

OECD releases economic impact analysis of BEPS 2.0 project proposals

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Executive summary

On 12 October 2020, the Organisation for Economic Co-operation and Development (OECD) Secretariat released an economic impact assessment report (the [Report](#)) on the international tax changes being developed in the ongoing project on addressing the tax challenges arising from the digitalization of the economy (the BEPS 2.0 project). The report was produced by the OECD Secretariat and it does not represent the consensus views of the members of the Inclusive Framework on Base Erosion and Profit Shifting (BEPS).

The impact analysis was released on the same date as a series of other documents related to the BEPS 2.0 project, including detailed reports on the blueprints (the Blueprints) on Pillar One (relating to revised nexus and profit allocation rules) and Pillar Two (relating to new global minimum tax rules). The Cover Statement by the Inclusive Framework on BEPS that is included in the two Blueprints indicates that the member jurisdictions of the Inclusive Framework view the Blueprints as providing "a solid basis for future agreement" and have agreed to work on the remaining issues under both Pillars with a target of successful conclusion by mid-2021.¹ It is also recognized that there are important policy and technical issues yet to be resolved.

The Report describes the geographic scope of the impact analysis as covering more than 200 jurisdictions, including all 137 members of the Inclusive Framework. The Report provides an “ex ante” impact assessment based on several assumptions regarding design choices, with the notation that these assumptions are without prejudice to the final decisions of the Inclusive Framework. Overall, the Report suggests that a consensus-based multilateral solution involving Pillar One and Pillar Two would result in tax revenue gains to most jurisdictions, except for investment hubs. According to the Report, Pillar One and Pillar Two could increase global corporate income tax revenues by about US\$50-80 billion per year. Taking into account the combined effect of these reforms and the United States (US) Global Intangible Low-Taxed Income (GILTI) regime, the total effect could represent US\$60-100 billion per year or up to approximately 4% of global corporate income tax revenues. The Report further suggests that such a solution would lead to a more favorable environment for investment and growth than would likely be the case in the absence of a consensus agreement. Finally, the Report notes that the effects on compliance and administrative costs depend on the exact design of Pillar One and Pillar Two.

The Report contains important caveats that the data used for the assessment predates the full implementation of the final measures developed in the original BEPS project. These measures were released at the end of 2015 and subsequently translated into legislation and policy measures by participating jurisdictions. This process took time and is still ongoing. Moreover, the data also pre-dates the effects of the 2017 US tax reform.

On 20 October 2020, the OECD hosted a webinar with representatives of the OECD’s Centre for Tax Policy and Administration and Economics Department discussing the methodology and results of the impact assessment contained in the Report.

Detailed discussion

Background

In May 2019, the OECD released the “Programme of Work to Develop a Consensus Solution to the Tax Challenges Arising from the Digitalisation of the Economy” (the Workplan).² The Workplan is divided into two pillars:

- ▶ Pillar One addresses the allocation of taxing rights between jurisdictions and considers various proposals for new profit allocation and nexus rules.

- ▶ Pillar Two involves the development of a coordinated set of global minimum tax rules.

The Workplan also 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 would have information about the economic and tax revenue impact of key decisions relating to the proposals.

On 13 February 2020, the OECD hosted a webcast to discuss some of the preliminary results of its ongoing work on the economic analysis and impact assessment of the BEPS 2.0 project.³ During that webcast, the OECD Secretariat noted that the analysis would be updated as the work on the BEPS 2.0 project progressed and further decisions were made by the Inclusive Framework on the specific international tax changes to be included in the consensus-based solution.

The OECD held both an [on-line press conference](#) and a [webcast](#) on 12 October 2020 to update the press and stakeholders on the latest developments in the BEPS 2.0 project. During the webcast, the impact assessment work was discussed. The Secretariat representatives noted that Pillar One and Pillar Two tools have been shared bilaterally with 115 countries for their use in estimating the revenue impact of the proposals for their country.

