OECD SECRETARY-GENERAL TAX REPORT TO G20 FINANCE MINISTERS AND CENTRAL BANK GOVERNORS

Italy
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Introduction

It is a great privilege to present my first tax report to you, as Secretary-General of the OECD and a real pleasure **to report that on 1 July 2021, 130 member jurisdictions of the G20/OECD Inclusive Framework on BEPS (Inclusive Framework), representing more than 90% of global GDP, joined an agreement for a two-pillar solution to address the tax challenges arising from the digitalisation of the economy**. Since then, one additional member jurisdiction (Peru) has joined the agreement, **bringing the total to 131. This historic success draws on** all the work done under your leadership over the past ten years to ensure more transparency and fairness in the international tax system through the adoption and implementation of the tax transparency and Base Erosion and Profit Shifting (BEPS) standards. As a result of your efforts, the field of international tax has become a standard-bearer for multilateralism.

As the combined effect of globalisation and digitalisation has caused distortions and inequities, **the century-old international tax system is no longer fit for these increasing challenges, which can only be effectively addressed through a multilaterally agreed solution**. You asked the Inclusive Framework to address the tax challenges arising from the digitalisation of the economy by mid-2021. At this crucial moment of ensuring strong economic recovery, the two-pillar package will provide much-needed support to governments needing to raise necessary revenues to repair their budgets and their balance sheets while investing in essential public services, infrastructure and the measures necessary to help optimise the strength and the quality of the post-COVID recovery. Only 8 of the 139 Inclusive Framework members have not yet joined the Statement at this time but they remain engaged and we are confident they will eventually be part of it. The agreement, together with an implementation plan, will be finalised in October with a view to being implemented in 2023. The Statement of the Inclusive Framework is set out in Annex A to this report, whereas the list of members that joined the Statement is set out in Annex B to this report.

This report also covers the tax policy aspects of climate change, which you will discuss during the *G20 High Level Tax Symposium on Tax Policy and Climate Change* on 9 July 2021, and progress made in support to developing jurisdictions in strengthening the capacity to build sustainable tax revenue bases.

Tax challenges arising from the digitalisation of the economy

After years of intense work and negotiations, 131 member jurisdictions of the Inclusive Framework, representing more than 90% of worldwide GDP, adopted the key elements of international tax reform designed to address the tax challenges of globalisation and the digitalisation of the economy. The two-pillar solution to these challenges, embedded in this historic agreement, will ensure that large multinational companies pay their fair share everywhere and brings much needed tax certainty and stability to the international tax system. This results from necessary compromises in the spirit of multilateral cooperation and in the context of trade tensions and public pressure. Concessions were made by all parties until the very last minute to accommodate the various interests across the negotiation table, including those of small economies and developing jurisdictions, thereby reaching a balanced agreement.

Under the two-pillar solution, Pillar One aims to ensure a fairer distribution of profits and taxing rights among countries with respect to the largest MNEs, which are the winners of globalisation. Pillar Two seeks to put a floor on tax competition on corporate income tax through the introduction of a global minimum corporate tax that countries can use to protect their tax bases. Pillar Two does not eliminate tax competition, but it does set multilaterally agreed limitations on it. The two-pillar package also accommodates the various interests across the negotiating table, including those of small economies and

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developing jurisdictions. It will provide much-needed support to governments needing to raise necessary revenues to repair their budgets and their balance sheets while investing in essential public services, infrastructure and the measures necessary to help optimise the strength and the quality of the post-COVID recovery.

The two-pillar package will also bring much needed tax revenue. Under Pillar One, taxing rights on more than **USD 100 billion of profit** are expected to be reallocated to market jurisdictions each year. With respect to Pillar Two, with a minimum rate of at least 15%, the global minimum tax is estimated to generate around **USD 150 billion in additional global tax revenues** per year. Additional benefits will also arise from the stabilisation of the international tax system and the increased tax certainty for taxpayers and tax administrations.

Participants in the negotiation have set an ambitious timeline for conclusion of the negotiations. This includes an October 2021 deadline for finalising the agreement on the two-pillar approach, as well as a framework for effective implementation in 2023. **I will report to you in October 2021** on the progress made for your last meeting under the G20 Italian Presidency, which I thank for its continuous leadership and support.

