# *The Global Minimum Tax and the Future of International Taxation*

John Vella
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Tax Law – Contemporary Issues

Bergen

5 October 2023

# November 2021

*The New International Corporate Tax System*

Michael Devereux and John Vella
University of Oxford

Tax Law – Contemporary Issues
Bergen
25 November 2021


Statement on a Two-Pillar
Solution to Address the Tax
Challenges Arising from the
Digitalisation of the Economy
October 2021
oe.cd/bepsaction1
@OECDtax
OECD Tax
# BEPS

November 2021

**Research Q**: Will P1 & 2 lead to a *good* tax system?

**Conclusions**:

- Too early to tell
- Initial analysis: P1 & 2 will improve/worsen/ unclear on different criteria

# Today's presentation

…is an update.

Analysis still on-going! But I now have some answers – even if more to be done.

Modified research question:

→ **Will Pillar 2 lead to a *good* international corporate tax system now and in future?**

# What has changed since Nov 2021?

- More time for analysis and reflection
- Clarity on rules: model rules, guidance etc
- Implementation: Pillar 1 vs Pillar 2
- Other important political developments – e.g. US, UN

# Presentation Outline

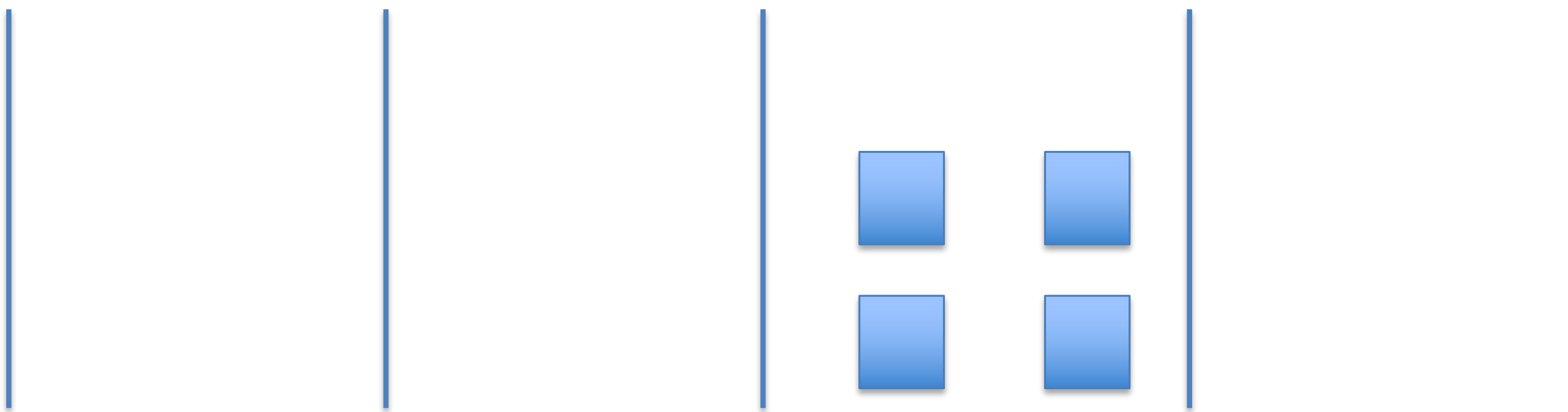
# I. The existing international tax system

