The need for global minimum tax: Assessing Pillar two reform

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Broad contours of the pillar 2 reform

- >=Euro 750 million
- Corporate tax base=aggregate the income, adjust for carry forward losses, exclude intra-group dividends
- Covered taxes= Pillar one tax, STTR and other taxes(Excludes DST)
- Carve out for tangible and payroll @5%
- Effective tax rates computed jurisdiction wise
- IIR
- Switch over rule
- UTPR is backstop
- GILTI related adjustments
- STTR complements the IIR but is delayed

Global minimum tax: Full circle for OECD

- 1996 work on tax competition that distorts economic decisions

"aimed at establishing a multilateral approach under which countries could operate individually and collectively to limit the extent' of 'tax schemes aimed at attracting financial and other geographically mobile activities' which 'can create harmful tax competition between States, carrying risks of distorting trade and investment and could lead to the erosion of national tax bases"

- 1998 report defining harmful tax competition
    - i. Incentives to real economic activity excluded
    - ii. Criteria of low tax with lack of transparency & EOI
- 2002 jurisdictions identified as tax havens
- *"The OECD does not seek to dictate to any country what its tax rate should be, or how its tax system should be, or how its tax system should be structured. It does not seek to hinder enterprises in carrying out normal business or to threaten the privacy of taxpayers. It aims to foster economic growth and development and ensure fair and equitable flow of capital world-wide by promoting fair competition on tax rates…"*
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- The classification of tax haven also became a controversial subject (exemptions vs. selective exclusions)
- 2011 work on expanding tax base and reducing tax rates
- 2013 IP regimes and Harmful Tax Practices (Action point 5) and Treaty Abuse(Action point 6)
- 2020 Pillar two proposal to implement global minimum tax

Lessons from regulating HTP and tax competition

- Dormant commerce clause- hard to establish the cost [*DaimlerChrysler Corp. v. Cuno]*
- State Aid Rules in EU [*Starbucks* and *Fiat]* where the Commission has to first show its ruling is erroneous and not just on methodological grounds then it must prove that an advantage was given
- Lack of clear definition of tax havens and HTP
- Empirical evidence on pure competition effects is not available since tax systems also respond to aggregate shocks such as macroeconomic changes, capital income shares, and technology
- Under Action point 5 review of 255 regimes, only two were found to be harmful and 11 as potentially harmful. Yet, 2016 CbCR statistics indicated that multinational enterprises (MNEs) continue to use holding structures for intangibles and shares in low tax jurisdictions
- The evidence from Action 11 is weak to support current changes

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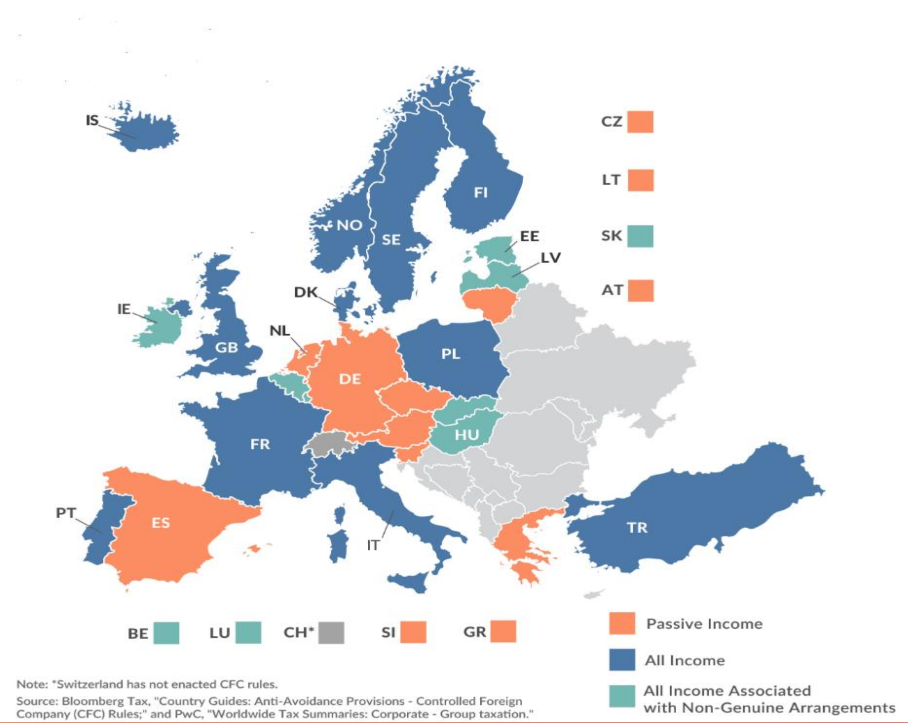
Lessons from regulating HTP and tax competition