Tax policy and climate change

As you gather on 9 July 2021 for the *G20 High Level Tax Symposium on Tax Policy and Climate Change*, the window to avoid dangerous climate tipping points is closing. Reaching net zero by 2050 requires deep, structural transformations of carbon-intensive production and consumption patterns in all sectors of the global economy. Tax systems need to align with climate goals and can contribute to carbon abatement by pricing pollution, supporting alternatives, and cushioning the adverse distributional impacts associated with climate policy.

It is crucial to address this issue in a multilateral manner. This would also lead to greater certainty, including for investments and growth post-pandemic. The OECD stands ready to facilitate international dialogue and cooperation, and to build bridges between countries and regions adopting different policy approaches on the path to net zero emissions.

Finance Ministers therefore have a key role to play, considering both domestic fiscal policy reform and the international context, as governments around the world act at different speeds and with different policy mixes that reflect their specific economic needs, to mitigate climate change. Greenhouse gas emissions pricing is one policy lever among others. As our report with the IMF to you in April showed, there is considerable divergence in the use of this instrument among G20 and OECD countries. Approximately 60% of carbon emissions still remain unpriced while fossil fuel subsidies continue to further weaken incentives to reduce GHG emissions.[1] In addition, carbon pricing performance varies across sectors, with a particularly low level in the electricity and the industry sectors. This suggests scope for strengthening the use of pricing or equivalent instruments as one component of mitigation policy packages, in the fight against climate change.

The Tax Symposium provides a unique opportunity to share experiences, consider the role that fiscal instruments can play in relation to incentives and distributional impacts, and to explore options to address persistent concerns including impacts on business and households, leakage, competitiveness and other spillovers. The goal of the symposium is to explore how tax, in conjunction with regulatory policies, can

[1] IMF/OECD (2021), *Tax Policy and Climate Change: IMF/OECD Report for the G20 Finance Ministers and Central Bank Governors, April 2021, Italy*, OECD, Paris, www.oecd.org/tax/tax-policy/imf-oecd-g20-report-tax-policy-and-climate-change.htm.

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contribute to reaching environmental objectives, by improving the mutual understanding of national policy choices, by identifying best practices on the use of tax tools and by exploring approaches that allow for an effective international cooperation on these topics. The Symposium will focus on the need for improving the measurement and analysis of both the explicit and implicit carbon prices that result from the diverse range of mitigation policy packages implemented by countries. The Symposium will also provide an opportunity for a reflection upon how G20 Finance Ministers can incorporate this important area of economic policy into their work in the future.

Tax and development

In April 2021, you reaffirmed your engagement to support developing jurisdictions in strengthening the capacity to build sustainable tax revenue bases. The COVID-19 pandemic has had a huge impact on the health of both people and economies, with developing countries hit the hardest. For developing countries with limited fiscal space and heavy debt burdens, balancing the need to provide income support and collect revenue to finance spending has been extremely challenging.

The pace and scale of progress in international tax reform and intergovernmental cooperation has meant that many developing countries are on a steep learning curve. Five years after the establishment of the G20/OECD Inclusive Framework and eleven years after the creation of the Global Forum on Transparency and Exchange of Information for Tax Purposes (Global Forum), the needs of lower income/capacity countries must be considered, in particular the need for simplicity in the design and implementation of new tax rules.

For your next meeting in October, the OECD will present the report you requested on progress made by developing countries through their participation at the Inclusive Framework and identify possible areas where domestic resource mobilization efforts could be further supported. The OECD has already undertaken extensive consultations with developing countries working with regional tax organisations in Africa, Asia, Eastern Europe and the Latin America and Caribbean regions to take stock their views. This process will feed into the report and help identify potential improvements to enable developing countries to integrate faster, and deeper, into the new international tax architecture and identify possible areas where domestic resource mobilisation efforts could be further supported.

The OECD has continued to provide capacity building to developing countries during the COVID-19 crisis, helping governments learn from each other as regards tax policy and administration responses and enhancing domestic resource mobilisation. As the pandemic accelerated the shift to e-commerce, the work to support developing countries implement effective e-commerce Value Added Tax (VAT) has grown, notably with the publication of regional VAT Digital toolkits[2]. Ongoing support for the implementation of the Base Erosion and Profit Shifting (BEPS) measures and assistance in exchange of information (EOI) to support the fight against tax evasion have also continued unabated, as mentioned our recently released report, *Tax Co-operation for Development: Progress report in the COVID-19 era*.[3]

[2] The latest publication covers Latin America and the Caribbean: OECD/WBG/CIAT/IDB (2021), *VAT Digital Toolkit for Latin America and the Caribbean*, OECD, Paris, www.oecd.org/tax/consumption/vat-digital-toolkit-for-latin-america-and-the-caribbean.htm.

