EUTAX Observatory

The Long Road to Pillar One Implementation:

Impact of Global Minimum Thresholds for Key Countries on the Effective Implementation of the Reform

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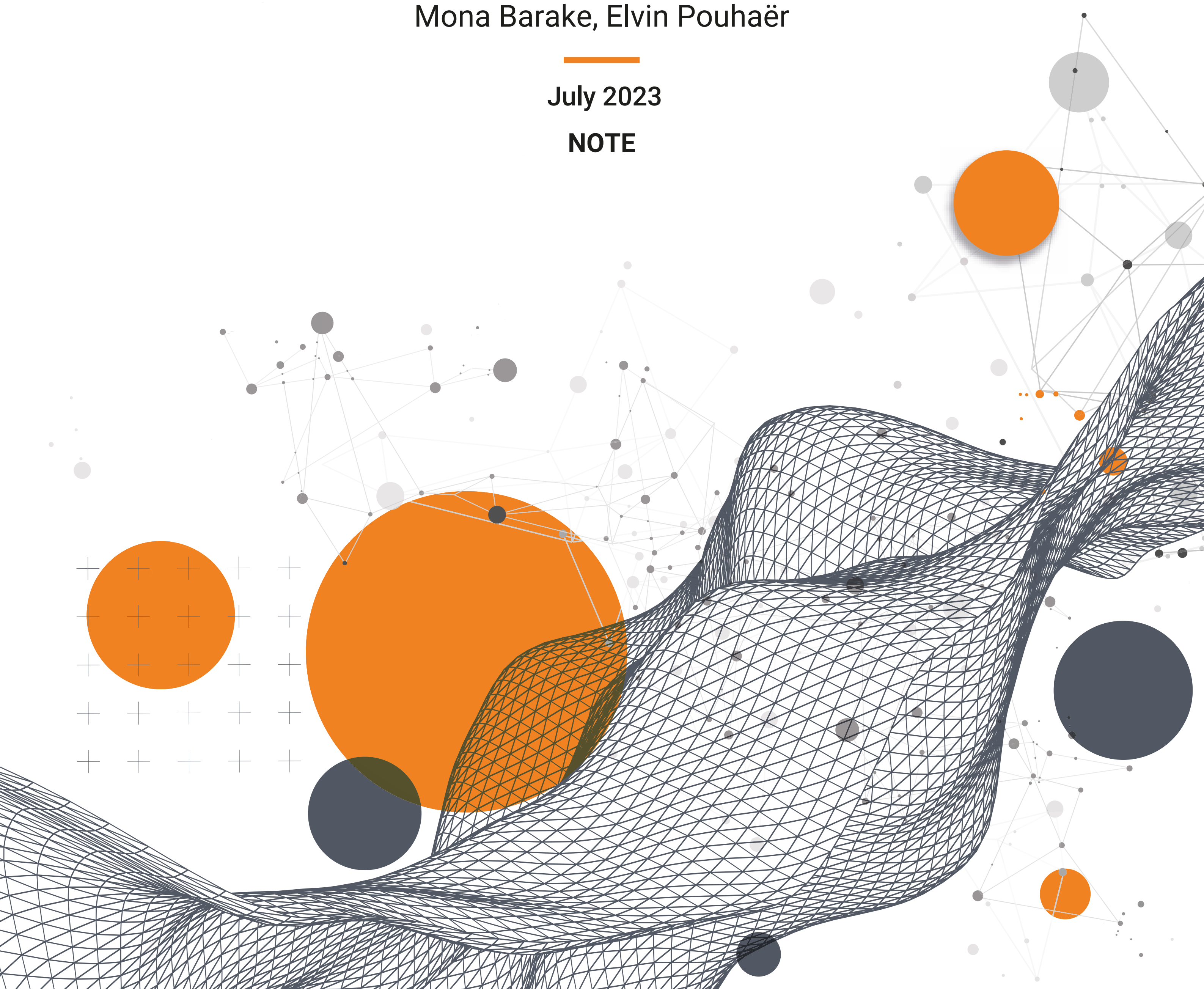
NOTE



