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An Oifig Buiséid Pharlaiminteach
Parliamentary Budget Office

An Update on the OECD BEPS Proposals

Introduction

This PBO note gives an overview of the current state of play in respect of the OECD's BEPS process, including a discussion of the two latest key pillars, and the projected impact on Irish corporation tax revenue.

Base Erosion and Profit Shifting (BEPS) activities are efforts by a company to erode taxable income and ultimately reducing tax liability. It can entail shifting profits from a high tax jurisdiction to a low tax jurisdiction or taking advantage of gaps or mismatches in tax legislation. An OECD report (2017) estimates that revenue forgone under BEPS activity amounts to $100bn to $240bn per annum.[1]

BEPS is the acronym of the OECD/G20 Inclusive Framework to address this tax avoidance activity. It is an international collaboration led by the OECD Secretariat between 139 countries to agree on substantial changes in tax policies to address tax challenges from the digitalisation and globalisation of the economy, improve the coherence of international tax rules and ensure transparency. The process started in 2015, and 15 Actions have been agreed.

The OECD recently released a Statement, signed by 132 out of 139 countries and jurisdictions (as of 9 July 2021), outlining a new framework for international tax reform. The 132 countries and jurisdictions represented more than 90% of global GDP. At the time of the OECD BEPS statement, 3 EU countries did not sign up: Ireland, Hungary, and Estonia. The OECD process has October 2021 as a deadline for completing the proposals with an expectation that this would be legislated for in 2022 and effective by 2023.[2]

The Irish government states that they remain committed to the OECD BEPS process and has established a public consultation on the OECD proposals from July 2021 to September 2021.[3]

The current OECD BEPS proposals fall under **two main pillars:**

- The **first pillar changes profit allocation rules for multi-national companies.** This involves reallocating a share of profits to where sales or users are located, previously it was on where a company is based.
- The **second pillar concerns a global minimum corporation tax rate of at least 15%.**

1 OECD (2017) Background Brief: Inclusive framework on BEPS
2 OECD (2021) Statement on a Two-Pillar Solution to Address the Tax Challenges Arising From the Digitalisation of the Economy
3 Department of Finance (2021) Consultation on OECD International Tax Proposals

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First Pillar: allocation of taxable profits and the associated taxing rights

The **allocation of taxable profits and the associated taxing rights** are traditionally based where goods and services are produced, which was generally close to the consumer. This pattern of commercial transactions changed significantly with trade globalisation and businesses digitalisation, as production can be entirely divorced from sales location. The role of the consumer has also changed. Previously the consumer was simply the receiver of the good or service, whereas now in the digital era, data from consumer behaviour is valuable and is being tracked and monetised.

Multi-nationals with group revenues of at least $750 million have been required to report income, profit, and taxes on a country by country basis. This data has highlighted the difference between where companies' profits are reported and where their commercial activity takes place. On average, the **investment hubs of multi-national companies report 25 per cent of group profits but only 4 per cent of employees and 11 per cent of tangible assets.**[4]

The first pillar of the OECD BEPS proposals mean that **taxation would not depend on the physical location of the company, but on its commercial activity in that jurisdiction.** Tax revenue will be generated in the country where that product or service is used or consumed. It is expected that the reallocation of taxing rights between countries and jurisdictions will consist of an annual projected figure of $100 billion of profit by multi-national companies. The current OECD BEPS Proposals do not include the extractive industry or the regulated financial services.

The Irish government has agreed to the first pillar of the OECD BEPS proposals.[5] This is estimated to reduce annual corporation tax receipts by €2 billion by 2025.[6]

Second Pillar: global minimum corporation tax rate of at least 15%

The second pillar of the OECD BEPS is the **global minimum corporation tax rate that would apply to all multi-national companies.** The proposed minimum rate is at least 15%. Governments would have the right to tax profits currently being taxed below a minimum rate. This global minimum corporation tax rate is projected to increase the annual international corporation tax revenue by $150 billion.

