

**INTERNATIONAL JOURNAL OF LAW
MANAGEMENT & HUMANITIES**

[ISSN 2581-5369]

Volume 4 | Issue 4

2021

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Global Minimum Tax with a Focus on Developing Countries India as a Case Study

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ABSTRACT

Under an inclusive framework for tax base erosion and benefit transfer as agreed by the G20 countries and the Organization for Economic Cooperation and Development, nations are considering the adoption of a global minimum corporate income tax for taxing multinationals based upon 'Pillar Two' proposals that are relevant for taxation for a globalized world in a digitalized era. The basis of the two pillars approach is the re-allocation of an additional share of profit to the market jurisdictions and minimum tax. The article provides a detailed analysis of the new two-pillar program aimed at reforming international tax rules and ensuring that multinational companies ought to pay a fair share of taxes wherever they operate. This article takes India as a case study and focuses on analyzing the proposed global minimum corporate tax.

Keywords: OECD, BEPS, minimum, two pillars

I. INTRODUCTION

The United States is proposing a new tax system as a measure to counter tax evasion of the world's leading multinational companies in the countries where they operate. The proposal requires all countries to levy at least 15% taxes on global companies. Its goal is to formulate tax structures related to the digital and globalized world. It is part of an inclusive framework for tax base erosion and benefit transfer agreed by the G20 countries and the Organization for Economic Cooperation and Development. It is based on two pillars: redistribution of additional profit share to market jurisdictions and minimum taxes.

The above proposal recommends that all the member states adopt two new income taxes for multinational corporations based on the OECD/G20 inclusive framework of Base Erosion and Profit Shifting. The first is to impose a minimum tax in the world on corporate profits, and the second is to impose a tax on base erosion payments.

The new system is specifically introduced to ensure that large technology companies are included in the tax network. Since these companies do not have an important physical presence

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in any country, such as factories or business premises, they can directly transfer the profits of their digital business to low-tax jurisdictions, thereby saving tax on profits. The attempt to ensure a basic minimum tax rate across countries came after scrutiny increased on the huge profits earned by global firms like Facebook and Alphabet (Nair, 2021).

As of now, 130 countries have joined a new two-pillar program aimed at reforming international taxation rules and ensuring that multinational companies ought to pay a fair share of taxes wherever they operate. These 130 countries and jurisdictions, accounting for more than 90% of the world's GDP, have joined the declaration to establish a new framework for international tax reform. The remaining elements of the framework, including the implementation plan, have a deadline to be completed by October, 2021. This framework updates the key elements of the century-old international tax system, which is no longer applicable to the 21st-century globalized and digitized world economy. The two-pillar package aims to ensure that large multinational corporations (MNEs) pay taxes and make profits where they operate while providing the necessary certainty and stability for the international tax system.

The first pillar will ensure a fairer distribution of profits and taxes among the largest multinational companies including digital companies, among countries. It will redistribute some of the tax rights of multinational companies from their home countries to the markets where they do business and profit, regardless of whether these companies have a physical presence there. Under the first pillar, the annual tax revenue of more than \$100 billion is expected to be redistributed to market jurisdictions. Countries can use it to protect their tax base. It is estimated that the global minimum corporate income tax rate under the second pillar is at least 15%, which will generate approximately US\$150 billion in additional global taxes each year. The stability of the international tax system and the tax certainty of taxpayers and tax authorities will also gain additional benefits.

The two-pillar package will provide much-needed support to governments that need to increase the revenue needed to repair budgets and balance sheets while investing in necessary public services, infrastructure, and helping to optimize the robustness and quality of public services. Measures needed. Recovery after COVID. (130 countries and jurisdictions have joined a bold new framework for international tax reform OECD, 2021).

This is the result of years of hard work and negotiation. The proposed package does not eliminate tax competition but establishes multilaterally agreed restrictions. The proposal should and will be accommodating various interests at the negotiating table, including the

interests of small economies and developing jurisdictions. The participants in the negotiations set an ambitious timetable for the conclusion of the negotiations. This includes completing the remaining technical work on the two-pillar approach within the October 2021 deadline, as well as plans for effective implementation in 2023.

In this article, I take India as an example to review and analyze the proposal and its impact on developing countries.