Summary

This note examines the impact of the recent introduction of minimum thresholds for the global implementation of the OECD/G20 Pillar One reform for key countries in the context of the negotiations. For more than four years, jurisdictions of the Inclusive Framework have been negotiating an agreement on the OECD/G20 Pillar One reform aiming at redistributing taxing rights to market countries. The OECD now aims at finalizing the deal by the end of 2023.[1]

One of the objectives of the reform is to prevent the proliferation of different Digital Service Taxes (DSTs). In July 2023, 138 jurisdictions agreed to refrain from introducing new DSTs for the next 12 months. Five countries opposed it, including Canada which reportedly plans to go ahead with a new DST.[2]

The state of play outlines the tensions and tradeoffs for some countries between DST and Pillar One revenues. Countries that agree to Pillar One will have to abandon any form of digital taxation. Previous analysis by researchers of the EU Tax Observatory has shown that the centerpiece mechanism of the reform – called Amount A – is expected to redistribute 91.2bn€ of profits made by 68 companies worldwide to destination market countries, generating an additional 15.2bn€ in global tax revenues.[3] Official estimates by the OECD have similar orders of magnitude. Research by the EU Tax Observatory showed countries currently implementing a DST can expect broadly similar (even somewhat higher) revenues from Amount A. But the effective implementation of Pillar One will largely depends on which countries ratify the reform.

The outcome statement shows that the 138 jurisdictions of the Inclusive framework agreed on minimum thresholds of implementation for the reform to apply globally ("global minimum thresholds"). This is to make sure that the amount of taxing rights distributed is large enough as only the companies that are headquartered in a jurisdiction that signs the multilateral agreement can be covered by the tax.[4]

The global minimum thresholds now set that at least 30 jurisdictions combining at least 60% of the companies covered by the reform would be necessary for the reform to enter into force globally. **Building on previous work, we show that the global minimum thresholds require the ratification of the USA for the reform to go ahead globally.**

This is of particular relevance as US Congress has so far shown opposition to incorporating the OECD-led reform into domestic law.[5] US companies represent 46% of the companies covered in Pillar One and 58% of redistributed profits. Without the USA, the number of covered groups would decrease to 37 and the Amount A profits available for redistribution to 38bn€.

[1] The outcome statement is available here: https://www.oecd.org/tax/beps/outcome-statement-on-the-two-pillar-solution-to-address-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-july-2023.pdf

[2] https://www.ft.com/content/244429fb-fe2c-41e5-afcc-882ea9a399d4?shareType=nongift

[3] In the central scenario presented in Barake and Le Pouhaër (2023), the Amount A profits of all Covered Groups in the world are redistributed across IF members. If one wants to study Pillar One Amount A revenues in the case where only IF members sign the agreement, a Taiwanese firm has to be excluded from the sample of Covered Groups (Taiwan not being part of the inclusive framework). Hence the slight decrease in total Amount A profits redistributed from 94.4 bn in the paper to 91.1 bn in this policy note.

[4] See Digital Service Taxes by Balladares, Barake, Baselgia, and Borders (2023): https://www.taxobservatory.eu/publication/digital-service-taxes/

[5] https://www.politico.eu/article/oecd-chief-manal-corwin-republican-lawmaker-collision-course-global-tax-deal/

The views expressed in this note are those of the authors and do not necessarily refect the views of the European Commission.

Gross tax revenues derived from Amount A would respectively decrease by 40.6% for developed countries, 52.3% for developing countries[6] and 28% for the least developed countries.

No other countries could block the global implementation of the reform on their own: Chinese companies represent 17% of the covered groups and 19% of the redistributed profits. The rest of Asia (Japan South Korea and Hong-Kong) accounts for 9% of the covered groups and 8% of redistributed profits. The EU accounts for 15% of the covered groups and 7% of redistributed profits.

The ratification of the Pillar One reform by the USA is of particular interest for the European Union as the EU Commission has proposed that Pillar One revenues become part of the next generation of EU's own resources. The absence of Pillar One could represent a shortfall ranging from 7.5 to 15% of the total revenues needed to fund the EU recovery package. In November 2022, the EU Parliament adopted a resolution stressing that "in the event of clear lack of progress by end of 2023, the Commission should submit a legislative proposal for a digital levy or a similar measure".[7]

EU institutions will therefore have to carefully weigh between expecting the USA to pass the reform – for which the current Congress is opposed – or resorting to alternatives.