# Fundamental features of existing system

i. **Taxes (largely) where affiliates are located (origin-based system)**

# Origin-based system

Shareholders | Parent Company | Affiliates | Consumers



# Fundamental features of existing system

i. **Taxes (largely) where affiliates are located (origin-based system)**

ii. **Source vs Residence**

iii. **Separate entity approach**

   – Affiliates within a group are generally viewed as separate entities

→ **Is this a *good* tax system?**

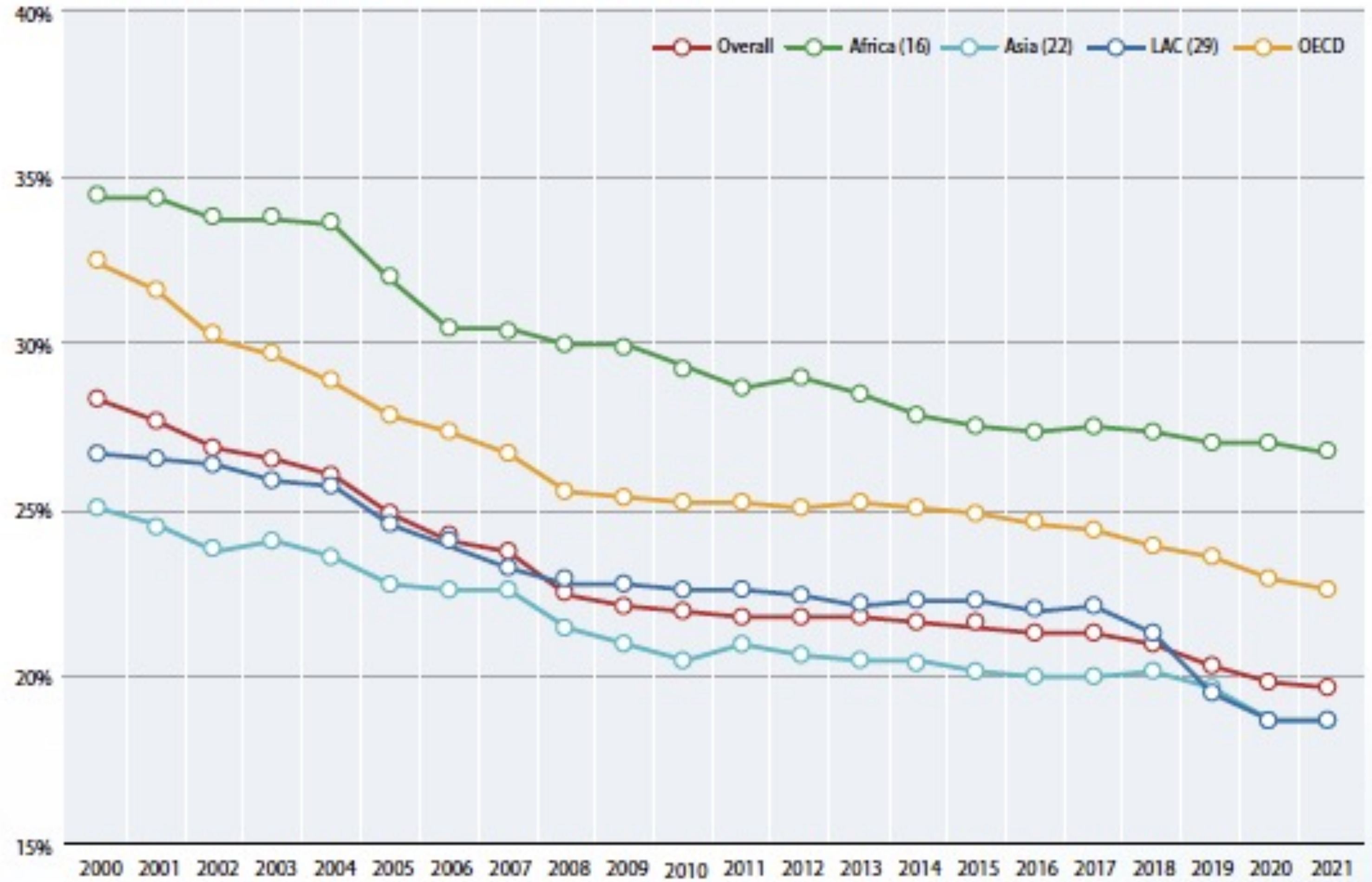
# What is a “good” tax system?

- Fairness
- Economic efficiency
- Robustness to avoidance
- Ease of administration
- Incentive compatibility

# Is the existing system "good"?

- Fairness ?
- Economic efficiency X
- Robustness to avoidance X
- Ease of administration X
- Incentive compatibility X

