REGIONAL CONSULTATIONS ON INTERNATIONAL TAX MATTERS

NOVEMBER 2022

SESSION 3
ECONOMIC IMPACT ASSESSMENT

ECONOMIC IMPACT ASSESSMENT UPDATE FOR DEVELOPING COUNTRIES

PRELIMINARY AND CONFIDENTIAL

Background

- **October 2020**: OECD Economic Impact Assessment (EIA 2020)
  - Assessment based on the Blueprints
- **October 2021**: Updated figures released with the global agreement
  - Pillar One: taxing rights on more than **USD 125 bn** of profit reallocated to market jurisdictions
  - Pillar Two: global revenue gains of around **USD 150 bn**
- **Now**: Updated revenue estimates, based on the latest data and design parameters
  - Pillar One: Significant growth in reallocated taxing rights in 2021
  - Pillar Two: ongoing work, but potential additional gains relative to previous estimates
- **Caveats**: on data limitations, simplifying assumptions, design issues to be agreed

Update: Parameters modelled and data

Pillar One

- Based on the **Amount A Progress Report**
- Includes up-to-date parameters on scope, losses & averaging, revenue sourcing, nexus, elimination (including elimination de minimis)
- Various options on Marketing and Distribution Safe Harbour (MDSH) provided to jurisdictions (e.g. offset %, de minimis thresholds)
- No accounting for withholding taxes
- Estimates for **2017-2018**, plus **projections for 2019-2021**

Pillar Two

- Based on **Pillar Two Model Rules**
- Includes Income Inclusion Rule (IIR), Undertaxed Payments Rule (UTPR) with latest allocation key, Substance-based Income Exclusions (SBIE) with latest parameters
- No accounting for the Subject-to-tax Rule (STTR)
- Qualified Domestic Minimum Top-up Taxes (QDMTT) is work in progress
- Estimates for **2017-2018**, but due to data limitations, no projections

Key Messages – Pillar One

- Overall, Pillar One revenue estimates are higher in the revised estimates relative to EIA 2020
- Most developing countries are likely to see their revenue gains increase due to increases in in-scope residual profit and key design changes
- Some investment hubs may lose more than in the EIA 2020 due to revised elimination approach
- Ongoing work to model latest developments on the Marketing and Distribution Safe Harbour
- Withholding Taxes cannot be modelled due to data limitations

