Global digital tax deal: A multilateral solution to end corporate tax avoidance

Access the podcast at:
https://doi.org/10.1787/6373cc8a-en

Please cite this podcast as:

OECD (2021), “Global digital tax deal: A multilateral solution to end corporate tax avoidance”, *OECD Podcasts*, Duration: 21:08, OECD Publishing, Paris, https://doi.org/10.1787/6373cc8a-en.

Host: Lawrence Speer
Speaker: Pascal Saint-Amans
Duration: 21:08
Date: 15 July 2021

OECD

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Intro [00:00:02] Welcome to OECD Podcasts, where policy meets people.

Lawrence Speer [00:00:07] Death and taxes, cynics say those are supposedly the only two things that are certain in life. For the last two decades, though, many multinational companies defied this logic using loopholes in the century old international tax system, they were able to earn significant revenues in markets worldwide while paying little, if any, tax in many of those countries. Countries around the world soon began to realise that the tax rules were no longer fit for purpose.

Lawrence Speer [00:00:37] The great financial crisis, which pushed many countries finances to the breaking point, was the catalyst then the G20 grouping the 20 largest economies worldwide as the OECD to coordinate efforts to rewrite the rules so that multinational enterprises pay a fair share of tax wherever they operate. Nearly a decade later, one hundred and thirty two countries and jurisdictions have just reached agreement on a radical overhaul of the international tax system. I'm Lawrence Speer and I'm talking today with one of the principal architects of this reform, Pascal Saint-Amans, director of the OECD Centre for Tax Policy and Administration. Pascal. Thanks for being with us today. And first things first, congratulations on the tax deal announced in early July as a historic breakthrough.

Pascal Saint-Amans [00:01:31] Indeed, that's historic. That's a very big deal. All the G20 finance ministers did celebrate the big achievement. It's a once in a lifetime achievement where you have the change of the international tax framework.

Lawrence Speer [00:01:47] Let's start from the very beginning. Describe for us the problem with taxing multinationals, how the situation gets to the point that people worldwide were angry about companies not paying their fair share. And how specific is this problem to digital companies?

Pascal Saint-Amans [00:02:05] For the past 30 to 40 years, we have had globalisation, meaning that multinational companies have been able to operate globally. And doing so, they have started some form of arbitrage between the different countries deciding to put their profits in the low tax jurisdiction. And increasingly they have relied on what we call aggressive tax planning, which means schemes which have allowed them to put their profits in countries where they had no activity, but where the level of taxation was very low. And after 40 years of globalisation, without any form of tax regulation, we ended up in a place where companies were able to lower their effective tax rate to very minimum close to 0%. And this was utterly unfair because the people who cannot move the women and the men in the streets, they pay Value-Added taxes, they pay personal income taxes, they pay Social Security contributions. While the largest companies in the world, the most profitable companies in the world, were able to use tax havens not to pay their fair share. And this is what we are now putting an end to.

Lawrence Speer [00:03:33] So what I've understood is there's two main challenges, the existing rules don't work anymore, and in a digitalised economy, multinational enterprises can very easily shift their profits to low tax jurisdictions. Now, this is the solution you've come up with, has two different pillars to address this. So how does each pillar work? What are you looking at doing on each side of this two pillar solution?

Pascal Saint-Amans [00:04:00] The deal, which has just been agreed, includes indeed two pillars. The first pillar is about addressing the challenges resulting from globalisation and digitalisation and the new rules we provide for companies to be taxed in the country even when they do not have a physical presence. Because since the early 20th century, for a company to be taxed in the country, it had to be physically present. That's the brick and mortar economy no longer relevant. So now we will have new rules. We call them a new nexus, which means that if a country if a company sells in the country, it will be taxable in that country. And the new agreement provides for part of the rents of the largest and most profitable companies, let's say the top 100 companies in the world, which together make more than 500 billion dollars of profit. A percentage of that profit of that trend, 20 to 30%, will be allocated to the countries where the services are provided or where the goods are sold. That's a new rule, kind of a formula based on assets. That's the first pillar. The second pillar is about ensuring that multinational companies will pay at least 15% of tax effective tax on their profits made abroad.

[00:05:31] Now, 15% may sound low. It's actually a big number because today the profits made by a company abroad are untaxed. They are not taxed because they are located in tax havens most of the time and they are not taxed by the country where the company is incorporated, the headquarter country of the company. What we are changing is that we are putting a safety net of full of at least 15%, which is a dramatic change compared to the current situation where the profits made and brought by multinational companies will be taxed that between 3 to 7%. So that's kind of putting an end to the use of tax havens by international companies.