II. A BRIEF HISTORY OF GLOBAL MINIMUM TAX

In 1992, the EU member states proposed a minimum corporate tax rate in the region. The proposal was presented by the Ruding Committee in 1992, a group of European Commission experts led by Onno Ruding. However, the committee's proposal for a minimum tax rate of 30% was not taken for implementation.

In 2019, the OECD, an intergovernmental association composed of mostly wealthy countries formed a group, bringing together an Inclusive Framework. The OECD established Inclusive Framework has since been exploring minimum tax rates among its member states. It began to propose the minimum corporate tax rate in the world. The said proposal was for a world with the growing importance of digital products and services in the global economy. And thus, requires tax rules to be updated to prevent companies from transferring profits to jurisdictions with lower corporate tax rates.

In May 2019, Germany and France published a joint proposal for a global minimum effective tax rate named Pillar Two, intending to stop the race to the bottom. The proposal received widespread international support including support from IMF President Christina Lagarde and then OECD Secretary-General Angel Gurría. The United States joined the talks of the OECD/G20 group on tax Base Erosion and Profit Shifting in 2020, and in April 2021, Janet Yellen, the United States Treasury Secretary, agreed with the Franco-German proposal (Wikipedia contributors, 2021).

In 2020, the G20's then 137 member states called the blueprint for Pillar Two "a solid basis for a systemic solution that would address remaining base erosion and profit shifting (BEPS) challenges". However, all except seven members of the group agreed to join the two pillar proposal. Base Erosion and Profit Shifting represents a tax evasion strategy used by multinational corporations (MNE) to reduce their tax base. They reiterated that companies ought to pay taxes on the income or profits they earn. Their concerns hold. Recently, multinational companies are developing sophisticated and refined tax planning practices to avoid taxes by transferring revenue and profits to other countries, especially tax-havens. These

practices have eroded the tax base for many countries having a relatively high rate of corporate tax.

III. WHY GLOBAL MINIMUM TAX?

Major economies are aiming to discourage multinationals from shifting profits and tax revenues to low-tax countries regardless of where their sales are made.

Increasingly, income from intangible sources such as drug patents, software, and royalties on intellectual property has migrated to low tax jurisdictions, allowing companies to avoid paying higher taxes in their traditional home countries. With its proposal for a minimum 15% tax rate, the G20 member countries hope to reduce such tax base erosion without putting domestic firms at a financial disadvantage, allowing competition on innovation, infrastructure, and other attributes. The larger aim is to push MNCs to pay fair taxes on their huge profits in the jurisdiction they operate.

The minimum proposed tax is expected to make up the bulk of the \$50 billion-\$80 billion in extra tax that the OECD estimates firms will end up paying globally under deals on both fronts.

The global minimum tax rate would apply to overseas profits. Governments could still set whatever local corporate tax rate they want, but if companies pay lower rates in a particular country, their home governments could ‘top-up’ their taxes to the minimum rate, eliminating the advantage of shifting profits.

The OECD reiterated that member governments have broadly agreed on the basic design of the minimum tax but some countries had some objections regarding the same. Other items still to be negotiated include whether investment funds and real estate investment trusts should be covered, when to apply the new rate, and ensuring it is compatible with participating countries efforts for tax reforms aimed at deterring erosion. And since, 130 countries have agreed on the basic design of the said proposal and talks have been on for further technicalities and is up for implementation in 2023.

Talks have focused around the U.S.-led proposal of a minimum global corporation tax rate of 15% which is above the level in countries such as Ireland and Singapore but below the lowest G7 level.

The final framework could have major repercussions for low-tax countries and tax havens such as Ireland. The Irish economy has boomed with the influx of billions of dollars in investment from various multinationals. Dublin, which has earlier resisted the attempts by the EU to harmonize its tax rules, is unlikely to accept a higher minimum rate without a fight.

However, for the low-tax countries, “the battle now is less likely to be about scuppering the overall talks and more about building support for a minimum rate as close as possible to its 12.5% or seeking certain exemptions” in the adopted proposal (Reuters, 2021).

IV. POSSIBLE EFFECT ON WORLD ECONOMIES

With a global minimum tax around the corner, it is useful to consider its impact on tax incentives and policy making. The OECD’s global minimum tax proposal involves paying a ‘top-up tax’ at the level of the parent company if income made further down the ownership chain has been taxed below the global minimum rate.