Economic impact assessment report

On 12 October 2020, the OECD Secretariat released an ex-ante economic impact analysis of the BEPS 2.0 project. The Report indicates that the impact analysis covers more than 200 jurisdictions, including all 137 members of the Inclusive Framework. It is based on a wide array of data sources, which the Report describes as having been combined in a consistent analytical framework. The data includes firm-level data, including the financial accounts of many multinational enterprises (MNEs) worldwide, as well as a wide range of aggregate data sources, including the anonymized and aggregated Country-by-Country Report statistics collected as part of the implementation of the BEPS package and published by the OECD for the first time in July 2020.⁴

The Report focuses primarily on the impact of the proposals on tax revenues, MNE investment and economic activity. The Report does not include jurisdiction-specific estimates as there was no consensus among the member countries of the Inclusive Framework to release such estimates publicly as part of the economic impact assessment.

The Report is divided into five chapters:

- ▶ Chapter 1 summarizes the main findings of the analysis at a high level
- ▶ Chapter 2 focuses on the tax revenue effects of Pillar One
- ▶ Chapter 3 focuses on the tax revenue effects of Pillar Two
- ▶ Chapter 4 discusses the effect of both pillars on investment and economic activity
- ▶ Chapter 5 describes the construction of the data “matrices” underpinning the estimates presented in the other chapters

Caveats

The OECD Secretariat acknowledged that their impact analysis has several limitations. In particular, because design options are still being considered, the methodology used for the impact analysis relies on simplifying and illustrative assumptions. Moreover, the data on which the analysis is based pre-dates important recent developments, including most notably the 2017 US tax reform, implementation by countries of aspects of the original BEPS package and the COVID-19 crisis.

Effect of the proposals on tax revenues

According to the Report, Pillar One and Pillar Two could increase global corporate income tax revenues by about US\$50-80 billion per year. Taking into account the combined effect of these reforms and the US GILTI regime, the total effect could represent US\$60-100 billion per year or up to approximately 4% of global corporate income tax revenues.

With respect to Pillar One, the Report states that the proposal would involve a significant change to the way taxing rights are allocated among jurisdictions, with the potential for taxing rights on about US\$100 billion of profit to be reallocated to market jurisdictions under Amount A which would lead to a modest increase in global tax revenues. The amount of reallocation is calculated by starting with the amount of excess profits that could be covered by Amount A given the MNEs and activities in scope, which the OECD estimates to be US\$500 billion. The assumption is made that 20% of this amount would be subject to reallocation to the markets, resulting in the estimate of US\$100 billion of profits to be reallocated. As noted above, this calculation reflects assumptions regarding key design issues, including the level that will be set for excess profits and the percentage of such profits that will be subject to reallocation. It also does not yet take into account the fact that many businesses may have local operations such that profits are already being

allocated to the markets in which these businesses operate. The Blueprint on Pillar One recognizes to the potential for double counting in this situation and proposes a solution in the form of a marketing and distribution safe harbor. Resolving the double counting issue would have an impact on the calculations made in the impact assessment with regard to the profits that would be available for reallocation to the markets.

With respect to Pillar Two, the Report suggests that the global revenue gains from the proposal could be significant, representing the bulk of the potential gains from the BEPS 2.0 project. The Report notes that the impact of Pillar Two would fall on MNEs with low-taxed profits, including due to profit-shifting behavior. The Report further notes that Pillar Two would reduce the differences in effective tax rates across jurisdictions, which are one of the main drivers of profit shifting. As indicated with the caveats in the Report, it is important to recognize in particular for Pillar Two that the data used for the calculations predates the implementation of aspects of the BEPS measures to address tax avoidance and the impact of the 2017 US Tax Reform.