Key Messages – Pillar Two

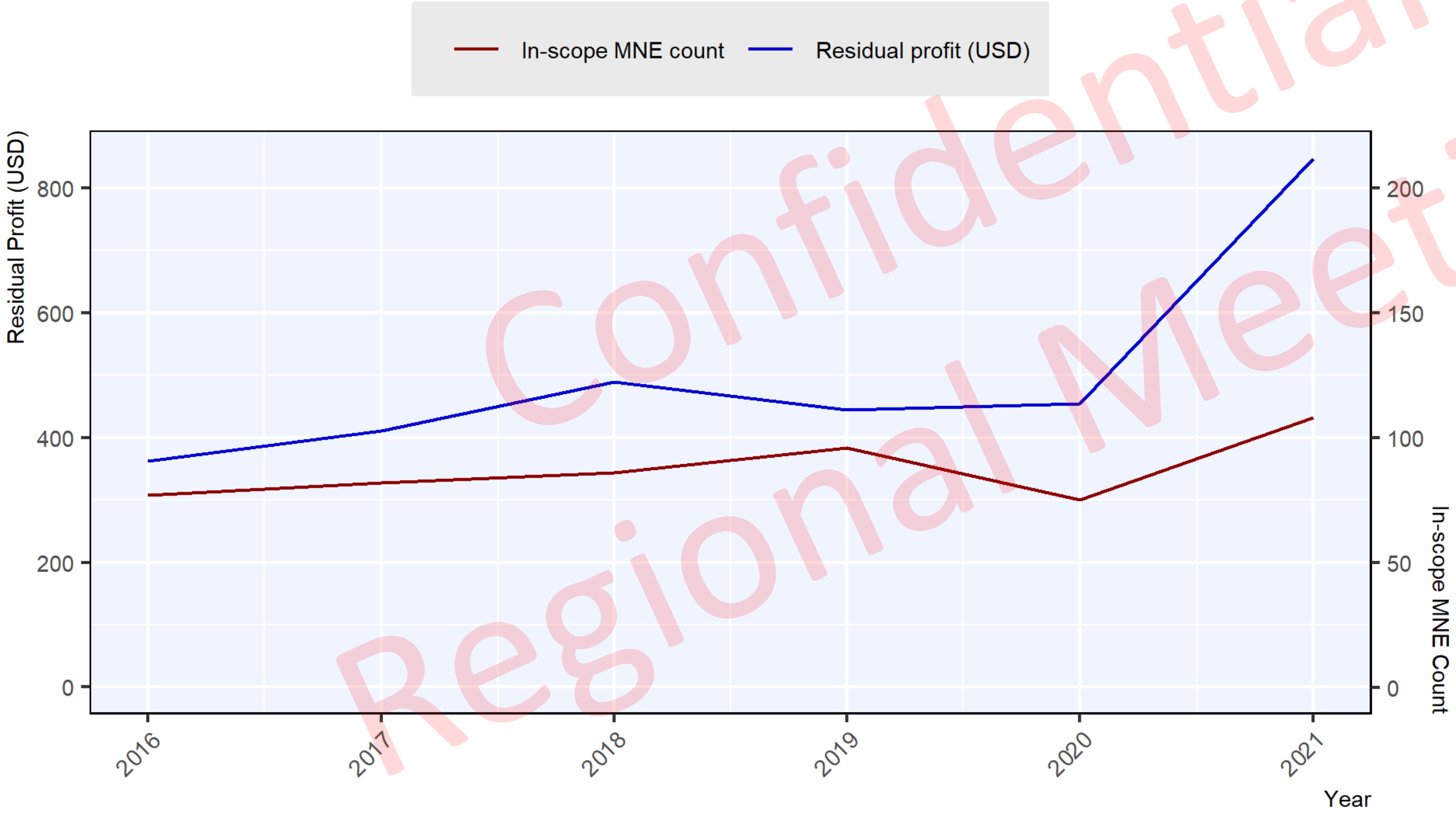
- The overall revenue estimates for Pillar Two are higher in the revised estimates than in the 2020 EIA baseline
- This is expected to be due to higher estimated low-taxed profits, the shift to a 15% minimum tax rate from the 12.5% used in the EIA 2020 baseline, and consistent implementation of the GloBE rules is assumed for all jurisdictions
- Revenue gains accrue to low, middle and high income jurisdictions and many investment hubs
- QDMTTs are a potential source of significant revenue gains for developing countries

Design features and developing countries

- Certain key design features have a significant positive impact on smaller and developing countries, including:
- Pillar One
  - Special nexus thresholds
  - De minimis rules on the Elimination of Double Taxation (EoDT) (and potentially MDSH)
  - Tail-end revenue provisions in revenue sourcing rules for consumer-facing businesses
- Pillar Two
  - Use of allocation key for UTPR
  - QDMTT (modelling work still ongoing)
- Ongoing work to assess the impact of these specific features

Pillar One Evolution of in-scope MNE count and residual profit:

For years 2016-2021



- Residual profit to be reallocated increases significantly in 2021
- This has resulted in increased revenue estimates
- Preliminary checks of 2022 Q1 financials of the largest in-scope MNEs, suggest the rapid growth in residual profit observed in 2021 has continued in 2022

Note: These estimates take into account the new scope as well as the most-up-to-date losses and averaging rules.