CFC Regimes across the world operate differently

- 8 EU countries only apply the CFC to passive incomes
- 7 EU countries tax all incomes of non-genuine arrangements
- 10 tax active and passive incomes whereas
- Switzerland does not apply CFC rules



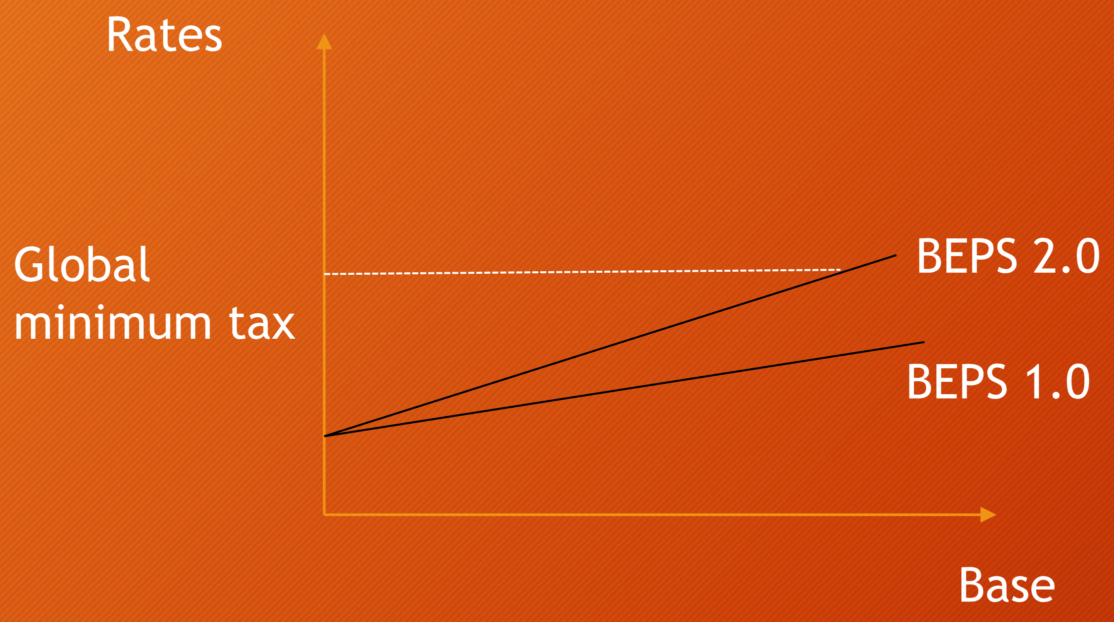
Source: Tax Foundation

Where are the profits located?

Country	Share of profits	Share in entities
United Kingdom	2.9	17.4
Switzerland	2.8	12.5
Netherlands	3.9	14.4
Luxembourg	4.1	12.3
Ireland	1.1	9.3
Singapore	4.3	15.8
Puerto Rico	1.4	6.2
Cayman Islands	3.5	12.4
Bermuda	6.4	9.9
Stateless	11.7	25.9
United States	53.1	29.7

