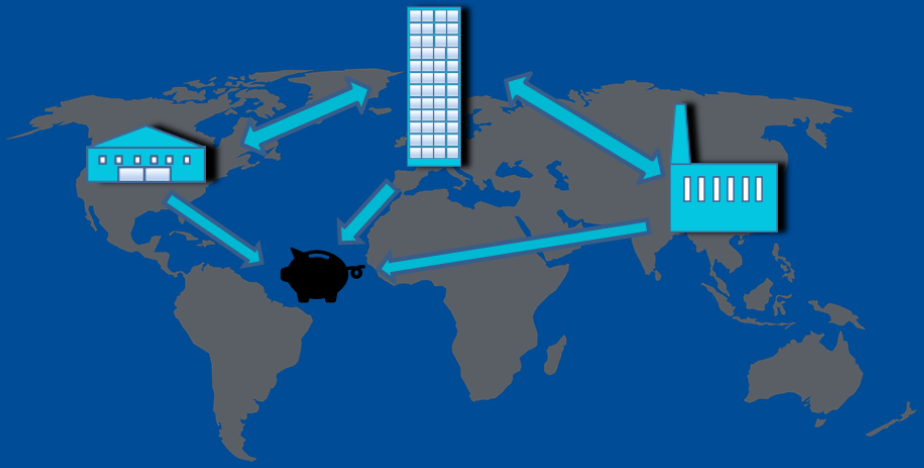

FISCAL AFFAIRS

International Corporate Tax: An Overview of the Current Situation

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History: A Reprise

- **Existing system developed nearly 100 years ago**
  - Much less cross border trade
  - Little/no trade in services
  - Less reliance on intangibles in production
  - Far less/no complex cross border supply chains
  - Easier to say where companies were “resident”

- **Separate accounting**
  - Intragroup transactions—such as they were—based on *“Arms-Length Pricing (ALP)”*

- **Source taxing rights based on physical presence (permanent establishment)**

- **Bilateral tax treaties**
  - Avoid double taxation source & residence
    - Source → mainly ‘active business income’
    - Residence → mainly ‘passive income’

Current situation

- World-spanning multinational groups, reliance on intangible assets, complex production chains lead to opportunities for tax planning/avoidance
- 2015 Base Erosion and Profit Shifting (BEPS) project action items aimed to close “loopholes” in this system to reduce tax avoidance opportunities….
- …but explicitly did not aim to change the fundamental ALP system
- Fundamental issues not addressed
  - Tax competition
  - Allocation of taxing rights across jurisdictions
- Notably, BEPS action item 1, addressing the “digital[izing] economy” failed to reach closure; would have come closer to the fundamentals of the existing system

Issues to Be Addressed

- Long-standing international tax challenges…
  - Profit shifting, tax competition

Pillar 1

Pillar 2

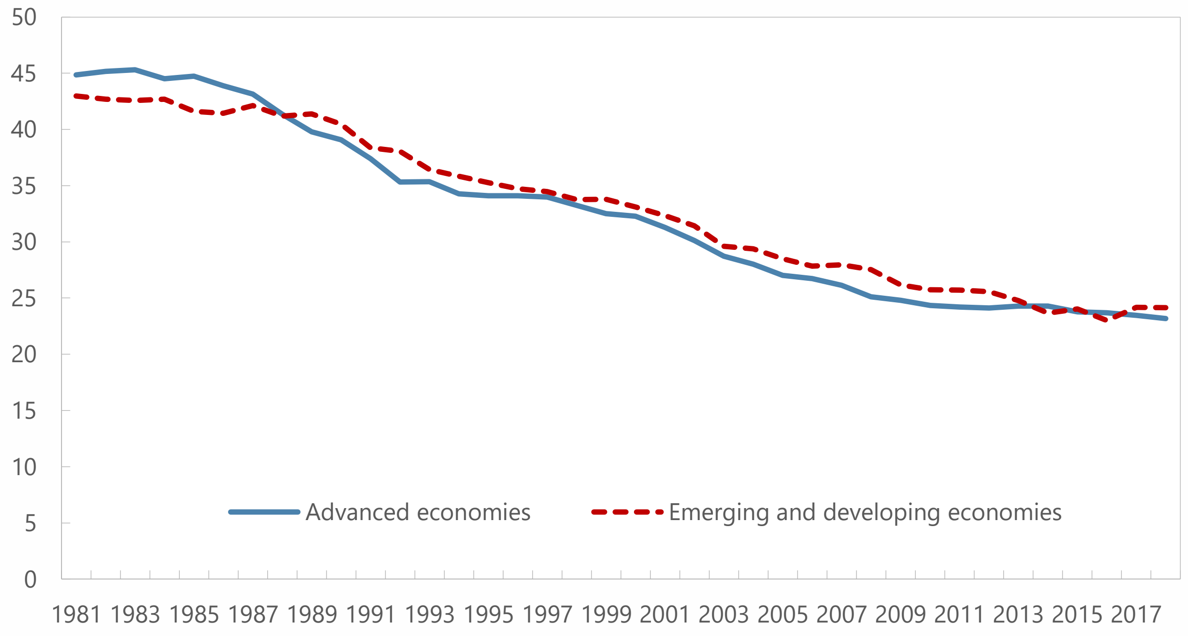
- …are exacerbated by digitalization.

