# A NEW INTERNATIONAL TAX PARADIGM - BUT WHAT'S IN IT FOR THE DEVELOPING WORLD

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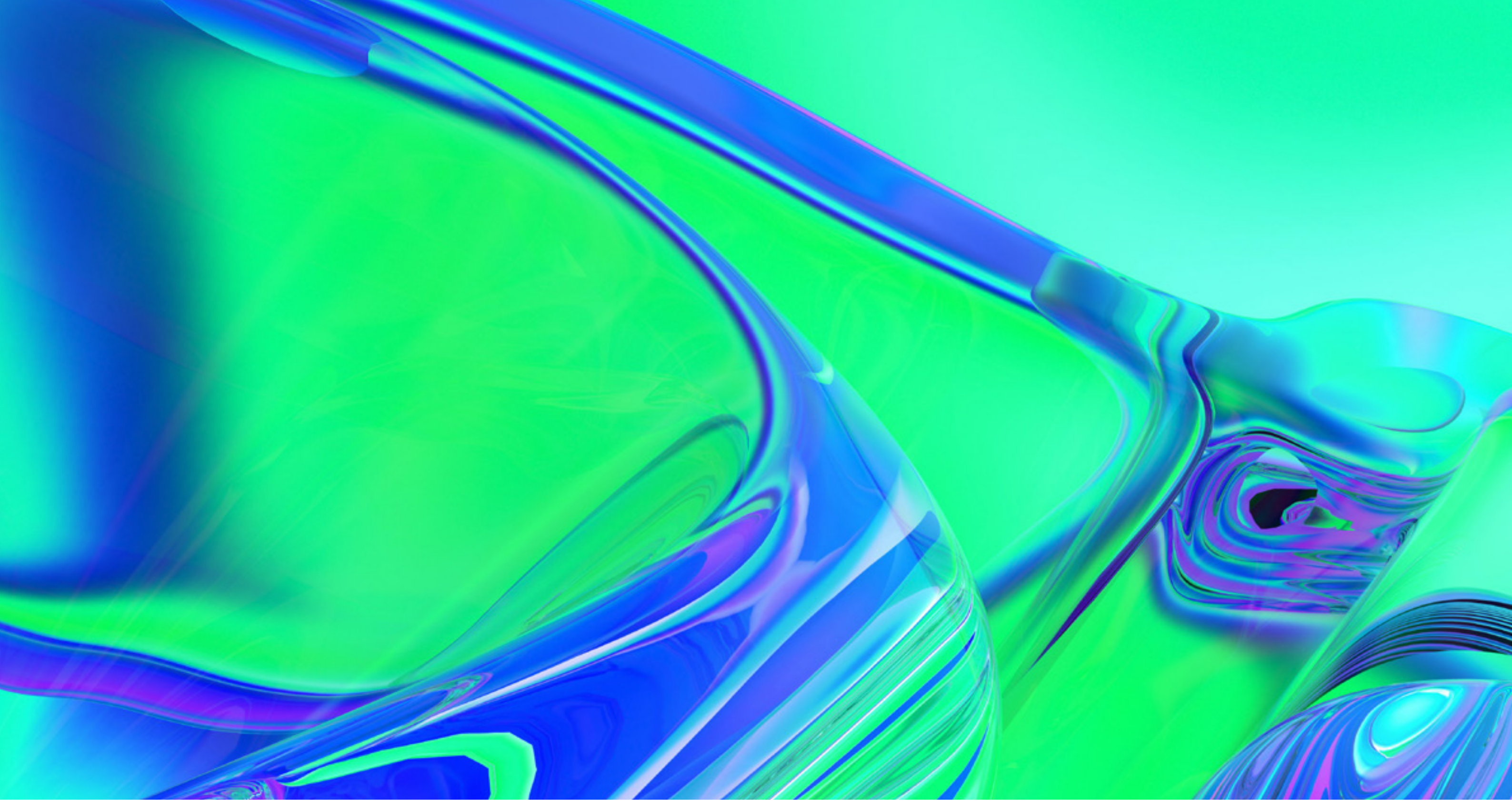
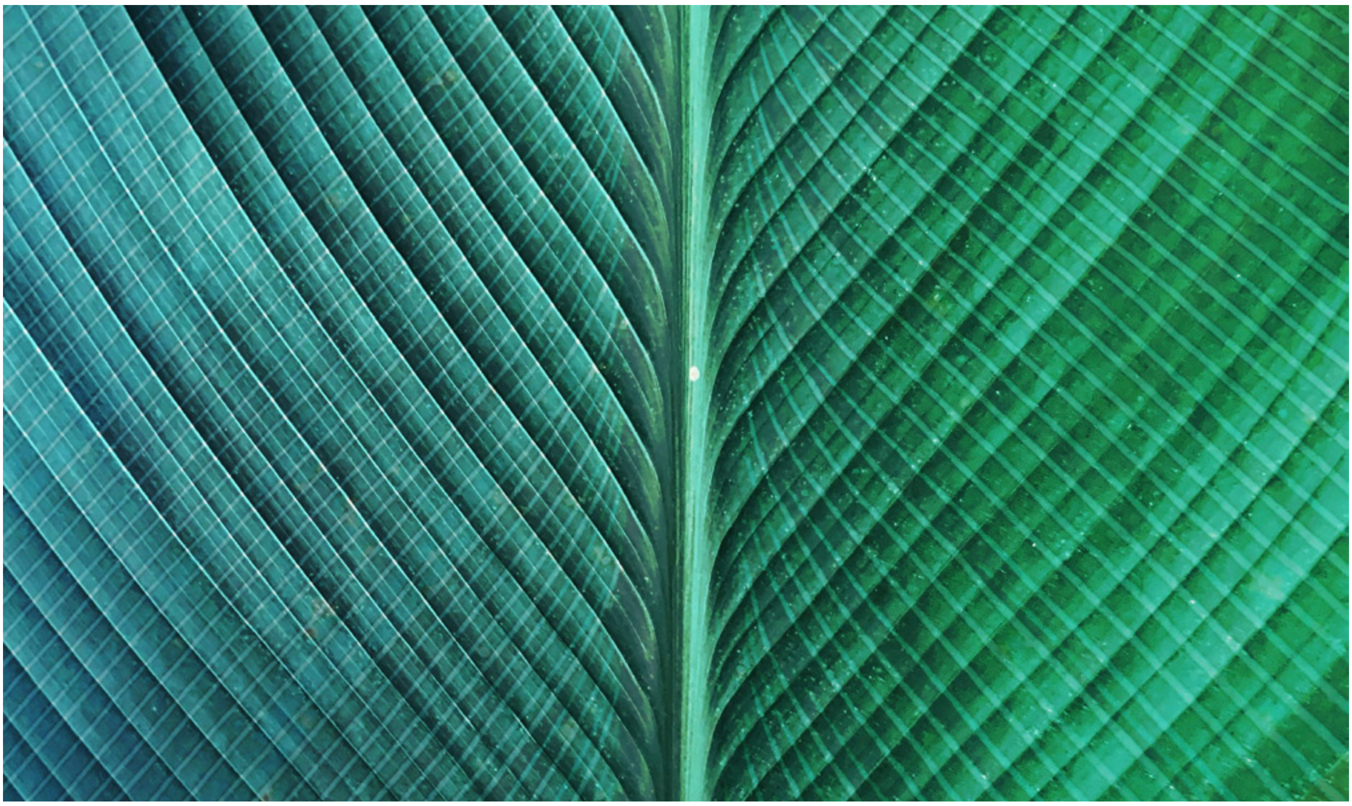
Even though absolute truths are dangerous and usually incorrect, one could note that the introduction of the Pillar II inspired legislation, i.e., minimum corporate income tax requirements for MNEs, such as the recent EU (Council Directive 2022/2523 of 14 December 2022 on ensuring a global minimum level of taxation for multinational enterprise groups and large-scale domestic groups) and US (GILTI rules introduced by the 2017 The Tax Cuts and Jobs Act) legislation are sounding the end of using low corporate income taxation as means of attracting foreign investment. However, it seems even more important that these developments provide developing countries with a much-needed incitement for reflection over the goals of their tax policy and perhaps even more importantly the means how to get their voices heard and considered on the global level. For this purpose, in this paper we will be using an example of a European, but nevertheless developing country: Serbia. In addition, it would be easy to align the following analysis with the circumstances of many comparable jurisdictions.

