

The Impact of the "Two-Pillar" Proposal for Cross-Border Taxation of the Digital Economy and China's Response

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Abstract

With the rapid development of the digital economy, the issue of cross-border corporate taxation has become increasingly prominent worldwide, making international tax allocation a critical topic in global taxation governance. This paper begins by examining the genesis of the Two-Pillar Solution, then provides an in-depth analysis of the impacts of OECD's new international tax rules under the digital economy framework. Building on this foundation, it systematically evaluates the differential effects of the Two-Pillar Solution on both developed and developing economies. By identifying challenges Chinese enterprises face in cross-border transactions and drawing comparative lessons from implementation measures adopted by other jurisdictions, the study proposes targeted policy recommendations for China. The findings aim to provide valuable references and insights for addressing cross-border taxation challenges in China's digital economy development.

Keywords

Digital economy; Cross-border transactions; "Two-pillar"; Taxation

1. Introduction

With the rapid advancement of the digital economy, emerging technologies such as mobile internet, artificial intelligence, cloud computing, and big data have flourished. While multinational corporations leverage the conveniences brought by economic globalization and digitalization, they also engage in profit shifting on a global scale to avoid taxation—practices that significantly undermine the fiscal interests of affected nations. The global governance of taxation in the digital economy has become an inevitable trend, with cross-border taxation issues increasingly becoming a focal point for countries worldwide. On October 8, 2021, the Organisation for Economic Co-operation and Development (OECD) convened its 13th plenary meeting, where 136 members reached a consensus on new international tax rules. The subsequent

Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy marked a milestone achievement in international tax reform. Against this backdrop of global digital economic development, a critical question emerges: How should China respond under these new circumstances? This issue demands our focused attention in the subsequent analysis.

2. The Background and Main Content of the "Two-Pillar" Solution

2.1 The Phased Background of the "Two-Pillar" Solution

Base Erosion and Profit Shifting (BEPS), as a core governance issue in the international tax system, has evolved through the following key phases:

2.1.1 Policy Initiative Phase (2009–2012)

The G20 first addressed BEPS in the Statement on Anti-Tax Evasion issued at the 2009 London Summit, marking formal international recognition of the issue. The 2012 Los Cabos Summit further proposed the governance objective of "curbing base erosion and unreasonable profit shifting," which gained broad consensus among member states and laid the political foundation for subsequent institutional development.

2.1.2 Framework Construction Phase (2013–2015)

In 2013, the Organisation for Economic Co-operation and Development (OECD), commissioned by the G20, released the Action Plan on Base Erosion and Profit Shifting (BEPS Action Plan). This framework outlined 15 specific measures covering key areas such as digital economy taxation, strengthening controlled foreign company (CFC) rules, and preventing tax treaty abuse. Participants included all G20 members, OECD countries, and 19 non-member economies. The final report on the Action Plan was published in October 2015 and formally endorsed at the G20 Antalya Summit in November of the same year.

2.1.3 Institutional Implementation Phase (2016–2018)

On November 24, 2016, the OECD introduced the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS (MLI), which innovatively employed a multilateral legal instrument to harmonize amendments to existing bilateral tax treaties. On June 7, 2017, Wang Jun, then Commissioner of China's State Taxation Administration, signed the convention on behalf of the Chinese government at the OECD headquarters in Paris. Following the statutory ratification process, the MLI officially entered into force on July 1, 2018.

This governance process exhibits distinct phased characteristics: progressing from political consensus-building (G20 initiatives) to technical solution design (OECD Action Plan), and culminating in a binding multilateral legal instrument (MLI). This reflects the typical "hardening of soft law" trajectory in international tax governance. As a key participant, China has been deeply involved in the institutional develop-

ment at every stage.