[6] We exclude China from developing countries for Scenario comparison. In the case of the US not implementing Pillar One, China would see its Amount A revenue decrease by 23,5%.

[7] https://www.europarl.europa.eu/doceo/document/TA-9-2022-0404_EN.html

1 Introduction

Globalization and the increasing digitalization of the economy have enabled large multinationals to disconnect the place where they have their real economic activity from the place where they register their profits and pay their taxes. In 2019, on average, 37% of multinationals' foreign profits were shifted to tax havens, generating significant tax revenue losses, according to research by Wier and Zucman (2022).[8]

In January 2019, more than 130 jurisdictions agreed to discuss the tax challenges arising from the digitalization of the economy as part of the OECD inclusive framework two-pillar solution to fix gaps of the international corporate tax system. The reform was divided into two streams of work.[9] A first stream – dubbed Pillar One - aimed at redistributing the residual profits of highly profitable companies to market countries to mitigate artificial profit shifting. A second stream – dubbed Pillar Two – aimed at establishing a minimum effective tax rate for large multinationals to mitigate the race to the bottom in corporate income tax. In October 2021, 130 jurisdictions agreed to a minimum effective tax rate of 15% for multinational companies.[10]

More than four years after the beginning of the negotiations on the two-pillar solution, countries of the inclusive framework are still unable to agree on the details of the OECD/G20 Pillar One reform. In July 2023, 138 jurisdictions agreed on global minimum thresholds of implementation for the reform of at least 30 jurisdictions combining at least 60% of the companies covered by the reform. This is to ensure that the amount of taxing rights distributed is large enough, since only the companies that are headquartered in signatory countries can be covered by the agreement.

The ambition of the reform is therefore largely reliant on which countries sign the multilateral agreement. Building on previous work, this note assesses the consequences of the non-implementation of the reform by key countries on the global minimum thresholds. Specifically, we estimate the expected revenues for the rest of the countries that sign on.

The first section of this note goes through the rationale and the design of Pillar One. The second section discusses the number of covered groups per country and the expected revenue in the context of the minimum global thresholds. The third section focuses on the impact on the EU, specifically, on EU's own resources, for which Pillar One is a part of.

[8] https://www.taxobservatory.eu/publication/global-profit-shifting-1975-2019/

[9] https://www.oecd.org/tax/beps/policy-note-beps-inclusive-framework-addressing-tax-challenges-digitalisation.pdf?_ga=2.40994724.746055818.1687529601-335112111.1686667568

[10] https://www.oecd.org/tax/beps/statement-on-a-two-pillar-solution-to-address-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-october-2021.html

2 Pillar One: Rationale and Design

2.1. The Rationale for a Pillar One Reform

The way corporations are structured and do business has radically changed over the past century. The globalization of the economy has created increasingly complex multinational companies with activities dispersed across the globe. The digitalization of the economy exacerbated the trend with highly mobile intangible assets representing an increasing share of companies' assets. Digitalization allowed companies to access market and customers without a physical (and hence taxable) presence. It enabled companies to increasingly disconnect the places where they register their profits (and hence pay their taxes) from the place where they have a real economic activity. Today, close to 40% of multinational corporations' foreign profits are shifted to tax havens (Wier and Zucman, 2022).

The rise of digital companies operating in a country without a physical presence pushed a number of countries to tax them directly on the revenue they derived from their activity. In 2020, 6 digital service taxes were in effect, 3 were in discussion, 3 were paused.[11] Many of these DSTs had different scope and thresholds meaning extra compliance cost for the covered companies.

TABLE 1

Main Characteristics of Implemented DSTs

Country	Scope	Global Threshold	National Threshold	Tax Rate	Year
OECD					
United Kingdom	Full	€560 million	€30 million	2%	2020
France	Full	€750 million	€25 million	3%	2020
Italy	Full	€750 million	€5.5 million	3%	2020
Spain	Full	€750 million	€3 million	3%	2021
Turkey	Full	€750 million	€2.5 million	7.5%	2020
Austria	Advertising	€750 million	€25 million	5%	2020
Portugal	Advertising	None	None	4%	2021
Non-OECD					
Kenya	Full	None	None	1.50%	2021
Tanzania	Full	None	None	2%	2022
Nepal	Full	None	€15 000	2%	2022
Kyrgyzstan	Full	None	None	2%	2022
India	Full	None	€220 000	2%	2020
India	Advertising	None	€1 350	6%	2016

The rise of DSTs fueled trade tensions between the US – where a large share of digital companies originates – and countries resorting to this tax as US companies faced additional taxes and higher compliance costs. The DST tensions indirectly paved the way to international negotiations on taxing corporations in a digitalized economy.