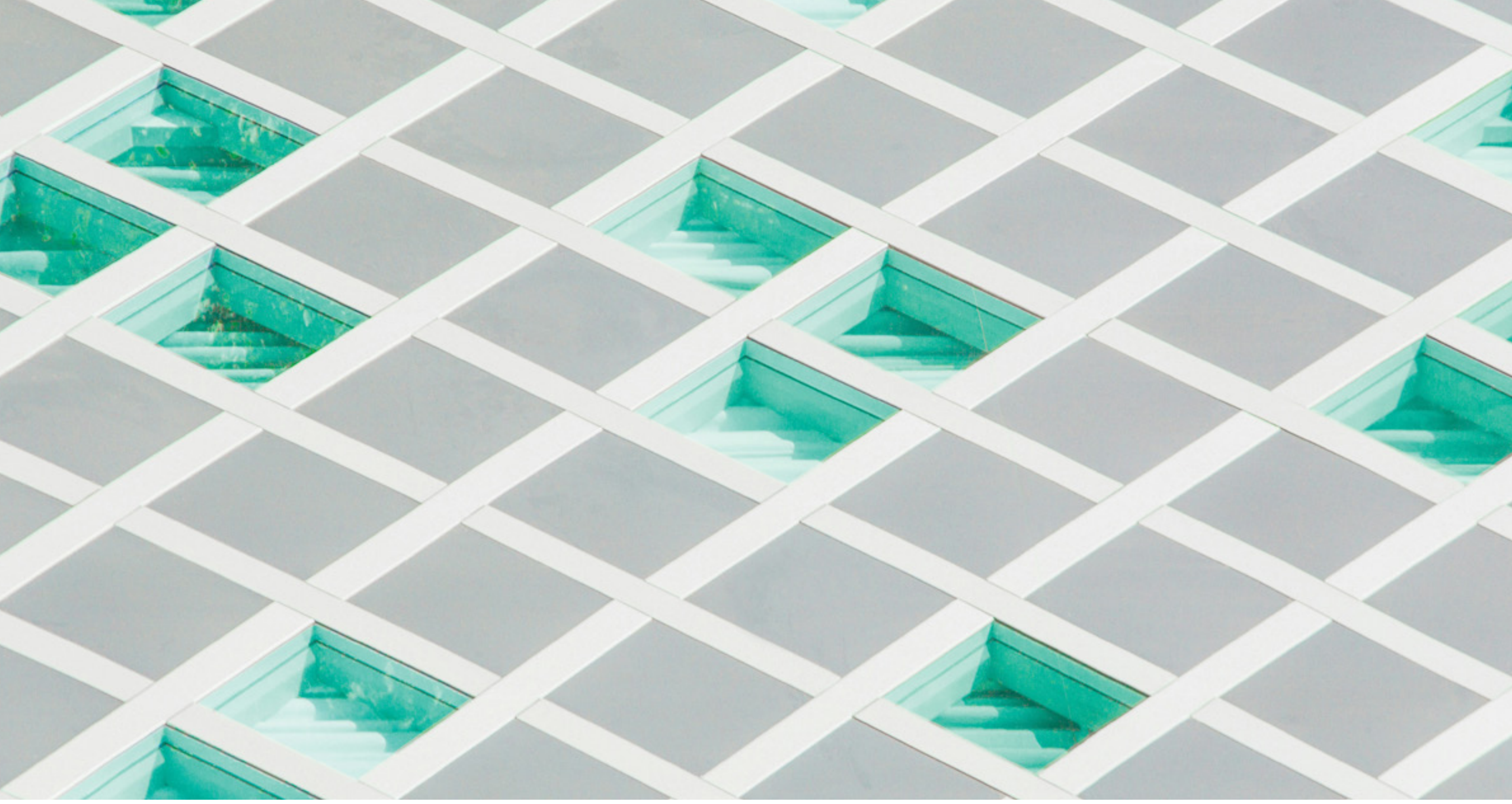
A quarter a century ago, the land in question was focusing its tax policy, particularly in the area of corporate income taxation on one key issue: unemployment. Unemployment was rampant, the country had very few domestic sources of capital and urgently needed foreign investment to speed up its development and open up new jobs. It is not difficult to understand why foreign capital was king at the time. Very soon policy makers realized that taxation was fertile ground for incentives aimed at attracting foreign investors.