2.2 Main Content of the "Two-Pillar" Solution

The "Two-Pillar" Solution consists of two interconnected rules: Pillar One and Pillar Two. Pillar One comprises three key components: Amount A, Amount B, and Tax Certainty. Amount A involves the reallocation of taxing rights on global profits of ultra-large multinational enterprises across different jurisdictions. Amount B represents a simplified application of the traditional arm's length principle. Tax Certainty establishes a mandatory and binding dispute prevention and resolution mechanism to avoid double taxation under Amount A. Pillar One is primarily based on the "Unified Approach" framework, aiming to address the reallocation of global taxing rights. Its key objectives are: Expanding market jurisdictions' taxing rights. Defining new nexus and profit allocation rules for in-scope multinational enterprises

In contrast to Pillar One, Pillar Two is less specifically targeted at the digital economy. Its main purposes are: Addressing profit shifting and base erosion by multinational enterprises. Reducing tax avoidance opportunities through the GloBE (Global Anti-Base Erosion) rules. Better balancing tax rights among countries. Pillar Two, often referred to as the "Global Minimum Tax," establishes: A global minimum effective tax rate for large multinational enterprises. Mechanisms to prevent profit shifting to low-tax jurisdictions. Solutions to remaining BEPS issues caused by tax competition. The core objective of Pillar Two is to ensure that large multinational enterprises pay a minimum level of tax (currently set at 15%) in every jurisdiction where they operate, thereby mitigating harmful tax competition between countries.

3. The impact of the "two-pillar" plan on different countries

The two-pillar plan is designed to allocate international taxing rights more equitably order to reduce tax competition and tax avoidance. However, its implementation will have varying impacts on different countries due to factors such as the type of country, economic strength, and tax. Countries should formulate corresponding response strategies based on their own situations to adapt to the new international tax environment.

3.1 Impact on Developed Countries

3.1.1 Increase in Tax Revenue

The implementation of the TwoPillar Solution is expected to result in the redistribution of over USD 100 billion in tax revenue through Pillar One, according to estimates. Developed countries are where headquarters of large multinational enterprises are located, and therefore, these companies tend to carry out related business activities on a global scale. The Two-Pillar Solution, through redistribution of tax rights, allows these countries to enjoy a more equitable share of the profits of multinational enterprises. Developed countries can gain increased tax revenue, which

helps to boost national tax revenue, thereby better supporting some public services and social welfare programs.

3.1.2 Enhancement of Tax Fairness

The international tax system has long faced challenge of Base Erosion and Profit Shifting (BEPS), where harmful tax competition is an important factor leading to unfair taxation. Countries often compete to attract multinational investment by lowering tax rates or providing excessive tax incentives, which not only erodes the tax base but also distorts global capital flows and market fairness. The Two-Pillar Tax Reform Solution aims to establish global minimum tax rules and reallocate taxing rights, thereby curbing harmful tax competition, promoting a fair competitive environment, and safeguarding the tax interests developed countries.

3.1.3 Checking Industrial Offshoring

The Two-Pillar Solution provides an effective mechanism to curb industrial offshoring from developed countries the global minimum tax regime. This system sets a 15% global minimum tax rate, significantly reducing the benefits for companies to avoid taxes through transfer pricing and profit shifting. multinational enterprises are unable to achieve a substantial reduction in their tax burden by shifting profits to low-tax jurisdictions, their tax incentives for offshoring are correspondingly weakened. Particularly, Top-Up Tax mechanism in Pillar Two ensures that the final tax burden of a company does not fall below the minimum standard regardless of where it operates. This not only reduces the of "paper offshoring" but also causes companies to consider non-tax factors such as operational efficiency more when making physical relocation decisions. While this solution cannot completely eliminate industrial transfer it does provide an important tax guarantee for developed countries to maintain industrial competitiveness, which helps to alleviate the issue of industrial hollowing out driven by tax arbitrage.