Lawrence Speer [00:06:18] It is quite dramatic, the notion of putting an end to the use of tax havens to finding a way to put a ceiling or a floor on what has some people have called the race to the bottom. We can all imagine the difficulty in getting such a large number of countries and jurisdictions to agree. Now, in particular, there's been a lot of talk about developing countries and whether they're going to benefit from these solutions, whether they're getting enough, whether they're sometimes giving up too much. How do you characterise the situation for developing countries in this deal?

Pascal Saint-Amans [00:06:58] When you face a global challenge, you need a global solution, so you need to bring all the countries together, which is why the OECD established what we have called an inclusive framework where you have one hundred and thirty nine countries on an equal footing. But the more countries you bring, the more difficulties you bring. Because, for instance, as you've just said, developing countries have their own view of the road. They want to attract more taxing rights, more profits to their territories while they're a small portion of the world economy. So they had demands which were legitimate demands, but very often in contradiction with the largest economies, either in the OECD countries like the US, Japan, Germany, or the largest non OECD countries like China or India or Brazil. So we had to accommodate all these different goals and concerns of countries, which means that the deal is a compromise. But this compromise does reflect a number of requests from developing countries.

[00:08:08] Let me just give you a very concrete example. For a company to be taxable in a country that will be a new Nexus four, which means that the company will no longer need to be physically present in the country, it will not have to have what we call, in the tax jargon, the permanent establishment. But you have to decide the threshold of sales to trigger the new tax. Right. These threshold for large economies are supposed to be around two to three million. Developing countries said we're small, three million of sales is too high a threshold. And they obtained a threshold of two hundred and fifty thousand euros of sales for a company to be taxable, which does reflect the needs of developing countries. That just one of many examples where you can see that the deal was shaped by all countries, including developing countries, which have been very active in the negotiation.

Lawrence Speer [00:09:12] Now, it's great that we managed to bring in so many of the developing countries. At the same time. I think you recognise everyone recognises that there are some members of the inclusive framework who've not yet joined their countries that aren't yet in agreement. What will the consequences be for those countries, for the tax reform in general, if there's if there's countries left out?

Pascal Saint-Amans [00:09:40] One of the merits of these reforms is that it doesn't require all the countries to be part of it. In other words, you can put a global minimum tax even though you would have some low tax jurisdictions or even zero tax jurisdictions not joining the government. That's the merit and the beauty of the agreement. You can neutralise the tax havens so the zero tax jurisdiction without necessarily having them implementing the agreement. Why so? Because the countries are residents of the countries where the multinational companies are headquartered can do it or what we call the source countries, meaning the countries where they do that business can do it. And if you have a critical mass, then you have the impact. That said, it would be good to have all the countries which participate to that to work through what we have built, which is this inclusive framework of 139 countries.

Lawrence Speer [00:10:40] You're talking about this minimum tax rate that countries will have to pay. Now, the agreement calls for a rate of at least 15%. Is 15% too low, given that a lot of countries have corporate tax rates that are a lot higher and or is 15% the right rate? And what and what does 15% mean? You were talking a minute ago about tax havens, about countries with zero corporate tax rates. How does it work for them? It seems a very, very big concept for a wide range of experiences around the world on this corporate tax rate.

Pascal Saint-Amans [00:11:19] The current situation is that a company is generally not taxed on its profits made abroad because the countries where it operates should taxed. But with globalisation, without regulation, the companies have been able to locate their profits in tax havens, in low tax jurisdictions where these profits are taxed at 2 to 3%, sometimes 6 to 7%. But for sure, at a much lower rate than what it should be. What we're putting in place is a safety net is a floor below which companies can no longer do tax planning, tax avoidance. And this floor is at 15%. The right benchmark to assess the 15% to determine whether it's a high level or low level is to compare it with what companies currently pay on the profits made abroad. And it's in the range of 3 to7%. So 15% is quite a big deal. And that's why you have some countries still objecting. Ireland has not yet joined the agreement. Hungary, which has a nominal rate of 9%, have not yet joined the agreement. That is explained by the fact that 15%, or at least 15%, which is the agreement, is pretty high.

Lawrence Speer [00:12:40] We manage to get to this to this agreement and when we get to implementation and we'll talk about that in a minute, what's the concrete impact? What kind of revenues will the solutions under discussion, both pillar one and pillar to bring who's going to pay and who's going to collect

Pascal Saint-Amans [00:12:58] This new tax deal? It's not a technical deal. It's a highly political deal which will change people's life. Housel By ensuring that the largest and most profitable companies in the world will pay more taxes where their clients are. It's a question of fairness. It's about the tech giants. But not only them leaving more profits where the clients are, but also by ensuring that you have a minimum level of taxation which will bring money.