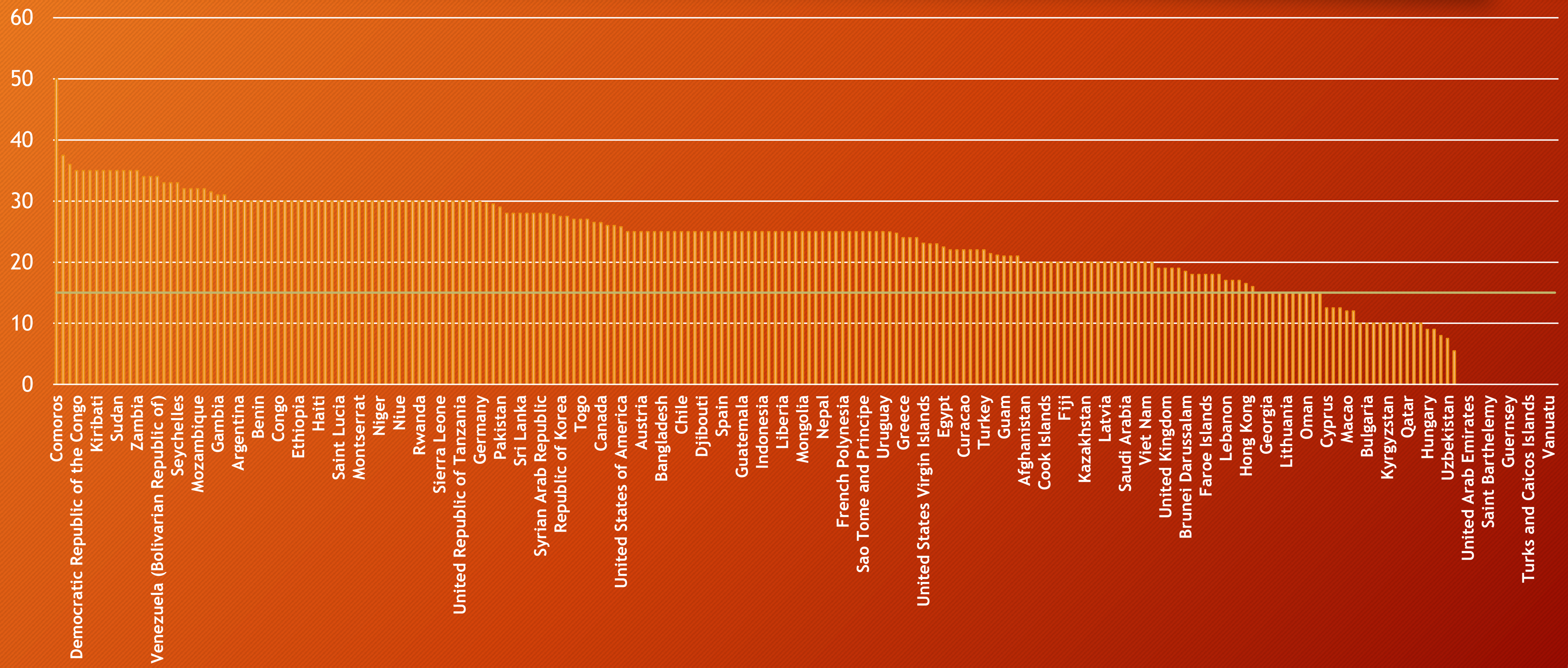
Source: US IRS CbCR

Solving the problem

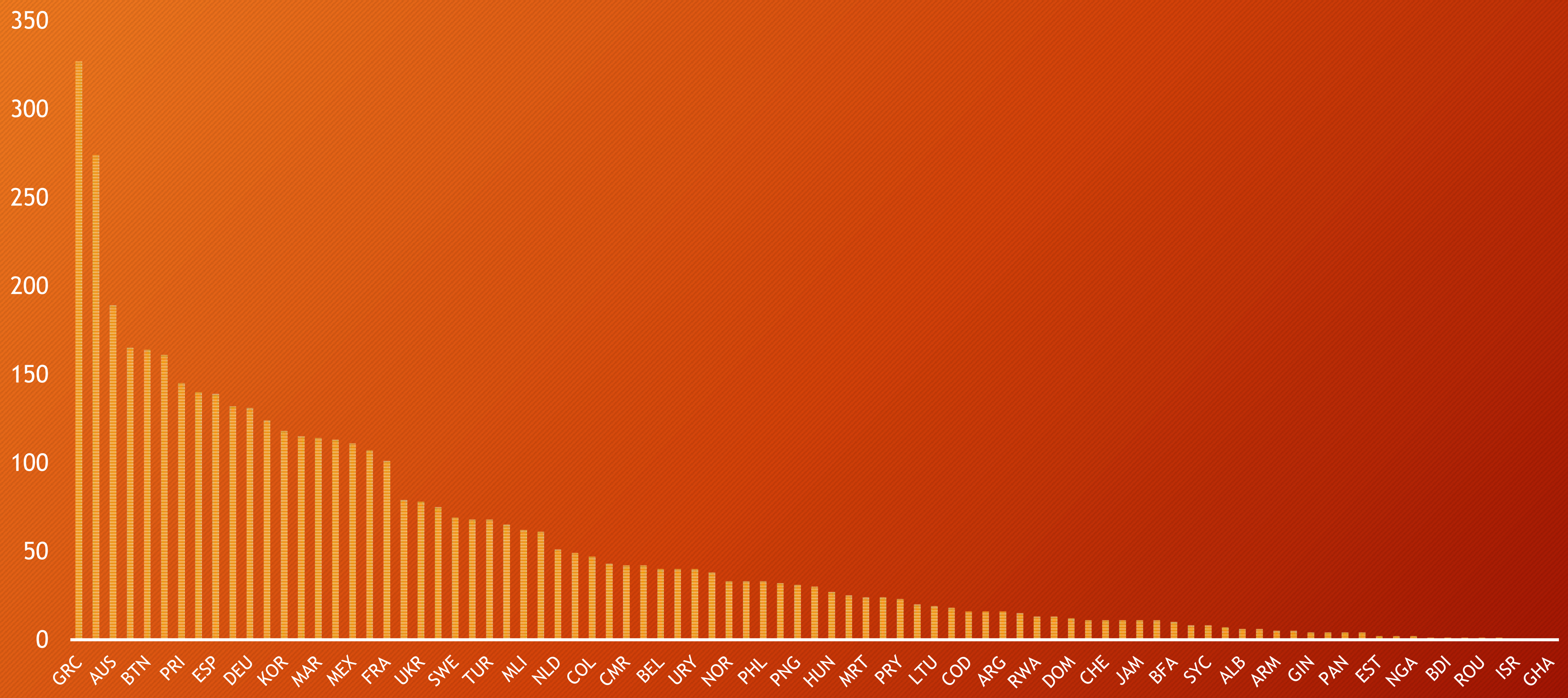


- This approach ignores the distributional consequences

Who will be impacted?



Who will be impacted?: tax expenditures



Who will be impacted?:Minimum taxes

Country	Minimum Domestic Tax
Algeria	10,000 DZD for nil return companies: 10% for reinvested profit
Angola	-
Argentina	-
Barbados	-
Benin	-
Bolivia	3% on incomes
Brazil	-
Burundi	1% on turnover if profits are less than turnover by 30
Cabo Verde	-
China	0
Côte d'Ivoire	0.5% of turnover with minimum of 3 million XOF of tax and maximum of 35 million
Cuba	0
Dominican Republic	1% on assets
Ecuador	-
Egypt	-
Gabon	1% of global turnover
Ghana	-
Guyana	2% of turnover
Honduras	0.75% of the income if gross income greater than HNL 1 billion
India	15% on book profit, 9% in IFSC
Indonesia	-
Iraq	15% deemed tax on revenue
Jamaica	Minimum tax of $60,000 repealed in 2019
Jordan	-

Who will be impacted?:Minimum taxes

Country	Minimum Domestic Tax
Liberia	2% tax on proceeds
Malawi	-
Malaysia	-
Mali	-
Mauritius	-
Micronesia	3% in excess of 10,000 revenue
Morocco	0.5% of turnover and specific revenues
Mozambique	0
Namibia	0
Nicaragua	1 to 3% on gross income
Nigeria	0.5% of income less franked investment income
Pakistan	1.25% of turnover
Panama	2% of equity, min USD 100 and max USD 60,000(operation notice tax)
Philippines	2% on turnover
Seychelles	-
Sierra Leone	-
South Africa	-
Sri Lanka	-
State of Libya	-
Sudan	-
Suriname	-
Uganda	-
Tanzania	0.5% of turnover
Venezuela	-
Vietnam	-
Zimbabwe	-
United States	There used to be an AMT of 20% on all corporations other than C and S corporations with annual revenue of more than USD 7.5 million. This was repealed in 2017
United Kingdom	-
Germany	-
France	-
Netherlands	-
Norway	-
Sweden	-
Switzerland	-
Hungary	2% of revenue is the minimum corporate tax base
Cambodia	1% minimum tax

Which countries may benefit?