3.2 Impact on Developing Countries

3.2.1 Acquisition of New Taxing Rights

The Two-Par International Tax Reform provides new opportunities for developing countries to participate in global tax governance. Under the rules of Pillar One, multinational enterprises with annual revenue exceeding 20 billion and a profit margin of more than 10% are required to reallocate 25% of their residual profits to the market jurisdictions, enabling developing countries, as important consumer, to acquire new taxing rights. This mechanism breaks through the limitations of the "physical presence" principle in traditional international tax rules, allowing developing countries to tax digital enterprises that operate in their territory but do not have a permanent establishment. Through this profit reallocation mechanism, developing countries are expected to gain an additional \$7 to \$12 billion in tax annually, which helps to offset the tax base erosion caused by BEPS and enhance their

fiscal sustainability.

3.2.2 Alleviation of External Pressures

The TwoPillar International Tax Reform provides developing countries with a breakthrough tax governance tool, enabling them to break away from the dilemma of excessive reliance on tax incentives. With the new tax rights established under Pillar One, developing countries no longer need to rely solely on reducing tax rates to attract foreign investment, but can directly tax multinational enterprises operating in their markets. This right allocation mechanism based on economic substance effectively alleviates the passive situation of developing countries in tax competition. Meanwhile, the global minimum tax rate set by Pillar Two narrows the profitmaking space for multinational enterprises through tax arbitrage, enabling developing countries to shift their policy focus from tax incentives to improving the business environment, infrastructure, and other more sustainable development factors. This not only helps to safeguard the tax sovereignty of developing countries, but also promotes them to achieve a fairer and more stable economic development model.

3.2.3 Improved Tax Environment

The implementation of the two-pillar international tax reform plan is driving a paradigm shift in foreign investment attraction strategies of developing countries. With the global minimum tax rate undermining the effectiveness of traditional tax incentives, countries are shifting their competitive focus to the substantial improvement of the environment: on one hand, accelerating the modernization of infrastructure, including the upgrading of transportation networks, energy systems, and digital infrastructure, such as Vietnam's substantial investment in deepwater ports and highway construction; on the other hand, deepening institutional reforms, streamlining administrative approvals, and strengthening intellectual property protection, similar to India's "Ease Doing Business" initiative. Meanwhile, talent cultivation becomes a new focus, with many countries increasing their investment in vocational education and improving social security systems. This transformation prompts multinational enterprises investment decisions to focus more on long-term factors such as market potential, supply chain efficiency, and human capital, rather than short-term tax incentives, ultimately driving the formation of more sustainable economic development model in developing countries.

Overall, the two-pillar plan has a significant but differentiated impact on countries worldwide. For developed countries, the plan can effectively the profit shifting of multinational enterprises while relieving the pressure of industrial hollowing. For developing countries, while they can gain new taxing rights through the profit reallocation mechanism, also face challenges such as increased difficulty in attracting foreign investment. Countries need to adopt differentiated strategies in the implementation process: developed countries should focus on the connection with domestic antitax avoidance legislation, while developing countries need to accelerate

the reform of the business environment. At the same time, the international community should establish effective dispute resolution mechanisms and technical assistance systems to the fairness and feasibility of the plan's implementation, ultimately achieving the optimization and upgrade of the global tax governance system.

4. Challenges to China in Cross-border Business Transactions in the Digital Economy

4.1 Difficulty in Application of Traditional Taxation Bases

The digital economy, characterized by its cross-border nature and intangibility, makes it difficult for traditional taxation systems to adapt to its development. With the digitalization, enterprises can provide the desired products or services to consumers without establishing physical institutions in other countries or with only a small-scale physical presence in the other country. The traditional taxation, which relies on the actual existence of a "permanent establishment" as the basis for taxation, is no longer applicable. In this case, the country where consumer is located does not have the right to tax multinational companies, resulting in a low level of taxation. This poses a huge challenge to international taxation. The convenience of carrying out activities and trading in goods and services in different countries without the need for a physical presence facilitates profit shifting and tax avoidance by some multinational companies. For example, large internet technology companies such as Google, Apple, Facebook, and Amazon shift a large amount of revenue and profit to "tax havens". Taxation, one of the important sources of national fiscal revenue, brings more losses to national finance in the context of digital trade if there is a lack of applicable taxation bases.

