Consultation Document, *Secretariat Proposal for a “Unified Approach” under Pillar One*, 9 October 2019 – 12 November 2019.

5. OECD (2020), *Statement by the OECD/G20 Inclusive Framework on BEPS on the Two-Pillar Approach to Address the Tax Challenges Arising from the Digitalisation of the Economy – January 2020*, OECD/G20 Inclusive Framework on BEPS, OECD, Paris.

6. For the purpose of this paper, user/market jurisdictions (henceforth “market jurisdictions”) are jurisdictions where an MNE group sells its products or services or, in the case of highly digitalised businesses, provides services to users or solicits and collects data or content contributions from them.

7. Conversely, to ensure elimination of double taxation, this new taxing right will reduce the taxing rights of jurisdictions where MNE entities entitled to residual profits under the existing profit allocation rules are resident.

Figure 1.1. Building Blocks of Pillar One



level (Amount A); a fixed return for certain baseline marketing and distribution activities taking place physically in a market jurisdiction, in line with the ALP (Amount B); and processes to improve tax certainty through effective dispute prevention and resolution mechanisms. Eleven building blocks have been identified as essential to the construction of Pillar One, and constitute the bedrock of this Blueprint.

While the technical work on the Pillar One building blocks is very advanced, Inclusive Framework members recognise that there are a number of open issues on key features of the solution that can only be resolved through political decisions. To complete the package, political decisions are required on a number of issues including the following:

- **Scope:** With the Outline agreed in January 2020, the Inclusive Framework tried to bridge the gap between those members seeking to focus Pillar One on a narrower group of “digital” business models and those insisting that a solution should cover a wider scope of activities. As a result, two categories of activities to be included in the scope of the new taxing right created by Pillar One were identified: Automated Digital Services (ADS) and Consumer Facing Businesses (CFB). As discussed below, considerable technical work has been done on how these categories could be defined, but to date political agreement has not been reached on the use of these categories, and the scope issue is not yet solved. In order to deliver a solution in 2020 in accordance with the G20 mandate,

some members have advocated for a phased implementation with ADS coming first and CFB following later. One member proposed implementing the new taxing right on a “safe harbour” basis, which would enable an MNE group to elect on a global basis to be subject to Pillar One.⁸ The scope of Amount A remains to be settled upon.

- **Amount of profit to be reallocated (the “Quantum”):** Agreement on how much residual profit would be reallocated under the new taxing right, which depends on the determination of different threshold amounts and percentages for the purpose of scope, nexus and profit allocation (the formula),⁹ is conditioned on agreement on scope. However, much work has been completed on the impact of different thresholds and percentages of profit to be allocated so that a political decision could be taken quickly as part of an overall political agreement. Also, some Inclusive Framework members are of the view that, beyond residual profit, a portion of routine profit should also be allocated to market jurisdictions in the case of remote marketing and distribution activities facilitated by digitalisation.

8. On 3 December 2019, the US Treasury Secretary, Steven Mnuchin sent OECD Secretary-General Ángel Gurría a letter, which, while reiterating the US support for a multilateral solution, proposed that Pillar One be implemented on a ‘safe harbour’ basis.

9. It should be noted that other features of Pillar One will have an impact on quantum, such as the question of whether the Amount A loss carry-forward regime is extended to “profit shortfalls”, the treatment of pre-regime losses, the issue of double counting (and possible inclusion of a marketing and distribution safe harbour), the process for identifying the “paying entities” (to eliminate double taxation). All these features will be relevant in the discussion of the quantum of Amount A.

Other members proposed “differentiation mechanisms” in order to increase the quantum of profit reallocated to market jurisdictions for certain business activities (for example, ADS), or a scalable reallocation depending on the profitability of the business (profit escalator). These variations to the Amount A profit allocation rules proposed by some Inclusive Framework members have not been decided upon.

- **Extent of tax certainty:** While all members have agreed on the need for an innovative solution to deliver early certainty and effective dispute prevention and resolution for Amount A, there continue to be differences of view on the scope of mandatory binding dispute resolution beyond Amount A. The Blueprint contains proposals to bridge these divergent views. A decision on this issue will need to be part of a comprehensive agreement also covering the other two open political issues on quantum and scope.
- **Scope and application of Amount B:** While this Blueprint contains an outline of a solution that assumes that in-scope distributors are to be identified based on a narrow scope of baseline activities, there is interest by some members to explore the feasibility of broadening the scope of Amount B. Some Inclusive Framework members have expressed the need to further refine the design of Amount B such that the intended simplification benefits are achieved, and further consider that implementation through a pilot programme at first may allow for some evaluation of

the benefits in practice. The Inclusive Framework will therefore need to decide how to proceed.

Subject to these pending political issues, the Pillar One Blueprint is described below.

The new taxing right (Amount A)

The new taxing right (Amount A) would be an overlay to the existing nexus and profit allocation rules. It would apply broadly and would not be limited to a small number of MNEs in a particular industry. However, given its innovative features, Inclusive Framework members are mindful of the need to keep the number of MNEs affected at an administrable level and have agreed to consider thresholds and other features that help keep the approach targeted while minimising compliance costs and being mindful of capacity considerations for tax administrations. The key design features of the new taxing right would include:

- A **revenue threshold** based on annual consolidated group revenue coupled with a **de minimis foreign in-scope revenue** carve-out. These thresholds are intended to minimise compliance costs and keep the administration of the new rules manageable for tax administrations. To avoid tax administrations being overwhelmed with the initial operation of the new taxing right, one option under consideration is to implement these thresholds on a phased approach. This could start with higher thresholds that could either be gradually reduced over a number of years



or be applied for a longer period and then only start the reductions after a post-implementation review has been undertaken. A phased approach may help to make the new rules manageable for both tax administrations and businesses and will allow both to gain practical experience before expanding coverage to a wider set of MNEs. Other approaches that seek to achieve these objectives could also be explored, including the option of a threshold based on in-scope revenues. No decision has yet been taken on the number of the revenue thresholds, the amount of these thresholds or the use of a phased approach.

- **Scoping rules** covering ADS and more broadly CFB. This includes businesses that are able to have significant and sustained interactions with customers and users in a market jurisdiction.
- The use of a **new nexus rule** to identify market jurisdictions eligible to receive Amount A. The nexus rules balances the interests of smaller jurisdictions, in particular developing economies, in benefiting from the new taxing right with the need for low and proportionate compliance costs, where appropriate in light of the overall balance, while avoiding spill-over effects in other tax and non-tax areas.
- The nexus rules are supported by detailed **sourcing rules** that are reflective of the particularities of digital services and consumer-facing businesses and balance the need for accuracy with the ability of in-scope MNEs to comply and the cost of doing so. It has been proposed that this may be achieved through due diligence rules subject to a clearly defined hierarchy, likely to be of particular importance in connection with third party distribution.
- An administrable approach for **reallocating residual profit**. Eligible market jurisdictions will receive a portion of (X%) of residual profit (income exceeding an agreed level of profitability of (Y%)) using a formula. To strike a balance between simplicity and accuracy, the calculation of the relevant measure of profit will rely as much as possible on published consolidated financial accounts. Book-to-tax adjustments (similar to those required for Pillar Two) and segmentation will be limited to a minimum. In practice, most MNEs will compute their Amount A profit (the tax base) on the basis of their consolidated accounts (including groups with out-of-scope activities), but only the portion of that group profit determined by a formula corresponding to in-scope revenue will end up being allocated to market jurisdictions. Accuracy and ensuring a level playing field between different MNEs (e.g. in-scope business line with a significantly different profitability from other business lines) may require the determination of the relevant measure of profit on a segment basis, but only in limited cases where the MNE will likely already prepare segmented accounts for financial reporting purposes. Further simplifications will be available for MNEs that compute a segmented tax base, such as the allocation of indirect costs through a revenue-based allocation key. In total, it is expected that only a small number of groups would be required to segment their tax base under Amount A.
- **A loss carry-forward regime** to ensure that there is no Amount A allocation where the relevant business is not profitable over time. To ensure Amount A applies only to economic profit, consideration will be given to MNEs in scope being allowed to bring existing losses incurred prior to the introduction of Amount A into this loss carry-forward regime. The regime will rely on an earn-out mechanism to enable offsetting past losses against future profit. Amount A losses will be preserved and carried forward in a single account at the level of the group (or segment level where relevant), and not allocated to individual market jurisdictions.
- In addition to the proposed mechanism to eliminate double taxation, different options are being considered to adjust the allocation of Amount A to market jurisdictions where an MNE already leaves residual profits under the existing ALP-based profit allocation rules (so-called “double counting” issues), including **a marketing and distribution profits safe harbour**. This approach would conceptually consider the income taxes payable in the market jurisdiction under existing taxing rights and Amount A together, and adjust the quantum of Amount A taxable in a market jurisdiction, limiting it where the residual profit of the MNE is already allocated to that jurisdiction as a result of the existing profit allocation rules. Under the safe harbour, groups that already allocate profits to market jurisdiction in excess of the safe harbour return would in some instances not pay Amount A or apply the mechanism to eliminate double taxation and thus could continue to allocate profits under the current rules. Other approaches considered to deal with double counting issues, next to the mechanism to eliminate double taxation, include the domestic business exemption.



- The **mechanism to eliminate double taxation** will have two components: (i) identification of the paying entities; and (ii) the methods to eliminate double taxation. To identify the entity or entities that will bear the Amount A tax liability, the “paying entities”, a process with up to four steps is contemplated. First, a qualitative activities test to identify entities that earn residual profit using a positive and negative list of indicia (which will be applied based on existing transfer pricing documentation). A profitability test would then be applied to ensure these entities have the ability to pay Amount A. As a priority rule, the Amount A tax liability for a market jurisdiction would first be allocated to paying entities that are connected to a market jurisdiction. But, where the paying entities connected to a market do not have sufficient profits to bear the full liability, any outstanding liability could be apportioned between other paying entities (not connected to a market) on a pro-rata basis, or on other alternative “back-stop” bases that are being considered. Consideration will also be given as to whether and how this process could be simplified by eliminating the first (activities) and/or third (market connection priority) test and applying a more strictly quantitative and formulaic approach. Having identified the entity or entities that would bear an Amount A tax liability, a residence jurisdiction would then use the exemption or credit method to relieve double taxation.
- Where an MNE is subject to the new taxing right, a **simplified administrative process** will be developed to minimise the complexity, burden and cost of filing and payment, which is aimed at benefitting tax administrations and taxpayers alike.
- The **new Amount A taxing right would be implemented** through changes to domestic law, and by way of public international law instruments, in particular, a multilateral convention would be required. The domestic law and multilateral convention would be supplemented by guidance and other instruments where necessary.

The fixed return for defined baseline marketing and distribution activities (Amount B)

The purpose of Amount B is two-fold. First, it is intended to simplify the administration of transfer pricing rules for tax administrations and lower compliance costs for taxpayers. Second, Amount B is intended to enhance tax certainty and reduce controversy between tax administrations and taxpayers. For this reason, it has been acknowledged by a number of Inclusive Framework members and MNEs as a key deliverable of Pillar One on the presumption that the intended benefits may be achieved.

Amount B will standardise the remuneration of related party distributors that perform “baseline marketing and distribution activities” in the market jurisdiction. The definition of baseline marketing and distribution activities covers distributors that (i) buy from related parties and resell to unrelated parties; and (ii) have a routine distributor functionality profile.

Further, the activities in scope are first defined by a ‘positive list’ of typical functions performed, assets owned and risks assumed at arm’s length by routine distributors (based on a narrow scope, akin to limited risk distributors). A ‘negative list’ of typical functions that should not be performed, assets not owned and risks not assumed at arm’s length by routine distributors are also used to qualitatively measure the additional factors that would deem a distributor as being outside the scope of Amount B. Certain quantitative indicators are then used to further support the identification of in-scope activities.

Amount B is intended to approximate results determined in accordance with the ALP, and therefore would be based on comparable company benchmarking analyses under the Transactional Net Margin Method (TNMM) with the quantum potentially varying by industry, as well as region, provided any such variation is supported by the relevant benchmarking analysis.¹⁰ As a result Amount B could have a number of ranges of potentially appropriate fixed returns. Each fixed return provided to remunerate baseline marketing and distribution activities under Amount B is intended to deliver a result that approximates results determined in accordance with the ALP.

While some members view that Amount B may provide certain benefits, in terms of tax certainty and as a simplification of the ALP, there remain divergent views on the breadth of baseline activities that should be included in its scope. This Blueprint assumes that in-scope distributors are to be identified based on a narrow scope of baseline activities, which is a view shared by a group of Inclusive Framework members. However, there is another group of members, particularly developing countries, that consider the rule will be only be effective in its policy objective if it is broad in scope and wish to explore broadening the scope of Amount B. There is also some interest in exploring the implementation of Amount B through an initial pilot programme, in order

to measure how simplification benefits may be achieved. The precise definitions of regions, industries and the relevant activities and indicators is to be finalised through further technical work.

Improved tax certainty processes

Tax certainty is a key component of Pillar One and is core to this Blueprint which provides for innovative dispute prevention and dispute resolution mechanisms.