Unlike more fundamental ones, such as education, development of infrastructure, improvement of legal certainty and public institutions, tax incentives warranted only simple legislative changes, the simpler the better as more complex ones usually require a sophisticated tax administration to implement (an element often lacking in developing countries). Corporate income taxation offered itself as the most obvious space to introduce them due to the fact that this fiscal form was of limited relevance for the budget whose primary sources were indirect taxes and taxes and mandatory social security contributions on the income of individuals. In 2004, Serbian politicians enabled themselves to have a slide on their presentations for potential investors in which they would boast that their country had the lowest corporate income tax rate in Europe – namely, in that year the Serbian corporate income tax rate was lowered to 10%. Furthermore, numerous tax incentives were introduced which lowered the effective rate of corporate income tax to below 5%. The ideal in heads of many Serbian tax policy makers was Ireland and they hoped that this sacrifice of potential fiscal revenues will quickly reap potent rewards. Alas, it was not to be so. However, what Serbia did succeed was in immediately starting a regional race to the bottom and in less than two years almost all of its neighbors, all very similar jurisdictions in terms of economic development, introduced a corporate income tax rate of 10%. One of them, Montenegro, took an additional step in order to be able to claim the title of being the country with the lowest corporate income tax rate in Europe. Within a year from Serbia's 10%, its legislation boasted a 9% corporate income tax rate.

The global economic crisis of 2008/2009 hit Serbia quite hard and due to irresponsible stewardship of national finances by 2012 the country was facing potential insolvency. Therefore, the government elected in the spring of 2012 had to lower spending and increase revenues. By the end of the same year, it pushed through legislation by which it had effectively tripled the effective corporate income tax rate, abolishing most of the incentives and increasing the nominal rate from 10% to 15%. This was the perfect testing ground for the dogma that low corporate income tax rates had a profound effect on the ability to attract foreign direct investment. Most Serbia's neighbors did not follow suit and kept their corporate income tax burdens intact. And yet, Serbia managed to attract more foreign investment after it had increased its corporate income tax rate than it had done at the time it was the champion of the low fiscal burden regime. In contrast, the domestic business sector lowered their investments into the home economy. There are two main reasons for the success of Serbia with foreign direct investments. Firstly, and most importantly, its government from 2012 put in real effort to show that it was foreign investor friendly and provided them a secure environment to do business. This security was not the result of a particularly well developed judiciary or sound institutional framework, but rather the political forces which had a vested interest in being good hosts to the foreign investors (as economic development and combating unemployment was the key political platform they ran on). The same treatment was not awarded to local business which





