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