Dispute prevention

The new taxing right will be determined by the application of a formula to a newly defined tax base, corresponding to a portion of the residual profit of large MNEs’ in-scope activities. The Blueprint embeds a mechanism to ensure that the application of the new taxing right to a particular MNE group is agreed among all interested jurisdictions. A panel mechanism would be put in place for tax administrations, working with the relevant MNEs, to agree on: (i) the tax base, in particular where there is business line segmentation; (ii) the result of the implementation of the formula, and (iii) any other feature of the new taxing right, including the paying entities and elimination of double taxation. It is also recognised that the resource implications of the multilateral process are significantly less than the resources that would be required by unilateral uncoordinated compliance activities.

As described in section 1.2.2, Amount B is intended to enhance tax certainty and reduce controversy between tax administration and taxpayers, particularly in jurisdictions where there are constraints in dealing with transfer pricing disputes. It does so by standardising the remuneration of related party distributors that perform “baseline marketing and distribution activities’.

Dispute resolution

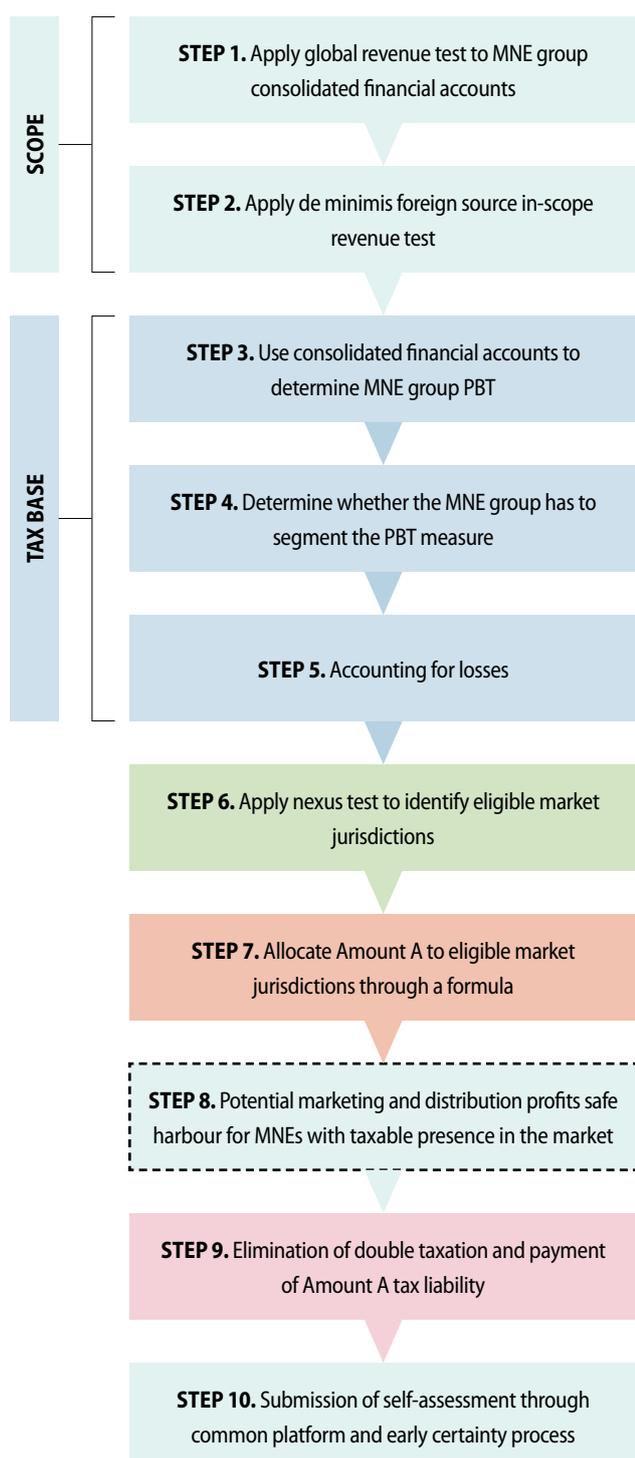
In addition to the innovative dispute prevention mechanisms, the Blueprint includes innovative dispute resolution mechanisms. Members of the Inclusive Framework agreed that, in the event a dispute related to Amount A might arise that is not dealt with by the Amount A dispute prevention process, appropriate mandatory binding dispute resolution mechanisms will be developed.¹¹ Members of the Inclusive Framework also agreed to explore mandatory binding timely dispute resolution mechanisms for disputes not related to the

10. Relevant industry categories could include: fast moving consumer goods (FMCG), motor vehicles, ICT, pharmaceuticals and general distribution.

11. This will require reaching consensus on such dispute resolution mechanism.

application of the new taxing right. These mechanisms should be respectful of jurisdictions' sovereignty, with consideration paid to the case of certain developing economies with no or low levels of mutual agreement procedure (MAP) cases. As indicated above, agreement on the scope of mandatory binding dispute resolution beyond Amount A is still pending.

Figure 1.2. Overview of the process map for Amount A



Process map

To illustrate how the Blueprint would apply in practice, the below contains an overview of the process map to apply its various elements (focusing on Amount A). More details on the different steps described in this process map are available in Annex A.

1. Global revenue test

Only MNE groups with revenue exceeding EUR [X] are potentially in scope of Amount A.

2. Apply de minimis foreign source in-scope revenue test

Only MNE groups with aggregated foreign source revenue from in-scope activities exceeding EUR [X] are taken into account for Amount A liability.

3. Use consolidated financial accounts to determine PBT measure

Identify eligible consolidated GAAPs and apply tax adjustments to compute MNE group standardised PBT.

4. Segmentation of PBT

MNE groups will only be required to segment the PBT measure if they do not qualify for the exemption / safe harbour and display the segmentation hallmarks.

5. Accounting for losses

If the group/segment has a loss, this is reported and carried-forward to offset again future profits. If the segment/group has a profit, available carry-forward losses can be offset.

6. Nexus test in each market jurisdiction

Nexus test applied (market revenue threshold, and other factors for CFB) to determine the market jurisdictions eligible for Amount A.

7. Formulaic calculation and allocation of Amount A

The quantum of taxable Amount A results from a threestep formulaic calculation (i.e. profitability threshold, reallocation percentage and allocation key) applied to the group/segment tax base after step 5.

8. Potential marketing and distribution profits safe harbour

For MNEs with taxable presence in eligible market jurisdiction, an option under consideration is to adjust the quantum of Amount A under step 7 to avoid any duplicative allocation of residual profit to that jurisdiction.

9-10. Identification of relieving jurisdictions and payment of Amount A tax liability and early certainty process

If Amount A tax is due, identify the jurisdiction(s) within the MNE group required to relieve double taxation and the entities that have to pay Amount A tax liability through simplified administrative procedure together with a early certainty process.

Pillar Two Blueprint

INTRODUCTION

Digital transformation spurs innovation, generates efficiencies, and improves services while boosting more inclusive and sustainable growth and enhancing well-being. At the same time, the breadth and speed of this change introduces challenges in many policy areas, including taxation. Reforming the international tax system to address the tax challenges arising from the digitalisation of the economy has therefore been a priority of the international community for several years, with commitments to deliver a consensus-based solution by the end of 2020.

These tax challenges were first identified as one of the main areas of focus of the OECD/G20 Base Erosion and Profit Shifting (BEPS) Project, leading to the 2015 BEPS Action 1 Report (the Action 1 Report).¹ The Action 1 Report found that the whole economy was digitalising and, as a result, it would be difficult, if not impossible, to ring-fence the digital economy. In March 2018, the Inclusive Framework, working through its Task Force on the Digital Economy (TFDE), issued *Tax Challenges Arising from Digitalisation – Interim Report 2018* (the Interim Report)² which recognised the need for a global solution.

Since then, the 137 members of the Inclusive Framework have worked on a global solution based on a two pillar approach.³ Under the second pillar, the Inclusive Framework agreed to explore an approach that is focused on the remaining BEPS challenges and proposes a systematic solution designed to ensure that all internationally operating businesses pay a minimum level of tax. In so doing, it helps to address the remaining BEPS challenges linked to the digitalising economy, where the relative importance of intangible assets as profit drivers makes highly digitalised business often ideally placed to avail themselves of profit shifting planning structures. Pillar Two leaves jurisdictions free to determine their own tax system, including whether they have a corporate income tax and where they set their tax rates, but also considers the right of other jurisdictions to apply the rules contained in the report where income is taxed at an effective rate below a minimum rate.

Consistent with the Policy Note Addressing the Tax Challenges of the Digitalising Economy, approved on 23 January 2019 and the Programme of Work, approved on 28-29 May, 2019, Members of the Inclusive Framework agree that any rules developed under this Pillar should not result in taxation where there is no economic profit nor should they result in double taxation. Mindful of limiting compliance and administrative burdens, Inclusive Framework Members further agree to make any rules as simple as the tax policy context permits, including through the exploration of simplification measures.

Following the adoption of the Programme of Work in May 2019, the Inclusive Framework worked on developing the different aspects of Pillar Two. A public consultation was held on 9 December 2019 which received over 150 written submissions, running to over 1,300 pages submitted by a wide range of businesses, industry groups, law and accounting practitioners, and non-governmental organisations, which provided critical input into the design of many of the aspects of Pillar Two. In January the Inclusive Framework issued a progress report on the status of the technical work. Since January, and in spite of the outbreak of COVID-19, all members have progressed the work and the engagement with stakeholders continued through digital channels including through the maintenance of digital contact groups set up by Business at OECD (BIAC).

This is a Report on the Pillar Two Blueprint (the “Blueprint”). It identifies technical design components of Pillar Two. It also identifies those areas linked to implementation and simplification, which would benefit from further stakeholder input, and where further technical work is required prior to finalisation. The finalisation of Pillar Two also requires political agreement on key design features of the subject to tax rule and the GloBE rules including carve-outs, blending, rule order and tax rates where, at present, diverging views continue to exist.

The remainder of this section sets out the overall design consideration, before focusing on administrative and compliance considerations that were important in the design of Pillar Two. It then discusses the co-existence of the United States’ Global Intangible Low-Taxed Income (GILTI) regime, before providing a chapter-by chapter summary complemented by a flow chart.

OVERALL DESIGN CONSIDERATIONS AND HIGH LEVEL SUMMARY

Pillar Two addresses remaining BEPS challenges and is designed to ensure that large internationally operating businesses pay a minimum level of tax regardless of where they are headquartered or the jurisdictions they operate in. It does so via a number of interlocking rules that seek to (i) ensure minimum taxation while avoiding double taxation or taxation where there is no economic profit, (ii) cope with different tax system designs by jurisdictions as well as different operating models by businesses, (iii) ensure transparency and a level playing field, and (iv) minimise administrative and compliance costs.

1. OECD (2015), *Addressing the Tax Challenges of the Digital Economy*, Action 1 – 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris.

2. OECD (2018), *Tax Challenges Arising from Digitalisation – Interim Report 2018*, Inclusive Framework on BEPS, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris.

3. *Addressing the Tax Challenges of the Digitalisation of the Economy – Policy Note*, as approved by the Inclusive Framework on BEPS on 23 January 2019, OECD 2019.

The principal mechanism to achieve this outcome is the income inclusion rule (IIR) together with the undertaxed payments rule (UTPR) acting as a backstop. The operation of the IIR is, in some respects, based on traditional controlled foreign company (CFC) rules principles and triggers an inclusion at the level of the shareholder where the income of a controlled foreign entity is taxed at below the effective minimum tax rate.⁴ It is complemented by a switch-over rule (SOR) that removes treaty obstacles from its application to certain branch structures and applies where an income tax treaty otherwise obligates a contracting state to use the exemption method.

The UTPR is a secondary rule and only applies where a Constituent Entity is not already subject to an IIR. The UTPR is nevertheless a key part of the rule set as it serves as back-stop to the IIR, ensures a level playing field and addresses inversion risks that might otherwise arise.

The Subject to Tax Rule (STTR) complements these rules. It acknowledges that denying treaty benefits for certain deductible intra-group payments made to jurisdictions where those payments are subject to no or low rates of nominal taxation may help source countries to protect their tax base, notably for countries with lower administrative capacities. To ensure tax certainty and avoid double taxation, Pillar Two also addresses questions of implementation and effective rule coordination.

Income inclusion rule and undertaxed payments rule (the “GloBE rules”)

The IIR and the UTPR use the same rules to determine scope and the level of effective taxation. They apply to MNE Groups and their Constituent Entities within the consolidated group as determined under applicable financial accounting standards. They only apply to businesses that meet or exceed a €750 million annual gross revenue threshold.⁵ This creates synergies with the current BEPS Action 13 Country-by-Country Reporting (CbCR) rules, thereby reducing compliance costs. It also avoids adverse impacts on SME’s while preserving the impact of the rules with in scope MNE Groups still earning over 90 percent of global corporate revenues.

The rules further exclude certain parent entities including investment and pension funds, governmental entities such as sovereign wealth funds and international and non-profit bodies, which typically benefit from an exclusion or exemption from tax under applicable domestic tax law. Special rules may apply to Associates, joint ventures and so called “orphan entities” that are not part of the consolidated group.

