INTERNATIONAL TAX REFORM: MINIMUM TAXATION

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Minimum Taxation - Overview

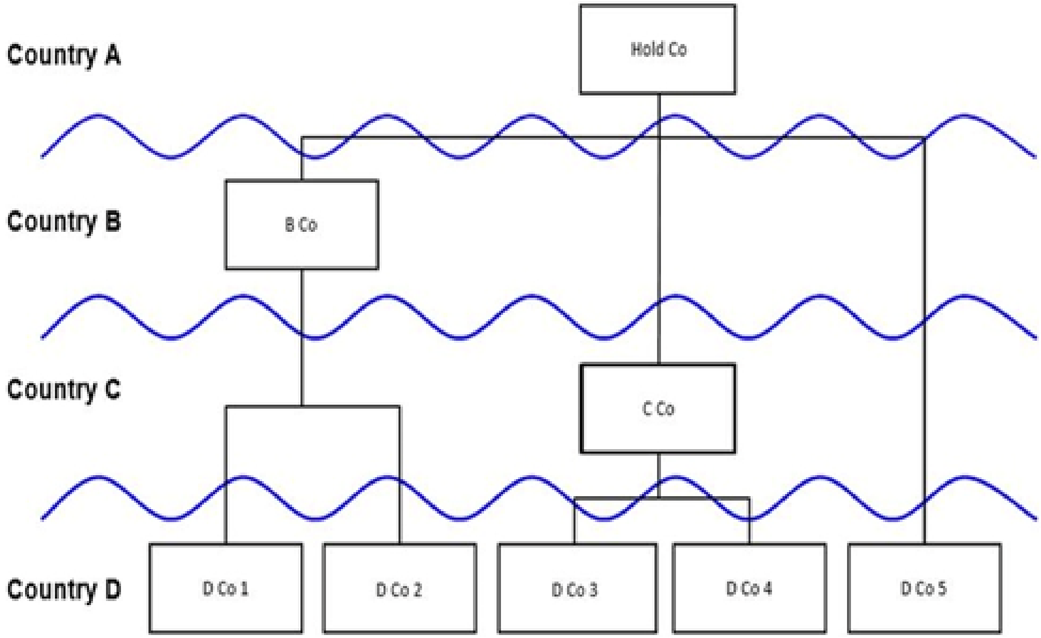
- **Objective:** Ensure MNE's global business income is subject to at least a minimum level of taxation
- **Two approaches:**
  - ***Outbound taxation***: residence country taxes foreign earnings if tax abroad below some minimum level
  - ***Inbound taxation***: source country imposes a minimum tax on resident affiliate's base to combat base eroding payments (e.g. to related parties)
  - Designed to preserve sovereignty on tax rates
- **Attractions:**
  - Reduces profit shifting and mitigates tax competition
  - Backstop to current arrangements/weaknesses; modest need for coordination
  - Developing countries gain from minimum on inbound; many have already adopted inbound rules to protect tax base
- **Challenges/issues**:
  - Can be blunt and increase distortions; design important
  - At what rate should minimum be set?