[3] OECD (2021), *Tax Co-operation for Development: Progress report in the COVID-19 era*, OECD, Paris, www.oecd.org/tax/tax-global/tax-co-operation-for-development-progress-report-on-2020.pdf.

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Over USD 1.06 billion in additional tax revenues and USD 2.90 billion in additional tax assessed have been collected in developing countries thanks to TIWB.

The OECD/UNDP Tax Inspectors Without Borders (TIWB) initiative continues its ground-breaking work to help developing countries collect taxes from multinational enterprises (MNEs) operating in their jurisdiction.[4] Working across Africa, Asia, Eastern Europe, and Latin America and the Caribbean, **88** TIWB programmes are ongoing or completed across **47** countries and jurisdictions to date. Demand remains strong for TIWB audit assistance, in addition to pilot programmes focused on the effective use of automatically exchanged financial account information and criminal tax investigations.

[4] Blogpost *Building tax capacity in Africa: A successful international partnership* by ATAF and TIWB Secretariats 22 April 2021 http://www.tiwb.org/resources/blog/building-tax-capacity-in-africa.htm

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Annex A. Statement on a Two-Pillar Solution to Address the Tax Challenges Arising From the Digitalisation of the Economy

This Annex sets out the Statement which has been discussed in the OECD/G20 Inclusive Framework on BEPS. 131 member jurisdictions have agreed to it as of 5 July 2021. It is noted that not all Inclusive Framework members have joined as of today.

The OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting (IF) has agreed a two-pillar solution to address the tax challenges arising from the digitalisation of the economy. The agreed key components of each Pillar are described in the following paragraphs.

A detailed implementation plan together with remaining issues will be finalised by October 2021.

Pillar One

Scope

In-scope companies are the multinational enterprises (MNEs) with global turnover above 20 billion euros and profitability above 10% (i.e. profit before tax/revenue) with the turnover threshold to be reduced to 10 billion euros, contingent on successful implementation including of tax certainty on Amount A, with the relevant review beginning 7 years after the agreement comes into force, and the review being completed in no more than one year.

Extractives and Regulated Financial Services are excluded.

Nexus

There will be a new special purpose nexus rule permitting allocation of Amount A to a market jurisdiction when the in-scope MNE derives at least 1 million euros in revenue from that jurisdiction. For smaller jurisdictions with GDP lower than 40 billion euros, the nexus will be set at 250 000 euros.

The special purpose nexus rule applies solely to determine whether a jurisdiction qualifies for the Amount A allocation.

Compliance costs (incl. on tracing small amounts of sales) will be limited to a minimum.

Quantum

For in-scope MNEs, between 20-30% of residual profit defined as profit in excess of 10% of revenue will be allocated to market jurisdictions with nexus using a revenue-based allocation key.

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Revenue sourcing

Revenue will be sourced to the end market jurisdictions where goods or services are used or consumed. To facilitate the application of this principle, detailed source rules for specific categories of transactions will be developed. In applying the sourcing rules, an MNE must use a reliable method based on the MNE's specific facts and circumstances.

Tax base determination

The relevant measure of profit or loss of the in-scope MNE will be determined by reference to financial accounting income, with a small number of adjustments.

Losses will be carried forward.

Segmentation

Segmentation will occur only in exceptional circumstances where, based on the segments disclosed in the financial accounts, a segment meets the scope rules.

Marketing and distribution profits safe harbour

Where the residual profits of an in-scope MNE are already taxed in a market jurisdiction, a marketing and distribution profits safe harbour will cap the residual profits allocated to the market jurisdiction through Amount A. Further work on the design of the safe harbour will be undertaken, including to take into account the comprehensive scope.

Elimination of double taxation

Double taxation of profit allocated to market jurisdictions will be relieved using either the exemption or credit method.

The entity (or entities) that will bear the tax liability will be drawn from those that earn residual profit.

Tax certainty

In-scope MNEs will benefit from dispute prevention and resolution mechanisms, which will avoid double taxation for Amount A, including all issues related to Amount A (e.g. transfer pricing and business profits disputes), in a mandatory and binding manner. Disputes on whether issues may relate to Amount A will be solved in a mandatory and binding manner, without delaying the substantive dispute prevention and resolution mechanism.