The second pillar is the part of the OECD BEPS Statement that Irish government currently has not agreed to.[7] This is likely to reduce annual corporation tax revenue, however the expected figure for reduction in revenue from the second pillar has not yet been estimated.

The **second pillar proposals would reduce tax differentials between jurisdictions** and also the opportunity for profit shifting by multi-national companies. For Ireland, it could make the current corporation tax rate of 12.5% less attractive for multi-national companies and could reduce economic activity and the levels of profit and corporation tax revenue. However, a global minimum corporation tax rate of at least 15% is higher than the current Irish rate of 12.5% and this could also lead to an increase in corporation tax revenue if Ireland can sufficiently retain multi-national companies.

4 OECD (2020) Corporate Tax Statistics, second edition
5 Department of Finance (2021) Consultation on OECD International Tax Proposals
6 Department of Finance (2021) Stability Programme Update 2021
7 Department of Finance (2021) Consultation on OECD International Tax Proposals

Projected impact on Irish corporation tax revenue

The net receipts for corporation tax in 2020 was €11.8 billion, amounting to 21 percent of exchequer tax receipts in 2020. From 2012 to 2018, 10 firms have on average contributed up to 35 per cent of corporation tax liability. The concentration of corporation tax payments peaked in 2020, with 10 firms contributing 51% of net corporation tax receipts (around €5.9 billion). There is a concern about the State becoming too reliant on this highly volatile and concentrated tax, mirroring the experience of relying on stamp duty and other transaction-based taxes in the Celtic tiger era.

The OECD BEPS proposal could pose a risk to corporation tax revenues in the small and open economy of Ireland. The first pillar, i.e. the allocation of Corporation Tax receipts based on the location of a company's sales or users would benefit larger markets that are net-importers. Small export intensive economies such as Ireland would lose a portion of its tax base as a larger proportion of profits would be allocated to larger countries.

The second pillar would reduce the influence of corporate taxes on investment decisions. Currently, the rate and design of corporation tax is an important consideration in where companies chose to invest. However, the proposals would have several dynamic effects that are extremely difficult to model and would be based on significant assumptions. For instance, strategic reactions from multi-national enterprise and governments in response to the very significant international tax changes.

With a global minimum corporation tax, multi-national companies could relocate their investments and operations to countries based on other factors, such as state supports to business, infrastructure, education, labour costs, labour laws, business climate, etc. Investment decisions by multi-national companies in Ireland will also be influenced by other taxes, including non-corporation tax support schemes, personal income taxes and tax credits for research and development. To mitigate these risks, **it will be important that Ireland will increase its competitiveness in respect of the non-tax factors to retain investment by multi-national companies.**

The Department of Finance has produced projections of the impact of the first pillar of the OECD BEPS proposal on Corporation Tax revenue. The Department of Finance's baseline assumes that annual corporation tax revenue to be around €2 billion lower by 2025, if the OECD BEPS proposals are implemented.[8] There is significant uncertainty regarding these estimates. With many variables, competing businesses and jurisdictions, and the complexity of these dynamic effects, the accuracy of a forecast of the impact on corporation tax revenue by the BEPS proposals could be limited. These forecasts do not include any estimation of the impact of pillar 2.[9]

The **investment decisions by multi-national companies will also have a significant impact on revenue from employment taxes.** Income Tax, USC and PRSI revenue from employees for all companies in 2019 was €21.5 billion. Foreign Owned Multinationals companies account for 49% of employment tax revenue in 2019. With combined corporation tax and employment tax revenue from large corporates exceeding €20 billion (corporation tax revenue is €10.3 billion and combined income tax, PRSI and USC is around €10 billion), the possibility of international companies exiting the Irish market would pose a significant systemic risk to the tax base overall.[10]

8 Department of Finance (2021) Stability Programme Update 2021
9 Department of Finance (2020) *Medium-Term Fiscal Strategy Slide Deck*
10 Office of Revenue Commissioners (2021) *Corporation Tax – 2020 Payments and 2019 Returns*