- Digital firms may have distorted:
  - Overall tax levels
  - Locations of taxation

DSTs

Tax Competition…

- Statutory tax rates have been falling for decades across all countries…



- …even leaving aside tax incentives and special regimes…

Allocation of taxing rights

- Calls to move away from allocation based (only) on location of physical production

- Two aspects:
  - “virtual” permanent establishment—uses concept of location of production, but without the need for physical presence, given intangible inputs and outputs
  - Related, but different—include aspect of location of *consumption/destination*

- Major industrialized economies aiming for slice of profits of “tech” MNEs—largely US based

- Developing economies aiming to obtain a “fair(er) share” of worldwide profit base
  - Evidence shows that profit shifting is a relatively larger problem for lower income economies

Important consideration!

- This should not be/isn't about only "digital"—the entire economy is subject to the changes discussed above
- Ringfencing will be difficult, complex, and subject to uncertainty…
- …and may not be so beneficial to LICs

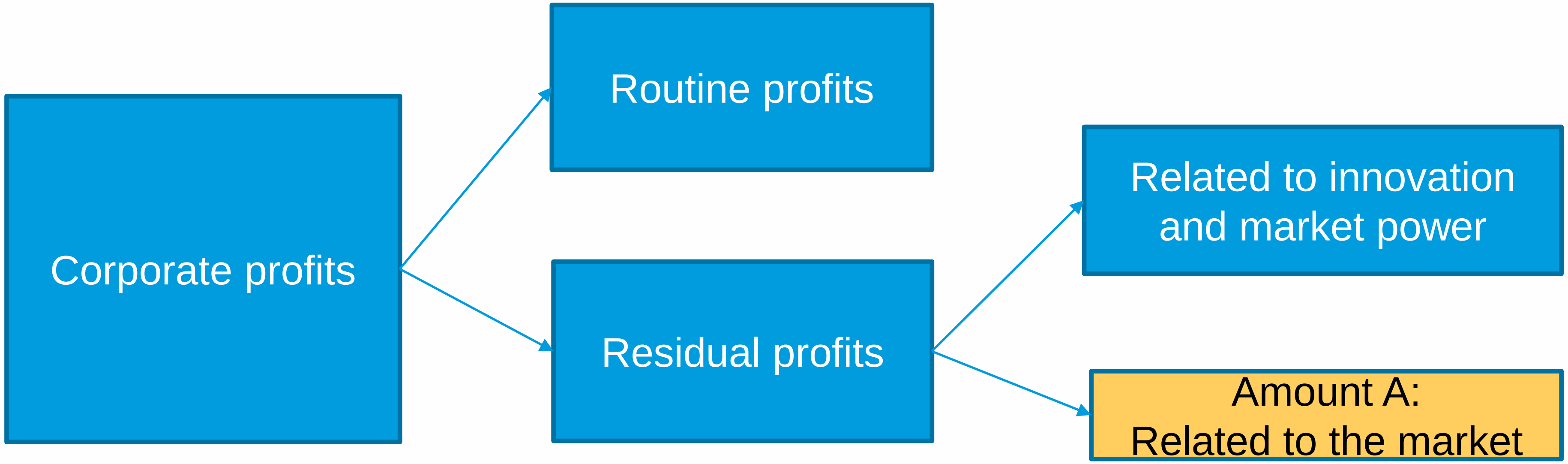
Inclusive Framework Proposals

- G20/OECD-Inclusive Framework now includes 139 countries
  - Though questions about who sets agenda and drives policy