Finding a coordinated way to fairly tax digital companies in countries where profits are being generated was at the heart of the discussions. From the initial discussions among countries

[11] Countries with DSTs in 2020: the UK, France, Italy, Turkey, Austria and India. Countries discussing a DST in 2020: New Zealand, Norway and Slovenia. Countries with a paused DST in 2020: Belgium, Tunisia and Brazil.

willing to target digital companies (UK, France), countries willing not to target a specific sector (USA) and countries willing to push for a deeper reform of the corporate tax system (G24 countries) emerged a “unified approach” that paved the way for the centerpiece of the Pillar one reform: “Amount A”.[12]

2.2 The Design of Pillar One

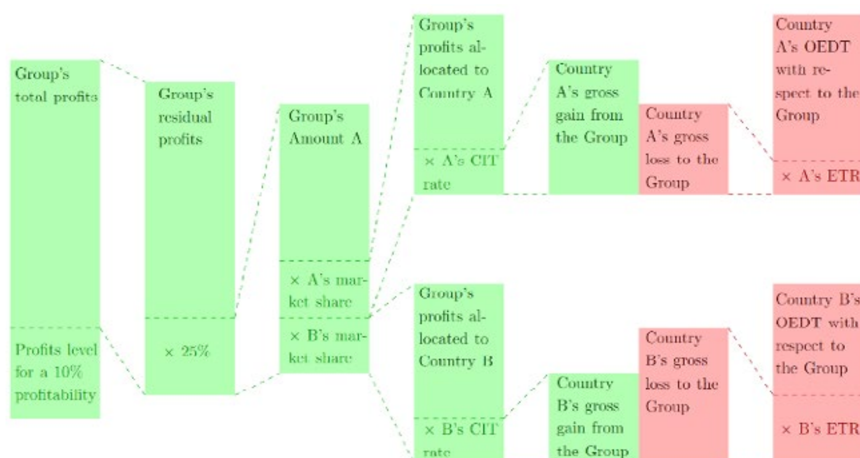
Detailed specific rules for the Amount A – Pillar One (“the reform”) proposal were introduced in July 2022 by the OECD. They create new taxing rights on the largest and most profitable multinationals (including but not limited to digital companies). These taxing rights are allocated across jurisdictions based on the market shares of these multinationals to circumvent the issue of companies operating in countries without physical presence.

Companies covered are multinational companies with both a global turnover above €20bn and a profitability (defined as global profit before tax divided by global revenue) above 10% in year t in order. In other words, only the largest and most profitable companies are targeted. In addition, they need to either have been covered in t-1 or t-2 or have had a profitability above 10% both in at least two periods in the past 4 years and on average over the last five years. Revenues from extractive and financial activities are excluded. If a company does not meet the thresholds but one of its segment activities does on a standalone basis, then the segment is subject to the rule.

Of all the profits above the 10% profitability threshold, 25% constitute the new tax base to be redistributed across jurisdictions following MNEs’ market shares. Only the jurisdictions where a group derives at least 1 million euros in revenues (250 000€ for developing countries) are eligible to redistribution under Pillar One Amount A. To eliminate double taxation on the redistributed profits, Obligations to Eliminate Double Taxation (OEDTs) are also allocated across jurisdictions where Covered Groups have high profits and returns on substance through a “waterfall procedure”.[13]

FIGURE 1

Functionong of Pillar One Amount A for Countries A and B Respectively Net Winner and Net Loser with Respect to Given Covered Group



[12] https://www.oecd.org/tax/beps/public-consultation-document-secretariat-proposal-unified-approach-pillar-one.pdf

[13] For the sake of simplicity, Figure 1 does not feature the details of the waterfall procedure. For more details, see Title 5 of the OECD Progress Report (2022) and Appendix I in Barake and Le Pouhaër (2023).