4.2 The Identification of Taxpayers is Challenge

The rapid development of digital technology is reshaping the way we perceive individuals and businesses and driving the rise of new business models and economic forms. In this process of transformation, the identification of taxpayers faces many challenges as it directly relates to the issue of national and regional taxation jurisdiction. First, digital technology has significantly lowered the threshold for online operations, making the taxpayer decentralized than ever before. Second, the virtual nature of the Internet provides some entities with the possibility of avoiding supervision, making it difficult for tax authorities to accurately identify taxable entities. This situation makes the confirmation of tax sources and tax bases extremely complicated. It is worth noting that the differences in taxation jurisdiction among different countries and regions further exacerbate the complexity of the issue. These differences not only cause difficulties in tax collection and management but also lead to some countries facing serious issues of base erosion and profit shifting (BEPS). This situation highlights the urgent need to improve the taxation management system in the digital economy era.

4.3 The burden of taxation presents inequity

The inequity of the burden of taxation in the context of digital trade presents new issues., the inequity of the burden of taxation between the digital trade industry and traditional industries, as the taxation of the digital economy is a new issue, some countries and regions have not corresponding new policies, which leads to the fact that the burden of taxation on the digital industry is lower than that on traditional industries in practice, forming an unfair competition between industries;ly, there is a significant difference in the burden of taxation between online and offline businesses, the Internet has promoted the rise of the platform economy, the online economy is developed, and overall burden of taxation on offline production and business activities is higher than that on online business activities, which is one of the important reasons for the loss of national taxation caused by trade in era of the digital economy; finally, the fairness of cross-border taxation urgently needs to be addressed, the fairness of the burden of taxation between domestic enterprises and foreign enterprises on operating and service income, as foreign enterprises do not have to set up entities in the country in order to provide services, the taxation of foreign enterprises under the digital trade faces new problems this new type of cross-border taxation and tax collection and management difficulties are intensifying the inequity of international tax competition.

5. Measures to be Taken by China under Digital Cross-border Transactions

China's national conditions As a major digital trade power, China not only needs to actively participate in the formulation of international digital taxation rules but also needs to continuously improve the domestic taxation and administration policies for digital trade, so as to bring a series of challenges to the international digital taxation. China should actively respond to the OECD reform plan, combine the current national conditions of, conform to the actual situation, and should take some measures to deal with the challenges.

5.1 In-depth Research and Understanding of the Two-pillar PlanWith the rapid

Development of the digital economy and the deepening of globalization, the international taxation system is facing unprecedented challenges. In response to the issue of multinational enterprises' base erosion profit shifting, the two-pillar international tax reform plan launched by OECD/G20 will have a profound impact on the global taxation governance pattern. In this context, we to systematically study the impact and coping strategies of this plan. Firstly, we should fully interpret the content of the two-pillar plan, deeply analyze the main and specific content of Pill One and Pillar Two, including how to improve the mechanism for the allocation of taxation rights for multinational enterprises and how the global minimum tax rate is set, etc.; carefully the formulation background, purpose and expected effects of the two-pillar plan, so as to understand its role and positioning in the global taxation system. Sec-

only, assess the impact of the-pillar plan on China, analyze the impact of the two-pillar plan on China's tax revenue, tax competition and tax structure, etc., so as to clarify the and opportunities faced by China at present; and compare the domestic and foreign taxation systems, find out the shortcomings and gaps in China's taxation system in dealing with the two-pillar. Finally, we can actively study the practices and experiences of other countries and regions in dealing with the two-pillar plan, so as to provide positive and beneficial references and enlightenment so as to better deal with the impact of the two-pillar plan.

