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Dangers lurking in the OECD tax proposals*

by

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In a recent *Perspective*, Pierce O'Reilly summarized and explained the OECD's flagship effort to rearrange the world of corporate taxation.¹ Nearing the end of its multi-year Base Erosion and Profit Shifting (BEPS) initiative, the OECD is making a valiant push for two tax "pillars" (released in October 2020): (i) assign a chunk of corporate earnings to countries where internet consumers live ([Pillar One](#)); and (ii) establish a global minimum corporate tax rate ([Pillar Two](#)). The "pillars" have a solid sound, but if adopted they will spawn tax confusion. Moreover, they could deprive the US Treasury of significant revenue at a time when President Biden is committed to extract higher corporate taxes.

Pillar One applies to two types of industries. The primary targets are automated digital services provided by US tech giants (e.g., Facebook, Amazon, Netflix, Google); the secondary targets are in-country sales by so-called "consumer facing businesses" (e.g., Proctor & Gamble, Walmart, Kraft Heinz). The proposal is designed to overturn the established international tax system whereby corporations are not taxed on profits earned from their sales abroad unless they have a physical presence in the foreign country. Pillar One would, instead, assign some percentage of corporate group earnings to each country where users live. The rationale is that digital firms gain valuable knowledge from their users—and hence the countries where the consumers are located are entitled to a tax bite.

The Pillar One proposal was designed as a multilateral framework for digital taxes at the national level, starting with the French digital services tax. The idea was to impose digital taxes on the US tech giants for purveying their internet services, along with targeted advertisements, to users around the globe. Added to the tax framework were other "consumer facing businesses" that reach users through digital technology. No doubt, digital firms gain valuable insights as to the purchasing proclivities of their users. The problem with this rationale is that—contrary to the wishes of the French Treasury and other digital tax advocates—the rationale is not confined to firms that use digital technology. All firms that serve consumers and most that serve industrial buyers constantly learn from their customers. This is just as true for Veuve Clicquot, Ferrari, LVMH, and Airbus, as it is for Facebook or Google.

As more and more firms "go digital", figuring out which firms are covered by the new taxes and which are not will be increasingly difficult. The extension of Pillar One to a range of goods will expose many imports to national corporate taxation. The outcome will be burdensome for MNEs, both in compliance

costs and tax burdens. Advocates of Pillar One should beware of what they wish: eventually new corporate taxes on merchandise trade could substantially exceed new tax revenues collected from tech giants. Given the persistently large US trade deficit, the US Treasury might be inspired to make up tax revenues lost on its tech giants through new taxes on foreign “consumer facing businesses.”

Only tax lawyers and accountants could find delight in this brave new world. Pillar One will lead to far more tax confusion than the established international principle of physical presence that has served international commerce well for the past century. Countries that want to tax consumption—indirectly the goal of the digital taxes—should instead fine tune their value-added tax systems, not complicating their already complex corporate tax systems.

Pillar Two is equally fraught, though the prospect of a global minimum corporate tax has great appeal. As Senator Russell Long famously said, there is a secret to raising taxes: “Don’t tax you, don’t tax me, tax the fellow behind the tree.” The fellow truly behind the tree is the MNE, currently criticized for paying its executives too much and tax collectors too little.

The core weakness of Pillar Two is rooted in basic tenets of political economy. National legislatures, curiously enough, think that it is their task to juggle the conflicting demands of raising public revenue with opposing calls to create well-paying jobs through tax relief and subsidies. If OECD governments manage to agree on the concept of a minimum tax rate (12.5%? 20%? – the figure remains to be settled), we may be sure that legislators who feel thwarted will create new deductions and credits in their systems. The OECD minimum² will be a floor in name only. Worse, some countries will escape the confines of a minimum tax through new subsidies to favored firms. The result will be more jagged, and thus more distortive, national systems of taxation and subsidization.

The OECD BEPS project has gone too far down the track to hope for a major course change. Very likely, a compromise version of the two pillars will be agreed in 2021. If the world of taxation is lucky, the components of the pillars will be unbundled, with some adopted and the rest left to the dustbin of history.

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¹ See [Pierce O’Reilly, “International tax reform and FDI,” *Columbia FDI Perspectives*, No. 302, April 19, 2021.](#)

² See [OECD, *Tax Challenges Arising from Digitalisation. Report on Pillar Two Blueprint: Inclusive Framework on BEPS* \(Paris: OECD, 2020\), pp. 11-13.](#)

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