FIGURE 6: **Average statutory corporate income tax rates by region**

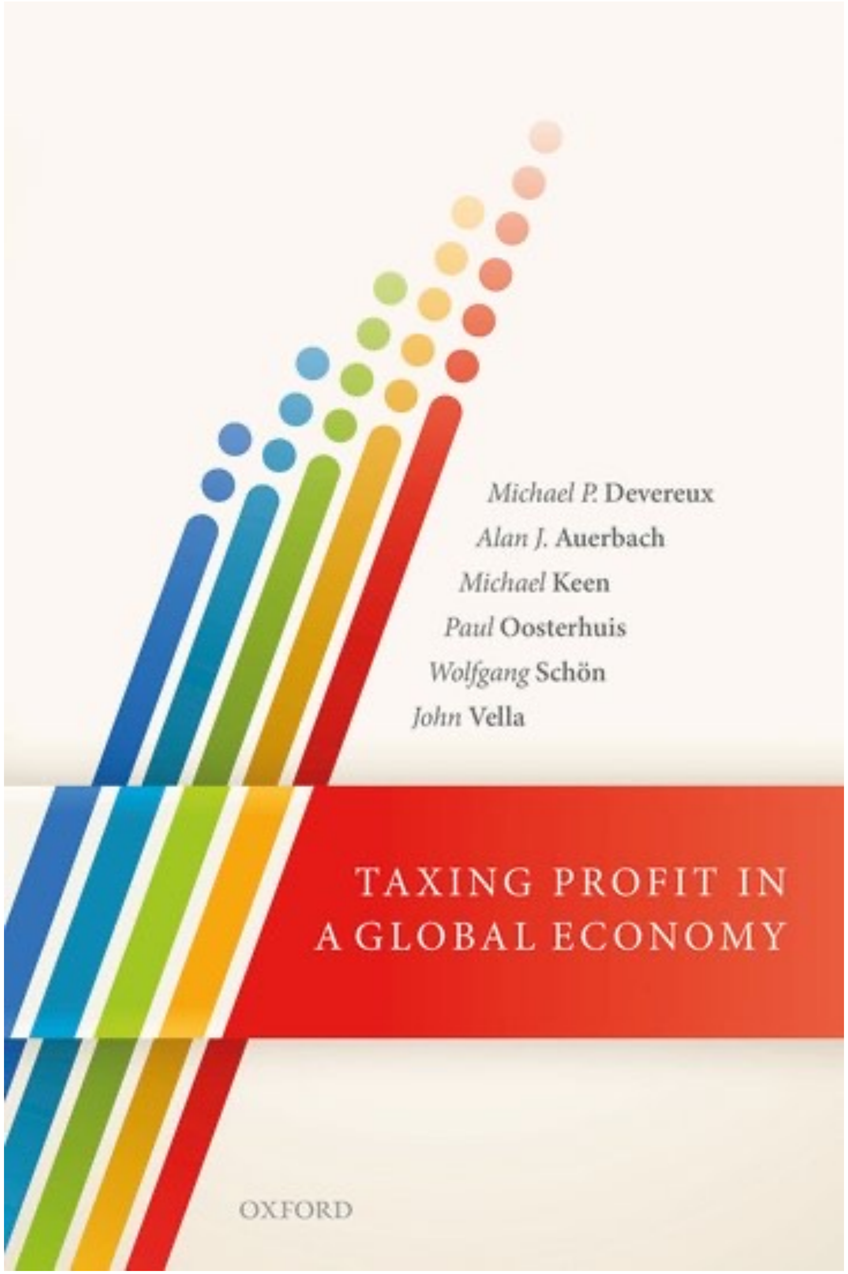



[OECD, 2021]

# Is the existing system "good"?

- Fairness ?
- Economic efficiency X
- Robustness to avoidance X
- Ease of administration X
- Incentive compatibility X

→ **NB: problems are mainly due to incentives created by origin-based system with separate entity approach**




It's free! [Link].

# II. Pillar 2 Outline and Evaluation

# Pillar 2 Outline

| Global Minimum Tax ('GloBE') | Model Rules released 20 December 2021 |
|---|---|
| What entities are covered? | MNEs with group turnover > 750m Euro |
| What is undertaxed? | Effective tax rate of < 15% in a jurisdiction(all entities grouped together) |
| How is income determined/allocated? | Accounting Profit (subject to modifications) |
| How much is the tax? | Top-up to 15% on 'Excess Profit' (profit exceeding the substance-based income exclusion (SBIE)) |
| Who applies the global minimum tax? | 'Source' Jurisdiction(QDMTT), Ultimate Parent Jurisdiction (IIR), or jurisdictions of other group entities (UTPR) |