If enacted, the imposition of a global minimum tax will have a significant impact on the use of tax incentives. Inevitably a global minimum tax will put pressure on those countries who have headline rates below the global minimum to increase their domestic rates, especially if not doing so will effectively export tax revenues.

Some governments believe that an element of appropriate tax competition should still be allowed by any global minimum tax regime, especially for smaller nations to enable them to compete with larger countries that have inherent economic advantages. But the ability to offer tax incentives will be fundamentally impacted by the reach of any global minimum tax regime.

We may see other policy initiatives where tax incentives are built around economic zones that offer certain benefits, but with any tax incentives being focused on property taxes or employer social security contributions, (those taxes that do not form part of any global minimum tax regime) any proposals of this nature are likely to meet strong challenges from opposing political parties and other public interest groups around concerns that such measures can still create tax haven for big companies.

A global minimum tax regime, as proposed, is not an attempt to harmonize taxes; instead, it is there to set guardrails within which a country is expected to operate and to curtail the tax havens.

However, the methodology for taxing any global minimum tax rate will inevitably redefine what is an acceptable tax base, and what is an acceptable tax rate. We could start to see an increasing homogeneity of different countries’ tax bases as well as the types of taxes employed as governments seek to ensure that their tax system is not disadvantaged by the minimum tax calculation methodology.

A broad local tax base will be an advantage in the calculation of the global minimum tax as applying a low rate to a broad base will increase the local effective tax rate. Over time, the

effect of the calculations may lead to governments adopting tax policies that increase the tax base or at least align it with the OECD calculation methodology and move to taxes that are recognized for any global minimum tax calculation.

But they will harm the country's overall investment tax burden if there is a local bias towards non-profit-related taxes and the country's main corporate tax regime falls within the global minimum tax measures. Restructuring said taxes so that they are respected for global minimum tax purposes would buttress the jurisdiction's general position vis-à-vis the global minimum tax regime and might also provide headroom to allow for some limited tax incentives, if any is possible.

In a post-Covid world, where all countries will be looking to rebuild their economies, there may be some concerns that a global minimum tax could cause that economic recovery to falter, particularly in countries that are heavily reliant on the inward investment encouraged by tax incentives (Global Minimum Tax: An Easy Fix? 2021).

V. INDIA AND THE GLOBAL MINIMUM TAX

India stands to gain from the changes in the global tax system. International trade and transactions, in general, have been more tax-favorable to developed countries. This is because, for most of recent industrial history, the flow of valuable trade, services, and technology has been largely from developed to developing countries and international tax rules have tended to restrict taxation rights in 'source' (developing) countries in favor of 'resident' (developed) countries being recipients of income.

Over the years, with the increasing economic importance of countries such as China and India, there has been an attempt in course correction through modified rules of international taxation, but it has largely played catch up with the traditional business models by seeking to levy flat tax rates on incomes such as royalties, technical service fees, dividends, and interest typically paid out by companies in developing countries to providers of technology or owners of capital in developed countries. This pace of slow progress has recently accelerated with the extraordinary growth of digital commerce.

India is likely to gain on account of the tax revenue, given the size of its market and the growth opportunities it offers. The country has been at the forefront to legislate in her domestic tax laws the concept of 'significant economic presence' to create the ability to levy tax on income generated in India from Indian customers, by foreign digital commerce companies.

And, a global minimum corporate tax rate proposed at 15% is expected to be beneficial to India.

The Tax Justice Network estimates the country to gain at least \$4bn (Rs 300 bn), equivalent to ~6 % of FY21 corporate tax collections. However, India needs to focus on capacity building and timely resolution of disputes. Besides, it would not hurt FDI to India or create any adverse or incremental tax liability in the hands of foreign investors given that the minimum tax rate for new manufacturing business has recently been legislated at 15% (plus surcharges) (Sen, 2021).

However, countries like India would have to abolish the equalization levy of 2 percent it charges on foreign online companies. The government has already cut corporate tax rates on existing and newly incorporated companies to 25 percent and 15 percent in September 2019. The government understands that any further tweaks to reflect a tax rate among the G20 countries, especially at a time of Covid-19 induced economic uncertainty will not help business sentiments. And thus, had apprehensions regarding the OECD led global minimum taxation proposal.