- Prepared 'Blueprints' of a proposal
  - Follow up on unsuccessful BEPS Action 1 on digitalization (2015)
  - Deadline for consensus extended several times (pandemic), to end-2020, and again now to mid-2021
  - 2 Pillars, combining common features of previously competing proposals

Pillar 1: addresses base allocation issues

- A new taxing right "Amount A" applicable to MNEs over a certain size
  - New nexus: sustained market presence (without physical presence)
  - New profit allocation: formulaic based on group profits instead of ALP
  - To be credited, somehow, to avoid double taxation



- "Amount B": a fixed return to baseline marketing/distribution operations, akin to a safe harbor

Assessment of Pillar 1

- Welcome departure from century-old norms
  - *Elements of formula apportionment and destination-based taxation*
- But lacks coherent economic rationale and is extremely complex
  - Not principles based
  - Leaves current system intact alongside—*including* for in-scope businesses
- Little revenue foreseen: about 0.5% of worldwide CIT revenues per OECD
- *LICs most likely to benefit from fixed returns (Amount B);* large market economies more likely to benefit from new taxing right (Amount A)
- Increased calls for simplification
- Political consensus remains in doubt, but recent US statements have revived hope of consensus by mid-2021

Pillar 2 (minimum tax): addresses tax competition issue

- **Global minimum tax:** would mitigate tax competition and profit shifting
- **Minimum rate**: not agreed (speculated to be in the range of 9% -12.5%)
- **Threshold**: €750m worldwide (high, puts 85% - 90% of MNE groups outside scope)
- **Three key interrelated rules:**
  - ***Income inclusion rule (IIR - outbound rule)***
    - tax profits in residence country if not effectively taxed at foreign source
    - like worldwide taxation, but only “excess income” within scope
    - similar to US GILTI, but: country by country and other deviations
  - ***Undertaxed payments rule (UTPR - inbound rule)***
    - deny local deductions if relevant cross-border amounts are lowly taxed offshore
    - similar to US BEAT, but: contingent on offshore tax being below the minimum rate
  - ***Subject to tax rule (STTR - inbound rule #2)***
    - additional tax in source country on certain tax treaty payments (interest and royalties)

Assessment of Pillar 2

- ***Will be addressed next today, but a few observations…***

- **Fundamentally sound, and greater revenue impact than Pillar 1**
  - introduces a global tax floor
  - estimated global revenue gains of 1.7% - 2.8% of CIT, per OECD (excl US GILTI)
- **Could mostly be done unilaterally**
  - But STTR would require tax treaty changes—how likely?
- **Ordering controversial**
  - *proposal favors advanced economies / capital exporters*
  - mostly benefits developing countries indirectly—but still helpful!

Digital Services Tax

- Taxes *receipts* (not profits) of non-residents from digital services they provide to residents (e.g., online advertising, streaming services)
  - generally posed as "interim" measure until international agreement reached

- Various types:
  - *Withholding taxes on payments*: India 2016 levy, Malaysia, Mexico, Pakistan, Vietnam
  - *User-based DST:* 2018 EU proposal, India 2020 Levy, France, Italy, Spain, Turkey, UK, Kenya
  - *Digital PE :* Indonesia, Nigeria

- High revenue thresholds, so tax paid mainly by US MNEs.
  - Perceived discrimination leading to retaliatory trade measures

An Assessment of DSTs

- A multilateral solution is preferred.
  - Unilateral measures can lead to double taxation, discouraging investment, and risk retaliation

- Ringfencing adds complexity and loses relevance as the economy becomes increasingly digitalized

DST Revenue

	USD billions	% of GDP
EU	6.1	<0.01
France	0.5	0.02
UK	0.6	0.02
India (2016)	0.09	<0.01

Source: National authorities

- DSTs raise little revenue and can distract countries from more important reforms—including of basic non-international taxes such as improved VATs …

- …but on the other hand, DSTs are a simple way for developing countries to preserve taxing rights
  - Now being supported by ATAF and UN (through amendments to the UN Model Tax Treaty)