P1: Revised scope methodology

- Approach in 2020 EIA was to build jurisdiction-by-jurisdiction matrices for profit, assets, sales, and payroll to understand location of MNE activity
- For revised Pillar 1 scope, the approach is to build MNE by MNE matrices to allow for estimation of revised approach to EoDT, MDSH, etc.
- This exercise very challenging due to limited data
- Secretariat has validated preliminary matrices with selected jurisdictions

Source No 1: Annual Reports and 10-Ks provide US / non-US splits (mainly for turnover)

Source No. 3 Some columns can be filled with MNEs CbCR provided confidentially

Columns without in-scope MNEs will be zero

Source No 2: ORBIS unconsolidated financial account data – can be used to benchmark firm-level cells

Source No 4: industry - weighted aggregate profit matrix

Jurisdiction of ultimate parent entity (UPE)

Jurisdiction of affiliate

	US		China	Croatia	... (>200 jurisd.)
	US Group #1	US Group #2	China Group #1	Croatia Group #1	
US	Profit of Group #1 in the US	Profit of Group #2 in the US	.	0	.
France	Profit of Group #1 in France	.	.	0	.
Nigeria	Profit of Group #1 in Nigeria	.	.	0	.
Bahamas	.	.	.	0	.
... (>200 jurisd.)	.	.	.	.	.

Pillar Two Overview: Dynamic Model

Scenario 1 = Static scenario (no behavioural reaction)

Scenario 2 = Scenario 1 + Interaction with Pillar One **(Not modelled for this iteration)**

Scenario 3 = Scenario 2 + MNEs reduce their profit shifting intensity

Scenario 4 = Scenario 3 + Some low-tax jurisdictions increase their ETR

Note: Other behavioural reactions to Pillar Two are also possible, but they are not modelled. These non-modelled reactions include for example changes in MNE 'real' investment location (with potential implications for CIT revenues but also for revenues from other tax bases) as well as policy changes in jurisdictions with an average ETR above the minimum rate. These potential reactions are discussed in Chapter 4 of the EIA 2020.

Pillar Two: Ongoing modelling

- Currently only **low-tax profit in low-tax jurisdictions** is modelled
- There is growing evidence that a high share of **low-tax profit is in high-tax jurisdictions**
  - Tax incentives may be may be a key factor
- **Additional modelling to assess location of low-taxed profit and the impact of QDMTTs required**
  - Important to improve the accuracy of jurisdiction-specific results
  - Significant data limitations

Next steps

- Pillar One
  - Ongoing work on Pillar One MDSH
  - Potential revised Pillar One results
  - Please contact us if you have not received or would like to discuss the results for your jurisdiction
- Pillar Two
  - Ongoing work to account for QDMTTs and pockets of low-taxed profit in high-tax jurisdictions
  - Preliminary high-level results to be shared with jurisdictions in February 2023
    - Global and jurisdiction groups
    - Jurisdiction-specific results to be shared on a confidential and bilateral basis
- Potential public communication of high-level Pillar One and Pillar Two results in 2023
  - Any public communication will be based on jurisdiction-group data only.
  - No jurisdiction-specific results will be released publicly