Both the IIR and the UTPR use a common tax base. The determination of the base starts with the financial accounts prepared under the accounting standard used by the parent of the MNE Group to prepare its consolidated financial statements. This must be IFRS or another acceptable accounting standard. The use of financial accounts as a common basis ensures a level playing field for both jurisdictions and MNEs, enhances transparency and leverages off existing systems thereby minimising compliance cost. Certain adjustments are then made to the financial accounts to eliminate specific items of income from the tax base, such as intragroup dividends and to incorporate certain expenses, such as tax deductible stock based compensation. This is necessary where the outcomes of the financial accounting rules would otherwise distort the tax policy objectives of Pillar Two.

The IIR and the UTPR also use a common definition of taxes. The definition of taxes, referred to as “covered taxes” is derived from the definition of taxes used for statistical purposes by many international organisations including the OECD, EU, IMF, World Bank and the UN. The definition is deliberately kept broad to avoid legalistic distinctions and accommodate different tax systems provided they substantively impose taxes on an entity’s income or profits.

The effective tax rate (ETR) is determined by applying the tax base and covered taxes on a jurisdictional basis. This requires an assignment of the income and taxes among the jurisdictions in which the MNE operates and to which it pays taxes. The GloBE tax computation also includes two important additional adjustments; a mechanism to mitigate the impact of volatility in the ETR from one period to the next and a formulaic substance carve-out.

The mechanism to address volatility is based on the principle that Pillar Two should not impose tax where the low ETR is simply a result of timing differences in the recognition of income or the imposition of taxes.

⁴ Although similar in operation, the IIR and CFC rules can co-exist because they have different policy objectives.

⁵ For a further discussion of the revenue threshold see Section 2.4 and 10.3 below.

The GloBE rules therefore allow an MNE to carry-over losses incurred or excess taxes paid in prior periods into a subsequent period in order to smooth-out any potential volatility arising from such timing differences.

The formulaic substance carve-out excludes a fixed return for substantive activities within a jurisdiction from the scope of the GloBE rules. Excluding a fixed return from substantive activities focuses GloBE on “excess income”, such as intangible-related income, which is most susceptible to BEPS challenges.

If an MNE’s jurisdictional ETR is below the agreed minimum rate, the MNE will be liable for an incremental amount of tax that is sufficient to bring the total amount of tax on the excess profits up to the minimum rate. The ETR calculation therefore operates both as a trigger for the imposition of the tax liability and as a measure of the amount of top-up tax imposed under the rules. This design ensures a level playing field as all MNE’s pay a minimum level of tax in each jurisdiction in which they operate while the top-up mechanism coupled with the common base makes sure that they face the same level of top-up tax irrespective of where they are based. The amount of top-up tax is collected either by application of the IIR, or – where no IIR applies – by the application of the UTPR.

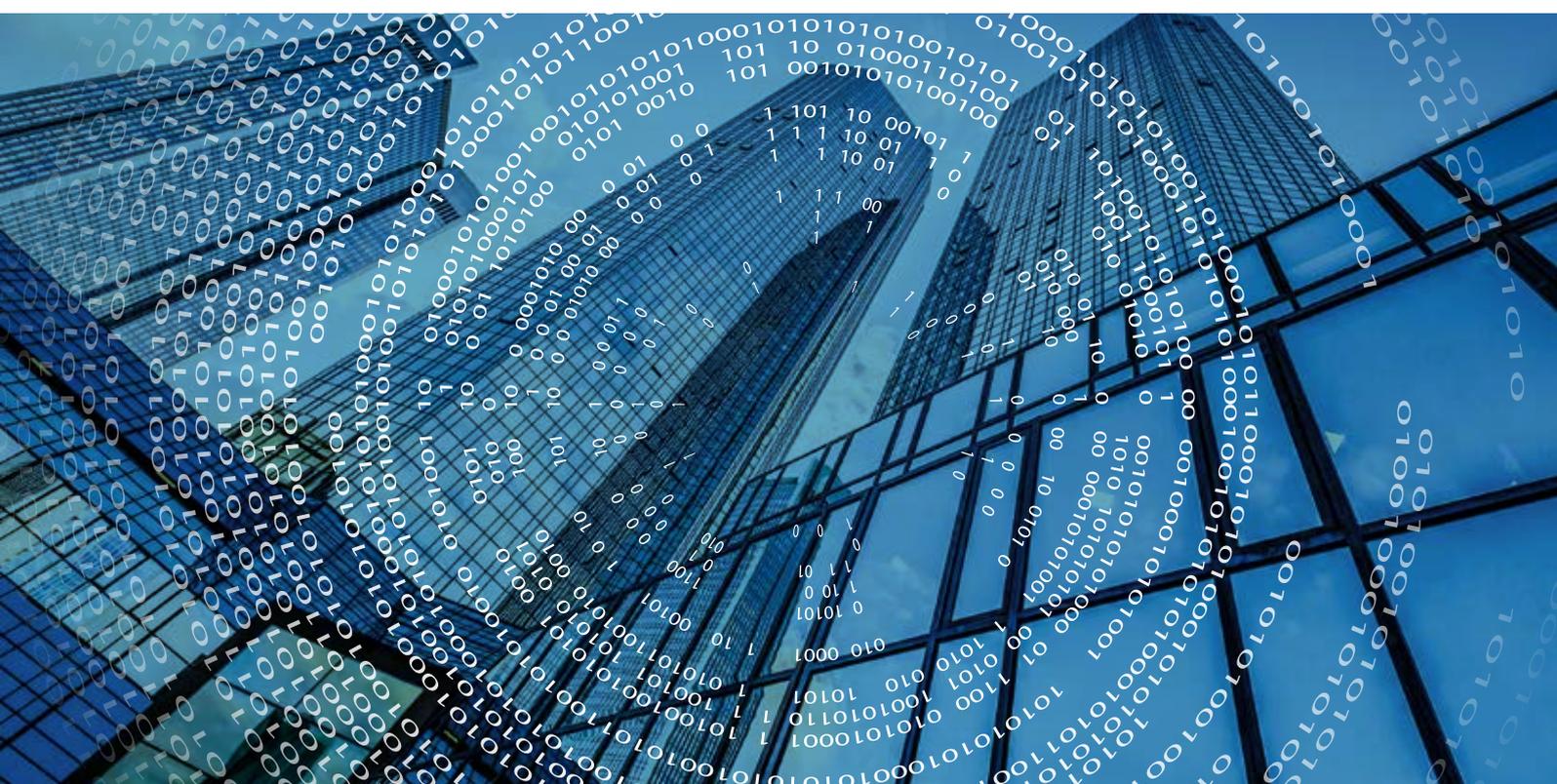
Subject to Tax Rule

The Subject to Tax Rule (STTR) complements these rules. It is a treaty-based rule that specifically targets risks to source countries posed by BEPS structures relating to intragroup⁶ payments that take advantage of low nominal rates of taxation in the other contracting jurisdiction (that is, the jurisdiction of the payee). It allows the source jurisdiction to impose additional taxation on certain covered payments up to the agreed minimum rate. Any top up tax imposed under the STTR will be taken into account in determining the ETR for purposes of the IIR and the UTPR.

Implementation

While the IIR and the UTPR do not require changes to bilateral treaties and can be implemented by way of changes to domestic law,⁷ both the STTR and the SOR can only be implemented through changes to existing bilateral tax treaties. These could be implemented through bilateral negotiations and amendments to individual treaties or as part of a multilateral convention. Alternatively the Multilateral Convention

6. As discussed in Section 9.1, the STTR may not in all instances be limited to intra-group payments.
7. See Section 10.5.3. of the Report on the Pillar Two Blueprint on the consideration of a multilateral convention to ensure co-ordination of the IIR and UTPR.



to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (the MLI), emerging from BEPS Action 15, may offer a model for a coordinated and efficient approach to introducing these changes.

Rule co-ordination and next steps

As a next step and to ensure rule co-ordination and increase tax certainty the IF will develop model legislation and guidance, develop a multilateral review process and explore the use of a multilateral convention, which could include the key aspects of Pillar Two. Dispute prevention and resolution processes can build on the existing infrastructure, but new provisions could also be included in a multilateral convention.

The graphic below shows the different components of Pillar Two and identifies the chapter where each of these components is discussed.

ADMINISTRATIVE AND COMPLIANCE CONSIDERATIONS

Within the context of the tax policy objectives of Pillar Two the design of each feature has been developed with the objective of minimising cost and resources for both tax authorities and taxpayers in applying and administering the Pillar Two rules. This has informed a number of design choices including the following:

- **Use of accounting consolidation rules for determining scope.** While from a tax policy perspective there could have been reason to go beyond the consolidated group definition, to minimise cost and complexity the Pillar Two design stays with this definition and addresses particular risk areas through targeted rules only.
- **Reliance on Country-by-Country reporting (CBCR) thresholds and definitions.** To limit compliance costs, maximise synergies, avoid adverse impacts on SME's, while preserving the overall impact of the rules, the Pillar Two design leverages off the CBCR concepts and definitions and excludes MNE Groups with consolidated gross revenues below €750 million.
- **List of excluded entities.** To provide certainty and translate the policy intent, the Pillar Two design includes a list of expressly excluded entities, including those that may, in certain circumstances, already be excluded under the operation of the consolidation rules.
- **Use of parent financial accounting standards, no book-to-book and limited book-to-tax adjustments.** The reliance on accounting information avoids the cost and complexity of having to re-compute the income and profits of each foreign group member in accordance with domestic tax accounting rules,

GloBE Rules – Chapters 2–7		Special Rules Chapter 8	STT Rule Chapter 9	Rule Co-ordination Chapter 10		
Scope – Chapter 2		Simplified IIR for JVs and Associated Entities	Scope	Rule Order		
Calculation of jurisdictional ETR – Chapter 3				Orphan Entities	Treaty Compatibility	
Carry-forwards – Chapter 4					Trigger	
Carve-out – Chapter 4					Adjustment	Co-ordination
Simplifications – Chapter 5						Dispute Prevention
IIR – Chapter 6	UTPR – Chapter 7					
Top-down Approach	1st Allocation Key					
Split Ownership	2nd Allocation Key					

which in practise is not something MNEs are often required to do to even where they are subject to CFC rules. In particular, a requirement to re-compute using domestic tax accounting in connection with the application of the UTPR would have resulted in disproportionate compliance burdens. Furthermore, the Pillar Two design accepts a range of accounting standards without requiring book to book adjustments, for instance between IFRS and US GAAP. The use of the accounting standards at the parent level – rather than local entity level – further reduces compliance cost. Finally, book to tax adjustments have been kept at a minimum in part to maintain the benefit of simplicity in using financial accounting standards in the first place.

- **Reliance on entity level financial information.** The Pillar Two design accepts that entity level financial information that is used in the preparation of the parent's financial accounts may not be in perfect accord with the parent's accounting standard, but considering cost and benefits, it allows MNE's to rely on such entity level information subject to certain conditions.
- **Timing differences simplifications.** The rules provide for a simplified mechanism to address timing differences that applies on a jurisdictional basis and includes mechanisms for calculating pre-regime losses and excess taxes.
- **Rule order.** The Pillar Two design has the IIR as the primary rule with the UTPR acting as a backstop. Both rules use the same computational rules for determining low taxed income, but the primacy of the IIR is largely driven by simplicity and lower compliance costs, including the ease of obtaining the necessary income and tax information required to make an ETR determination; the fact that the IIR will generally require only one adjustment to be made by a single taxpayer and the availability of mechanisms to avoid the risk of double taxation. Equally, the general decision to use a top-down rather than a bottom-up approach for the use of the IIR in connection with multi-tier MNE Groups is driven in significant part by compliance and simplicity considerations. The top-down approach will limit the number of jurisdictions applying the IIR thereby reducing the need for co-ordination and, by extension, complexity, administrative burden, and the risk of double taxation under the rules.
- **STTR using a nominal tax rate test.** The STTR is limited to certain categories of payments made between members of a controlled group and is based on a nominal tax rate test, thereby avoiding the conceptual and administrative challenges of using an effective tax rate test.
- **Bright line and mechanical rule design.** Wherever possible, within the context of the tax policy objectives, Pillar Two uses bright line rules (e.g. on scope and for the determination of the tax base including any permanent adjustments) and more mechanical, formulaic approaches (e.g. the design of a formulaic substance-based carve-out and in the mechanics for allocating top-up tax under the IIR and UTPR) which should make compliance easier and avoid the types of disputes that often result from more subjective rules with significant reliance on facts and circumstance tests.
- **Further simplification options in particular in light of jurisdictional blending.** During the December 2019 Public Consultation, many MNEs stressed that simplification measures are needed to reduce the complexity and administrative burden associated with complying with the GloBE rules, particularly in the context of jurisdictional blending. Several submissions pointed out that large MNEs often operate in more than 100 jurisdictions and would be required to undertake the same number of ETR calculations under a jurisdictional blending approach. Other submissions expressed concern that, under jurisdictional blending, it would be necessary to compute the ETR in jurisdictions that are likely to be above the agreed minimum rate year-after-year, given the base and tax rate in these jurisdictions. These inputs informed a number of the design features already discussed above, but also led to the exploration of several further simplification measures, as set out in Chapter 5 of the Report. These simplification measures would benefit from further public consultations with stakeholders and business in particular and therefore no decision has yet been taken on which, if any, of these simplification measures to incorporate into the final design of the rules.