Access to these new taxing rights comes with strings attached. Jurisdiction currently having DSTs need to roll them out. They also need to curtail their right to unilaterally tax large corporations[14] and accept arbitration courts.[15]

Importantly, only the companies that are headquartered in a country that signed the multilateral agreement can be covered. This is why the lasted OECD outcome statement features global minimum thresholds of at least 30 jurisdictions representing at least 60% of the covered groups.[16] Therefore, to fully assess the revenue potential of this reform, it is necessary to focus on who ratifies and effectively implement the reform and its impact on the global minimum thresholds.

[14] https://www.oecd.org/tax/beps/public-consultation-document-draft-mlc-provisions-on-dsts-and-other-relevant-similar-measures.pdf

[15] https://www.oecd.org/tax/beps/public-consultation-document-pillar-one-amount-a-tax-certainty-issues.pdf

[16] https://www.oecd.org/tax/beps/outcome-statement-on-the-two-pillar-solution-to-address-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-july-2023.pdf

3 Revenue Assessment of Pillar One

3.1 Pillar One vs DSTs

Unlike the minimum effective tax for multinational companies, the primary aim of the Pillar One reform is not to generate additional resources but to redistribute taxing rights. However, by redistributing taxing rights from low-tax countries to high-tax countries, Pillar One does generate additional tax revenues for some countries.

In March 2023, a first country-by-country revenue assessment of Pillar One was carried out by the EU Tax Observatory's researchers Mona Baraké and Elvin Le Pouhaër. These researchers estimate that a full implementation of Pillar One would redistribute 91.2bn€ of profits made by 68 companies worldwide to market countries, generating an additional 15.6bn€ in tax revenues.[17] The amount of revenue generated by the reform is significantly lower than the other stream ("Pillar Two"), which the OECD estimates would generate about $220 billion in additional tax revenue globally.[18]

Under Pillar One, countries currently implementing digital service taxes will have to roll them out. According to a recent study of the EU Tax Observatory, most countries currently enacting a DST can expect broadly similar (even somewhat higher) revenues from implementing Pillar One.

TABLE 2

Estimates of Net Gains from Pillar One and Collected DST Revenues for Selected European Countries (m€)

Country	Pillar 1 - 2020	DST - Closest to 2020	Year for DST
Austria	117	43	2020
France	571	375	2020
Italy	285	233	2021
Spain	261	166	2021
United Kingdom	574	416	2021

This comparison is limited for a number of reasons. First, the tax revenues yielded by the DSTs do not consider potential retaliation such as trade tariffs. Second, the tax revenues expected from Pillar One or generated by DSTs do not consider their respective administrative implementation costs. Last and most importantly, the estimated Pillar One revenues do not consider the scenario where the reform is not implemented, in the absence of a critical mass of countries implementing it.

[17] In the central scenario presented in Barake and Le Pouhaër (2023), the Amount A profits of all Covered Groups in the world are redistributed accross IF members. If one wants to study Pillar One Amount A revenues in the case where only IF members sign the agreement, a Taiwanese firm has to be excluded from the sample of Covered Groups (Taiwan not being part of the inclusive framework). Hence the slight decrease in total Amount A profits redistributed from 94.4 bn in the paper to 91.1 bn in this policy note. https://www.taxobservatory.eu/wp-content/uploads/2023/03/wp_202312_.pdf

[18] https://www.oecd.org/tax/beps/economic-impact-assessment-presentation-january-2023.pdf

3.2. Pillar One: Assessment of Key Countries Contribution to Global Minimum Thresholds

On July 12, 138 jurisdictions agreed to global minimum thresholds for the implementation of the OECD/G20 Pillar One reform. Building on previous work, we outline the contribution of key countries to the global minimum threshold.

We show that the absence of ratification by the USA could block the global implementation of the reform altogether. US companies represent 46% of the companies covered in Pillar One and 58% of redistributed profits. Without the USA, the number of covered groups would decrease to 37 and the Amount A profits available for redistribution to 38bn€.

No other countries could block the global implementation of the reform on their own: Chinese companies represent 17% of the covered groups and 19% of the redistributed profits. The rest of Asia (Japan South Korea and Hong-Kong) accounts for 9% of the covered groups and 8% of redistributed profits. The EU accounts for 15% of the covered groups and 7% of redistributed profits.

