THE IMPACT OF RECENT OECD/G-20 RULES ON THE TAXATION OF MULTINATIONALS

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Abstract: *Digitalisation and globalisation have had a profound impact on economies, and these changes have brought with them challenges to the rules for taxing income from international business. The Organisation for Economic Co-operation and Development has stepped up its efforts to address these challenges in response to tax avoidance concerns by multinational companies. The global agreement is designed to stop large corporations from moving to low-tax jurisdictions and to establish a more equitable system of distributing tax rights to multinationals, depending on where they operate, rather than their headquarters. The tax will no longer be due only where the respective corporations have registered their headquarters and thus managed, through tax optimization practices, to pay lower taxes. A state will be able to tax profits made abroad by a company registered in that home country if it has been taxed abroad at a lower rate than the agreed minimum threshold, in order to offset the difference. Strong tax competition between countries and the significant cross-border transfer of profits by multinational companies have distorted and reduced tax revenues. The global taxation of multinational companies shows a change of attitude on the part of the strong states.*

Keywords: *taxation, multinational firms, tax havens, tax competition.*
JEL Classification*: F23, H25.*

1. Introduction

Following negotiations to bring international tax rules into the 21st century, members of the G20 / OECD Inclusive Framework have reached an agreement on a tax reform for multinationals to impose a minimum global profit tax of at least 15%. The OECD has recently stepped up its efforts to address these challenges in response to growing concerns about tax avoidance by multinational companies. The rules so far have allowed multinational companies to earn significant revenue in one jurisdiction without paying income tax there.

The rise of intangibles, such as trademarks, copyrights and patents, and the ability of companies to transfer profits to jurisdictions that impose little or no tax, have in the past led to multinational profits to often avoid taxation. There are a number of commercial jurisdictions that are involved in unfair tax competition, which offer low (or even zero) taxation to attract foreign direct investment. Thus, there has been a need to reform the international tax system of multinational companies to combat tax evasion and avoidance of the payment of tax obligations, as well as to respond to the challenges of taxing the digital economy.

In order to address the fiscal issue arising from the digitalization of the economy, a two-pillar solution has been agreed: Pillar One - aims to ensure a more equitable distribution of profits and tax rights between countries in relation to multinational companies; Pillar Two - sets a threshold for fiscal competition in corporate income tax by introducing a minimum global profit tax at a rate of 15% that countries can use to protect their tax bases (GloBE rules - Global Anti-Base Erosion). The OECD will provide personalized technical assistance to support all aspects of implementing the two-pillar solution.

2. Characteristics and stages in the implementation of the Two Pillar Agreement, agreed in order to tax multinationals

Pillar One provides for the annual redistribution of multinational profits (totaling approximately $ 125 billion in all international trade jurisdictions) to facilitate access to funds for developing countries. Therefore, the tax will no longer be due only where the respective corporations have registered their headquarters and thus managed, through tax optimization practices, to pay lower taxes. The goal is for multinational companies, especially those in the digital sector, which have benefited greatly from the pandemic, to stop paying ridiculous taxes on their revenue.

Pillar Two provides for the introduction of a 15% global corporate tax, which will be applied to multinational companies with revenues of over 750 million euros. A state will be able to tax the profits obtained abroad by a company registered in that country of origin, if it was taxed abroad at a lower rate than this minimum threshold, in order to compensate for the difference. Basically, the global agreement is designed to stop large corporations from moving to low-tax jurisdictions and to establish a more equitable system of distributing taxing rights to multinationals, depending on where they operate, rather than their headquarters.

Table no. 1: Key elements of the two pillar solution

Pillar One	Pillar Two
Taxing rights over 25% of the residual profit of the largest and most profitable MNEs would be re-allocated to the jurisdictions where the customers and users of those MNEs are located	GloBe rules provide a global minimum tax of 15% on all MNEs with annual revenue over 750 milion euros
Tax certainty through mandatory and binding dispute resolution, with an elective regime to accommodate certain low-capacity countries	Requirement for all jurisdiction that apply a nominal corporate income tax rate below 9% to interest, royalties and a defined set of other payments to implement the „Subject to Tax Rule” into their bilateral treaties with developing Inclusive Framework members when requested to, so that their tax treaties cannot be abused
Removal and standstill of Digital Services Taxes and other relevant, similar measures	Carve-out to accommodate tax incentives for substantial business activities
The establishment of a simplified and streamlined approach to the application of the arm’s length principle in specific circumstances, with a particular focus on the needs of low capacity countries	