GILTI CO-EXISTENCE

The United States enacted the Global Intangible Low-Taxed Income (GILTI) regime in 2017 as part of a substantial reform of the US international tax rules. The GILTI regime, which draws on elements of the BEPS

Action 3 Report, provides for a minimum level of tax on the foreign income of an MNE Group. While the GILTI and GloBE rules as described in the Blueprint have a similar purpose and overlapping scope, the design of GILTI differs from GloBE in a number of important respects.

While GILTI results largely, but not completely, in a global blending of foreign income and taxes, in a number of other respects, the GloBE rules, as described in the Blueprint, would be more permissive than GILTI, depending also on their final design. These include the carry-forward of losses and excess taxes, a broader definition of covered taxes and a carve-out based on a broader range of tangible assets and payroll. Furthermore, GILTI applies without threshold limitations and incorporates expense allocation rules in the calculation of foreign tax credits which can result in effective rates of taxation above the minimum rate. Finally, the GILTI effective rate is currently set at 13.125% and will increase to 16.4% in 2026.

Given the pre-existing nature of the GILTI regime and its legislative intent there are reasons for treating GILTI as a qualified income inclusion rule for purposes of the GloBE rules provided that the coexistence achieves reasonably equivalent effects. This treatment would need to be reviewed if subsequent legislation or regulations in the US would have the effect of materially narrowing the GILTI tax base or reducing the legislated rate of tax. The Inclusive Framework recognises that an agreement on the co-existence of the GILTI and the GloBE would need to be part of the political agreement on Pillar Two.

At a technical level further consideration will be given to how the interactions between the GILTI and the GloBE rules would be coordinated. That includes the coordination with the application of the GILTI to US intermediate parent companies of foreign groups headquartered in countries that apply an IIR. Moreover, considering the role of the undertaxed payments rule as a back-stop to the IIR, the IF strongly encourages the United States to limit the operation of the Base Erosion and Anti-abuse Tax (BEAT) in respect of payments to entities that are subject to the IIR.

CHAPTER BREAKDOWN AND FLOW-CHART

This Pillar Two report consists of ten chapters that set out the overall design of the rules and includes an Annex with examples illustrating the operation of the rules.

Chapter 1 is this executive summary and introduction.

Chapter 2 contains the rules that determine the scope of the GloBE rules and includes the relevant definitions for in scope groups and Constituent Entities, as well as excluded entities. It also explains the application and computation of the consolidated revenue threshold.

Chapter 3 covers the rules and explanations relating to the calculation of the ETR and top-up tax under the GloBE rules. The starting point for applying the GloBE rules is the consolidated financial statements prepared by the MNE Group. A limited number of adjustments are then made to the financial accounts to add or eliminate certain items in order to arrive at the GloBE tax base. The Chapter also defines the covered taxes that can be taken into account in determining the ETR on a jurisdictional basis.

Chapter 4 sets out a number of adjustments that may be made to the top-up tax calculation either through the carry-over of losses or excess taxes from other periods or through the application of a formulaic substance based carve-out. The carry-forward adjustments are intended to ensure that Pillar Two does not result in the imposition of additional tax where the low ETR is simply a result of differences in the timing for recognition of income or the imposition of taxes while the formulaic substance-based carve-out is intended to exclude a fixed return for substantive activities within a jurisdiction from the scope of the GloBE rules.

Chapter 5 explores a number of simplification measures designed to reduce the compliance burden in particular from the use of a jurisdictional ETR calculation. As noted in that chapter these simplifications would benefit from further public consultations with business in particular and therefore no decision has yet been taken on which, if any, of these simplification measures to incorporate into the final design of the rules.

Chapter 6 describes the operation of the IIR including how the IIR is applied in the context of a multi-tiered ownership structure, where Pillar Two uses a top down approach except in cases where the ownership is split with a minority holder outside the group. In the latter case the split-ownership rules require the intermediate parent entity to apply the income inclusion rule to the controlled subsidiaries of the sub-group. This chapter also explains the need for a treaty based switch over rule that would allow a jurisdiction to override the exemption method to the extent necessary to apply the IIR to the profits of a permanent establishment.

Chapter 7 contains a detailed discussion of the UTPR. The UTPR only applies to those Constituent Entities in the MNE Group that are not controlled by an entity further up the chain that applies an IIR. Where the UTPR applies top-up tax is allocated proportionately among Constituent Entities applying UTPR in a co-ordinated way first to those entities making direct payments to the low-tax Constituent Entity and then amongst all entities in the group that have net intra-group expenditure.

Chapter 8 discusses two special rules, one dealing with associates and joint ventures and another dealing with so-called “orphan entities.” The first rule applies a simplified IIR to the income of an MNE Group attributable to ownership interests in entities or arrangements that are reported under the equity method. The second rule is designed to extend the application of the UTPR to “orphan” entities or arrangements that could otherwise be used to extract profit from the MNE Group for the benefit of the controlling shareholders, giving rise to a BEPS risk.

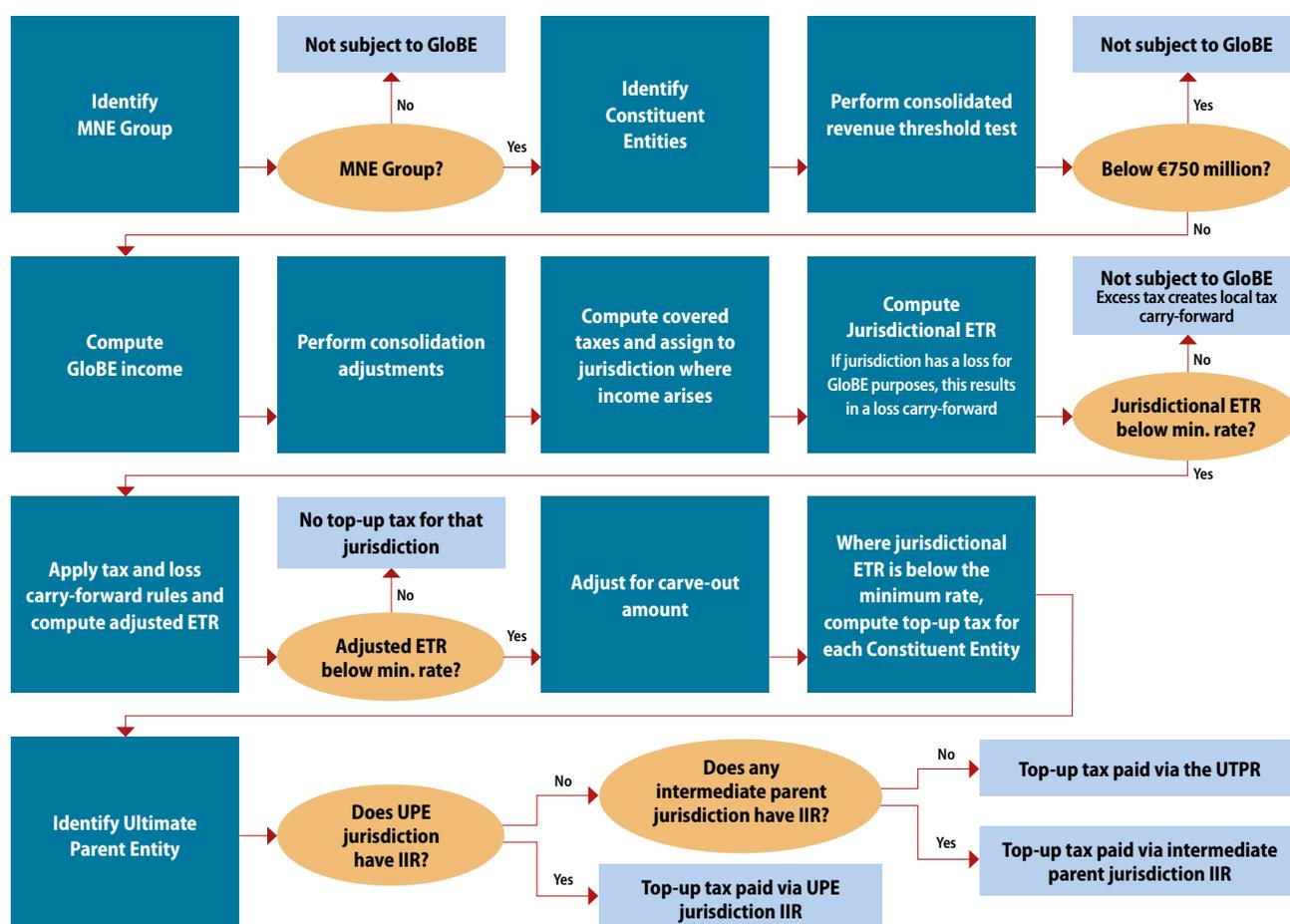
Chapter 9 addresses the STTR. It sets the framework for the development of a treaty-based rule that specifically

targets risks to source countries posed by BEPS structures relating to intragroup payments that take advantage of low or nominal rates of taxation in the other contracting jurisdiction (that is, the jurisdiction of the payee). The effect of the rule will be to allow the payer jurisdiction to apply a top-up tax to bring the tax on the payment up to an agreed minimum rate.

Chapter 10 deals with implementation and rule co-ordination. This chapter is forward looking and explains how the Inclusive Framework will ensure rule co-ordination and increase tax certainty including through the development of model legislation and guidance, a multilateral review process and the exploration of a multilateral convention, which could also include new provision on dispute prevention and resolution.

Flow Diagram

The flow diagram below is intended to provide a high-level overview of the process steps for applying the GloBE rules to wholly-owned Constituent Entities of an MNE Group.



Economic Impact Assessment

INTRODUCTION

The Programme of Work adopted by the OECD/G20 Inclusive Framework on BEPS in May 2019 mandated the OECD Secretariat to carry out an economic impact assessment of the Pillar One and Pillar Two proposals. The aim was to ensure that all members of the Inclusive Framework could be kept fully informed of the economic and tax revenue impact of key decisions relating to the proposals. The main results of this work, which has benefitted from extensive interactions with Inclusive Framework members, are presented in the Economic Impact Assessment and summarised in this section. The assessment focuses on the effect of the proposals on tax revenues, investment and economic activity. It is an 'ex ante' assessment, which relies on illustrative assumptions on a number of design elements and parameters of Pillar One and Pillar Two that will be the subject of future decisions by the Inclusive Framework.

Key Findings

The Economic Impact Assessment analyses the economic and tax revenue implications of the Pillar One and Pillar Two proposals. A number of the design elements and parameters of Pillar One and Pillar Two will be the subject of future decisions by the Inclusive Framework. The ‘ex ante’ assessment in the report, which has been carried out by the OECD Secretariat, relies on a number of illustrative assumptions on proposal design and parameters, without prejudice to the final decisions of the Inclusive Framework.

The impact assessment relies on the best data available to the OECD Secretariat across a wide range of jurisdictions, combining firm-level and more aggregate data sources, including the newly published anonymised and aggregated Country-by-Country Report (CbCR) data. Extensive work has been undertaken to ensure the highest possible level of data quality. Nevertheless, the underlying data have several limitations and the assessment relies on a number of simplifying assumptions on the proposals and the potential reactions of multinational enterprises (MNEs) and governments. In particular, the underlying data pre-date important recent developments, most notably the 2017 US tax reform, implementation of some aspects of the OECD/G20 Base Erosion and Profit Shifting (BEPS) package and the COVID-19 crisis.

EFFECT OF THE PROPOSALS ON TAX REVENUES

Pillar One and Pillar Two could increase global corporate income tax (CIT) revenues by about USD 50-80 billion per year. Taking into account the combined effect of these reforms and the US GILTI regime, the total effect could represent USD 60-100 billion per year or up to around 4% of global CIT revenues. The exact gains could differ from these ‘ex ante’ estimates as they would depend on the final design and parameters of Pillar One and Pillar Two, the extent of their implementation, the nature and scale of reactions by MNEs and governments, and future economic developments. Global gains would primarily come from Pillar Two:

- Pillar One would involve a significant change to the way taxing rights are allocated among jurisdictions, as taxing rights on about USD 100 billion of profit could be reallocated to market jurisdictions under the Pillar One rules. This would lead to a modest increase in global tax revenues. On average, low, middle and high income economies would all benefit from revenue gains, while ‘investment hubs’ would tend to lose tax revenues.
- Pillar Two would yield a significant increase in CIT revenues across low, middle and high income economies. It would significantly reduce the incentives for multinational enterprises (MNEs) to shift profits to low-tax jurisdictions, which would generate revenue gains in addition to the direct gains collected through the minimum tax itself.
- The combined revenue gains from both pillars are estimated to be broadly similar – as a share of current CIT revenues – across low, middle and high income jurisdictions.