TABLE 3

Country by Country Breakdown of Covered Groups and Their Amount A profits under Pillar One Reform

Headquarter jurisdictions	Covered groups	% of Covered groups	Amount A profits	% Amount A profits
United States	31	45,6%	52 853	57,9%
China	13	19,1%	15 800	17,3%
France	5	7,4%	3 818	4,2%
Switzerland	4	5,9%	5 442	6,0%
Japan	3	4,4%	2 419	2,7%
United Kingdom	3	4,4%	3 354	3,7%
Germany	3	4,4%	1 629	1,8%
South Korea	2	2,9%	2 942	3,2%
Hong Kong	1	1,5%	2 017	2,2%
Ireland	1	1,5%	490	0,5%
Spain	1	1,5%	418	0,5%
Canada	1	1,5%	45	0,05%
Total	68	100%	91 227	100%

Barake and Le Pouhaër (2023)

Questions over the implementation of the reform by the USA are therefore central to reach the global minimum thresholds. The reform will have to go through parliamentary approval and the ratification of the US Congress which has so far shown opposition to the prospect of passing the OECD-led reform.[19]

Global minimum thresholds are designed make sure that the amount of taxing rights distributed is large enough. Comparing a Scenario where all the countries from the Inclusive framework ratify and implement the reform (Scenario 1) to a Scenario without the USA (Scenario 2) gross tax revenues derived from Amount A would decrease respectively by 40.6% for developed countries, 23,5% for China, 52.3% for developing countries and 28% for the least developed countries.

[19] https://www.politico.eu/article/oecd-chief-manal-corwin-republican-lawmaker-collision-course-global-tax-deal/

Revenue sensitivity due to major countries not implementing Pillar One might end up being a key issue for other countries looking at trade-offs between Pillar One and DSTs. Whilst some countries like France or Austria, are better off with Pillar One regardless of the implementing scenario. On the other hand, for countries like Italy, Spain, the implementation of the reform by the US matters in terms of revenue gain.

TABLE 4

Comparing DST and Net Gain of the Pillar One Reform Under Partial Implementation Scenarios for Selected European Countries (in m€)

Countries	DST	P1 S1	P1 S2
Austria	43	115	103
France	375	571	427
Italy	240	285	198
Spain	166	261	158
UK	358	574	370

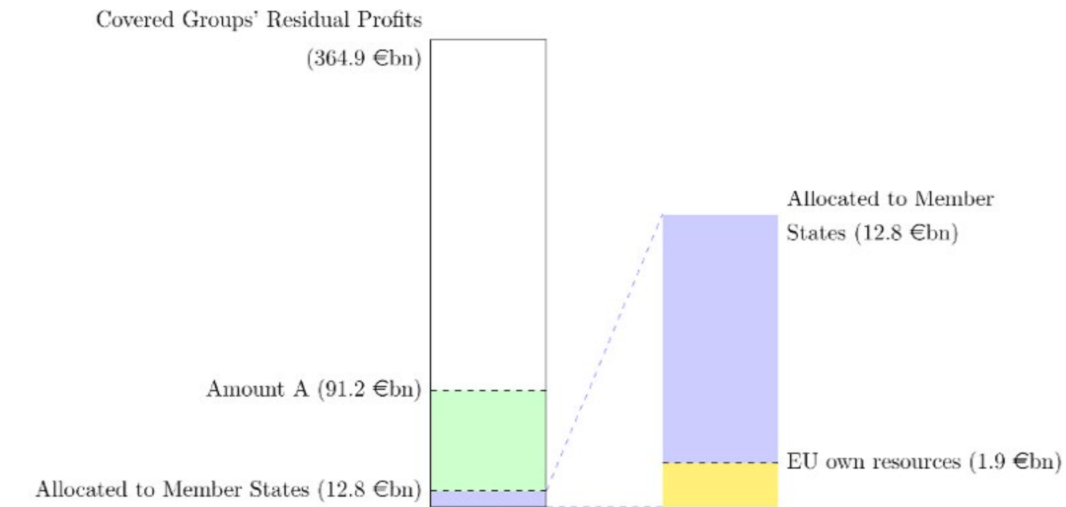
4 The Case of Europe: Pillar One and the EU's Own Resources

The effective implementation of Pillar One is of particular interest to the European Union. In 2020, Member states agreed to an unprecedented EU effort to fight the coronavirus crisis by resorting to a recovery package of over €804bn. The centerpiece of the plan – called the Recovery and Resilience Facility (RRF) – amounts for €723,8bn split between loan (385,8bn€) and grants (338bn€). Grants and interests from the loans of the recovery package are to be paid for by the EU by 2058 by raising additional resources called "next generation own resources".