HQ Country	Number of companies	Share of total companies
USA	278	24.5
China	184	16.2
Japan	144	12.7
Germany	36	3.2
France	37	3.3
Brazil	15	1.3
Russia	16	1.4
Australia	14	1.2
United Kingdom	44	3.9
Ireland	13	1.1
India	28	2.5
Total	1134	71.3

Which countries may benefit from STTR?

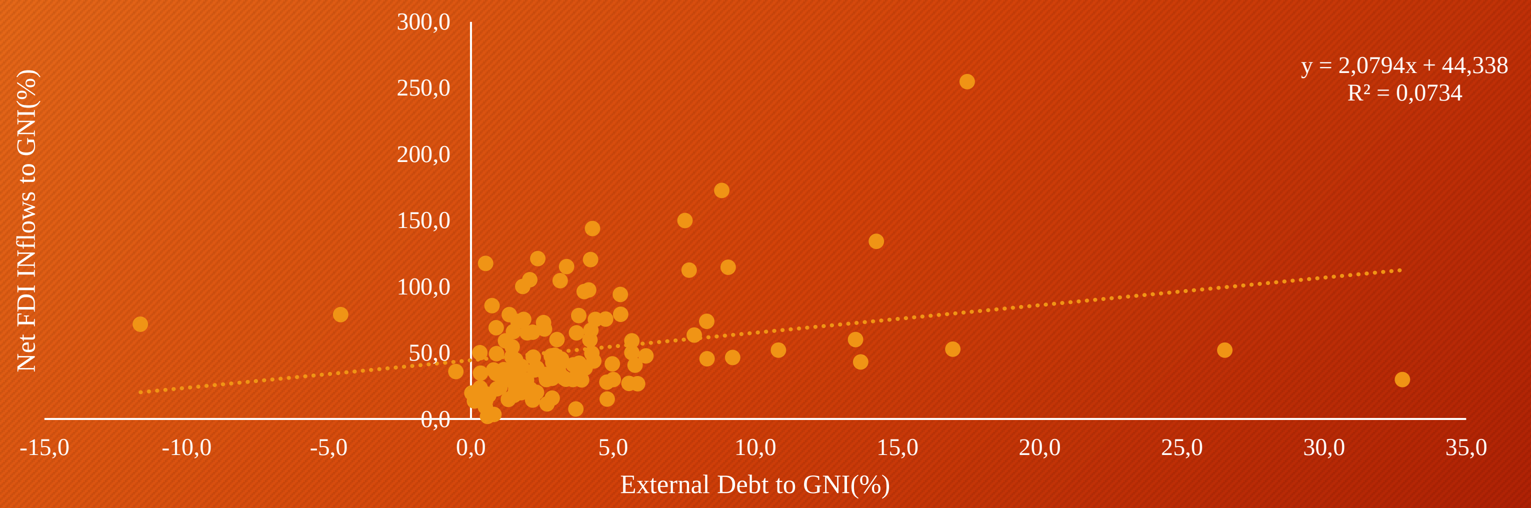
Countries	Dividend	Interest	Royalty	FTS
Developed-developed	17	42	55	3
Developing-developed	117	240	302	47
Developing-developing	140	113	130	25

Macroeconomic implications of the reform

- Minimum tax is akin to removal of incentives and can adversely affect investment
- Leads to redistribution of revenue to US
- -2/3 revenue to US(Clausing, 2021)
- Can remove tax base on developing economies that have fixed tax rates based on their base and composition of revenues
- Indirect tax rate increases
- Tax incentives are linked to priority sectors (20%) and encourage investment (25%)

Why are tax rates low?

- Tax rates are a function of institutional features, norms and level of economic development
- Related to fiscal capacity
- Level of external debt



Why are tax rates low?: Structure of the economy

Corporate tax rate~ per capita GDP, CC inflows, CC outflows, share of services in GDP, share of natural resource rent