TAX INCENTIVES AND THE GLOBAL MINIMUM TAX

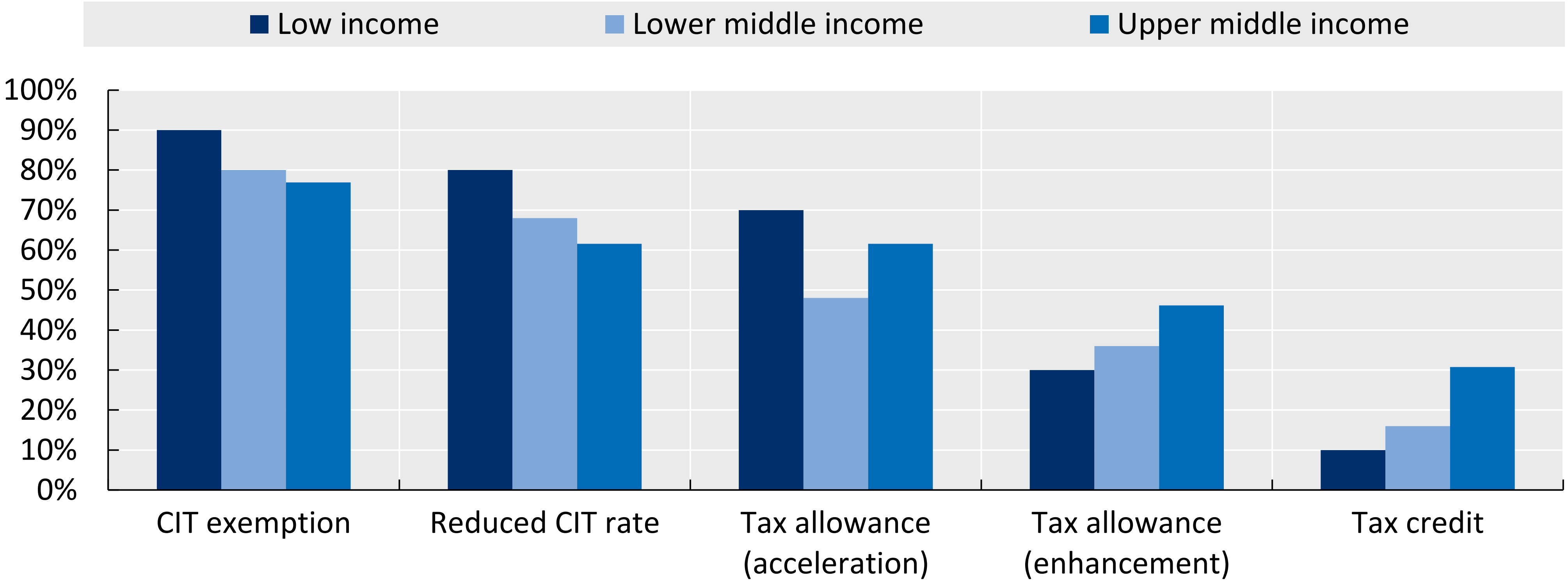
OECD Report on Pillar Two and Tax Incentives

- Pillar Two will be a **‘game-changer’ for** tax incentives
- **The GloBE rules affect jurisdictions, MNEs and tax incentives differently**
- They create a **need to review tax incentives**
- **This report explores the impacts on tax incentives and potential responses**

Tax incentives are used very widely among developing and emerging economies

Tax exemptions, reduced rates and accelerated depreciation are the most commonly used instruments among developing economies

(% of countries using tax incentives by instrument type)



Source: OECD Investment Tax Incentives database, July 20 version, based on information for 48 countries (9 low income, 26 lower middle income and 13 upper middle-income countries) and 387 entries of CIT incentives available on 1 January 2021.

Key factors determining the impact of GloBE

Jurisdiction Level	Entity Level	Incentive Level
- **Baseline CIT systems** - **Other international provisions** (e.g. CFC rules)	- Whether entities are **part of an in-scope group** - The nature of **the entities' activities**: substance and income mix in the jurisdiction	- **Eligibility conditions** - **Scope** of the incentives (narrowly or broadly targeted) - **Tax instrument design** interacts with GloBE Rules

Interactions are complex as they are jurisdiction-, MNE- and incentive-specific:

There is no "one-size-fits-all" conclusion

Key GloBE provisions for tax incentives

PERMANENT DIFFERENCES	Book and tax differences that **do not revert in subsequent financial years (FY)**	Affected
TEMPORARY DIFFERENCES	Book and tax differences that do **revert in subsequent FY**	
	▪ Within the **5 subsequent FY**	Not affected
	▪ Beyond the **5 subsequent FY**	Affected
	➢ **Some exceptions allowed, e.g.** ▪ Cost recovery allowances for tangible assets ▪ R&D expenses ▪ Gains from the sale of tangible assets if reinvested	Not Affected
REFUNDABLE PROVISIONS	**Qualified refundable tax credits (QRTCs)** (within 5 years) are to be treated as GloBE income	Less affected