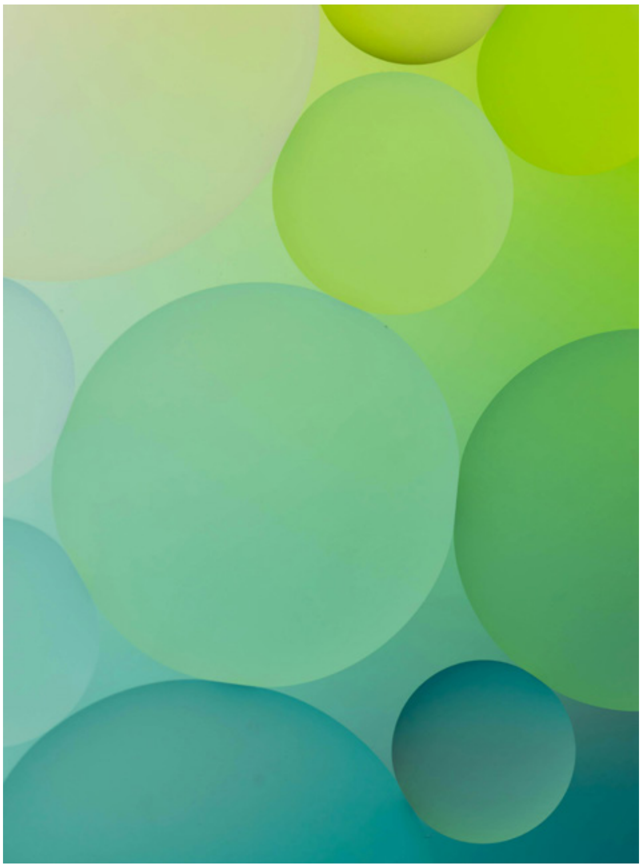
led to their feeling of insecurity and the corresponding drop in confidence in the home market. Simply, the domestic economy was not strong enough to provide the government with what it needed – quick labor intensive investments which could solve the burning issue of unemployment which by 2012 reached a staggering 26%.  Secondly, the Serbian government turned to generous subsidies for attracting targeted foreign investments.  From a fiscal perspective a selective number of MNEs were still receiving notable inputs from the Serbian budget, while the brunt of the increase in the burden was born by the domestic economy (which had a much more limited access to subsidies as it could not easily meet the criteria set for their granting).

Unfortunately, two forces were having a far more relevant impact on the problem of unemployment than any legislative measure.  Namely, high levels of emigration from the country in combination with low birth rates, supported by modest economic growth, managed to lower the Serbian unemployment rate from 26% in 2012 to 9% in 2024.  The economy generated more than half a million new jobs in this period (Serbia has population of app. 6.5 million), but a very significant portion of the unemployment problem was resolved by people leaving the country. Furthermore, the demographic decline led to each new generation bringing in less new individuals into the employment pool.  Serbia today has two thirds of newborns in comparison to their number 40 years ago, while its fertility rate is 1.63.

This state of affairs is shared by countries across the globe. If we compare our experimental country – Serbia, with those of the Caribbean we will find notable similarities. For example, the number of newborn Jamaicans today is only half of those which this country had in the early 80s of the XX century (the Jamaican fertility rate today in lower that that of Serbia). A similar situation will be found in Cuba and Trinidad and Tobago. In Puerto Ricco the number of newborns today is 4 times lower in comparison to the early 80s and three times lower than what it was only 20 years ago. The fertility rate is below 1. Just like Serbia the Caribbean nations are losing multitudes of their nationals due to immigration, while they are unable to attract inbound migrants flow to amend the incurred losses.

By 2018 Serbian policy makers were shifting their attention from providing incentives to investors to trying to assist them in maintaining their workforce and attracting new employees. In essence, the main goal of tax policy shifted from combating unemployment to making Serbian employers more competitive in a global work market with the main goal being how to increase available net income for employees so as to influence them not to seek their fortunes elsewhere. From a struggle to attract capital, the focus was now on how to keep and, if possible, attract talent, human capital. Furthermore, the preservation of highly skilled individuals increasingly required investments which brought with them technological and scientific advancements not to be found in the country.