Pascal Saint-Amans [00:13:30] Under pillar one, the largest and most profitable companies in the world will leave more profit between 20 and 30% of their rent to the markets where they operate. Currently, these companies pay hardly anything where the clients are. Tomorrow, these countries will get much more. 100 billion of profit will be shifted from low tax jurisdictions or countries where these large tech giants and other largest companies are headquartered to where the clients are. That has been a claim for the past 10 years. You know, many countries have talked about gaffar taxes or digital services taxes, and they tried to take unilateral measures. Here you have a guillotine, a treaty agreed solution which will ensure the same outcome, but in a peaceful manner without any risk of trade, war. And these 100 billion, at least 100 billion dollars of profit will shift from a few countries to many more countries where the clients are.

Lawrence Speer [00:14:41] And about pillar two, the global minimum corporate tax at at least 15%. What's that going to generate?

Pascal Saint-Amans [00:14:50] The global minimum tax is going to generate significant money, $150b will be generated, which at the time of Covid and post-Covid are badly necessary.

Lawrence Speer [00:15:05] Let's talk about the business community, businesses are going to pay these taxes, right? You've had a lot of discussions with them over the years. They've been deeply involved, I think, in this process. Where are they now? Are they on board?

Pascal Saint-Amans [00:15:23] Let's be clear, for many years, the business community has not been very supportive of the work we've done at the OECD. They said they preferred emeriti, literally a great solution than unilateral measures, which would have triggered trade tensions, but they were not very positive in their support. That said, I think they now have read the writing on the wall, the time where companies could use tax havens, low tax jurisdictions, the time where companies could use aggressive tax planning, very sophisticated schemes, has come to an end. They understand that. And you may have seen that the reaction to the deal from business is actually positive, even though they still raise issues like the cost of compliance, the complexity and their rights. We need to make sure that the implementation of the deal will be as simple as possible for all would bring as much certainty as possible for all. It has to be a balanced deal. But again, we are changing paradigms and the good old time for companies could reduce that tax burden through artificial scheme has really come to an.

Lawrence Speer [00:16:40] At the same time, there are a few sectors that have been left out of the deal, a lot of people are talking about it, things like financial services, the extractive industries, shipping. How did this come about? Why are some of these regulated sectors or extractive industries left out of the deal?

Pascal Saint-Amans [00:17:00] Let's be clear. The deal has not been reached because you would have many exceptions, carve outs pleasing a number of countries. It's a pretty tough deal for businesses. Now, there is one exception for the global minimum tax, which is shipping WIZO, because the ships are in the middle of the ocean and you cannot tax them. And if you don't have all the countries in the world, they may all register in one country. And that's why, for a very pragmatic reason, shipping was excluded from the global minimum tax. There is no other exclusion, no other exception. As regards pillar one, there are two exceptions extractives and financial services. These are no exceptions. It's just the fact that for extractives, the rent belongs to the land where the extractives are, and there is no reason to reallocate the rent to the market jurisdiction. So there is a consensus amongst economies as regards financial services. One could say that as regards the B2C, because of regulations, the money is in the market and this regards B2B investment banking. And so the question did arise and it was decided that it would be extremely complex to reallocate the profits to the market jurisdiction. So these two sectors are not included one, but they will be under the rules of Pillar two, which means that there will be a minimum tax for them both.

Lawrence Speer [00:18:36] There's still a long way to go to go from where we are, this high level agreement that you've reached, this political agreement to hammering down the final deal. So what are those next steps and when can we really think about implementation happening?

Pascal Saint-Amans [00:18:56] The next step is finalising the political deal in October 2021. There is not much to do. Just a few numbers to firm up. What is the precise percentage of the rent between 20 and 30%, which will be relocated to the market jurisdiction? What will be the rate of the global minimum tax? It's at least 15%, but would it be a bit of both? These are questions which are not that difficult, which have to be solved by October. The following step will be the implementation to move from a political agreement to legislation. You need to have a multilateral convention and you need to have a set of model domestic legislations established by OECD and all these countries working together. And we aim to complete these by year end or very early in twenty two so that countries can enact the legal changes by the end of 2022 for a concrete implementation in 2023. It may sound like a bit far, but when you look at the time the parliament takes to change its legislation, it's a normal course of business. Actually, it's moving extremely fast and that's the common goal of all the countries. I can tell you that the finance ministers in Venice, while celebrating the agreement, all said we now need to move extremely fast for the implementation. There is the political momentum.

Lawrence Speer [00:20:32] Well, Pa., it sounds like you have your work cut out for you, then finalising the deal, then the implementation plan and finally seeing these countries collecting this new tax from the agreement. So thank you very much for this fascinating update on the continuing efforts to reform the international tax rules. And good luck in the months ahead.

Pascal Saint-Amans [00:20:54] Thank you, Larry.

Lawrence Speer [00:20:55] And thanks to all of you out there listening. If you'd like to find out more about the issues discussed in today's podcast, please go to www.OECD.org/tax/beps. Thanks for listening.

Outro [00:21:14] To listen to other OECD Podcasts, find us on iTunes, Spotify, Google podcast and SoundCloud.com/OECD.