

US Treasury's Call for a Global Minimum Tax

Why in news?

U.S. Treasury Secretary Janet Yellen recently urged the adoption of a minimum global corporate income tax.

How would a global minimum tax work?

- The global minimum tax rate would apply to companies' overseas profits.
- So, if countries agree on a global minimum, 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 agreed minimum rate.
- This would eliminate the advantage of shifting profits to a tax haven.
- The Biden administration in the U.S. has said that it wanted to deny exemptions for taxes paid, to countries that did not agree to a minimum rate.

What is the rationale?

- Major economies are aiming to discourage multinational companies 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 these jurisdictions.
- This, in turn, is allowing these companies to avoid paying higher taxes in their traditional home countries.
- With a broadly agreed global minimum tax, the Biden administration hopes to reduce such tax base erosion.
- This could be done without putting American firms at a financial disadvantage, allowing them to compete on innovation, infrastructure and other attributes.
- The Trump administration attempted at capturing revenues lost to tax havens with a U.S. corporate offshore minimum tax in 2017.
 - The "Global Intangible Low-Taxed Income," or GILTI, tax rate was only 10.5% - half the domestic corporate tax rate.

How about the international tax talks?

- The Paris-based Organization for Economic Cooperation and Development

(OECD) has been coordinating tax negotiations among 140 countries for years on two major efforts.

- These are setting rules for taxing cross-border digital services and curbing tax base erosion, with a global corporate minimum tax part of the latter.
- The OECD and G20 countries aim to reach consensus on both fronts by mid-2021.
- If deals on both efforts are enacted, companies will end up paying an extra corporate tax.
- The minimum tax is expected to make up the bulk of this \$50 billion-\$80 billion extra corporate tax.
- The OECD recently said that governments broadly agreed already on the basic design of the minimum tax.
- However, the rate remains to be agreed, which is a challenging task.
- Other items still to be negotiated include -
 - i. whether industries like investment funds and real estate investment trusts should be covered
 - ii. when to apply the new rate and ensuring it is compatible with the 2017 U.S. tax reforms aimed at deterring tax-base erosion

What is the challenge with finalising the minimum rate?

- The Biden administration wants to raise the U.S. corporate tax rate to 28%.
- So, it has proposed a global minimum of 21% which is double the rate on the current GILTI tax.
- It also wants the minimum to apply to U.S. companies no matter where the taxable income is earned.
- That proposal is far above the 12.5% minimum tax that had previously been discussed in OECD talks.
 - This level happens to match Ireland's corporate tax rate.
- The Irish economy has boomed in recent years from the influx of billions of dollars in investment from foreign multinationals.
- So, Ireland which has resisted European Union attempts to harmonize its tax rules for more than a decade, is unlikely to accept a higher minimum rate without a fight.
- However, the battle for Ireland and other low-tax countries is less likely to be about trying to ruin the overall talks.
- Rather, it is more about building support for a minimum rate as close as possible to its 12.5%.

What does it mean for India?

- For India, committing to such a global standard needs to be assessed

carefully.

- This is especially since the proposal will apply to companies with global revenues above Euro 750 million.
- Moreover, India has witnessed a consistent rise in the effective tax rate which is now close to 26%.
- The call for a minimum tax may be seen as US correcting for the slippages in its own tax laws and as a means to finance the \$2 trillion spending programme.
- For the rise in US tax rates to pay off, it requires other countries to reform their tax systems accordingly.
- Most importantly, it requires other countries to allow for the taxation of incomes that are perceived to be undertaxed.
- India has, over the past few years, adopted legal measures to tax incomes of companies that avoid residence in India.
- So, it is perhaps time to reflect if the two pillars of international tax reform are meant to support the super structure of developed countries.

Source: The Economic Times, The Indian Express

