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**Global reform**

Reform is a never-ending task. There is no starting point, and no finish line. It is just a continuous process of being better.

After years of rigorous work and engagement, on July 1, 2021 the world came together, and agreed to a momentous tax agreement – one that advances the global community closer to reforming the international tax architecture rather swiftly. An agreement now signed by 132 countries, representing more than 90 percent of global Gross Domestic Product, to reform international corporate taxation. It is not often that a universal near-consensus is reached on an issue with far-reaching consequences. The inclusive reform based on a two-pillar framework, has been further endorsed by G20 countries in Venice on July 11, 2021.

Pillar One mandates a fairer distribution of profits and greater taxing rights in the jurisdictions where goods or services are consumed, rather than produced. The Organisation for Economic Co-operation and Development (OECD) estimates that taxing rights on more than $100 billion of profit may be reallocated to these market jurisdictions annually – a substantive amount indeed.

The new framework is an endeavour to cover the in-scope multinational enterprises (MNEs) with global turnover above 20 billion euros and profitability above 10 percent. The treaty reaches about 100 of the most notable MNEs with annual revenue above 20 billion euros. It includes digital giants like Google and Twitter and consumer businesses such as Amazon and Apple. The idea is to allocate taxing rights over MNEs conducting large-scale businesses in jurisdictions with little or no physical presence.

The political drive for the reform came from European countries – many of which were unhappy at inadequate taxes paid by the United States’ digital sector despite substantive revenues generated in European and other markets. The reform was aggressively pursued by the UK, France, Germany, Italy and others in the European Union. It is noteworthy that many of these economies had already taken steps by imposing unilateral digital taxes.

The absence of an agreement would have resulted in a spread of a country-based approach to digital taxes. This would be an uncoordinated approach creating uncertainty and friction in a global trading and tax system with a higher consumer burden as well as increased compliance and administration costs.

Pillar Two of the new framework determines a global minimum tax of at least 15 percent on multinationals with annual revenue greater than 750 million euros. This reform builds on a long-term international effort led by the OECD through an inclusive framework to prevent tax avoidance by base erosion and profit shifting. A key focus of this effort is to address the challenges rising from digitalisation and globalisation to bring fairness and certainty to the way multinationals are taxed. With a global minimum tax rate, jurisdictions earlier offering a corporate tax rate of well below 15 percent – the so-called ‘tax havens’ – will cease to exist.

Corporate tax avoidance costs countries anywhere from $100 billion to $240 billion annually, which is equivalent to 4-10 percent of global corporate income tax revenues as per OECD estimates. The number crunching by experts, however preliminary in nature, tells a good story – the framework makes a significant new revenue impact. The OECD estimates that under Pillar Two, the global minimum tax, with a rate of at least 15 percent, is expected to generate more than 150 billion euros in new tax revenues globally.

This reform is indeed a leap forward for countries. However, this good process needs strengthening. Even with a minimum rate, many corporate profits will still be taxed according to the residence principle. Thus, the number of multinational corporations in the global framework needs to be increased with time. Efforts must continue to convince the very small group of the Inclusive Framework’s 139 members, which have not yet joined – seven to be precise. The special carve-outs for banks and natural resource companies need to be rethought in the future. Most importantly governments must continue to focus on simplifying rules and regulations so that interpretation and their implementation remains easy.

Pakistan has made its effort and proudly become part of the global consensus for tax reform. This is likely to give a boost to the country’s taxation revenues. The effort must continue for the future. Pakistan has the opportunity to strengthen its engagement in the OECD-led multilateral process. It is needless to say that strong actions by the tax authority to strengthen the integrity of the country’s corporate tax system can prevent multinational tax avoidance.

International taxation remains a less-exploited area of revenue in Pakistan. Globalisation, digitalisation and increased mobility of tax bases have increased pressures on tax systems and led to the introduction of international standards like BEPS and automatic exchange of financial information. Governments can lose a high percentage of revenues due to profit shifting by MNEs. Pakistan has the potential of collecting $3-5 billion yearly in revenues due from profits earned by multinational enterprises – a substantive amount for a country looking to boost its tax-to-GDP ratio.

It is heartening that these global changes move forward the agenda of fairness and efficiency in taxation. This highlights the need for the global tax architecture to respond in a speedily transforming world. The multilateral design of the two-pillar framework is likely to reduce potential for trade wars related to country-based taxes targeting digital companies. The idea is that global tax reforms simultaneously advance national and global interests.

The next two years will require a lot of heavy lifting to move forward. The timeline for the framework to make everything happen is indeed challenging. The real issue is always implementation. This requires integration of these new principles by every country into their tax systems; they would have to do some serious work. Finalisation of the agreement and resolution of technical details for implementation is expected in October 2021.

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