Among the resources of the first basket of own resources was a "15% of the share of the residual profits of the largest and most profitable multinational enterprises that are reallocated to EU Member States under the [Pillar One] agreement".[20] Under such proposal, the EU would capture 15% of Amount A profits allocated by the reform to EU Member States. Member States could claim the difference in revenue between the 15% EU tax and their own CIT rate.

FIGURE 2

EU Own Resources from Pillar One Amount A (Scenario 1)



Building on the work of Barake and Le Pouhaër (2023) we estimate that such a contribution could yield 1.9bn€ in 2020. This is somewhat lower than the yield expected by the Commission in the Own resource proposal which is 2.5bn€ to 4bn€ per year.[21] Assuming a constant annual yield for the 32 years of repayment between 2027 and 2058, the non-implementation of Pillar One could represent between 61bn€ and 128bn€ shortfall representing between 7.5 and 15% of the total revenues needed to fund the recovery package.

TABLE 5

Estimated Revenue Gap for EU Own Resources of Partial Pillar One Implementation

(in bn€)	Baraké & Le Pouhaër	Commission Lower Bound	Commission Upper Bound
Annual yield	1,92	2,5	4
Total Yield	61,44	80	128

[20] https://ec.europa.eu/commission/presscorner/detail/en/ip_21_7025

[21] Ibid.

In November 2022, the Parliament adopted a resolution[22] stressing that "the successful implementation of the OECD/G20 IF Pillar One agreement [...] by certain key third countries is not yet guaranteed." The resolution further stresses that "in the event of clear lack of progress by end of 2023, the Commission should submit a legislative proposal for a digital levy or a similar measure". In a new resolution[23] adopted in May 2023, the Parliament stated it was "concerned that the negotiations on the Pillar One reform are moving too slowly at global level".

A working document published in June 2023, the Commission reiterated that "the implementation of the OECD/G20 Pillar One agreement remains an essential priority in the rea of corporate taxation for the EU and its Member States."[24]

Conclusion

The global minimum thresholds just agreed by countries to effectively implement the Pillar One reform require the ratification by the USA. Without the USA, the number of covered groups would decrease to 37 and the Amount A profits available for redistribution to 38bn€.

The political uncertainty over the implementation of the reform in these two countries are therefore important factors to consider for other countries before implementing the reform, as it comes with strings attached (removal of existing DSTs, restrictions to unilaterally tax large corporations and subjection to arbitration courts).

This is of particular interest to the EU which has based part of the funding of its recovery plan on the Pillar One reform. The absence of the reform could result in a shortfall representing between 7.5% and 15% of the revenues needed to pay for the recovery package, resulting in the need for additional resources. EU institutions will therefore have to carefully weight between expecting the USA to pass the reform – for which the current Congress is opposed – or resorting to alternatives.

Data and Methodology

This policy note builds on the data and methodology used in Barake and Le Pouhaër (2023) looking at different scenarios of partial implementation of Pillar One. The central scenario in this note corresponds to the Scenario of implementation of by all members of the Inclusive Framework in Barake and Le Pouhaër (2023). The only distinction with the original paper is that a Taiwanese firm has to be excluded from the sample of Covered Groups (Taiwan not being part of the inclusive framework). Hence the slight decrease in total Amount A profits redistributed from 94.4 bn in the paper to 91.1 bn in this policy note.

Covered groups are identified combining data from Forbes and Orbis. The OECD AMNE database is used to proxy companies' market share in each jurisdiction. Tax reliefs are attributed using the OECD CBCR data.

For more detail, please refer to Barake and Le Pouhaër (2023).

[22] https://www.europarl.europa.eu/doceo/document/TA-9-2022-0404_EN.html

[23] https://www.europarl.europa.eu/doceo/document/TA-9-2023-0195_EN.html

[24] https://commission.europa.eu/system/files/2023-06/SWD_2023_331_1_EN_autre_document_travail_service_part1_v4.pdf