Impact of GloBE will differ by incentive design

Likely affected	Less likely affected	Likely not affected
• **Full exemptions** (e.g. tax holidays) • Reduced tax rates or partial exemptions • Tax allowances • Tax credits	• Accelerated depreciation for short-lived intangibles • Immediate expensing • Qualified Refundable Tax Credits	• Accelerated depreciation for tangible assets

- **Other design factors matter for the impact of the GloBE Rules**
- **Expenditure-based tax incentives** will be more likely to benefit from the substance-based income exclusion (SBIE)

Options for policymakers (1/3)

Time to revisit and reconsider incentives

- **The benefits of using certain tax incentives may change due to the GloBE Rules**
  - No ‘one-size-fits-all’ conclusion
- **Pillar Two should provide impetus for tax reform**
  - Failing to act could mean that countries forego vital tax revenues that will be collected by other countries anyway and could leave them with tax incentives that are ineffective
- **Options will vary by jurisdiction**
  - Reform should be based on jurisdiction-specific analysis, identifying and assessing the tax incentives most likely to be impacted by the GloBE Rules
  - Adopting a “whole-of-government” approach will be important

Options for policymakers (2/3)

Tax design matters

- **Narrowly-targeted incentives** (to certain categories of income or expenditure) may be less affected, as may incentives with ceilings or caps
- **Income-based incentives** may be more strongly affected than expenditure-based incentives, particularly for very profitable investments
- **Expenditure-based tax incentives** targeted to payroll or tangible assets may be less affected due to the SBIE
- **Incentives based on timing differences** are less likely to be affected, e.g. expensing or accelerated depreciation (for certain assets) or **extended loss carry-over**
- **Qualified refundable tax credits** may be less affected. However, jurisdictions should consider the revenue consequences of refundable tax incentives

Options for policymakers (3/3)

Other short-term actions

- **Care should be exercised** in implementing new incentives or when considering entering into new investment agreements or contracts
- **Qualified Domestic Minimum Top-Up Tax (QDMTT)** will be an important option for many countries, but it will unlikely be a substitute for a thorough country-specific re-evaluation of tax incentives
- **Pillar Two Revenues** can support DRM and improve investment climate
  - Revenues will support domestic resource mobilisation (DRM)
  - Additional revenues could be invested in ways that support a more attractive investment environment (e.g. investments in skills development and infrastructure)

Next steps

- The Secretariat is undertaking bilateral engagement with countries to assess the impact of Pillar Two on tax incentives
- A series of pilot programmes have been launched with the assistance of the Global Relations Division, with initial engagement already in place
- Technical assistance on Pillar Two implementation, including with QDMTT drafting, is being carried out by the Pillar Two team
- Continuous engagement with the Platform for Collaboration on Tax

ANNEX

Key instrument types and interaction with GloBE

Nature of relief	Type of instrument		Interaction with the computation of GloBE ETR (Firms in-scope)		
			Tax benefits affected by the GloBE computation	Numerator	Denominator
Income-based incentives		Full exemption	More likely	↓	
		Partial exemption	More likely	↓	
		Reduced rates	More likely	↓	
Expenditure-based incentives	Tax deductions*	Tax allowances	More likely	↓	
		Immediate expensing	Less likely	Adjusted for timing differences**	
		Accelerated depreciation	Less likely	Adjusted for timing differences***	
	Tax credits	Qualifying refundable	Less likely		↑
		Other tax credits	More likely	↓	

Note: * Tax deductions include any tax provisions that reduce taxable income; while tax credit reduce the firms' tax liability. Tax incentives may apply to current or capital expenses; and when referring to capital they can target the acquisition cost or depreciation expense. ** Of tangible assets or R&D expenses; *** of tangible assets

THANK YOU

For more information:

- Contact us by e-mail: ctp.contact@oecd.org
- Visit our public website: www.oecd.org/tax
- Sign-up to our tax news alerts: http://oe.cd/taxnews-signup