EFFECT OF THE PROPOSALS ON INVESTMENT AND ECONOMIC GROWTH

A consensus-based multilateral solution involving Pillar One and Pillar Two would lead to a more favourable environment for investment and economic growth than would likely be the case in the absence of an agreement by the Inclusive Framework:

- Pillar One and Pillar Two would lead to a relatively small increase in the average (post-tax) investment costs of MNEs. The ensuing negative effect on global investment is estimated to be very small, as the proposals would mostly affect highly profitable MNEs whose investment is less sensitive to taxes. The impact of the proposals is expected to fall predominantly on highly-profitable MNEs in digitalised and intangible-intensive sectors in the case of Pillar One and on MNEs engaging in profit shifting in the case of Pillar Two.

Overall, the negative effect on global GDP stemming from the expected increase in tax revenues associated with the proposals is estimated to be less than 0.1% in the long term.

- Pillar One and Pillar Two would support global investment and growth through less quantifiable but nonetheless significant channels, which may partly or even fully offset this small negative effect. In particular, the proposals aim to increase tax certainty and could enhance the efficiency of global capital allocation by increasing the importance of non-tax factors (e.g. infrastructure, education levels or labour costs) in investment decisions. To some extent, they would also reduce the need to raise revenues by implementing other (potentially more distortive) tax measures in the constrained post-COVID 19 budget environment. Finally, the proposals could result in additional compliance and administration costs for MNEs and governments. The extent of these costs is difficult to assess and would depend on the final design of the proposals.
- In contrast, 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. This would undermine tax certainty and investment and also result in additional compliance and administration costs. The magnitude of the negative consequences would depend on the extent, design and scope of these unilateral measures, and the scale of any ensuing trade retaliation. In the “worst-case” scenario, these disputes could reduce global GDP by more than 1%.

IMPLICATIONS OF THE COVID-19 CRISIS

The full impact of the COVID-19 crisis remains highly uncertain at this stage, but a few likely implications for the impact assessment of Pillar One and Pillar Two already stand out:

- The COVID-19 crisis is likely to reduce the expected revenue gains from Pillar One and Pillar Two at least in the short run as the crisis weighs on the profitability of many MNEs, even though some digital-intensive MNEs have managed to sustain or enhance their profitability since the beginning of the crisis.
- The crisis has accelerated the trend towards the digitalisation of the economy, further increasing the prominence of the tax challenges arising from digitalisation and the need to address them. Accelerating digitalisation will also increase the relative importance of automated digital services (ADS) in the envisaged scope of Pillar One.
- Accelerated digitalisation, increased pressures on public finances after the crisis, and growing public dissatisfaction with tax planning by MNEs are all likely to reinforce the likelihood of unilateral tax measures if a consensus-based solution cannot be secured by the Inclusive Framework. The likely ensuing tax and trade disputes would undermine investment and economic growth at a time when the global economy is at its most fragile due to the COVID-19 crisis. They would compound the negative effect of the crisis and hinder the recovery prospects.



BACKGROUND

The Economic Impact Assessment (OECD, 2020) focuses primarily on the impact of the Pillar One and Pillar Two proposals on tax revenues, MNE investment and economic activity. A number of design elements and parameters of Pillar One and Pillar Two will be the subject of future decisions by the Inclusive Framework. For the purpose of the ‘ex ante’ impact assessment, a number of illustrative assumptions on proposal design and parameters have been made, without prejudice to the final decisions of the Inclusive Framework. The report presents results for a range of illustrative parameters for both Pillar One and Pillar Two in order to inform the ongoing discussions of the Inclusive Framework around the design of the proposals.

The geographic scope of the analysis in the Economic Impact Assessment is very wide, as it covers more than

200 jurisdictions, including all 137 members of the Inclusive Framework. The analysis is based on wide-ranging and thorough data analysis, as well as insights from the economic literature. It has benefitted from extensive interactions with representatives of Inclusive Framework jurisdictions, as well as exchanges with academics, civil society and business representatives and other international organisations. As is the case for any economic analysis, the methodology relies on a number of simplifying assumptions, for example on the design of the proposals and the way MNEs and governments may react to their implementation.

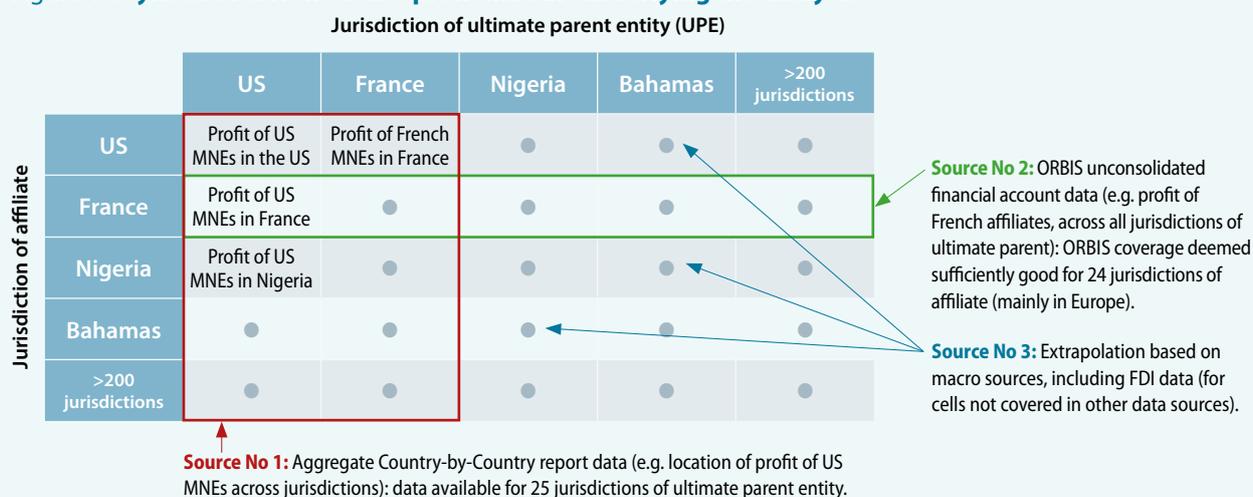
The analysis mobilises a wide array of data sources that are combined in a consistent analytical framework (see Box 1). This comprises firm-level data, including the financial accounts of most of the large MNE groups worldwide, as well as a wide range of aggregate data

Box 1: Overview of the data “matrices” supporting the Economic Impact Assessment

A central instrument supporting the Economic Impact Assessment is a set of four data matrices: a profit matrix, focusing on the location of the profit of MNEs across jurisdictions, and three matrices focusing on indicators of the economic activity of MNEs (turnover, tangible assets and payroll). Each matrix contains data spanning more than 200 jurisdictions (each jurisdiction corresponding to a matrix row) and broken down across more than 200 jurisdictions of ultimate parent of the MNE considered (each jurisdiction of ultimate parent being a matrix column). Each matrix therefore takes the form of a square table with more than 200 rows and more than 200 columns (see Figure 1 for a stylised illustration).

The matrices combine data from a range of sources in a consistent framework, including anonymised and aggregated CbCR data, firm-level data from the ORBIS database, and data from the OECD Analytical Activity of Multinational Enterprises (Analytical AMNE) database. Gaps in data are filled using extrapolations based on macroeconomic data, including via a sophisticated procedure to extrapolate profit based on foreign direct investment (FDI) data. Extensive benchmarking has been undertaken to ensure consistency across the data sources and extrapolations used in the matrices.

Figure 1. Stylised overview of the “profit matrix” underlying the analysis



Note: CbCR data are used to fill columns of the profit matrix (e.g. profit of French MNEs across jurisdictions). ORBIS unconsolidated account data are used to fill rows of the profit matrix (i.e. MNE profit in France, split across ultimate parent jurisdictions). These two sources are used only where available, and in the case of ORBIS, where data coverage is sufficiently good. Other cells in the profit matrix are filled with extrapolations based on macroeconomic data, including FDI data. See Chapter 5 of the Economic Impact Assessment for more details and the description of the other data matrices underlying the analysis.

Source: OECD Secretariat.

sources, including the anonymised and aggregated Country-by-Country Report (CbCR) statistics collected as part of the implementation of the BEPS package and published by the OECD for the first time in July 2020 (OECD, 2020). Nevertheless, the data underlying the analysis have limitations in terms of coverage, consistency and timeliness. In particular, the data focus primarily on 2016-17 and therefore pre-date some significant recent developments, including the implementation of various measures under the OECD/G20 BEPS project, the 2017 US tax reform (US Tax Cuts and Jobs Act) and most importantly the COVID-19 crisis. The potential implications of the COVID-19 crisis for the impact of the proposals are discussed in the final section.

EFFECT OF THE PROPOSALS ON TAX REVENUES

The effect of the proposals on tax revenues will depend on the final design and parameter choices to be agreed by the Inclusive Framework. Under an illustrative set of design and parameter assumptions, the combined effect of Pillar One and Pillar Two on global corporate income tax (CIT) revenues could increase global CIT revenues by 1.9% to 3.2%, or about USD 50-80 billion per year (Table 1).¹ These estimates assume illustratively – while no

decision has been taken by the Inclusive Framework at this time – that the US Global Intangible Low Tax Income (GILTI) regime would ‘co-exist’ with Pillar Two and US MNEs would not be subject to the income inclusion rule (IIR) under Pillar Two. As a result, Pillar Two revenue gains in Table 1 do not include potential gains related to the application of Pillar Two by US MNEs, which are assumed to remain subject to the GILTI regime. Taking into account the combined revenue gains of both pillars and the US GILTI regime,² the total effect could represent about USD 60-100 billion per year or up to 4% of global CIT revenues.

Global tax revenue effects of Pillar One

Pillar One seeks to adapt the international corporate tax system to the digital age through significant changes to the rules applicable to business profits to ensure that the allocation of taxing rights on business profits is no longer exclusively determined by reference to physical presence. It intends to expand the taxing rights of market jurisdictions (which, for some business models, is the jurisdiction where the user is located)³ where there is a significant and sustained participation of a business in the economy of that jurisdiction, either physically

1. Global CIT revenues are estimated to represent about USD 2.5 trillion in 2019. This is based on OECD and IMF data on CIT revenues in 2016 (the year with best geographic coverage of CIT revenues, with more than 120 jurisdictions covered), extrapolations based on the median ratio of CIT revenues to GDP (i.e. 2.7%) in jurisdictions not covered in OECD or IMF data, and World Bank data on nominal global GDP growth between 2016 and 2019 (assuming a constant ratio of global CIT revenues to global GDP).

2. Gains from the US GILTI regime are based on ex ante estimates from the US Joint Committee on Taxation. See Chapter 3 of the Economic Impact Assessment for more details.

3. For the purpose of the Economic Impact Assessment, user/market jurisdictions (henceforth “market jurisdictions”) are jurisdictions where an MNE group sells its products or services or, in the case of highly digitalised businesses, provides services to users or solicits and collects data or content contributions from them.

Table 1. Overview of global tax revenue effects from the proposals

Estimates based on illustrative assumptions on the design and parameters of Pillar One and Pillar Two

Estimated global tax revenue gains		In % of global CIT revenues	In USD billion
Pillar One		0.2%-0.5%	5-12
Pillar Two	Direct revenue gains	0.9%-1.7%	23-42
	Additional gains from reduced profit shifting	0.8%-1.1%	19-28
	Total Pillar Two	1.7%-2.8%	42-70
Total Pillar One and Pillar Two		1.9%-3.2%	47-81
US GILTI regime		0.4%-0.8%	9-21
Total, including GILTI		2.3%-4.0%	56-102

Note: The estimates in this table are based on the following illustrative assumptions. Pillar One, for which only Amount A is modelled, is assumed to focus on Automated Digital Services (ADS) and Consumer Facing Businesses (CFB), with a global revenue threshold of EUR 750 million, a profitability threshold percentage of 10% (based on the ratio of profit before tax to turnover), a reallocation percentage of 20% and a nexus revenue threshold of EUR 1 million for ADS and EUR 3 million for CFB. Pillar Two is assumed to involve a 12.5% minimum tax rate with jurisdictional blending and a 10% combined carve-out on payroll and depreciation expenses. The US GILTI regime is illustratively assumed to ‘co-exist’ with Pillar Two. Therefore, US MNEs (which are subject to the GILTI regime) are excluded from the Pillar Two gains in this table. Revenues from GILTI are included in this table based on estimates from the US Joint Committee on Taxation. MNEs are assumed to reduce their profit shifting intensity in reaction to Pillar Two introduction, resulting in additional tax revenue gains. The interaction between Pillar One and Pillar Two is taken into account in this table. Estimates are presented as ranges to reflect uncertainty around the underlying data and modelling. See Chapters 2 and 3 of the Economic Impact Assessment for more details.

Source: OECD Secretariat calculations, and estimates from the US Joint Committee on Taxation for GILTI.

or remotely. It also aims to improve tax certainty by introducing improved dispute prevention and resolution mechanisms.