5.2 Strengthen International Tax Cooperation and Coordination

Against the backdrop accelerating economic globalization and the booming development of the digital economy, the international tax governance system is undergoing profound changes. China needs to take systematic coping strategies, which can be focused on following three dimensions: First, participate actively in the process of formulating and revising international tax rules, actively promote the construction of a fairer and more reasonable international tax, be good at using the preferential tax system and tax agreement treatment of various countries, maintain competitive advantages in the new round of technological revolution and industrial transformation, and cultivate multinational enterprises international competitiveness. Second, we should establish and improve the tax information sharing mechanism, strengthen coordination and cooperation with major economies and tax partner countries, deepen international cooperation in the fields of collection and management and tax audit, and jointly crack down on the tax evasion and tax avoidance behaviors of multinational enterprises. Through international exchanges, learn from advanced experience and practices, improve the level of tax governance in China; third, we should participate in-depth in the activities of various international tax organizations such as OECD and the United Nations, strengthen exchanges cooperation with these organizations. Through participation in international organizations, strengthen the exchange of tax information with other countries, keep abreast of the latest developments in international taxation, and jointly crack on cross-border tax avoidance behaviors.

5.3 Promoting Tax Reform and Innovation

In the face of the comprehensive implementation of the international-pillar tax reform plan, in order to quickly adapt to the global tax reform and governance, and to protect our national interests, it is imperative to accelerate the improvement of the domestic legal system. Specifically, we can start from the following aspects: First, we should study and formulate tax policies and measures that are compatible with the development of the digital economy, promote the reform and innovation of the tax system; strengthen tax collection and management and services in the field of the digital economy, and improve the efficiency and accuracy of tax collection and management strengthen domestic tax reform, on the one hand, we should deepen the

reform of personal income tax, ensure that personal income tax policies are internationally compatible, and better cooperate with the of the two-pillar plan; on the other hand, we should reform corporate income tax, especially the tax system of multinational enterprises, so as to ensure tax fairness and efficiency., explore new tax collection and management models, learn from advanced foreign tax collection and management models and technical means, and explore tax collection and management models suitable for China's national conditions improve the tax collection and management system, strengthen the strength of tax collection and management, and continuously improve the efficiency of tax collection and management to ensure the effective implementation of tax policies strengthen the information construction of tax collection and management, and improve the intelligent and automated level of tax collection and management. Third, strengthen the construction of the talent team for tax collection and, strengthen the training and introduction of tax collection and management talents, improve the professional quality and professional ability of tax collection and management personnel; pay attention to the professional ethics education of collection and management personnel, and improve the service consciousness and sense of responsibility of tax collection and management personnel.

5.4 Strengthening Financial Supervision

In to ensure the stability of China's financial system, prevent the risk of abnormal cross-border capital flows, and ensure the transparency of tax information, it is imperative to build a and multi-level financial supervision system. This system should focus on the following aspects for improvement: First, strengthen the effectiveness of financial supervision. It is necessary to continuously strengthen the allround supervision of domestic and foreign financial institutions, establish and improve the risk prevention and control mechanism, and effectively guarantee the healthy and stable development of the financial market. At the same, it is necessary to actively cooperate with the implementation process of the two-pillar plan, focus on strengthening the dynamic supervision of cross-border financial activities, and effectively prevent corporate taxasion and abnormal capital outflow risks. Second, promote the innovation of supervision technology. It is necessary to focus on developing intelligent risk assessment model systems, fully use big data analysis technology to the accuracy of risk identification, and use blockchain technology to ensure the authenticity and reliability of regulatory information. Finally, improve the tax dispute resolution mechanism. It is necessary to focus on building systematic and standardized tax dispute resolution system, and provide more efficient and convenient channels for dispute resolution for market entities. In addition, we should deepen exchanges and cooperation with international organizations and work together to promote the optimization and upgrading of global tax dispute resolution mechanisms.

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