POLICY RESPONSES TO THE OECD MINIMUM TAX PROPOSAL

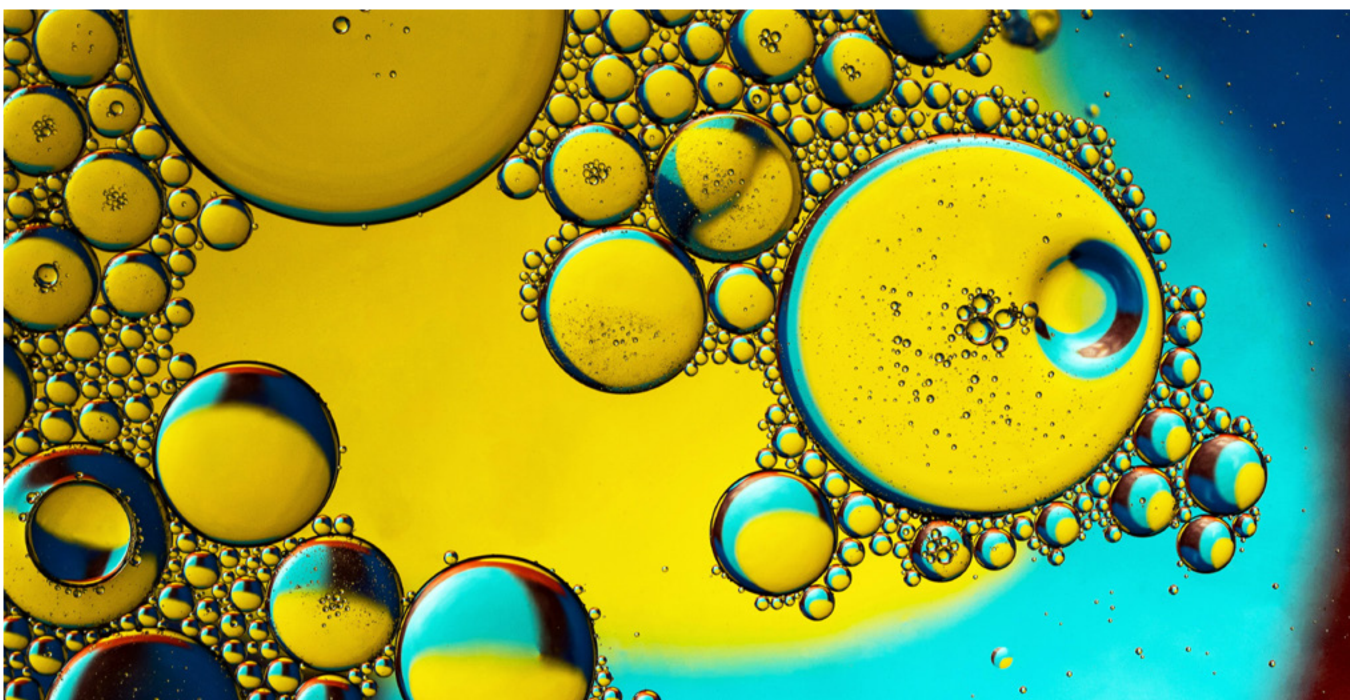
By Dr. Aitor Navarro, Max Planck Institute for Tax Law and Public Finance[1]

The OECD minimum tax, also known as Pillar Two or Global Anti-Base Erosion (GloBE), has been at the centre of the policy debate in the last 4 years since the initiative was first announced in a policy note back in February 2019. Its purported goal is to limit tax competition, and its design follows a regulatory rationale. It nudges countries to raise their effective tax rates to meet a minimum of 15% because if they don't, other countries may tax the spread to reach such an outcome. In this regard, GloBE entails a relevant limitation on the jurisdiction not to tax corporate income as an incentive to attract investment, a tax policy tool mainly employed by developing countries to compensate for shortcomings in other relevant factors such as infrastructure, stability and the like. Plus, it is designed in a manner in which the adoption of a handful of countries would have a significant impact worldwide: any in-scope multinational enterprises (MNE) having a constituent entity located in a country that adopted GloBE will see all its constituent entities affected by the minimum tax, either through the effect of the income inclusion rule (IIR) or that of the undertaxed profits rule (UTPR). For instance, the adoption of GloBE by the European Union entails that all in-scope MNEs having a presence therein will be affected by the minimum tax not only at the level of such EU-located constituent entity but at the level of the whole chain of entities in the entire organisation.

That said, GloBE does not limit the jurisdiction to tax the said income, meaning that countries may raise their effective tax rates in order to prevent other countries from applying the said rules. Several policy options are available for countries to react to the full implementation of the proposal by other countries. For instance, the very GloBE proposal includes a so-called Qualified Domestic Minimum Top-Up Tax (QDMTT), which is prima facie designed to allow the country where a low-taxed constituent entity is located, to tax the spread resulting from the application of GloBE, but not more than that. Regarding existing responses to the minimum tax, one may draw a distinction between aligned countries, namely those agreeing

with the policy rationale and outcomes of GloBE, such as the European Union, and non-aligned countries, being this other group the focus of the present article.