The key elements of Pillar One can be grouped into three components: a new taxing right for market jurisdictions over a share of residual profit (i.e. profit in excess of a certain profitability threshold percentage) calculated at an MNE group level based on a formulaic approach (Amount A); a fixed return for defined baseline marketing and distribution activities taking place physically in a market jurisdiction (Amount B); and improved tax certainty processes through innovative dispute prevention and dispute resolution mechanisms (Tax certainty component).

Amount A would lead to a reallocation of a portion of the tax base of in-scope MNE groups from jurisdictions where the residual profit of MNE groups is currently located, to market jurisdictions. Not all MNE groups would be subject to this reallocation, as it is assumed that it would only apply to relatively large and profitable MNE groups (i.e. MNE groups with revenues above a certain global revenue threshold, and profitability above

the profitability threshold percentage). Although subject to political agreement, for present purposes this work has proceeded on the basis of the technical proposals to define the in-scope activities as Automated Digital Services (ADS) and Consumer Facing Businesses (CFB). By design, the impact of Amount A would fall primarily on large and profitable MNE groups in the digital-oriented and intangible intensive sectors.

Based on illustrative assumptions on Amount A parameters (including the profitability threshold to define residual profit), the residual profit of the MNE groups that would be in scope of Amount A could represent about USD 500 billion, of which a percentage to be decided by the Inclusive Framework would be reallocated to market jurisdictions.⁴ Assuming illustratively that this reallocation percentage would be 20%, this would imply that taxing rights over about

4. This USD 500 billion estimate assumes illustratively that the MNE groups in scope of Amount A would be those with revenues above a global revenue threshold of EUR 750 million, profitability above a profitability threshold percentage of 10% (based on the ratio of profit before tax to turnover) and activities in ADS and CFB. Estimates based on other potential assumptions on the parameters of Amount A are presented in Chapter 2 of the Economic Impact Assessment.



USD 100 billion of profit would be reallocated to market jurisdictions as a result of Amount A. The existing transfer pricing rules would continue to determine the allocation of taxing rights for other MNE profits (i.e. the profits of out-of-scope MNEs and the non-residual profits of MNEs as well as the share of their residual profits not reallocated under Amount A, which is 80% in this illustrative example).

On average, corporate tax rates are relatively higher in the market jurisdictions where residual profit would be reallocated under Amount A than in the jurisdictions where it is currently located. Indeed, a substantial share of residual profit is currently located in relatively low-tax jurisdictions. This implies that the reallocation occurring under Amount A would generate a net revenue gain at the global level. The magnitude of this overall revenue gain would be relatively modest (e.g. up to 0.5% of global CIT revenues under the assumptions in Table 1) reflecting that only a percentage of the residual profit of the MNEs in scope would be reallocated, and that not all reallocated profit would face a higher tax rate in market jurisdictions than the tax rate it faces where it is currently located.

The effect of the other components of Pillar One (Amount B and the Tax certainty component) is more difficult to quantify due to data limitations (e.g. lack of sufficient data on the nature of MNE activities at the MNE entity level, and lack of transaction-level data) and methodological challenges. As a result, quantitative estimates of Pillar One in the Economic Impact Assessment focus exclusively on Amount A. While the effect of Amount B and the Tax certainty component will depend on their design and scope, their impact on global tax revenues is generally expected to be small. This reflects the fact that these proposals seek to support the existing transfer pricing system and prevent tax disputes, in contrast to Amount A, which establishes a new taxing right.

Amount B would set a fixed return for defined baseline distribution and marketing functions of MNEs taking place physically in market jurisdictions. Amount B is expected to reduce administration costs for governments and increase tax certainty for taxpayers, and may be of particular benefit to jurisdictions with low administrative capacity. Where the fixed return for baseline and marketing functions exceeds current returns taxable in market jurisdictions, Amount B would contribute to additional revenues in those jurisdictions. A number of jurisdictions with low administrative

capacity assess that this is likely to be the case in their jurisdiction, as a result of the challenges they face applying the existing transfer pricing rules effectively. However, at the global level, the revenue effect of Amount B is likely to be modest, as it does not provide market jurisdictions with a new taxing right, but is merely designed to simplify the administration of the current transfer pricing system.

Global tax revenue effects of Pillar Two

The various components of Pillar Two would ensure a minimum level of tax on MNE profit. The GloBE rules (i.e. the income inclusion rule (IIR) and the undertaxed payments rule (UTPR)) would operate as a ‘top-up’ on existing taxes to ensure that the effective tax rate on MNE profit that would otherwise be taxed below an agreed minimum rate is brought up to this minimum rate, which has to be decided by the Inclusive Framework. A variety of minimum rates have illustratively been explored in the analysis. The results in Table 1 assume illustratively a 12.5% minimum rate. Results for other rates are presented in Chapter 3 of the Economic Impact Assessment.

The Inclusive Framework also has to decide on a number of Pillar Two design features, including the degree of ‘blending’ (i.e. the level of aggregation at which the effective tax rate test would be applied). Two main options are considered: jurisdictional blending (i.e. blending the income and covered taxes of all entities from an MNE group in a jurisdiction) or global blending (i.e. blending all foreign income and covered taxes of an MNE group). While no decision has been taken by the Inclusive Framework yet, the results in the Economic Impact Assessment are illustratively based on jurisdictional blending.⁵

Another design question that the Inclusive Framework has to decide upon relates to the existence and design of a formulaic substance-based carve-out. Such a carve-out would exclude a fixed return for substantive activities within a jurisdiction from the scope of the GloBE rules. This fixed return could be defined as a certain percentage of expenses on payroll and depreciation of tangible assets. For example, the results in Table 1 assume illustratively a 10% carve-out on payroll and depreciation of tangible assets. The analysis

5. Global blending, which is more difficult to model with the available data, would bring less revenues than jurisdictional blending for a given level of minimum tax rate, as it would allow MNEs to use high-taxed profit in certain jurisdictions to ‘offset’ low-taxed profit in other jurisdictions.

in the Economic Impact Assessment considers a range of potential options regarding formulaic substance-based carve-outs and suggests that their effect on global Pillar Two revenue gains would be relatively small under the assumptions considered.⁶

The analysis suggests that the global revenue gains from Pillar Two could be significant. The impact of Pillar Two would fall on MNEs with low-taxed profits, including due to profit shifting behaviour. The exact size of the tax revenue gains would depend on the design of Pillar Two and the agreed minimum tax rate. In addition to direct revenue gains collected through the Pillar Two minimum tax provisions (e.g. the income inclusion rule or the undertaxed payments rule), Pillar Two is expected to generate indirect tax revenue gains by reducing MNE profit shifting.

6. In particular, it is illustratively assumed in the Economic Impact Assessment that an MNE group that claims the benefit of the carve-out would be required to make a corresponding and proportional adjustment to the covered taxes for the calculation of the ETR. The alternative option (i.e. not making a corresponding and proportional adjustment to the covered taxes) would be difficult to model with the available data. See Chapter 3 of the Economic Impact Assessment for more details.

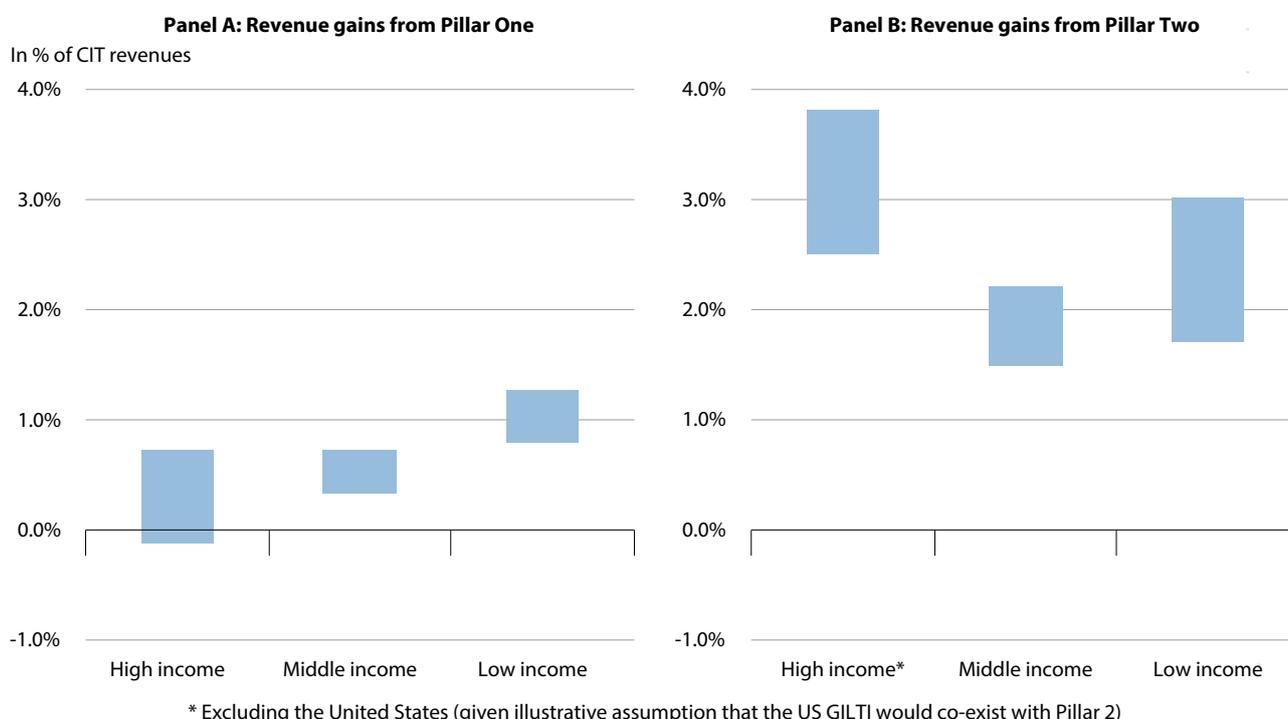
Indeed, Pillar Two would reduce the differences in effective tax rates across jurisdictions, which are one of the main drivers of profit shifting. Reducing these tax rate differentials would reduce MNEs' incentives to shift profit to low-tax jurisdictions. This would likely lead MNEs to reassess their profit shifting strategies, and some MNEs would likely consider that the gains of certain profit shifting schemes would no longer be worth the costs (e.g. financial and advisory costs of the schemes, reputational costs, etc.). The exact scale of the reduction in profit shifting and location of profits in a post Pillar Two world are difficult to anticipate with certainty as profit shifting schemes are very complex and firm-specific. Nevertheless, the reduction of profit shifting is expected to contribute significantly to the global revenue gains from Pillar Two.

Interaction of Pillar One and Pillar Two

The effects of Pillar One and Pillar Two would interact, in the sense that the joint implementation of the two pillars would have a slightly different effect from the effect resulting from the two pillars considered in isolation. Assuming that the minimum tax in Pillar Two would be applied after the reallocation involved



Figure 2. Estimated effect of the proposals on tax revenues, by jurisdiction groups
Estimates based on illustrative assumptions on the design and parameters of Pillar One and Pillar Two



Note: The estimates in this figure are based on the following illustrative assumptions. Pillar One is assumed to focus on Automated Digital Services (ADS) and Consumer Facing Businesses (CFB), with a global revenue threshold of EUR 750 million, a profitability threshold percentage of 10% (based on the ratio of profit before tax to turnover), a reallocation percentage of 20% and a nexus revenue threshold of EUR 1 million for ADS and EUR 3 million for CFB. Pillar Two is assumed to involve a 12.5% minimum tax rate with jurisdictional blending and a 10% combined carve-out on payroll and depreciation expenses. The US GILTI regime is assumed to 'co-exist' with Pillar Two. As a result, the United States is not included in Panel B to ensure greater comparability of results (but it is included in Panel A). Pillar Two estimates take into account the interaction with Pillar One and include gains from a reduction in the profit shifting intensity of MNEs resulting from Pillar Two introduction. Estimates are presented as ranges to reflect uncertainty around the underlying data and modelling. Groups of jurisdictions (high, middle and low income) are based on the World Bank classification. Investment hubs (defined as jurisdictions with a total inward FDI position above 150% of GDP) are not included in this figure. See Chapters 2 and 3 of the Economic Impact Assessment for more details.

Source: OECD Secretariat calculations.

by Pillar One, the analysis in the Economic Impact Assessment suggests that the interaction between the two pillars would reduce the overall revenue gains compared to a hypothetical situation where there would be no interaction between the pillars. However, this interaction effect would be quantitatively small under the assumptions on Pillar One and Pillar Two considered in the report.

Revenue effects of Pillar One and Pillar Two by jurisdiction groups

On average, it is estimated that low, middle and high income jurisdictions would all benefit from revenue gains as a result of the proposals (Figure 2). Gains would be relatively small under Pillar One and larger under Pillar Two. The combined revenue gains from both pillars are estimated to be broadly similar – as a share of current CIT revenues – across low, middle and high income jurisdictions.