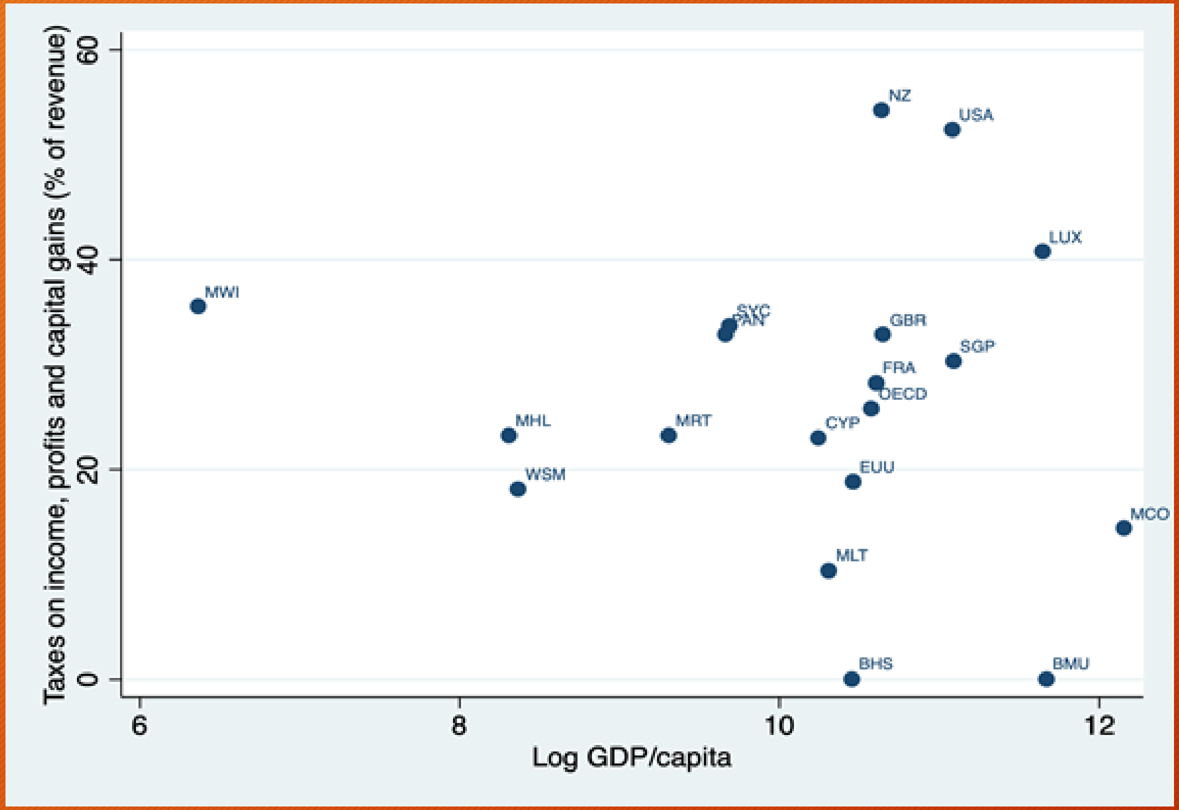
- preliminary results suggest
- Higher PC GDP is associated with lower STR
- Share of services tend to be associated with lower STR in Asia
- In all country groupings the countries with higher share of rents from natural resources tend to have higher STR