Pillar 2 – Global Minimum Tax

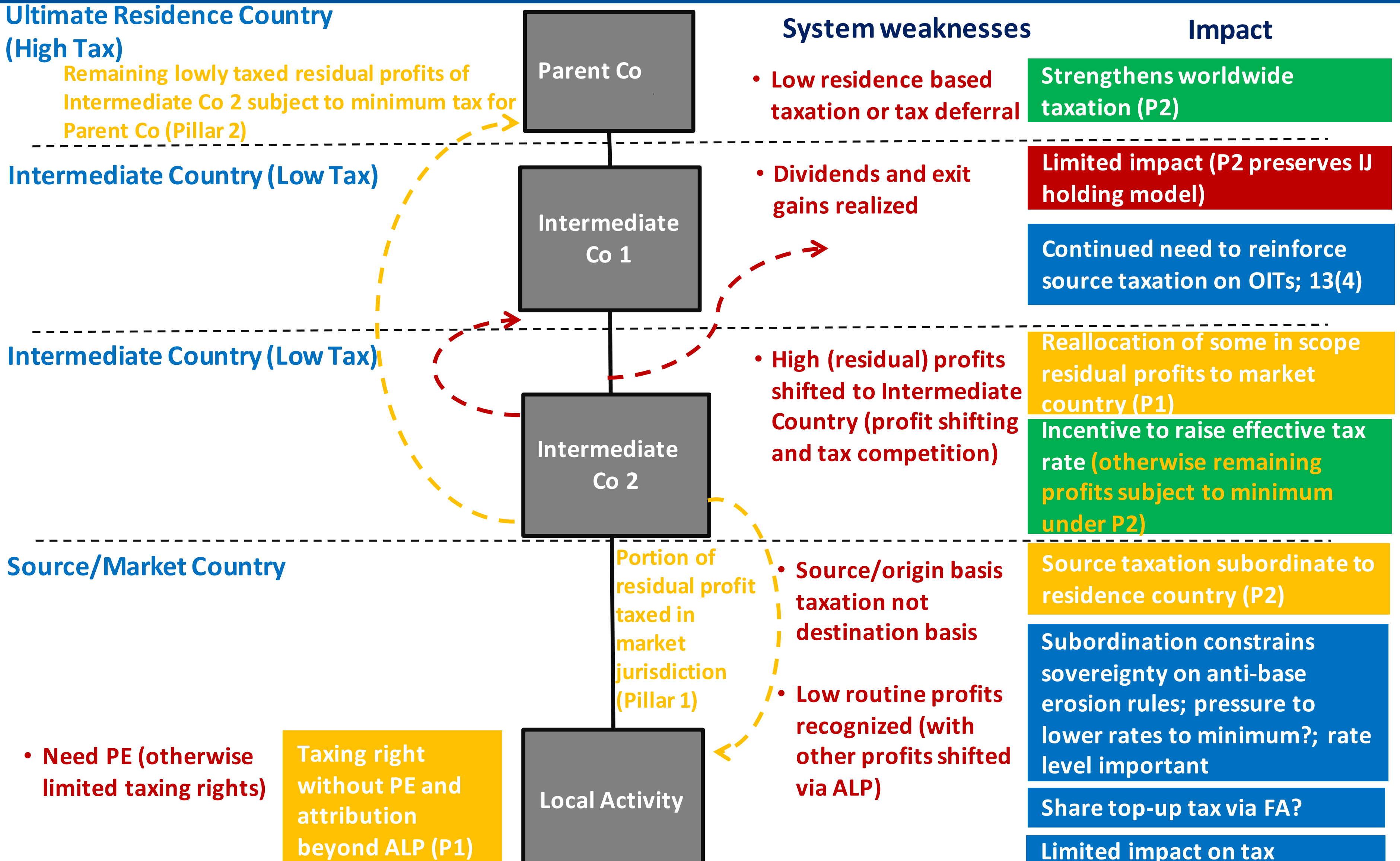
- **Minimum rate**: not agreed (speculated to be in the range of 9% -12.5%; too low?)
- **Threshold**: €750m (high, puts 85% - 90% of MNE groups outside scope)
- **Key interrelated rules:**
  - ***Income inclusion rule (IIR - outbound rule)***
    - tax profits in residence country if not effectively taxed at foreign source
    - like worldwide taxation, but only "excess income" within scope
    - similar to US GILTI, but: country by country and other deviations
    - also embodies a switch over rule
  - ***Undertaxed payments rule (UTPR - inbound rule)***
    - deny local deductions if relevant cross-border amounts are lowly taxed offshore
    - similar to US BEAT, but: contingent on offshore tax being below the minimum rate (c.f. also thin cap/earnings stripping rules)
  - ***Subject to tax rule (STTR - inbound rule #2)***
    - additional tax in source country on certain tax treaty payments (interest and royalties)

Inter-relationship of Pillar 2 Rules

- **Proposed rule order** (no consensus):
  - ***STTR*** (source country taxation but limited in scope and likely optional)
  - **IIR** (primacy given to residence country taxation)
  - **UTPR** (source country taxation further subordinated, with possible phasing in)
- **Order could matter** (inter-nation equity – source country rules most relevant for developing countries)…
- …but also **depends on behavioral impacts** (low tax countries could move to the minimum)



Impact of Minimum Taxes and Pillar 2



Pillar 1 (P1): New nexus/profit allocation
Pillar 2 (P2): Global minimum tax

Assessment of Pillar 2

- **Fundamentally sound and greater revenue impact**
  - Introduces a global tax floor – but would minimum rate of 9% -12.5% be too low?
  - Estimated global revenue gains of 1.7% - 2.8% according to the OECD (excl US GILTI); for LICs?
- **Could mostly be done unilaterally**
  - IIR like US GILTI; UTPR like US BEAT (all domestic rules); others require treaty changes
- **Ordering controversial**
  - Proposal favors capital exporters; mostly benefits developing countries indirectly
  - Priority (if combined with low minimum rate) may become detrimental to source countries (downward rate pressure); also costs if sovereign right to adopt or maintain own minimum tax rules becomes constrained
  - Rate level important; more equitable to share top-up tax under FA? (*Cobham*, *Picciotto* et al.)

Assessment of Pillar 2 (continued)

- **Complex with difficulties determining effective tax levels**
  - Adjustments preserve holding company jurisdiction model
  - Multilateral agreement to stay above the minimum rate would make rules redundant?
- **Incentive to raise effective tax rates to the minimum**
  - E.g., for other low tax residual profit jurisdictions with holidays for profitable sectors etc.
  - Trend toward alternative minimum taxes (with same rate and base)?
- **Softer impact on jurisdictions with tax incentives focused on routine profits**
  - Due to high threshold and substance based carve-out; design (profit vs cost based) still matters