Corporate Minimum Tax – Diplomacy Reshaping Global Economy

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Leaders at the Group of 20 summit in Rome are expressing broad support for sweeping changes in how big global companies are taxed.The goal deterring multinationals from stashing profits in countries where they pay little or no taxes commonly known as tax havens.The proposal was finalized in October among 136 countries and sent to the G-20 for a final look after complex talks overseen by the Organization for Economic Cooperation and Development.

In news: How G20-backed corporate minimum tax would work
Placing it in syllabus: Economy
Dimensions:

- What is the problem with the current corporate taxation?
- Impact of Tax Havens on Indian Economy
- What is Global Minimum Tax?
- Objectives of Global Minimum Tax
- Criticisms of the plan

Content:

What is the problem with the current corporate taxation?

- In the modern economy, multinational companies can earn huge profits from things like trademarks and intellectual property that are easier than factories to move.
- Companies can assign the earnings they generate to a subsidiary in a country where tax rates are very low.

- Some countries compete for revenue by using very low rates to lure companies amassing huge tax bases. Even though the tax rates are marginally above zero still these countries earn huge revenues from it.
- Between 1985 and 2018, the global average corporate headline rate fell from 49% to 24%.
- By 2016, over half of all U.S. corporate profits were booked in seven tax havens: Bermuda, the Cayman Islands, Ireland, Luxembourg, the Netherlands, Singapore and Switzerland.
- White House officials are saying the global minimum would result in almost $60 billion of added U.S. tax revenue.

Important terms to know:

Base Erosion and Profit Shifting (BEPS): practice of multinational corporations of shifting their profits from high-tax jurisdictions to low-tax jurisdictions (tax havens) is known as Base Erosion and Profit Shifting (BEPS).

Tax Haven: It can be defined as a country/place/jurisdiction where the rate of taxation is very low. This low rate of taxation usually varies from 2% to sometimes as low as 0.02%. Countries engage in upholding such a low rate of taxation in order to increase foreign investment as well as the cash flow in their economy.

Black Money: It can be best understood as any money that breaks laws in its origin, movement or use, and is not reported for tax purposes, then such money would fall within the meaning of black money.

In other words, any money to be classified as Black money must fall under either of the two categories: –

First, any money earned through any activity which is defined as illegal by virtue of any law prevailing in the country.

The second category comprises the generation of income from a legal activity that is not reported to the tax authorities and any audit trail relating thereto has been removed, leading to evasion of one or more taxes.

Tax Evasion: it is a practice of reducing tax liability through illegal means, i.e. by suppressing income or inflating expenses or by showing lower income. It is an illegal act, made to escape from paying taxes. Such illegal practices can be deliberate concealment of income, manipulation in accounts, disclosure of unreal expenses for deductions, showing personal expenditure as business expenses, overstatement of tax credit or exemptions, suppression of profits and capital gains, etc.

Tax Avoidance: An arrangement made to beat the intent of the law by taking unfair advantage of the shortcomings in the tax rules is known as Tax Avoidance. It refers to finding out new methods or tools to avoid the payment of taxes which are within the limits of the law.

Impact of Tax Havens on Indian Economy:

Traditionally, tax havens have been used for both Tax Avoidance and Tax Evasion, they have had numerous negative repercussions upon the Indian economy.

Prevents Mobilization Efforts:

- the most fundamental effect that the usage of Tax Havens has on the Indian economy is that it **prevents the various mobilization efforts** as made by the government of India
- Reduction of Tax liability by the usage of Tax Havens considerably decreases the tax base (as available to the taxation authorities) and this leads to a significant shortage of funds in the hands of the government.
- This shortage of funds, in turn, leads to the distortion of the government’s plans regarding economic growth and

development.

- In India, tax havens have been a significant barrier towards government expenditure and has had the negative impact of restricting/slowing down the growth rate.

Interferes with implementation of economic policies:

- Reduction of Tax liability by the usage of Tax Havens also interferes with the Indian government's efforts to implement its economic policies.
- Though the economic policies have been structured by the government for the benefit of the people, Tax Havens have served as a significant barrier towards the proper execution/implementation of the former.
- This, too, occurs due to a shortage of funds in the hands of the government.

Store of "Black Money"

- Tax evasion by the usage of Tax Havens to store "Black Money" also dismantles the equity attribute of any tax system
- In India, specifically, reduction of their tax liability by many leads to an increase in the rates of taxes as charged by the government for every assessment year (for the purpose of increasing its revenue) and the burden of that unfortunately ends up falling upon the honest tax payers.
- As a consequence of this, even the taxpayers who always pay their taxes honestly end up engaging in practices such as tax evasion in order to reduce an already incremental burden.

Unnecessary time consumption of Tax Authorities:

- Base Erosion and Profit Shifting through the usage of Tax Havens leads to an unnecessary consumption of time, effort and energy on behalf of the Indian tax authority.

- The Indian tax authorities have to constantly engage themselves in developing various policies for the purpose of countering the intricate mechanisms that corporations use in order to shift their profits for the purpose of reducing their tax liability.

Impact on social and moralistic values:

- With the usage of tax havens for tax evasion comes unsocial and immoral activities such as bribery, intimidation, tampering of official records, submission of fake documents etc.
- These activities create a significant impact on the social and moralistic values of Indian society.