There are several reasons that explain the non-alignment of certain countries with the minimum taxation proposal drawn by the OECD. This may come as a disagreement with at least the following aspects. First, due to a disagreement with its underlying policy, as there are several countries worldwide that do not have the need to curtail the options of other jurisdictions to attract investment through low or no taxes. Plus, it would certainly be hypocritical to impose a specific tax incentives' policy to foreign jurisdictions while maintaining tax incentives at home that would lead to an effective tax rate lower than that of the minimum tax proposal. Second, from a design perspective, GloBE is fairly complex and challenging to administer, especially regarding the calculation of the effective tax rate. Hence, even when one agrees with the aim of the minimum tax, one may criticise the configuration of the OECD proposal, as there are other alternatives available that would achieve a similar result while maintaining simplicity intact. Third, there may be concerns about the compatibility of the proposal with international public law or against specific international instruments, such as investment agreements, as defended by certain scholars[2]. Fourth, to avoid retaliation by the United States, as certain US politicians have expressed that GloBE could lead adopting countries to tax US MNE profit without nexus to their tax sovereignty sphere. Plus, GloBE could affect the effectiveness of US subsidies such as those granted through the Inflation Reduction Act (IRA), although the OECD has modified the reach of GloBE through the issuance of further administrative guidance to downplay its reach in this context. Fifth, rejection may come due to legitimacy concerns, inter alia, due to the perception of the OECD as a non-inclusive forum that should be abandoned in favour of the UN.



Without intending to evaluate the merits of the aforementioned reasons, what is indisputable is that there are countries non-aligned with the OECD minimum tax proposal, especially in the developing world. This already would lead to considering the non-adoption of either the IIR or the UTPR, as they would limit tax competition from other countries. If a country identifies with one of the reasons above not to be aligned with GloBE, it seems pretty clear that the adoption of the said measures is senseless. If revenue raising were an argument favouring adoption, it would be senseless as well because there are other means of raising revenue that are actually not dependent on the actions of other jurisdictions, as GloBE is. A country adopting the IIR and the UTPR would see revenue raised going to zero if all countries worldwide adopted a well-designed QDMTT because collection would take place at the level of those countries, as the QDMTT takes preference over the IIR and the UTPR. Therefore, if revenue raising is the goal, GloBE measures are not the best policy tool to achieve it.

Once the IIR and the UTPR are discarded for non-aligned countries, the query of how to react to the adoption by other countries in any case remains. Indeed, not reacting would mean assuming the risk of other countries applying GloBE rules to tax low constituent entities located in the non-aligned country to tax the spread and reach the preached 15% effective tax rate. In that case, the low-taxation incentive that existed pre-GloBE would be curtailed; therefore, if that is the outcome, it would make more sense for the country to collect such revenue, instead of a foreign one. The query would not be whether to react, but instead how to react. In this regard, two main aspects should be taken into account.

First, how should effective tax rates be increased? Should countries aim at a “surgical cut” in order to collect GloBE amounts and not more? Or would an increase detached from GloBE be more plausible? This would depend, of course, on the country's policy preferences. If the intention is to remain tax competitive in the new framework created by GloBE, the aim should be to strictly collect amounts that fall under the scope of GloBE, and not more. To that end, adopting a well-tailored QDMTT would be in order, designed to match the calculations of GloBE liabilities that would otherwise arise. Calculations would mimic those of GloBE in such a scenario.

Countries could also adopt corporate tax increases detached from GloBE, such as the expansion of the corporate tax base, an increase in the corporate tax rate, the adoption of other minimum domestic taxes generally applicable to accounting profits –such as the US alternative minimum tax–, or a combination of any of these measures. Here, countries would have to assume overkill effects or the risk that, due to mismatches in calculating liabilities resulting from these measures vis-à-vis those of GloBE, instances of

taxation lower than the GloBE minimum could trigger GloBE liabilities elsewhere. Second, countries should re-evaluate the design of tax incentives aimed at in-scope MNEs due to the impact of GloBE on their effectiveness, as described above. Moreover, it must be stressed that OECD policymakers have, over time, eroded the effectiveness of GloBE as it was initially conceived through the introduction of several exceptions that would, in fact, leave some tax incentives out of the scope of the minimum tax. On the one hand, the introduction of a substance-based income exclusion (SBIE) that would reduce the taxable profit in accordance with a formula based on employees and tangible assets favours the modification of domestic tax incentives to be dependent on these factors, as exemplified by the new incentives introduced by Barbados in its Corporation Tax Reform 2024 proposal, granting for instance a "Qualified Jobs Credit" to certain sectors up to 475% of the average payroll cost. On the other hand, further implementation guidelines issued by the OECD have reduced or even neutralised the impact of the minimum tax on certain tax incentives in the form of tax credits, creating categories such as the "qualified refundable tax credits" or "marketable transferable tax credits" –as stated above, mainly to reduce the impact of the minimum tax on the incentives adopted by the US in the IRA– that should lead countries to rethink their array of tax incentives and whether they should be modified to match GloBE categories, maintained or eliminated.

Due to the aforementioned, the impact of GloBE on non-aligned developing countries may vary depending on the current status of their corporate taxes and the policy objectives to be pursued in the described new scenario. What seems clear all things being considered is that tax competition will continue to exist under new forms.

Aitor Navarro

[1] This note replicates considerations presented in the conference titled "The EU Minimum Corporate Tax Directive and its Impact on Non-Member Countries", organized by the University of Belgrade Faculty of Law and the Serbian Academy of Sciences and Arts that took place in Belgrade (Serbia) on November 24th, 2023. I'd like to thank Svetislav Kostic for the organization of the event and the kind invitation. My gratitude also goes to Leopoldo Parada, who also participated in the said conference and encouraged me to write this note and present it to the Caribbean Tax Journal for publication.

[2] See, e.g. P. Hongler et al., UTPR - potential conflicts with international law? 111(2) Tax notes international 141-151 (2023). See also B. Kuźniacki, Pillar 2 and international investment agreements: 'QDMTT payable' seals an internationally wrongful act, 112(2) Tax notes international 159-177 (2023).
[3] See Barbados Corporation Tax Reform 2024, paragraphs 48–54, available at https://www.barbadosparliament.com/uploads/sittings/attachments/8548dbe944a97cd2acfe22f78eade9f5.pdf.