# Is research question unfair?

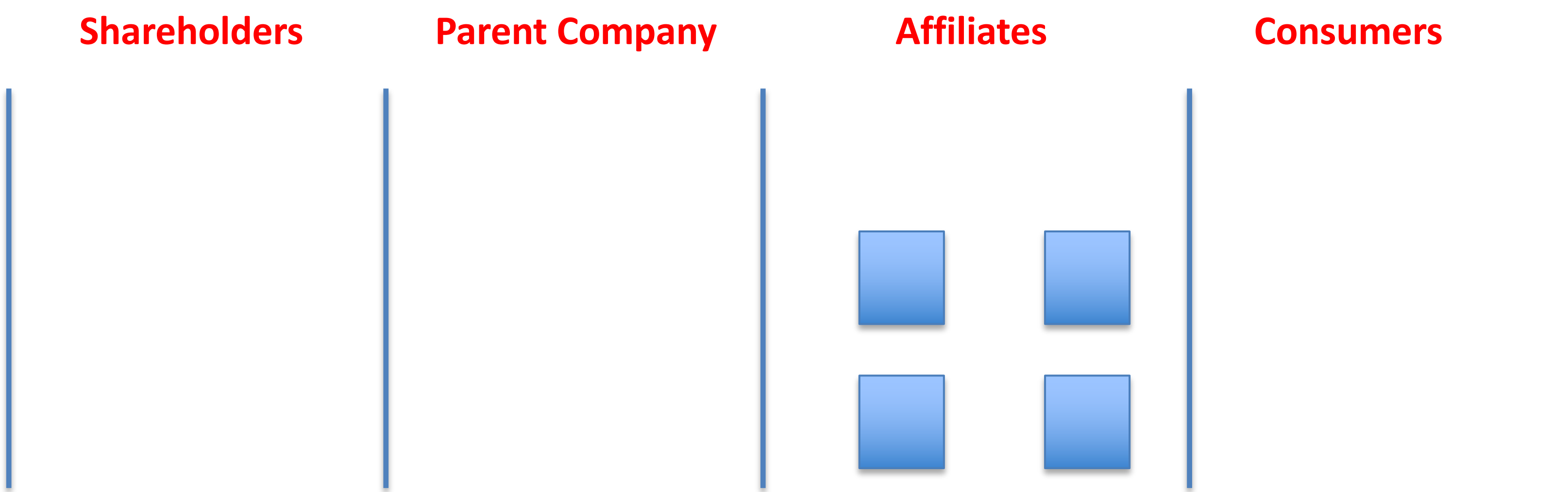
- **Political reality**

  - Hype
    - Scholz: this agreement “will really change the world”
    - Grinberg: “We believe this deal is part and parcel of restoring the foundation for the continued success of the liberal international economic order as we have known it over the last 75 years”
  - Policy evaluation

- **Pillar 2’s stated goals:** Profit Shifting and Tax Competition

  - Turning point
    - In 2015-2018 international tax system was at a cross-road
    - Proposals to shift to destination on table (became Pillar 1)

# Origin-based system



# Is research question unfair?

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- **Pillar 2’s stated goals:** Profit Shifting and Tax Competition

  - Turning point
    - In 2015-2018 international tax system was at a cross-road
    - Proposals to shift to destination on table (became Pillar 1)
    - P2 doubles down on origin-based system
    - Was P2 anchor dropped deliberately by DE & FR to stop drift towards destination?
    - We may be stuck with this system for years to come (part IV)

# Will Pillar 2 lead to a good tax system?

- Incentive compatibility
- Fairness
- Ease of administration
- Economic efficiency
- Robustness to avoidance

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# Incentive compatibility – November 2021

**EconPol POLICY BRIEF**

**39**
**2021**
November
Vol.5

## What Is the Substance-Based Carve-Out under Pillar 2? And How Will It Affect Tax Competition?

*Michael P. Devereux, Martin Simmler, John Vella and Heydon Wardell-Burrus*
*(Oxford University Centre for Business Taxation)*

### Key Messages

- The success of the recently agreed international tax reform hinges on a technical issue in the design of the Pillar 2 global minimum tax
- Pillar 2 ensures the minimum taxation of 'residual' (e.g. non-routine) profits at 15%. 'Routine' profit is not subject to Pillar 2.
- The effects depend on which of two possible options is used:
  - Option 1 removes the incentive to compete below a liability of 15% of residual profits and puts a floor to tax competition
  - Option 2 still maintains an incentive for governments to compete by reducing their taxes – possibly all the way to zero.
- Consequences for tax competition depend on the technical details to be revealed. Announcement containing more details of the proposal are expected shortly.