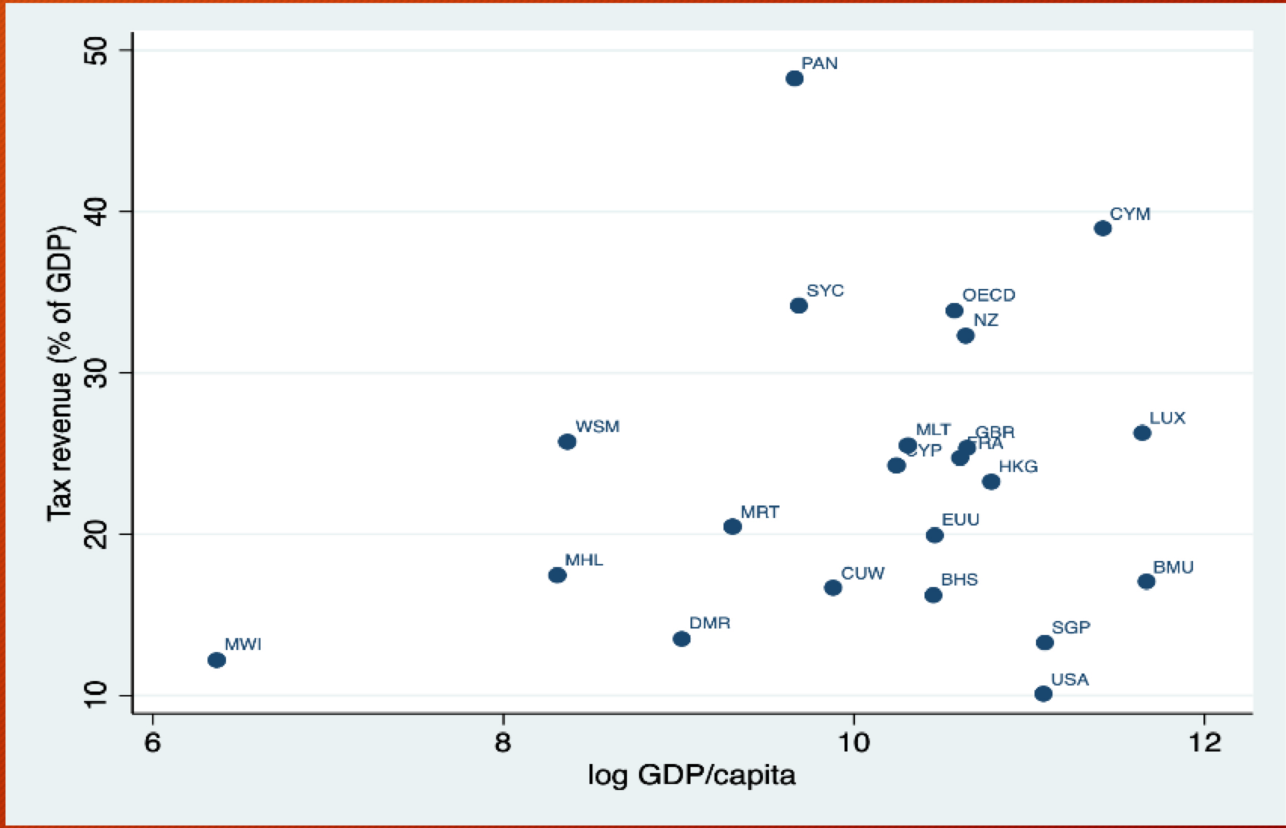
Why are tax rates low?; regulations

Stricter capital controls on inflows-> lower corporate tax rates (Asia)

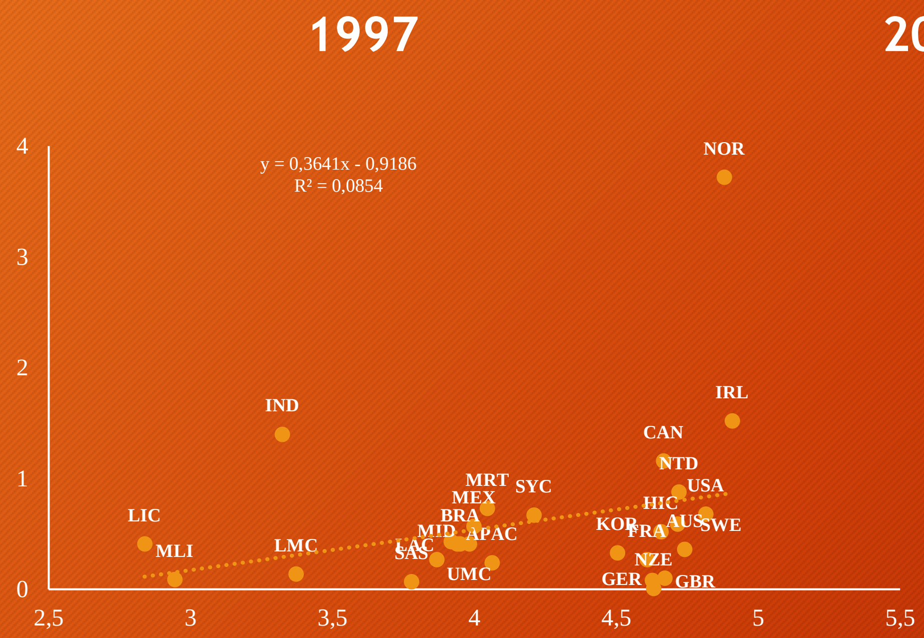
- Stricter capital controls on inflows-> higher corporate tax rates (OECD)
- Stricter capital controls on outflows-> higher corporate tax rates (Asia)
- Stricter capital controls on outflows-> lower corporate tax rates (OECD)