Estimated revenue gains from Pillar One tend to be larger – as a share of current CIT revenues – among low and middle income jurisdictions than high income ones, reflecting that relatively low amounts of residual profit are currently located in low and middle income jurisdictions, which implies that they would gain unambiguously from the reallocation occurring under Pillar One.⁷ These results focus exclusively on Amount A, though depending on its ultimate design, some lower income jurisdictions, particularly those with low capacity tax administrations, may also see revenue gains from Amount B. This reflects the fact that these jurisdictions report that they face challenges applying the existing transfer pricing rules effectively,

7. High income jurisdictions are likely to see higher amounts of residual profit allocated to them under Amount A, but they already have taxing rights over some residual profit of in-scope MNE groups, and will see their taxing rights over these profits reduced where they are reallocated to other jurisdictions under Amount A. Hence, the overall revenue gains from Amount A are estimated to be on average lower for high income jurisdictions than for low and middle income jurisdictions.

with some MNEs reporting low or negative returns for baseline marketing and distribution activities in their jurisdiction.

Revenue gains from Pillar Two are estimated to be significant across all income groups presented in Figure 2. The estimated gains tend to be relatively larger among high income jurisdictions, reflecting that gains from the income inclusion rule would accrue to the jurisdiction of ultimate parent of MNE groups, which are often high income jurisdictions. Still, lower income jurisdictions could benefit from significant gains as a result of the reduction in MNE profit shifting expected to result from Pillar Two. The subject to tax rule, which has not been modelled in this analysis due to data limitations, could also support revenues in low and middle income jurisdictions by allowing the source jurisdiction to apply a top-up tax to an agreed minimum rate to certain related-party payments that are subject to low nominal rates of tax in the residence jurisdiction.

Furthermore, Pillar Two would put a floor on the competition to attract MNE activities through special tax incentives (e.g. tax holidays), which could bring additional revenue gains to lower income jurisdictions. Indeed, these jurisdictions often have a weak bargaining

position vis-à-vis investing MNEs, which can lead them to offer very low tax rates to these MNEs. Pillar Two could enable these jurisdictions to impose at least the minimum rate. The potential resulting gains are not included in the estimates in Figure 2.

Results for investment hubs⁸ are omitted from Figure 2 as they generally involve a higher degree of uncertainty than other results and because investment hubs are a relatively heterogeneous group of jurisdictions. These results are presented in Chapter 2 (for Pillar One) and Chapter 3 (for Pillar Two) of the Economic Impact Assessment. In general, investment hubs would tend to lose tax base from Pillar One. The magnitude of the resulting tax revenue loss would depend on the effective tax rate on the residual profit of MNEs that is currently located in their jurisdiction. As this rate is sometimes zero, some investment hubs would lose tax base but not tax revenue. Pillar Two, by reducing MNE profit shifting, would lead many investment hubs to lose tax base (as they would tend to receive less shifted profit after the introduction of Pillar Two).

8. In the Economic Impact Assessment, investment hubs are defined as jurisdictions with a total inward FDI position above 150% of GDP. Many of them have relatively low statutory and/or effective tax rates on corporate profit. The jurisdiction groups considered in the report (i.e. high, middle and low income jurisdictions) exclude investment hubs.



Still, 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. This question is further discussed in Chapter 3 of the Economic Impact Assessment, which also presents the potential implications of stylised scenarios on the effect of such tax rate increases on revenue gains across jurisdiction groups.

Revenue effects of Pillar One and Pillar Two at the jurisdiction level

Jurisdiction-level revenue estimates of Pillar One and Pillar Two were shared by the OECD Secretariat on a confidential and bilateral basis with most Inclusive Framework members. The OECD Secretariat has provided estimates to more than 115 jurisdictions at their request. After extensive consultation with members of the Inclusive Framework, there was no consensus over whether or not jurisdiction-specific estimates should be publicly released as part of the Economic Impact Assessment. In view of this lack of consensus, no jurisdiction-specific estimates are included in the Economic Impact Assessment. As jurisdiction-specific estimates have only been shared with Inclusive Framework members on a confidential and bilateral basis, each jurisdiction has received estimates for its jurisdiction only.

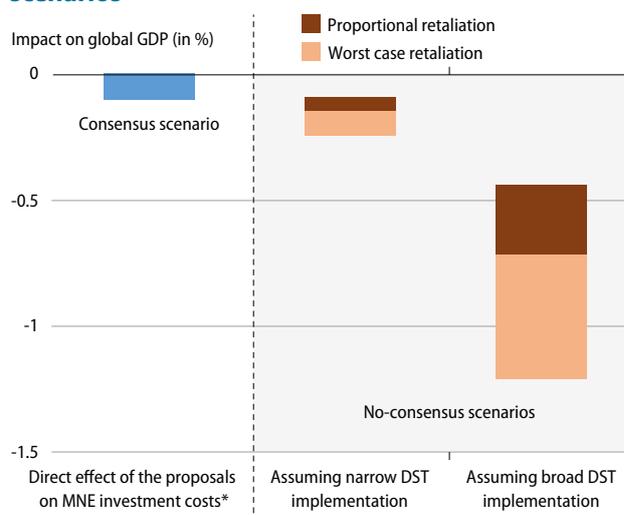
Jurisdiction-specific results were shared in the form of revenue estimation ‘tools’. These tools provide jurisdictions with the ability to consider the estimated impact on tax revenues in their jurisdiction of a range of potential Pillar One and Pillar Two parameters (e.g. profitability threshold percentage under Pillar One, minimum tax rate under Pillar Two, etc.) in order to inform the discussions of the Inclusive Framework. Preliminary versions of the Pillar One and Pillar Two tools were shared respectively in October 2019 and February 2020. Refined and updated tools were later shared in June and July 2020, taking into account progress in the design of the proposals, refinements in the underlying data and methodology and feedback from Inclusive Framework jurisdiction officials on the earlier tools and results.

EFFECT OF THE PROPOSALS ON INVESTMENT AND ECONOMIC ACTIVITY

The proposals would affect MNE investment, innovation and economic activity through a range of channels. The most direct channel is that, by raising additional tax revenues, the proposals would increase (after-tax) investment costs for the MNEs affected. This would likely have a negative effect on investment and activity, but the magnitude of this effect is estimated to be relatively small: less than 0.1% of GDP in the medium to long term (further details are included in Chapter 4 of the Economic Impact Assessment).

This small negative effect may be partly or even fully offset by the positive effect from other less quantifiable but nonetheless significant channels. In particular, the proposals aim to increase tax certainty, would affect compliance and administration costs in various ways,

Figure 3. Estimated effect on global GDP in stylised scenarios



* The proposals would also have positive impacts on GDP through indirect channels (e.g. increased tax certainty, reduced need to increase other distortive taxes) which are not quantified in this figure.

Note: The estimate in the consensus scenario only takes into account the direct effect of the proposals on MNE after-tax investment costs and its implications on MNE investment and ultimately GDP. The range reflects uncertainty on the tax sensitivity of the affected MNEs as well as uncertainty about whether lower investment in a jurisdiction where after-tax investment costs are increased would result in higher investment in other jurisdictions (where some of the investment may be relocated) or not. In the no-consensus situation, two cases are considered: (i) a narrow digital services tax (DST) implementation, where jurisdictions currently subject to Section 301 investigation by the United States introduce a DST, the United States retaliates with tariffs and these jurisdictions counter-retaliate also with tariffs; and (ii) a broad DST implementation, where all jurisdictions except the United States, China and Hong Kong (China) introduce a DST and reactions similar to the previous case ensue. In each case, the uncertainty ranges correspond to the range of outcomes between scenarios with 3% to 5% DST rates and 1-time (i.e. “proportional”) to 5-time (i.e. “worst case”) trade retaliation factors. See Chapter 4 of the Economic Impact Assessment for more details.

Source: OECD Secretariat calculations.

may enhance the efficiency of global capital allocation, and would reduce the need to raise revenues by implementing other (potentially more distortive) tax measures, as further discussed below.

For the purposes of this analysis, the consensus scenario involving the adoption of Pillar One and Pillar Two by the Inclusive Framework assumes the withdrawal of existing digital services taxes (DSTs) as well as a commitment to refrain from introducing such measures in the future. In contrast, the absence of a consensus-based solution would likely see the proliferation of uncoordinated and unilateral tax measures (including DSTs) continue, which would likely result in an increase in damaging tax and trade disputes. This would undermine tax certainty and investment, with negative effects on global GDP that could far exceed the direct effect of the reform on investment costs, especially in a scenario involving widespread adoption of DSTs and a “worst-case” (i.e. five-time) trade retaliation factor (Figure 3).

Direct effect of the proposals on investment costs

By raising additional tax revenues on the profit of certain MNEs, the proposals would likely increase the effective tax rate on their investment, and therefore after-tax investment costs. Under illustrative assumptions on the

parameters of Pillar One and Pillar Two, it is estimated that the effective *average* tax rate (EATR, i.e. the average tax rate on the profit derived from a new investment project) on a typical investment project by an MNE would be increased by around 0.3 percentage points on average. The effective *marginal* tax rate (EMTR, i.e. the tax rate on the profit derived from a *marginal* increase in the scale of an existing investment project) would be increased by around 1.3 percentage points on *average* (see Chapter 4 of the Economic Impact Assessment and Hanappi and González Cabral (2020)). These estimated increases are relatively small compared to the current average level of EATRs and EMTRs on MNE investments (about 24% and 25%, respectively). The increases would primarily come from Pillar Two, consistent with the finding that Pillar Two would have larger effects on tax revenues than Pillar One.

This small increase in investment costs would likely have a relatively small effect on global business investment. This is because the firms most affected by the additional investment costs would be relatively large and highly profitable MNEs. These firms are estimated to be less sensitive to corporate taxes in their investment decisions than less profitable firms, as discussed further in Chapter 4 of the Economic Impact Assessment and Millot et al. (2020). For example, firms belonging to MNE



groups 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%. This lower sensitivity may reflect that more profitable firms face fewer financing constraints, and also that they are more likely to benefit from economic ‘rents’ (e.g. related to market power).⁹ Taxes on rents are generally thought to affect firm investment less than taxes on ‘normal’ profits.

As a result, the negative impact on economic activity of this increase in investment costs is estimated to be very modest: less than 0.1% of GDP over the medium to long term. This impact could be even less negative to the extent that some MNE groups that reduce investment in jurisdictions where investment costs have increased may reallocate this investment to other jurisdictions.

Indeed, the proposals would encourage some relocation of investment, as investment costs would increase relatively more in jurisdictions that currently offer low

effective tax rates (e.g. below the potential minimum rate under Pillar Two). This could affect investment in these jurisdictions significantly, with potential knock-on effects on the CIT tax base and other tax bases (e.g. personal income tax), although this negative effect on investment could be reduced if Pillar Two includes a formulaic substance-based carve-out that excludes a fixed return for substantive activities from the scope of the GloBE rules. In contrast, jurisdictions with tax rates above the minimum rate would face no significant investment loss and may even benefit from higher investment.

All in all, by reducing differences in effective tax rates across jurisdictions, the proposals would tend to increase the relative importance of non-tax factors, such as infrastructure, education levels or labour costs, in the investment location decisions of MNEs. This would generally contribute to a more efficient global allocation of investment, in the sense that investment would be more likely to be located where it is the most economically productive, rather than in the jurisdictions that provide the most favourable corporate tax treatment.

9. The lower sensitivity may also relate to tax planning behaviour, which is expected to be reduced by the proposals.



Other effects of the proposals on investment and economic activity

Beyond their direct effect on investment costs, the proposals would affect economies through several other channels. One important channel is that, by increasing tax revenues, the proposals would reduce, at least to some extent, the need for governments to rely on other (potentially more distortive) tax measures or cuts in government spending to restore public finances after the COVID-19 crisis. As such, the proposals would also support domestic resource mobilisation in developing economies.

The proposals would increase global tax revenues through their direct effect (discussed in the revenue section above) and they could further support tax revenues in the longer term by reducing the intensity of corporate tax competition between jurisdictions. This is because the introduction of a minimum tax rate would limit possibilities for governments to use very low statutory corporate tax rates or very generous preferential regimes to attract MNE activity and profit. Indeed, the introduction of a minimum tax rate would lift the floor on the effective corporate tax rate paid by MNEs to an agreed minimum level. The full implications of this on governments' future tax rate and base setting behaviour are hard to anticipate with certainty and will depend on future circumstances. Nevertheless, in the context of the post-COVID-crisis constrained budgetary environment, this could have the effect of slowing or even halting some of the aggressive tax competition that has taken place over the past decades.

A potential downside of curtailing the ability of governments to offer very low tax rates is that it may, to some extent, reduce their ability to use tax incentives to pursue specific policy objectives, such as promoting innovative activities or economic development (e.g. via investment tax incentives or tax incentives for R&D). Under the Pillar One and Pillar Two design and parameters illustratively considered in the Economic Impact Assessment, governments would retain a relatively wide margin to use the corporate tax system to pursue these goals, especially if Pillar Two includes a formulaic substance-based carve-out, as such a carve-out would make it easier to offer low rates to activities involving economic substance. In addition, as discussed further in Chapter 4 of the Economic Impact Assessment, the efficiency of these preferential schemes is not always well-established. Finally, governments would continue to have a range of other policy tools

at their disposal to support their policy objectives, meaning that they could likely adapt their mix of policy instruments if necessary without significantly undermining their ability to pursue these objectives. As a result, it seems unlikely that the reform would have detrimental effects on innovation or economic development via this channel.

Another important question is the potential impact of the proposals on compliance costs for MNEs and administration costs for governments. This impact is difficult to assess comprehensively at this stage, as it will depend on the exact design of the proposals and, in particular, on the extent to which the Inclusive Framework adopts simplification measures in the architecture of the proposals.

The new tax provisions under both pillars will increase tax filing requirements, which will have a cost for MNEs and governments (e.g. in terms of time spent and need to adapt existing procedures and IT systems). However, this cost will be moderated by the fact that smaller and less profitable MNEs would be out of the scope of the proposals, and the extent to which efficient design options, such as a centralised and simplified administration system, are to be included in the final design of the proposals. In addition, certain provisions of Pillar One (Amount B and the Tax certainty component) would reduce compliance and administrative costs by simplifying the tax treatment of certain business functions, and preventing tax disputes. It is also important to emphasise that, if a consensus-based solution cannot be secured, compliance costs for businesses would likely increase, as a proliferation of unilateral tax measures would likely give rise to a more fragmented and less consistent international tax system, as well as more frequent tax and trade disputes.

The economic impact of the proposals will also depend on who bears the economic 'incidence' of the additional taxes. In theory, the cost of additional taxes can ultimately fall on MNE shareholders (in the form of lower dividends), workers (in the form of lower wages) or consumers (in the form of higher prices). In practice, the incidence may be split between these three categories in proportions depending on the specific situation of each firm, as further discussed in Chapter 4 of the Economic Impact Assessment.

Finally, the proposals may also affect competition dynamics among firms. By increasing taxes on large, profitable and profit-shifting 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. This could contribute to mitigating current trends towards greater market concentration, especially in digital markets, that risk undermining consumer welfare, investment and innovation. Indeed, preliminary evidence suggests that profit shifting MNEs use tax savings to crowd out other firms.

Impacts on the global economy in case no consensus is reached

The expected effects of the proposals must be compared to the implications of a counterfactual scenario where a multilateral consensus-based solution cannot be secured. The exact nature of this counterfactual scenario is uncertain, but it seems likely that it would not look like the status quo. Indeed, recent years have seen a proliferation of tax and trade disputes, as a number of jurisdictions have taken unilateral action to address the tax challenges arising from the digitalisation of the economy (e.g. by introducing DSTs or similar measures). In particular, this has led to the United States announcing retaliatory tariffs on about USD 1.3 billion of French goods under section 301 of the US Trade Act and to launch several additional section 301 investigations in June 2020.

Tax and trade disputes are likely to intensify further if a multilateral consensus-based solution is not agreed. Indeed, in addition to those jurisdictions that have already announced DSTs, a number of jurisdictions considering DSTs have announced that they will refrain from introducing them if a multilateral, consensus-based solution can be secured. If no agreement is reached, they would likely proceed with introducing DSTs and an escalation of DST-related trade tensions would follow. Several recent surveys confirm that tax uncertainty is a key concern of MNEs and that the perception of uncertainty has been increasing in recent years. A consensus-based solution, which for the purposes of the Economic Impact Assessment assumes the withdrawal of existing DSTs as well as a commitment to refrain from introducing such measures in the future, is expected to provide greater tax certainty than the counterfactual scenario where no multilateral agreement can be secured.

A proliferation of DSTs would generate economic inefficiencies. As DSTs are not designed as taxes on corporate profits, but are typically designed more like

taxes on turnover, DSTs are more likely to give rise to instances of double taxation. In addition, contrary to profit-based taxes, DSTs would also affect loss-making firms, which could be damaging in the context of a significant economic downturn like the current COVID-19 crisis.

These inefficiencies, combined with growing tax uncertainty and the likelihood of further tax and trade disputes, would undermine investment and economic activity. The magnitude of these adverse effects would notably depend on the number of jurisdictions introducing DSTs, the design and rate of these DSTs, and the scale of the tariff retaliation and potential subsequent tariff counter-retaliation by jurisdictions targeted by tariffs. Under stylised scenarios with ‘narrow’ DST implementation (i.e. only focusing on jurisdictions currently under section 301 investigation by the United States), it is estimated that the negative effect on global GDP could reach -0.1% to -0.2%. In scenarios with broader DST implementation, the negative effect on global GDP could reach -0.4% to -1.2%. The upper end of these ranges corresponds to scenarios with proportional trade retaliation, while their lower end corresponds to worst-case scenarios with trade retaliation factors going up to five times beyond proportional. In most of these scenarios, the negative effect on GDP would be significantly larger than the direct effect of Pillar One and Pillar Two on investment costs (see Figure 3).

CONCLUSION AND MAIN PROSPECTS IN THE CONTEXT OF THE COVID-19 CRISIS

Overall, the analysis suggests that a consensus-based multilateral solution involving Pillar One and Pillar Two would bring significant tax revenue gains to most jurisdictions. In addition, it would lead to a more favourable environment for investment and growth than would likely be the case in the absence of an agreement by members of the Inclusive Framework, while its effects on compliance and administrative costs would depend on the exact design of Pillar One and Pillar Two.

More broadly, the analysis suggests that a multilateral consensus-based solution involving Pillar One and Pillar Two could provide a series of key benefits to the international tax system. It would adapt the international corporate tax system to the digital age by ensuring that the allocation of taxing rights on business profits is no longer exclusively determined by reference to physical presence. It would support a more level

playing field between highly digitalised and intangible intensive MNEs and other firms, and also enhance the efficiency of global capital allocation. The proposals would likely increase tax certainty, particularly when compared to the unilateral tax measures and escalating tax and trade disputes that would likely result in the absence of a consensus-based solution. The proposals would reduce profit shifting and place a floor on tax competition, which would support the ongoing revenue needs of governments, particularly as they seek to rebuild their economies after the COVID-19 crisis. Finally, the proposals would support the long-term sustainability of the system as the importance of digitalisation and intangibles are likely to intensify further in the coming decades.

The full implications of the COVID-19 crisis remain uncertain at this stage. The assessment in the Economic Impact Assessment is based on pre-crisis data. Its key messages are likely to remain valid in the post-crisis environment, with nuances discussed in Box 2 below. Looking ahead, the COVID-19 crisis will likely make it even more pressing to address the tax challenges arising from the digitalisation of the economy, for three main reasons:

1. The crisis is accelerating the digitalisation of the economy, making the tax challenges from digitalisation even more acute.
2. The crisis will lead to a sharp deterioration of public finances in most countries, which will raise questions about how to support tax revenues once the post-crisis recovery is firmly on track.
3. As many firms are receiving government support during the crisis and many members of society will be asked to make additional contributions and sacrifices to the collective efforts in the context of the crisis, there is likely to be even less tolerance of aggressive tax planning by MNEs than before the crisis.

All this suggests that, in the absence of a consensus-based solution, uncoordinated and unilateral tax measures would become even more likely than in the pre-crisis environment. In turn, the negative effects of the ensuing tax and trade disputes would undermine investment and activity at a moment when the global economy is at its most fragile due to the crisis, which could compound the negative effects of the crisis and hinder the recovery prospects.

Box 2: Implications of the COVID-19 crisis for the impact of the proposals

The COVID-19 crisis will affect firms, economies and governments in ways that could modify the expected impact of the proposals, primarily in the short term, but also in the longer term. The full impact of the COVID-19 crisis remains highly uncertain at this stage, but a few likely implications already stand out.

In the short term, the economic crisis is having a strong negative effect on the profitability of most MNEs, reflecting declining consumer demand as well as difficulties with production (e.g. locked-down workers, restrictions on travel, supply chain disruptions). There are some exceptions, including highly-digitalised MNEs that are benefitting from the increasing reliance on digital technologies.

Overall, lower MNE profitability will reduce the amount of residual profit available for reallocation under Pillar One, as fewer MNEs will have profitability above the profitability threshold percentage. It would also reduce the global amount of low-taxed profit and the expected revenue gains under Pillar Two. These effects should largely dissipate over time, as economies and MNE profits recover from the crisis. The timing of the recovery in expected revenue gains from the Pillar One and Pillar Two proposals will depend on the shape and speed of the economic recovery. It will also depend on the design of potential loss carry-

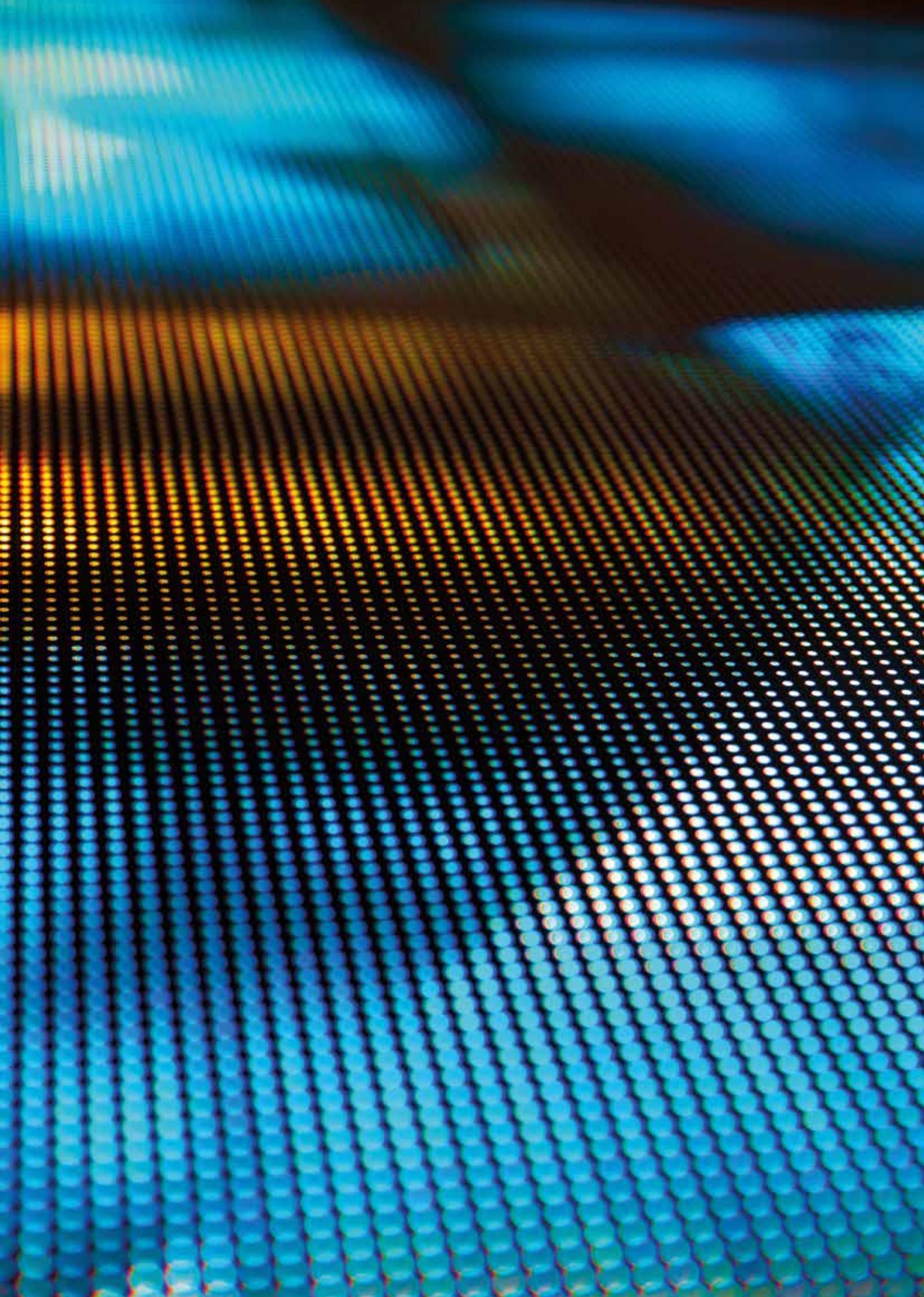
forward provisions under both pillars, as MNEs experiencing losses during the crisis could make use of these provisions to offset tax liabilities in the future.

The crisis is accelerating the trend towards the digitalisation of the economy. This will increase the relative importance of automated digital services (ADS) in the overall scope of Pillar One, as envisaged in the Economic Impact Assessment. In 2016, ADS represented about one-fifth of the residual profit of MNEs in the envisaged scope of Pillar One. This share was already on a fast-growing trajectory before the crisis. For example, the residual profit of the top 10 MNEs in ADS sectors was 30% higher in 2019 than 2016. In addition, given that MNEs with a heavy reliance on intangible assets and with highly-digitalised business models generally have more possibilities to shift profits to low-tax jurisdictions than other MNEs, accelerating digitalisation could also increase the revenue effects of Pillar Two.

Finally, the crisis may bring or accelerate other structural economic changes, including potential changes in the sectoral structure of economies, the organisation of global value chains and the competition dynamics among firms. The nature and magnitude of these changes is difficult to anticipate with certainty, but they could also have implications for the long-term impact of the proposals.

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