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INSIGHT: OECD's Alarm on Coronavirus and the World Economy—Where Do Pillars 1 and 2 Fit In?

BY JEFFERSON VANDERWOLK

On March 2, 2020, the Organization for Economic Cooperation and Development (OECD) issued an interim economic assessment titled ''Coronavirus: The world economy at risk.'' The 15-page report discusses the negative effects of the disease on global GDP growth, and the need for policy responses that will help support growth. Although fiscal policy is considered in the report, there is no mention of the OECD-led tax policy work on the Pillar 1 and Pillar 2 proposals being considered by the 137-member Inclusive Framework on Base Erosion and Profit Shifting (IF) in relation to the tax challenges of digitalization.

Pillar 1 would reallocate taxing rights in favor of market jurisdictions in relation to businesses in two categories: automated digital services, including cloud computing, and consumer-facing businesses. It would also require, for all industries, a fixed taxable return on routine distribution and marketing functions. Pillar 2 is a global minimum tax proposal that would ensure that all multinational business profits were taxed at a minimum rate (or higher rate, if a country chose) under either an income-inclusion rule (applicable to the parent company of the group in its home country) or an undertaxed-payments rule (applicable to a group company making a base-eroding payment to a nonresident with an effective tax rate below the global minimum rate).

The OECD recently stated, in a presentation of preliminary findings from economic analysis, that implementing these proposals could raise $100 billion of additional corporate income tax revenue each year from multinational enterprises (MNEs) globally. The OECD Secretary-General noted this estimate in his February 23 remarks to the G20 Finance Ministers and Central Bank Governors in Riyadh, saying, ''As a share of corporate tax revenues, the revenue gains are broadly similar across high-, middle-, and low-income economies.'' He went on to exhort his audience to help the Inclusive Framework reach agreement on Pillars 1 and 2, in these words: ''The stakes are high. If we fail, tax wars could turn into trade wars, further impacting global growth and investment.''

Let's step back for a moment. On one hand, the OECD is pointing out that the spread of coronavirus is putting the world economy at risk, necessitating pro-growth policy responses. On the other hand, the organization is simultaneously cheerleading for global tax policy changes that would substantially increase the corporate income tax burden on multinational businesses of all kinds. Given that economists agree that increasing corporate income taxes is a drag on economic growth, there is clearly some inconsistency in the OECD's messages.

It should be noted that similarly mixed messaging is coming from the U.S. government. In recent days, Treasury Secretary Mnuchin, along with many others, has expressed concern about the economic effects of the coronavirus, and has also said that the U.S. fully supports global agreement on the Pillar 2 minimum tax proposal (assuming that the GILTI regime is considered to meet the proposal's requirements).

If Pillars 1 and 2 were aimed at aggressive tax planning that defeats countries' fiscal policies, one could reconcile the apparently conflicting messages. However, they have a different focus (although countries are not in complete agreement on the purpose of each proposal). Broadly, Pillar 1 aims at giving greater taxing rights to market countries, while Pillar 2 effectively prevents countries from using tax incentives to attract investment. The driving force behind the proposals is a

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desire to avoid the chaos of uncoordinated unilateral tax measures aimed at nonresident businesses, such as digital services taxes, which (it is assumed) would be repealed or withdrawn if agreement is reached at the OECD. This is a legitimate concern, but it is not clear that Pillars 1 and 2 are the best way to achieve that goal.

The inclusion of cloud computing services in the list of businesses that would be subject to the reallocation rules of Pillar 1 is another aspect of the OECD's work that seems to be anti-growth. Cloud computing is effectively digital infrastructure for businesses of all kinds, lowering costs and enabling innovation and growth by small and medium-sized enterprises that otherwise would not have access to the resources provided through the cloud. The academic literature appears to support unequivocally the idea that cloud computing is good for economic growth. Yet the OECD is lumping it in with internet-based businesses that it claims need to be taxed in market countries, regardless of physical presence, because of their ability to create value and compete effectively with local, less-digitalized competitors on a tax-free basis by gathering, analyzing, and exploiting data obtained from consumers.

In contrast, providers of cloud computing services do not have any less-digitalized competitors, nor do they interact with the public: their customers are generally other businesses, who use the cloud services as inputs in a way that is almost always invisible to their customers or end-users. It is hard to see the policy rationale for including cloud computing in the Pillar 1 list of in-scope businesses.

The OECD's mission is to provide policy recommendations for beneficial and sustainable economic growth. At a time when the world economy is threatened, pro-growth tax policies should be prioritized. Avoiding uncoordinated unilateral measures and devising effective new dispute prevention and resolution mechanisms are certainly good goals to work toward##8213;but it is not apparent that imposing a heavier tax burden on businesses worldwide is the right way to get there.

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