Moreover, the Report estimates that on average low, middle and high income jurisdictions would all benefit from revenue gains as a result of the proposals. Also, the combined revenue gains from both Pillars are estimated to be broadly similar across these jurisdiction groups; estimated revenue gains from Pillar One tend to be larger among low and middle income jurisdictions than high income jurisdictions, and revenue gains from Pillar Two tend to be relatively larger among high income jurisdictions. In contrast, the Report suggests that investment hub jurisdictions would tend to lose tax base from both Pillar One and Pillar Two. For the purposes of the Report, investment hubs are defined as jurisdictions with a total inward Foreign Direct Investment position above 150% of Gross Domestic Product.

Effect of the proposals on investment and economic growth

According to the Report, Pillar One and Pillar Two would lead to a relatively small increase in the average investment costs of MNEs. The Report indicates that the impact of the proposals is expected to fall predominantly on highly-profitable MNEs in digitalized and intangible-intensive sectors in the case of Pillar One and on MNEs with low-taxed profits, including due to profit shifting behavior, in the case of Pillar Two.

The Report also suggests that the proposals would affect economies beyond the direct effect on investment costs. One channel for such effects is that, by increasing tax revenues, the proposals would reduce the need for governments to rely on other tax measures or cuts in government spending to restore public finances after the COVID-19 crisis. The Report further indicates that a potential downside of curtailing the ability of governments to offer very low tax rates is that this may, to some extent, reduce governments' ability to use tax incentives to pursue specific policy objectives, such as promoting innovation or economic development.

In the scenario where a multilateral consensus-based solution is not achieved, the Report suggests that there could be a proliferation of unilateral measures, such as digital service taxes, that would generate economic inefficiencies. According to the Report, these inefficiencies, combined with growing tax uncertainty and the likelihood of further tax and trade disputes, would undermine investment and economic activity.

Implications of the COVID-19 crisis

Even though the full implications of the COVID-19 crisis are not yet known, the Report includes some views on the potential impact of the post-crisis environment on the proposals. In this regard, the Report notes that lower MNE profitability likely will reduce the amount of residual profit available for reallocation under Pillar One, as fewer MNEs will be above the profitability threshold percentage. The Report also suggests that the crisis could also reduce the global amount of low-taxed profits and thus the expected revenue gains under Pillar Two.

Moreover, the Report suggests that the COVID-19 crisis has increased the prominence of the tax challenges arising from the digitalization of the economy and the need to address

such challenges. The Report reflects the view 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 and would likely lead to tax and trade disputes that would undermine investment and economic growth, thus compounding the negative effect of the crisis and hindering the recovery prospects.

Implications

The complex issues underlying the Pillar One and Pillar Two work will be the subject of continuing policy and technical discussions among the Inclusive Framework jurisdictions at least until mid-2021. The ongoing project, with the participation of 137 jurisdictions, could lead to fundamental changes in the global international tax system under which multinational businesses operate and could have significant consequences in terms of both the overall tax liabilities of businesses and the tax revenues of countries.

The OECD Secretariat's impact analysis provides some indication of the information that is being provided to participating jurisdictions as they consider their posture in the negotiations and evaluate what the proposals under development would mean to them in economic terms.

Companies should follow further developments with respect to analysis of the potential economic impact of the proposals being developed. They also may want to consider engaging with the OECD and policymakers at both national and multilateral levels on the data used and assumptions made in the impact assessments, as well as the business implications of these proposals.

Endnotes

1. See EY Global Tax Alert, [OECD's Inclusive Framework releases BEPS 2.0 documents and agrees to continue work with target of conclusion by mid-2021](#), dated 13 October 2020.
2. See EY Global Tax Alert, [OECD workplan envisions global agreement on new rules for taxing multinational enterprises](#), dated 3 June 2019.
3. See EY Global Tax Alert, [OECD hosts webcast on preliminary impact assessment and economic analysis of BEPS 2.0 project proposals](#), dated 21 February 2020.
4. See EY Global Tax Alert, [OECD releases new corporate tax statistics including anonymized and aggregated Country-by-Country report statistics](#), dated 15 July 2020.

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