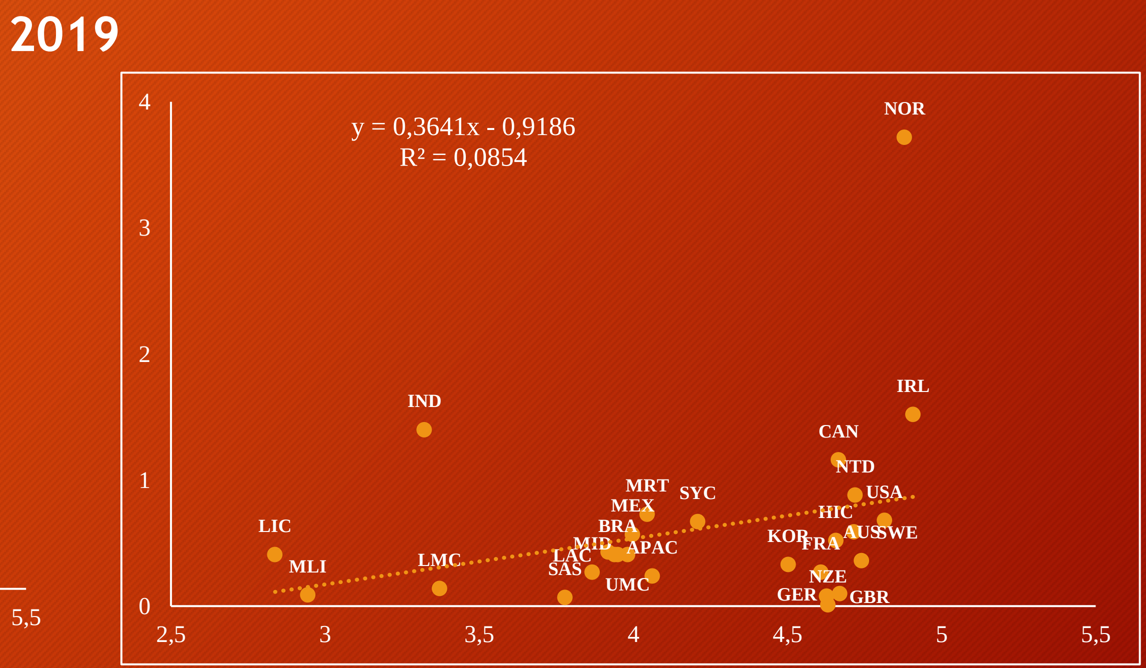
The tax structures vary





Tax incentives are offered by low income countries?





Source: Global Tax Expenditure Database and World Development Indicators

Preliminary firm- level evidence in India

- R&D deductions do not enhance firm level productivity
- Direct tax benefits to exports tend to improve firm level sales

Variables	***Sales***	***Sales***
Export incentives	39.61***	7.089***
	(1.366)	(1.002)
Total Assets		0.617***
		(0.005)
Constant	10,095***	3,299.634***
	(250.8)	(185.628)
Observations	18,701	18,694
R-squared	0.048	0.521
Number of companies	1,992	1,990

Tax Rates and foreign investment

Long term and short term relation between FDI and Corporate tax 1970 to 2019

Country	LR coefficient	SR coefficient	Error Adjusted LR coefficient
US	-1.60e+10	1.21e+10	-.4165388**
UK	1.63e+09	1.09e+10	-.7224906***
India	-8.07e+09	-9.29e+07	-.1386789
Malaysia	-1.33e+09***	1.41e+09	-.7403951***
South Africa	2.33e+07	-7.64e+08*	-.9105641***
Singapore	-7.35e+09**	8.23e+09*	-.3398284*
France	-3.53e+09	1.27e+08	-.6274752**
Germany	7.12e+08	5.41e+09	-.5889237**
Brazil	1.28e+08	-7.42e+07	-.1616481

Future of tax reform

- The tax rates are not harmful per se, the macroeconomic factors are important
- Some incentives work in certain contexts and revenue foregone≠ revenue gained when incentive is discontinued
- IIR will apply to select companies and therefore incentives can continue to apply to others, bifurcation of international tax system
- Moving the problem to other regulations
- CFC regimes vary widely and with such differences tax competition for residence will continue if countries exercise the option of modified CFC instead of IIR (in spite of exit taxes or anti-inversion)
- Tax avoidance no longer an issue
- Non-tax competition