Relationship Between Proposals

Pillar 1 and DST

- Seen as alternatives by some
  - But: Pillar 1 broader than DST
- Pillar 1 will take longer to implement—even after agreement is (may be) reached

Pillars 1 and 2

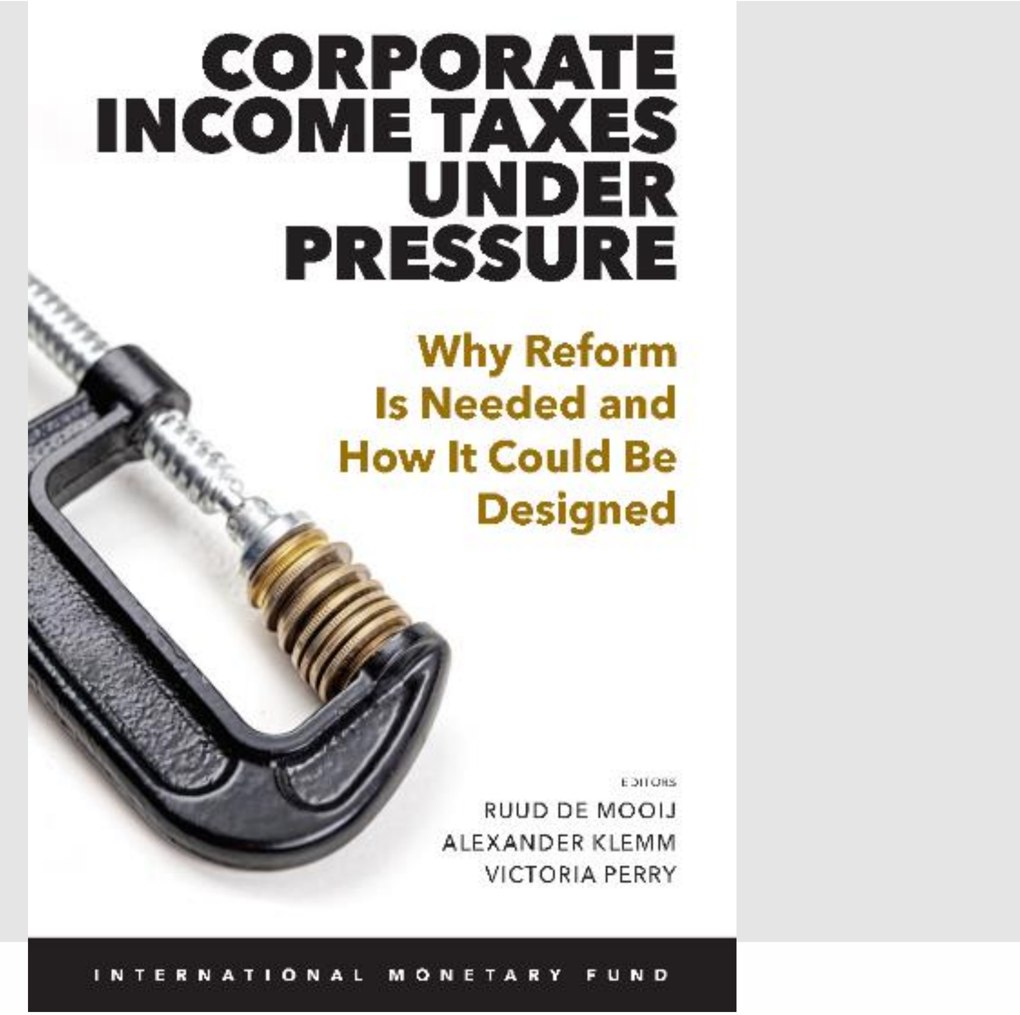
- Both part of IF proposal, but in principle independent
  - Pillar 1 zero sum versus pillar 2 as revenue raiser
  - Unclear if pillar 2 would proceed if pillar 1 failed
- Pillar 2 (or something equivalent) could be implemented unilaterally

IMF in the debate

- **Distinct views on current system**
  1. ALP conceptually and practically flawed
  2. Concerns about tax competition
  3. Issues for developing countries
  4. Digitalization is/should be only a part of wider tax debate

- **Economic analysis**
  - Estimating ‘spillovers’
  - Impact of alternative systems: minimum tax; residual profit split; formulary; DBCFT

New book on-line this week at IMF website



AND, another notable recent contribution: