October 8, 2019 - Oxfam

OECD corporate tax proposals - NOTES IN EXPLANATION

On October 9th, the OECD will present a new stage of the BEPS 2.0 initiative, to address the challenges of taxing multinational corporations in the digital era. Previous attempts at tax reform have only tried to plug the holes in our international tax system and have met with limited success. As a result multinational corporations are still paying less tax than before the financial crisis in 2008 and multinational corporations continue to shift as much as 40 percent of their foreign profits to tax havens[i]. The expectations were very high on this new round of discussions led by the OECD to deliver the fundamental reform needed to ensure our century old tax system was fit for purpose in the increasingly digitalized economies of the 21st Century. The proposal announced today is however does not match that the ambition. But the game is not over, there is still a window of opportunity on how the minimum global tax is to be set. Developing countries cannot wait to take action.

What was expected?

On the table, two quite radical strands of work: where companies' profits should be taxed and an agreement on a minimum level of taxation. This was meant to make possible that all multinational corporations would pay a minimal amount of tax no matter where the profits are registered, end their practice of "profit shifting" to corporate tax havens, discourage tax holidays and endless tax competition, and pave the way for a fairer corporate tax system.

In practice, a great deal of effort has been made to little effect. The expected transformation of the system is not happening. The rules will still the remain the same for the vast majority of profits, and only a fraction of profits will be taxed under the new alternatives, that are becoming even more complex. The two levels of discussions seem to take separate roads. As the scope and revenue impacts of pillar 1 becomes smaller, the importance of pillar 2 as a complementary measure further increases.

What will be delivered so far?

Pillar 1 – Taxing rights. Where should corporate profits be taxed?

- The new proposal will only deliver a very limited increase in taxing rights for most countries.
- The reallocation of "new taxing rights" to market jurisdiction will largely benefit big markets which are mostly composed of developed and large emerging countries.
- If the initial ambition was to make the new system more "simple" and "efficient", that will again be kept aside. This new hybrid approach makes it extremely complex to define which profits are going to be taxed under the new mechanism. This can lead to increasing tax uncertainty and disputes. The new rules should focus on avoiding disputes and not impose inappropriate dispute settlement systems on developing countries.
- Only a very small fraction of the total profits of some multinationals will be covered by the new system It feels like the OECD stopped halfway through to compromise between countries willing to make the system fundamentally change and countries willing to stay as close as possible to the current system to protect their interests.
- Next to this, there will be some patches to the arm's length principle that could apply more broadly, to address the problem that the current system allows tiny profit margins for distributor companies. Introducing a system of fixed margins can help to alleviate tax administration problems of developing countries and generate additional revenues for them.
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Pillar 2 – Global Anti Base Erosion: Should all corporations be required to pay a minimum rate of tax?

While the developments on Pillar 1 looks disappointing, Pillar 2 still hold a promise. If ambitious and balanced, it could give the right signals to compensate developing countries. And here, the major decisions still need to be taken. If the OECD aims to leave legacy on how to recover fairness in the international tax system and avoid a cannibalism of tax competition between countries, here is where the window of opportunity is.

While the percentage to be agreed is not yet on the table, the way this minimum tax can be applied could make all the difference. A combination of two rules is being developed::

- A Tax on base Eroding Payments (TBEP) would allow countries to deny a deduction of payments or levy a withholding tax on payments to a foreign country where profits are effectively taxed below the minimum rate.
- An Income Inclusion Rule (IIR) would allow countries where multinational corporations are headquartered to top up the tax foreign profits that are effectively taxed abroad below the minimum rate.

Combined, both rules have the potential of releasing billion of dollars for developing countries, the TBEP by protecting their tax base, the IIR by incentivizing countries to limit the offer of unproductive tax incentives. An ambitious minimum effective tax rate applied in every country would remove the incentive for companies to move their profits to low or zero corporate tax countries – effectively putting tax havens out of business – and put an end to the damaging tax competition between countries.

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[i] https://gabriel-zucman.eu/files/TWZ2018.pdf