India's efforts so far to tackle the problem of tax heavens:

- Renegotiating a Revised Double Taxation Avoidance Agreement
- India has, furthermore, enabled itself to tackle the issue of Treaty-Shopping.
- Especially with regards to the India-Mauritius DTAA, Indian authorities can now tax Mauritius residents upon their transactions (to and from India) based on their own personal discretion
- This has, positively, limited the practice of third party corporations to incorporate themselves in Mauritius in order to conduct tax-free business in India.
- This has also, positively, led to the generation of a higher amount of revenue in the hands of Indian authorities.

Tax Information Exchange Agreements (TIEA)

- India has also put severe restrictions upon the practice of storage of money received in the form of illicit/illegitimate gains ("Black Money") in tax havens by entering into Tax Information Exchange Agreements

(TIEA) with several tax havens.

- A TIEA provides India with the power to gather information from these havens upon requests relating to a criminal or civil tax-related investigation.
- This has subsequently reduced the secrecy provided by many of the tax havens and potential tax evaders find it risky to store their "Black Money" in these havens.
- India has entered into TIEAs with several tax havens such as Bahamas (2011), Bermuda (2011), Liberia (2012) and Belize (2014).

Imposing an Equalisation Levy

- India has also successfully implemented the Equalisation Levy to all business transactions irrespective of a corporation's Permanent Establishment (PE).
- As a result of this, any corporation that has incorporated itself in a tax haven but engages in regular transactions with entities in India will be charged a fee (Equalisation Levy) for doing the same.
- Many other countries have followed India's footsteps and have implemented the Equalisation Levy for business transactions.

Implementing OECD's BEPS Action Plan:

- In order to limit the practices of Base Erosion and Profit Shifting, the Organisation for Economic Co-operation and Development (OECD) introduced a set of action plans.
- These plans, collectively named as the BEPS Action Plan, were discussed and subsequently approved by all members of the G20.
- The BEPS Action Plan consists of 15 different action plans, each for a different issue relating to Base Erosion and Profit Shifting.
- India, like many other countries, have adopted these action plans in order to resolve complications arising

out of the various number of issues discussed above

What is Global Minimum Tax?

- The Global Minimum Tax or Corporate Minimum Tax is an idea to impose a minimum rate of corporate tax all over the globe on earnings of multinational companies.
- The basic idea is simple: Countries would legislate a minimum rate of at least 15% for very big companies with annual revenues over 750 million euros ($864 million)
- If company earnings go untaxed or lightly taxed in one of the world's tax havens, their home country would impose a top-up tax that would bring the rate to 15%.
- That would make it pointless for a company to use tax havens, since taxes avoided in the haven would be collected at home.
- The goal: deterring multinationals from stashing profits in countries where they pay little or no taxes — commonly known as tax havens.
- It will end a decadeslong "race to the bottom" that has seen corporate tax rates fall as tax havens sought to attract businesses that used clever accounting to take advantage of low rates in countries where they had little real activity.
- The proposal was finalized in October among 136 countries and sent to the G-20 for a final look after complex talks overseen by the Organization for Economic Cooperation and Development.
- It would update a century's worth of international taxation rules to cope with changes brought by digitalization and globalization.

How does the plan address the challenge of taxing digitalized economy?

- The plan would also let countries tax part of the earnings of the 100 or so biggest multinationals when

they do business in places where they have no physical presence, such as through internet retailing or advertising.
- The tax would only apply to a portion of profits above a profit margin of 10%.
- In return, other countries would abolish their unilateral digital services taxes on U.S. tech giants such as Google, Facebook and Amazon.
- That would head off trade conflicts with Washington, which argues such taxes unfairly target U.S. companies.

Criticisms of the tax plan:

- Some developing countries and advocacy groups such as Oxfam and the UK-based Tax Justice Network say the 15% rate is too low.
- Although the global minimum would capture some $150 billion in new revenue for governments, most of it would go to rich countries because they are where many of the biggest multinationals are headquartered.
- The EU Tax Observatory research consortium cautions that exemptions for companies with actual assets and employees in a given country could "exacerbate tax competition by giving firms incentives to move real activity to tax havens."
- That means some tax competition among countries would still be possible when actual business operations — as opposed to shifty accounting — are involved.

Implementation:

- Backing from the G-20 leaders completes a years long process of negotiation.
- Once approval is reflected in the summit's final statement, implementation then moves to the individual nations.
- The tax on earnings where companies have no physical presence would require countries to sign on to an

intergovernmental agreement in 2022, with implementation in 2023.
- The global minimum could be applied by individual countries using model rules developed by the OECD.
- If the U.S. and European countries where most multinationals are headquartered legislate such minimums, that would have much of the intended effect, even if some tax havens don't.

Mould your thought: How do tax havens affect the Indian Economy? Evaluate the rationale behind the Global Minimum tax for tackling tax havens.

Approach to the answer:

- Introduction
- Define tax havens
- List out the effects of tax havens on Indian economy
- Discuss the idea of Global Minimum tax
- Mention its objective and how it tries to achieve it
- Discuss the criticisms of Global Minimum Tax
- Conclusion