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# Incentive compatibility – August 2023

Michael Devereux and John Vella*

## *The Impact of the Global Minimum Tax on Tax Competition*

**This article examines the impact of the Pillar Two Global Anti-Base Erosion (GloBE) Rules on tax competition. It sets out and explores three main conclusions on the GloBE Rules' impact on tax competition. First, the GloBE Rules set a floor on tax paid on profit by multinationals equal to 15% of "Excess Profit". They also set a floor on competition among "source" countries. Second, the GloBE Rules may provide some countries with an incentive to raise revenues through a qualified domestic minimum top up tax rather than a corporation tax. Third, countries can compete below the floor by offering grants and "Qualified Refundable Tax Credits". The article proposes an alternative design for the top-up tax calculation that may have been preferable. Overall, it concludes that the impact of the GloBE Rules on tax competition may be less straightforward and significant than may have been expected. The rules also create incentives that are not clearly desirable from a policy perspective.**

**Contents**



* University of Oxford. The authors are grateful to Heydon Wardell-Burrus who made a substantial contribution to this article and was a co-author of the prior working paper. The authors would also like to thank Tom Brennan, Richard Collier, Victor Fleischer, Michael Keen, Omri Marian, Victoria Perry, Alvin Warren and two anonymous referees for their helpful comments. The usual caveats apply.

# Top-up tax calculation

1. **Effective Tax Rate:** $\frac{Adjusted\ Covered\ Taxes}{Adjusted\ GloBE\ Income}$

2. **Top-up Rate**: *15% - ETR*

3. **Top-up Tax:** *Top-up Rate* $* \ (Adjusted\ GloBE\ Income - SBIE) - QDMTT$

# 1. Floors created by GloBE

- What types of floors does GloBE create?
  - Floor on tax paid by multinationals?
  - Floor to the race to the bottom?

- At what point are those floors set?

- NB this analysis is simplified – in paper we discuss impact of CFC legislation etc

# 1. Floors created by GloBE

- Example:
  - Countries X and Y compete to attract investment from MNE resident in W
  - X and Y both levy CIT at 15%
  - Assume $1000 financial profit, $400 SBIE, $600 Excess Profit.
  - Will reduction in X's CIT rate improve X's competitive position relative to Y?

| | | |
|---|---|---|
| **Domestic Tax Rate** | 14% | 0% |
| **1. ETR**<br><br>**Numerator** | 140 | 0 |
| **Denominator** | 1,000 | 1,000 |
| **ETR** | 14% | 0% |
| **2. Top-Up Rate** | 1% | 15% |
| **3. Top-Up Tax** | 0 | 0 |
| **QDMTT** | 6<br>(1% of 600) | 90<br>(15% of 600) |
| **Total tax paid by MNE** | 146 | 90 |
| **Total tax collected by X** | 146 | 90 |

| | | |
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# At what points are floors set?

- Both floors are set

- For MNEs: 15%*EP

- For Source countries: 0% Corporation Tax and 15%*EP <u>through QDMTT</u>
  - Floor is not:
    15%*CIT tax base
    15%*GloBE tax base
    15%*Excess Profit (must be QDMTT)

- **NB**: **subject to point 3!**

# 2. Increased incentive to reduce corporation tax

- Countries may have to reduce  CIT to *retain* same competitive position relative to competitor countries – even if they raise same amount through QDMTT.

- Somewhat controversial

  - Cited by Republican Senators 16 February 2022
  - And response by US Treasury 29 March 2022

| | Country Y | Country X | | |
|---|---|---|---|---|
| | | **No P2** | **P2** | **P2** |
| **Income** | 1200 | 1000 | 1000 | 1000 |
| **Rate** | 25% | 10% | 10% | 5% |
| **Excess Profit** | / | / | 500 | 500 |
| **Total Tax** | 300 | 100 | 125 (100CIT + 25 QDMTT) | 100 (50 CIT +50 QDMTT) |
| **After-Tax Income** | 900 | 900 | 875 | 900 |

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# 3. Floors can be broken through

- Point 1: GloBE effectively creates floors = 15% of EP through QDMTT
- ***But post-Pillar 2 ETR can be < 15% EP*** through government grants, Qualifying Refundable Tax Credits (QRTC), and Marketable Transferable Tax Credits (MTTC)
- QRTC: must be 'paid as cash or available as cash equivalents within four years from when a Constituent Entity satisfies the conditions for receiving the credit'.
- Why? Added to denominator and not deducted from numerator

Previous example but now X provides 100 credit

| | Non-QRTC | QRTC |
|---|---|---|
| **1. ETR**<br><br>**Numerator** | 50 (150-100) | 150 |
| **Denominator** | 1000 | 1,100 |
| **ETR** | 5% | 13.6% |
| **2. Top-Up Rate** | 10% | 1.4% |
| **3. Top-Up Tax** | 0 | 0 |
| **QDMTT** | 60<br>(1000-400)*10% | 9.8<br>(1100 – 400)*1.4% |
| **Total Tax Paid by MNE (excl. credit)** | 210 | 159.8 |
| **Total Tax Paid by MNE (incl. credit)** | 110 | 59.8 |
| **Post-Pillar 2 ETR** | 11% | 5.9% |
| **Post-Pillar 2 Tax as % of EP** | 18.3% | 9.9% |

