

# INTERNATIONAL TAX REFORM: MINIMUM TAXATION



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International Taxation

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# Minimum Taxation - Overview

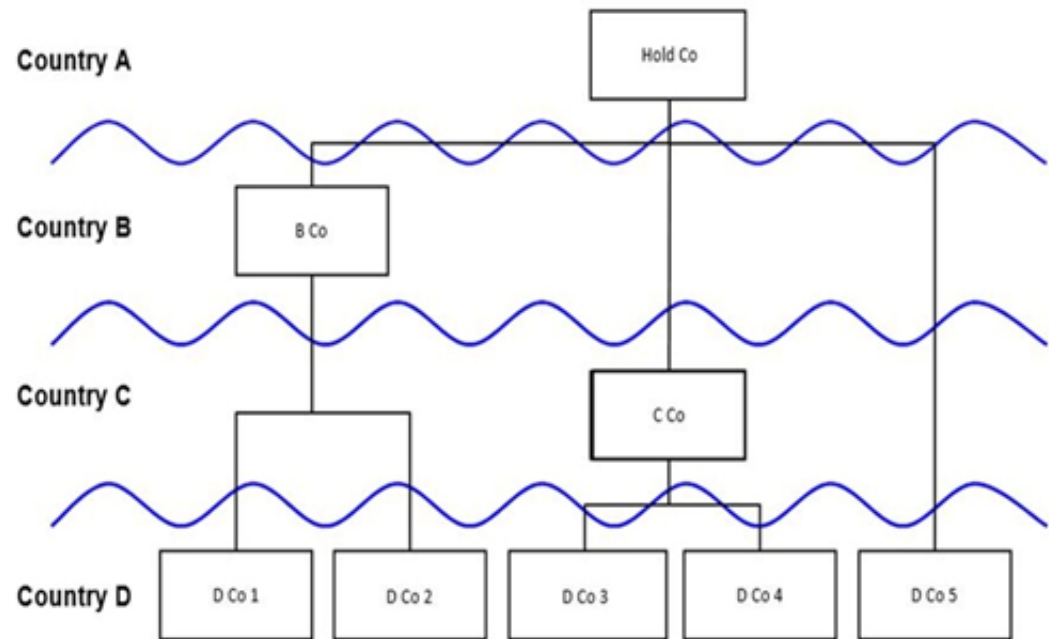
- **Objective:** Ensure MNE's global business income is subject to at least a minimum level of taxation
- **Two approaches:**
  - ▶ **Outbound taxation:** residence country taxes foreign earnings if tax abroad below some minimum level
  - ▶ **Inbound taxation:** source country imposes a minimum tax on 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

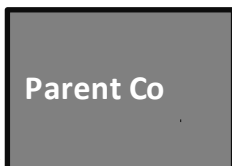
- **Proposed rule order** (no consensus):
  - ▶ **STTR** (source country taxation but limited in scope and likely optional)
  - ▶ **IIR** (primacy given to residence country taxation)
  - ▶ **UTPR** (source country taxation further subordinated, with possible phasing in)
- **Order could matter** (international 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

## Ultimate Residence Country (High Tax)

Remaining lowly taxed residual profits of Intermediate Co 2 subject to minimum tax for Parent Co (Pillar 2)



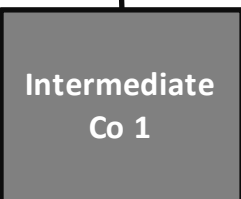
## System weaknesses

- Low residence based taxation or tax deferral

## Impact

Strengthens worldwide taxation (P2)

## Intermediate Country (Low Tax)

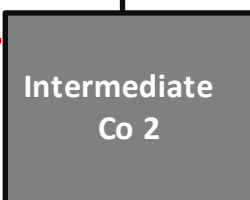


- Dividends and exit gains realized

Limited impact (P2 preserves IJ holding model)

Continued need to reinforce source taxation on OITs; 13(4)

## Intermediate Country (Low Tax)



- High (residual) profits shifted to Intermediate Country (profit shifting and tax competition)

Reallocation of some in scope residual profits to market country (P1)

Incentive to raise effective tax rate (otherwise remaining profits subject to minimum under P2)

## Source/Market Country



Portion of residual profit taxed in market jurisdiction (Pillar 1)

- Source/origin basis taxation not destination basis
- Low routine profits recognized (with other profits shifted via ALP)

Source taxation subordinate to residence country (P2)

Subordination constrains sovereignty on anti-base erosion rules; pressure to lower rates to minimum?; rate level important

Share top-up tax via FA?

Limited impact on tax incentives over routine profits; design still important

- Need PE (otherwise limited taxing rights)

Taxing right without PE and attribution beyond ALP (P1)

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