Source: OECD

The two-pillar solution recognizes developing countries' demands for more predictable rules and generally provides a redistribution of tax rights to market jurisdictions based on where sales and users are located - often in developing countries. It also provides for a global minimum tax, which will help eliminate tax havens, reduce the transfer of profits from developing countries and reduce the pressure on governments of developing countries to provide unnecessary tax incentives. This solution avoids the risk of trade retaliatory sanctions, which could result from unilateral approaches such as Digital Services Taxes (DST). Regarding a possible option for some countries to tax these multinational companies on their own, as some have tried to do with DSTs, it can be stated that the two-pillar package provides for blocking and eliminating unilateral measures, such as DSTs or other relevant similar measures.

Table no.2 : Target Deadlines

Pillar One	Pillar Two
Early 2022 – Text of a Multilateral Convention (MLC) and Explanatory Statement to implement Amount A of Pillar One	November 2021 – Model rules to define scope and mechanics for the GloBe rules
Early 2022 - Model rules for domestic legislation necessary for the implementation of Pillar One	November 2021 – Model treaty provision to give effect to the subject to tax rule
Mid 2022 - High level signing ceremony for the Multilateral Convention	Mid 2022 – Multilateral Instrument(MLI) for implementation of the STTR in relevant bilateral treaties
End 2022 - Finalisation of work on Amount B for Pillar One	End 2022 – Implementation framework to facilitate co-ordinated implementation of the GloBe rules
2023 – Implementation of the Two Pillar Solution	

Source: OCDE

As for when multinational companies will start paying this new fee, the detailed implementation plan provides a clear and ambitious timetable to ensure effective implementation starting in 2023. For Pillar One, the model rules for national legislation will be developed by the beginning of 2022, and the new real estate profit tax ("Amount A") will be implemented through a multilateral convention, in order to allow the entry into force in 2023. Disputes concerning issues that may be related to "Amount A" will be compulsorily resolved, without delaying the mechanism for preventing and resolving substantive disputes. In the meantime, until the end of 2022, activities will be carried out regarding the implementation of the "Amount B". Fiscal compliance will be streamlined (including filing obligations) and will allow multinationals in the scope to manage the process through a single entity. For Pillar Two, it was previously agreed to provide the model treaty for the implementation of the rule of taxation and, at the same time, that the model rules on the minimum profit tax be developed by November 2021. A Multilateral Instrument will be launched by mid-2022 to facilitate the implementation of this rule in bilateral treaties.

The GloBE rules will work to impose an additional charge using an effective test of the tax rate that is calculated on a jurisdictional basis and uses a common definition of the taxes covered and a tax base determined by reference to the accounting financial income (with adjustments agreed in consistent with the fiscal policy objectives of Pillar Two). With respect to existing distribution tax systems, there will be no additional tax liability if earnings are distributed over 4 years and taxed at or above the minimum level. The GloBE rules will also provide for minimis exclusion for those jurisdictions where the multinational has revenues of less than € 10 million and profits of less than € 1 million.

3. Predictable effects in general, in the context of taxation of multinational companies

The global taxation of multinational companies shows a change of attitude on the part of the most important states. There are some experts who say that the taxation of multinationals will not have the desired impact if new rules on transfer pricing are not established, and it is necessary to adopt tax regulations in this regard. Also, some non-governmental groups analyzing the tax optimization strategies used by multinationals (eg

Oxfam) have criticized the OECD agreement for allowing rich countries to keep most of their additional tax revenue, and the world's poorest countries will recover less than 3%.

