Box A: BEPS Reforms of International Tax Rules

Some 137 international tax jurisdictions are discussing proposals for major reforms of international tax rules under the aegis of the OECD/G20 Inclusive Framework on Base Erosion and Profit Shifting project. The reforms come as challenges posed by an increasingly digital economy have become more prominent, with existing taxing rights relying heavily on physical presence. This box discusses some of the latest work published on these reforms and assesses the potential implications for Ireland.

Two pillars

The BEPS initiatives are split into two pillars. Two reports, published in October 2020, set out blueprints for how each of the pillars would work (OECD, 2020a and 2020b).

1. "Pillar One" involves a change to the way rights to tax digitally-intensive/consumer-facing MNEs are allocated. In particular, it would allocate a portion of profits for taxing rights to the jurisdiction where the market or user is located. This would be a significant change from the existing approach, which principally allocates taxing rights on the basis of physical presence. The aim is to ensure that MNEs pay taxes where they have significant business, even without a physical presence.
2. "Pillar Two" involves a global minimum corporate tax rate. This would reduce incentives for firms to shift profits to low-tax jurisdictions. It would only apply to businesses that meet or exceed a threshold for annual gross revenue of €750 million.

The impact of reforms

As part of the BEPS workplan, the OECD carried out an economic analysis and impact assessment of the proposals (OECD, 2020c). Without giving country-specific estimates, the OECD report covers so-called "investment hubs" — jurisdictions with a total inward FDI position above 150 per cent of GDP. This category includes Ireland and the OECD notes that these hubs would tend to lose out on tax revenues. The Minister for Finance noted in his budget speech that reforms would reduce taxable profits in Ireland.[4] The negative assessment contrasts with the assessments for other jurisdictions, which shows that both BEPS pillars would be expected to boost tax revenues.

Country-specific estimates of the revenue impacts of Pillar One and Pillar Two were shared with jurisdictions by the OECD on a confidential and bilateral basis. The impact on Ireland has not been made public and the Department of Finance did not share the estimates produced under the new analysis. However, it noted that it did not feel that there were enough grounds to change its previous estimated revenue impact range of €0.8 to €2 billion, which were incorporated in previously published medium-term forecasts. The Department cited the unreliable and partial nature of the OECD estimates and highlighted several reasons for sticking with its own original estimates. These included that (1) the newer estimates predate recent developments, including various aspects of the BEPS Action Plan and key tax reforms in the US (the Tax Cuts and Jobs Act); (2) the tool captures profit-making sub-groups rather than net overall profits from all MNE entities, which underestimates tax impacts for Ireland; and (3) important behavioural responses like investment decisions are not incorporated in the tool.

The path ahead

Finance ministers of the G20 (2020) committed to address remaining issues and reach a global solution by mid-2021. It is also possible that tax reforms at EU level could happen if these are not otherwise agreed at the OECD level, while any future tax policy changes in the United States could also affect developments in Ireland.

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[4] See the Minister of Finance's Budget 2021 speech at: https://www.gov.ie/en/speech/063d4-budget-speech-by-the-minster-of-finance-paschal-donohoe/