Consideration will be given to an elective binding dispute resolution mechanism for issues related to Amount A for developing economies that are eligible for deferral of their BEPS Action 14 peer review and have no or low levels of MAP disputes.

Amount B

The application of the arm's length principle to in-country baseline marketing and distribution activities will be simplified and streamlined, with a particular focus on the needs of low capacity countries. This work will be completed by the end of 2022.

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Administration

The tax compliance will be streamlined (including filing obligations) and allow MNEs to manage the process through a single entity.

Unilateral measures

This package will provide for appropriate coordination between the application of the new international tax rules and the removal of all Digital Service Taxes and other relevant similar measures on all companies.

Implementation

The multilateral instrument through which Amount A is implemented will be developed and opened for signature in 2022, with Amount A coming into effect in 2023.

Pillar Two

Overall design

Pillar Two consists of:

- two interlocking domestic rules (together the Global anti-Base Erosion Rules (GloBE) rules): (i) an Income Inclusion Rule (IIR), which imposes top-up tax on a parent entity in respect of the low taxed income of a constituent entity; and (ii) an Undertaxed Payment Rule (UTPR), which denies deductions or requires an equivalent adjustment to the extent the low tax income of a constituent entity is not subject to tax under an IIR; and
- a treaty-based rule (the Subject to Tax Rule (STTR)) that allows source jurisdictions to impose limited source taxation on certain related party payments subject to tax below a minimum rate. The STTR will be creditable as a covered tax under the GloBE rules.

Rule status

The GloBE rules will have the status of a common approach.

This means that IF members:

- are not required to adopt the GloBE rules, but, if they choose to do so, they will implement and administer the rules in a way that is consistent with the outcomes provided for under Pillar Two, including in light of model rules and guidance agreed to by the IF;
- accept the application of the GloBE rules applied by other IF members including agreement as to rule order and the application of any agreed safe harbours.

Scope

The GloBE rules will apply to MNEs that meet the 750 million euros threshold as determined under BEPS Action 13 (country by country reporting). Countries are free to apply the IIR to MNEs headquartered in their country even if they do not meet the threshold.

Government entities, international organisations, non-profit organisations, pension funds or investment funds that are Ultimate Parent Entities (UPE) of an MNE Group or any holding vehicles used by such entities, organisations or funds are not subject to the GloBE rules.

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Rule design

The IIR allocates top-up tax based on a top-down approach subject to a split-ownership rule for shareholdings below 80%.

The UTPR allocates top-up tax from low-tax constituent entities including those located in the UPE jurisdiction under a methodology to be agreed.

ETR calculation

The GloBE rules will operate to impose a top-up tax using an effective tax rate test that is calculated on a jurisdictional basis and that uses a common definition of covered taxes and a tax base determined by reference to financial accounting income (with agreed adjustments consistent with the tax policy objectives of Pillar Two and mechanisms to address timing differences).

In respect of existing distribution tax systems, there will be no top-up tax liability if earnings are distributed within 3 to 4 years and taxed at or above the minimum level.

Minimum rate

The minimum tax rate used for purposes of the IIR and UTPR will be at least 15%.

Carve-outs

The GloBE rules will provide for a formulaic substance carve-out that will exclude an amount of income that is at least 5% (in the transition period of 5 years, at least 7.5%) of the carrying value of tangible assets and payroll.

The GloBE rules will also provide for a *de minimis* exclusion.

Simplifications

To ensure that the administration of the GloBE rules are as targeted as possible and to avoid compliance and administrative costs that are disproportionate to the policy objectives, the implementation framework will include safe harbours and/or other mechanisms.

GILTI co-existence

It is agreed that Pillar Two will apply a minimum rate on a jurisdictional basis. In that context, consideration will be given to the conditions under which the US GILTI regime will co-exist with the GloBE rules, to ensure a level playing field.

Other exclusions

The GloBE rules also provide for an exclusion for international shipping income using the definition of such income under the OECD Model Tax Convention.

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Subject to tax rule (STTR)

IF members recognise that the STTR is an integral part of achieving a consensus on Pillar Two for developing countries.[5] IF members that apply nominal corporate income tax rates below the STTR minimum rate to interest, royalties and a defined set of other payments would implement the STTR into their bilateral treaties with developing IF members when requested to do so.

The taxing right will be limited to the difference between the minimum rate and the tax rate on the payment.