But since, India's effective tax rate is still above the proposed global minimum tax rate, this would not impact companies doing business in India. The manufacturing sector in India will not be affected by the proposal as the recently announced lower rate of 15 percent for new manufacturing units in India just about meets the proposed tax. Thus, giving a much-needed boost to the manufacturing sector.

At the same time, in respect of outbound investments, it will prevent base erosion of tax in the country as the government will be able to claw back any shortfall in tax paid below 15 % by an overseas business owned by an Indian resident, once the global threshold rule becomes operational.

VI. CONCLUSION

The actual implementation of a global minimum tax still looks fiendishly difficult and there is a long and challenging road ahead. Both in terms of completing the technical aspects of the taxation and its implementation proposed to start in 2023.

The proposal is set to change the dynamic of the debate and shift negotiating positions, particularly in those countries that will be negatively affected by new taxation. There is still huge uncertainty, however, over whether in the US congress Biden's proposed domestic tax reform agenda will get over the line and, if not, it is difficult to see how his ideas for the global minimum tax will survive.

The said proposal are in a package of Pillar One and Pillar Two. Different economies have

different priorities concerning the pillars. The UK, for example, prioritizes the resolution of the digital issue, which falls under Pillar One. It views any solution to be not just about a minimum tax but, critically, about the location of where tax is paid. The UK has signaled that it will take Pillar Two with Pillar One as part of a consensus deal, but only if there is a satisfactory resolution on digital issues. Other countries see Pillar Two as the more critical pillar. But by binding both pillars together as a package, the overall appeal is widened.

This has been set to give broad acceptance to the proposal and that the increasing digitalization of businesses must be dealt with in the tax world in a way that produces equitable outcomes for all stakeholders.

Estimates by the UK's Tax Justice Network suggest that the G7 countries would gain \$168bn in increased corporate income tax with a 15% global minimum corporate tax rate (Pillar 2), while all other countries would gain \$107bn. This is because, for most of recent industrial history, the flow of valuable trade, services, and technology has been largely from developed to developing countries and international tax rules have tended to restrict taxation rights in developing countries in favor of 'resident' (developed) countries being recipients of income.

Countries like India are also set to gain from such taxation systems. The Tax Justice Network estimates India to gain at least US\$4 billion, equivalent to ~6% of FY21 corporate tax collections. Overall, countries with a moderate tax rate system stand to benefit at the cost of 'tax havens' with low or nil tax rates. With the taxation in favor of developing countries, they are set to gain from the proposals as India is estimated to gain.

Whilst this will be very difficult in practice, the consensus appears to be that a global minimum tax will come to pass, not least because the alternative would be more disruptive. Inaction will lead to a plethora of unilateral measures that seek to fix problems on a bespoke per-country basis outside of an international framework. That will inevitably lead to double taxation and complex international disputes. It also has the potential to lead to more damaging political and economic ramifications such as trade wars.

It has been suggested by some that a global minimum tax is a non-complex fix for a complex problem by leveling the playing and achieving the so-called fair taxation of multinationals. "But tax rules are complex and understanding the interaction of different tax systems can be like playing three-dimensional chess: it is not intuitive, there are many moving pieces, and the moves are interdependent of each other" (Global Minimum Tax: An Easy Fix?, 2021).

The proposal is bound to achieve an element of certainty that allows governments to focus attention on fixing economies ravaged by the global pandemic is surely welcomed, even if the

proposal may have some shortcomings.

There are bound to be potential costs involved in adopting a global minimum tax. The first cost is some loss of sovereignty at the national level since there is now a global lower bound on corporate income tax (CIT) rates applicable to all jurisdictions. Secondly, if the source country is unable or unwilling to either establish a CIT (if its rate is currently zero) or raise its CIT rate to the proposal, the additional tax proceeds are captured by the residence country of the foreign Multinational corporations. Thus, the benefits to the source country from minimum tax are not realized. Moreover, if the global minimum tax is set inappropriately or incorrectly or can be manipulated, there can be efficiency and distributional losses.

In sum, there is some evidence for the establishment of a global minimum effective tax rate with some pitfalls. It may not be the best solution but may provide a useful and necessary backstop if countries continue to exempt foreign-source income from taxation. The proposal will lead MNCs to pay a basic minimum tax on their huge profits and will also keep in check the 'Tax Havens' countries.

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