Taking all of this into consideration one could be tempted to forgive Serbian policy makers for not being particularly interested in the Pillar II developments. True, there could be some space for generating additional revenue from MNEs whose effective tax rate would be below 15% by introducing a domestic top up tax, but in essence the introduction of new EU and US legislation will not effect the key drivers of Serbian tax policy.



However, some strong criticism is in order, although Serbia shares the same guilt as the majority of the world's developing countries. Serbia's fundamental international taxation sin is in its inability to suggest proposals and counterproposals which would address its interests. The sin of being placid and dormant. Also, it is failing in its ability to find common ground and create a united front on the global stage with those with whom it shares the same interests.

Pillar II is not a proposal which addresses any of the fundamental issues developing countries face. The flow from their coffers to those of MNEs will not stop but will rather change form, wherein we already have telling confirmations of this presumption. For example, Vietnam introduced its domestic top-up tax which will ensure that MNEs operating in the country pay a minimum 15% corporate income tax. At the same time this country is establishing an Investment Support Fund which will be financed by the revenue from the new top-up tax but will in essence be returning this money in the form of subsidies primarily to those companies which paid the top-up tax in the first place. One can only compliment Vietnam for this policy as at the very least they made sure that tax on the profits generated in Vietnam stayed in Vietnam and were used in line with Vietnamese policy interests. Developing countries will be pressed to find solutions how to stay competitive on the global capital market and probably most will in the end turn to subsidies. The current legal framework impacting their ability to do so is mostly found in WTO law, but this sets only modest limitations on freely tailoring their policy on providing subsidies. Some may revert to trying to introduce qualified tax credits, but this would not be very likely as the success of such policy depends on other nations accepting the respective measure as being qualified i.e., one cannot unilaterally guarantee to the beneficiary of the qualified tax credit the ultimate success of the applied mechanism.

As the global demographic decline only accelerates and the struggle for human capital becomes increasingly merciless, tax policy makers will have at their disposal personal income taxation and mandatory social security contributions as potential space to work.

In some countries the goal will be to lure in top level management, in some it will be the need to keep the skilled workforce in the country which will drive the policy development.  In other words, from a tax competition focused on the lowering of the fiscal burner on corporate profits, countries may shift to a one which will enable corporations to increase their profits by lowering the overall workforce costs.  For most developing countries this will as a rule mean that the focus will remain on retaining the domestic workforce, as the ability to attract foreigners is deeply connected with the quality of the public goods and infrastructure offered by a particular society (education, healthcare, safety, etc.), something which is still lacking in many of them.

Alas, all of what we have mentioned is merely a response to measures demanded by and introduced by the developed world.  Whether or not this is sound policy for them is also disputable, but what is certain is that developed countries were the ones who pushed through the minimum corporate income tax concept.  What the developing countries failed to do is come up with their counter proposals. Most recently in 2023 South American countries led by Colombia voiced their dissatisfaction with the proposals emanating under the auspices of the BEPS project underlining the fact that they fail to address the concerns of developing countries. The November 2023 UN General Assembly resolution on the promotion of inclusive and effective international tax cooperation is also a very clear sign of dissatisfaction of the less affluent majority of the world's population.

In conclusion, the global tax debate is at the moment quite one sided. Some developing countries at best are managing to find adequate responses to initiatives coming out from the developed world.  No initiatives are emanating from the global south (hopefully, yet).  However, when we talk about the developing countries, we must realize that the majority of them are relatively small and economically irrelevant jurisdictions – like Serbia, or like the nations of the Caribbean.  Unless such countries find common ground, and there is surprisingly a lot of it, and find ways in which to present a united front their voices will not be heard. If anything, the BEPS projects shows that unless we find ways to drastically increase the decibel levels of our cries, we will not be heard.

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