Previous example but now X provides 100 credit

| | Non-QRTC | QRTC |
|---|---|---|
| **1. ETR**<br><br>**Numerator** | 50 (150-100) | 150 |
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# Floors can be broken through

- Questions:
  - Will countries be willing to provide grants, MTTCs and QRTCs?
  - Competitive pressure for countries to introduce them when others do?
  - How far can countries push in designing grants, QRTCs and MTTCs?
    - For QRTCs Refund mechanism must have "practical significance for those taxpayers entitled to the credit"
    - Disputes likely
    - Commentary leaves open the possibility of 'developing further conditions' for a QRTC and exploring 'alternative rules' if there are 'unintended outcomes'.
    - Lack of clear principle/objective makes this difficult
      - OECD 2021: "Pillar Two does not eliminate tax competition, but it does set multilaterally agreed limitations on it"

# Incentive compatibility: conclusions

- P2 should have an impact on tax competition, but:
  - Impact not straightforward
  - Creates “interesting” incentives
  - Less significant than some may have thought?
    - Shift to competition over subsidies and credits?

# Fairness

- Different issues:
  - OECD: P2 increases global CIT revenues by 9%
    - Will this address the view that MNEs pay less than *fair share*?
  - Some countries argue that P2 undermines their sovereignty
  - Dissatisfaction about process and outcome among countries:
    - 23.11.22: Resolution adopted by Second Committee of UN General Assembly: “Promotion of inclusive and effective international tax cooperation at the UN”
    - 30.12.22: Resolution adopted by UN General Assembly
    - Report by Secretary General of UN (August 2023)
      - “As a result, **the substantive rules developed through these OECD initiatives often do not adequately address the needs and priorities of developing countries and/or are beyond their capacities to implement**.”

# Ease of administration

- GloBE rules are **COMPLEX**!
  - E.g.
    - adjustments to financial accounts – use of domestic GAAP
    - Interaction between US GILTI and P2
  - Simplification procedures: transitional, permanent and QDMTT Safe Harbours

- Critical issues
  - Unlikely to lead to reduction of existing complexity (i.e. removal of existing rules)
  - Unlikely to stop new taxes (e.g. conditional taxes)? (unlike P1 on DSTs)
  - Peer review process is critical
    - Subsidies, QRTCs, QDMTT, etc
  - Difficult disputes likely to arise
    - Unravelling results once UTPR collected etc?

# Economic efficiency

- Impact of GloBE still requires further analysis:
  - Location decisions
  - Investment conditional on location
  - Use incentives to address positive externalities, e.g. R&D tax credits
  - New distortions created by different treatment of in-scope & out-of-scope entities
  - Ownership

# Robustness to avoidance

- Reduces PS because profits with no substance taxed at 15%
- But,
  - Shift from countries with rates >15%
  - Profit shifting strategies (Blending, sheltering, passive income)
  - Possible use of grants etc

# Conclusions

To what extent will GloBE lead to a *good* tax system?

- At this stage I would say:
  - Incentive compatibility √ ?
  - Fairness X
  - Ease of administration X
  - Economic efficiency ?
  - Robustness to avoidance √

# III. The future of the international corporate tax system

# Future

- Existing system was in terminal condition, P2 last-ditched attempt to save it

- Problems due to fundamental structure (origin based and separate entity)
  - P2 *does not address critical problems* at heart of system, e.g. Transfer Pricing and Profit Attribution
  - P2 *does not remove incentives created by system just constrains them* –> ultimately this is why system with P2 performs poorly

- P2 doubles down on existing system – are we locked in?
  - Once EU Dir., national laws and institutional architecture in place how easy will it be to move away?
  - How much harder will it be adopt more radical, principled, coherent, and comprehensive reform? E.g. unitary taxation/FA, RPAI or DBCFT?
  - Requires further analysis, but initial thoughts…

# The future

- Politically:
  - Victory has been declared by many
  - Political exhaustion?
  - Business/revenue authority investment

- Technically:
  - Would all 140 countries have to agree to change? Would all IIRs and UTPRs have to be repealed/amended?
  - E.g. destination based tax, BEFIT?
  - Hold out problems

- So I think the system will limp on into the future …

# IV. Conclusion


ANKA