Table no. 3: Additional revenues stemming from tax havens, non-havens or the headquarter of a 15% minimum tax

	Data 2017			
	Tax deficit of 15% min. tax in billion 2021 EUR			
Parent country	**Domestic**	**Non-havens**	**Tax havens**	**Foreign agregate data**
Austria	2.4	-	-	0.7
Belgium	1.3	18.6	1.3	-
Bulgaria	-	-	-	-
Croatia	-	-	-	-
Cyprus	0.0	0.1	0.1	-
Czech Republic	0.0	0.0	0.0	-
Denmark	1.1	0.3	0.5	-
Estonia	0.1	0.0	0.0	-
Finland	1.0	-	-	0.5
France	0.0	0.1	3.8	-
Germany	7.2	2.2	3.7	-
Greece	0.1	-	-	2.0
Hungary	0.5	0.0	0.0	-
Ireland	2.8	-	-	9.5
Italy	1.0	1.5	0.6	-
Latvia	0.1	0.0	0.0	-
Lithuania	-	-	-	-
Luxembourg	1.8	2.8	1.2	-
Malta	0.1	0.0	0.0	-
Netherlands	2.3	-	-	0.0
Poland	3.6	0.0	0.0	-
Portugal	0.0	0.0	0.0	-
Romania	0.1	0.0	-	-
Slovakia	0.0	0.0	0.0	-
Slovenia	0.0	-	-	0.0
Spain	2.2	2.6	0.5	-
Sweden	0.1	-	-	2.5
EU total	**27.9**	**28.4**	**11.8**	**15.2**

Source: OECD (based on country-by-country data from fiscal year 2017)

Large countries will be able to adopt economic sanctions on states that will not adjust their tax rate to that set globally. Strong states may impose higher taxes on trade in tax havens (which will not align with the new global fiscal policy) or impose more severe economic sanctions. As long as the EU, the states of North America, China, India and Brazil agree to this global tax on multinational companies, the countries that today are tax havens are too small to oppose. At the same time, some experts in the field believe that, apart from global taxation, no other regulations would be needed, not even to eliminate the tax avoidance practices of large companies. In terms of tax avoidance, this was actually a tax optimization, with companies doing business where the tax system was friendlier to them. Given that governments have spent extremely much on the pandemic, they need money in the budget, and the new agreement puts a minimum global tax on the profits of multinational companies.

4. Conclusions

The recent international agreement could be a cornerstone for countries to adopt more ambitious tax rates. Developing countries have had a significant influence on the agreement. For example, on Pillar One, the agreement includes: a commitment to reduce the application threshold by 7 years (provided that the system operates as intended), which will result in a larger profit fund to be reallocated to the markets; the "nexus" threshold - the point at which developing countries would see a Pillar One allocation from a multinational in the field - is set at a low level (€ 1 million, reduced to € 250,000 for small countries) so as to maximize the number of countries that will benefit from revenue. Pillar One also includes the commitment to develop simplified, streamlined approaches, with a particular focus on the needs of low-capacity countries, when applying transfer pricing rules to certain arrangements that are often the subject of tax disputes. These elements contributed to a balanced agreement for all parties to the negotiations.

In Europe, the profit tax remains an important source of income. Cross-border tax competition and significant cross-border profit shifting by multinational companies have distorted and reduced tax revenues, despite an increasing share of corporate profits in GDP. Domestic companies are at a competitive disadvantage, and citizens perceive the existing corporate tax system as unfair.

The impact of the COVID pandemic on public finances has added to the urgency of CIT (corporate income tax) reform, and many governments are spending more than they anticipated before this crisis, while collecting fewer taxes. Many countries are accumulating public debt at rates reminiscent of major wars. In this context, there is a major concern for collecting an adequate and fair tax on corporate profits.

Corporate income tax revenue performance varies considerably across European countries, in part due to tax competition and profit shifting. The continuing downward trend in statutory CIT rates seems to indicate a decline in corporate taxation in Europe, with a significant cost of revenue. The proliferation of preferential tax regimes, especially for intellectual property income, has reduced effective tax rates considerably below legal ones. In order to move towards a more equitable taxation of economic activities and to expand the fiscal space needed to respond to the current crisis, it is more urgent than ever to reduce excessive tax competition and to effectively combat tax evasion. Given the transnational nature of these challenges, a successful response requires international cooperation, preferably globally.

The first and best solution to these challenges is the agreed global agreement on the limits of tax competition and taxation in the digital economy, together with the effective implementation of related measures. Regardless of the feasibility of this global agreement, it will be necessary to better coordinate corporate tax policies between OECD countries, both in terms of tax rate and tax base, in order to reduce competition and tax evasion.

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