The minimum rate for the STTR will be from 7.5% to 9%.

Implementation

IF members will agree and release an implementation plan. This will contemplate that Pillar Two should be brought into law in 2022, to be effective in 2023.

The implementation plan will include:

- GloBE Model rules with proper mechanisms to facilitate over time the coordination of the GloBE rules that have been implemented by IF members, including the possible development of a multilateral instrument for that purpose.
- An STTR model provision together with a multilateral instrument to facilitate its adoption.
- Transitional rules, including the possibility of a deferred implementation of the UTPR.

Next steps

The agreement reached above indicates the ambition of the IF members for a robust global minimum tax with a limited impact on MNEs carrying out real economic activities with substance. It acknowledges that there is a direct link between the global minimum effective tax rate and the carve-outs and includes a commitment to continue discussions in order to take a final decision on these design elements within the agreed framework by October. Excluding MNEs in the initial phase of their international activity from the application of the global minimum tax will also be explored.

[5] For this purpose, developing countries are defined as those with a GNI per capita, calculated using the World Bank Atlas method, of USD 12 535 or less in 2019.

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Annex B. Members of the OECD/G20 Inclusive Framework on BEPS joining the *Statement on a Two–Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy* as of 5 July 2021

1. Albania
2. Andorra
3. Angola
4. Anguilla
5. Antigua and Barbuda
6. Argentina
7. Armenia
8. Aruba
9. Australia
10. Austria
11. The Bahamas
12. Bahrain
13. Belarus
14. Belgium
15. Belize
16. Benin
17. Bermuda
18. Bosnia and Herzegovina
19. Botswana
20. Brazil
21. British Virgin Islands
22. Brunei Darussalam
23. Bulgaria
24. Burkina Faso
25. Cabo Verde
26. Cameroon
27. Canada
28. Cayman Islands
29. Chile
30. China (People's Republic of)
31. Colombia
32. Congo
33. Cook Islands
34. Costa Rica
35. Côte d'Ivoire
36. Croatia
37. Curaçao
38. Czech Republic
39. Democratic Republic of the Congo
40. Denmark
41. Djibouti
42. Dominica
43. Dominican Republic
44. Egypt
45. Eswatini
46. Faroe Islands
47. Finland
48. France
49. Gabon
50. Georgia
51. Germany
52. Gibraltar
53. Greece
54. Greenland
55. Grenada
56. Guernsey
57. Haiti
58. Honduras
59. Hong Kong, China
60. Iceland
61. India
62. Indonesia
63. Isle of Man
64. Israel
65. Italy
66. Jamaica
67. Japan
68. Jersey
69. Jordan
70. Kazakhstan
71. Korea
72. Latvia
73. Liberia
74. Liechtenstein
75. Lithuania
76. Luxembourg
77. Macau, China
78. Malaysia
79. Maldives
80. Malta
81. Mauritius
82. Mexico
83. Monaco
84. Mongolia
85. Montenegro
86. Montserrat
87. Morocco
88. Namibia
89. Netherlands
90. New Zealand
91. North Macedonia
92. Norway
93. Oman
94. Pakistan
95. Panama
96. Papua New Guinea
97. Paraguay
98. Peru
99. Poland
100. Portugal
101. Qatar
102. Romania
103. Russian Federation
104. Saint Kitts and Nevis
105. Saint Lucia
106. Samoa
107. San Marino
108. Saudi Arabia
109. Senegal
110. Serbia
111. Seychelles
112. Sierra Leone
113. Singapore
114. Slovak Republic
115. Slovenia
116. South Africa
117. Spain
118. Sweden
119. Switzerland
120. Thailand
121. Trinidad and Tobago
122. Tunisia
123. Turks and Caicos Islands
124. Turkey
125. Ukraine
126. United Arab Emirates
127. United Kingdom
128. United States
129. Uruguay
130. Viet Nam
131. Zambia

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This report provides an update on the historic success of the *Statement on a Two-Pillar Solution to Address the Tax Challenges Arising From the Digitalisation of the Economy* adopted on 1 July 2021 by a majority of member countries and jurisdictions of the G20/OECD Inclusive Framework on Base Erosion and Profit Shifting (BEPS). The report also includes a short update on the tax policy aspects of climate change, in relation to the G20 High Level Tax Symposium on Tax Policy and Climate Change of 9 July 2021, and the progress made in support to developing countries in building sustainable tax systems.

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