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Impact of Global Minimum Tax Regime

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In October 2021, 137 countries out of 141 Organization of Economic Co-operation and Development (OECD) / G20 member countries agreed to implement a minimum 15% corporate tax rate for multinational entities (global turnover over Euro 750 million) as a part of two pillar approach of OECD's ground-breaking taxing the digital economy framework. A global deal has been announced between 137 countries, including India, to ensure large MNEs pay a Global Minimum Tax (GMT) rate of 15% by the OECD. Since 2017, the G20 / OECD inclusive framework on Base Erosion and Profit Shifting ('BEPS') has been jointly developing a Two-Pillar Solution to address the tax challenges associated with digitalization. At present, the consenting governments are discussing implementation plans.

Why should there be a Global Minimum Tax?

- Digitalization

International tax rules must keep up with the times of the digital age. A number of new issues have arisen as a result of the digital revolution: scale without mass (firms growing without a physical presence), reliance on intangible assets, and the centralization of information. The use of both previously available and new technologies has enabled tax avoidance by shifting profits to low-tax jurisdictions. In order to attract foreign investment, countries are competing with each other on their tax rates. In countries with higher taxes, this results in loss of tax revenue and threatens government functions.

- Tax haven diversion

Drug patents, software, and intellectual property royalties have increasingly been migrating to tax havens to avoid paying higher taxes in their home countries. The GMT aims to stop this outflow of tax revenue in lower tax jurisdictions and aims to eliminate tax heavens. However, a carve-out allows countries to continue to offer Tax incentives to promote business activity with real substance (i.e., tangible assets and personnel).

- Resource mobilization

Global tax revenues will increase by $150 billion a year as a result of the minimum tax, according to the OECD.

- Global tax reforms

It is another positive step towards global taxation reform following the implementation of the BEPS. The term BEPS refers to tax avoidance strategies aimed at shifting profits to low or no tax jurisdictions through mismatches in tax rules.

- Common approach

The Pillar Two rules will have the status of a common approach: countries will not be required to adopt them, but if they choose to, implementation must be in a manner that is consistent with the model rules and IF guidance.

- Tax competition

On account of low or no tax jurisdictions, countries are facing harmful tax competition. Addressing such competition, coherence of international tax rules and ensure transparent tax environment is essential.

What is the proposed tax structure?

It is based on a two-pillar system that should improve current corporate taxation rules.

Reallocation of a residual profit to market jurisdictions (Pillar One)

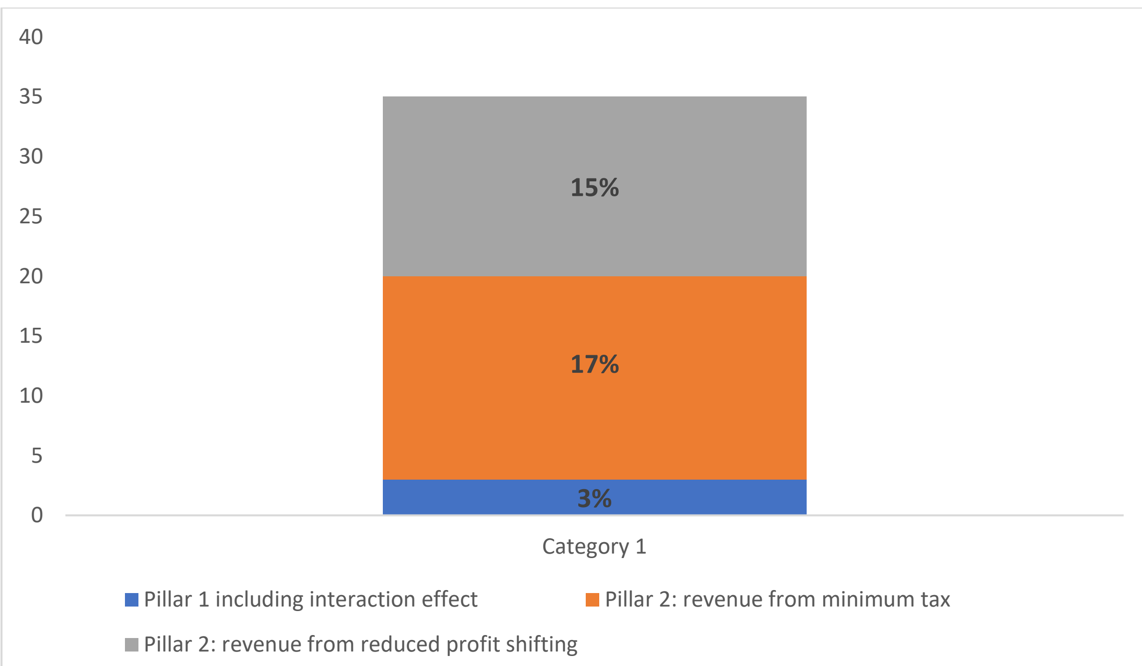
The first pillar pertains to the implementation of new profit allocation rules applicable to the largest and most profitable MNEs (Multinational Enterprises) with worldwide revenues greater than Euro 20 billion and profitability greater than 10%. If implementation succeeds, this amount could also be reduced to Euro 10 billion in 7 years. The objective of this pillar is to redistribute excess profits of MNEs to jurisdictions where consumers or users reside, regardless of whether firms are physically present there. The redistribution amount is calculated by dividing residual profits by 25%. The result should be a more equitable distribution of profits and taxing rights among countries.

Global minimum tax (Pillar Two)

The Pillar Two proposes a global minimum tax to eliminate incentives for companies to shift profits based solely on tax outcomes. Competing countries may offer tax incentives or lower tax regimes to attract inward investment. Furthermore, multinationals who derive significant value and profit from intangibles may be able to move income and profit to these low-tax jurisdictions due to differences between domestic tax rules.

Illustration 1- Chart- **Pillar 2- Estimated impact on corporate tax revenues**

Gains in global tax revenues (% of CIT revenues)



Note: This estimate for Pillar One (amount A only) is based on an example in which residual profit is defined as profits above 10% of profit before tax to turnover, assuming a 25% reallocation of residual profile to market jurisdictions, excluding commodities and financial sectors. As an illustration, the Pillar Two estimates are based on a jurisdiction that blends a minimum tax rate of 15%.

*source-OECD

Tax policy implications of a global minimum tax

First, a global minimum tax will neutralize the low tax incentive, and second, it may effectively lead to tax revenues being exported to other countries.

A global minimum tax will inevitably increase pressure on countries with headline rates below the global minimum to increase their domestic rates, especially if not doing so will effectively export tax revenue. Assuming a global minimum tax rate of 15%, or slightly higher, some tax-based incentives and substance-based incentives will likely survive. It is possible, though, that non-tax platforms and taxes based on non-profits could shift competition over time.

There will, however, be inevitable changes in the methodology for taxing any global minimum tax rate. These changes will redefine what constitutes a legitimate tax base, a legitimate tax, and a legitimate tax rate.