Global Minimum Tax

For Prelims: Global Minimum Tax, European Union, OECD, BEPS Programme.

For Mains: Significance of Global Minimum Tax and related Issues.

Why in News?

Recently, EU members have agreed to implement a minimum tax rate of 15% on big businesses in accordance with **Pillar 2 of the global tax agreement framed by the** Organisation for Economic Cooperation and Development (OECD) in 2021.

- In 2021, **136 countries including India** had agreed on a plan to redistribute tax rights across jurisdictions and enforce a minimum tax rate of 15% on large multinational corporations.

What is Global Minimum Tax?

- A **Global Minimum Tax (GMT)** applies **a standard minimum tax rate to a defined corporate income base** worldwide.
- The OECD developed a proposal **featuring a corporate minimum tax of 15% on foreign profits of large multinationals,** which would give countries new annual tax revenues of USD 150 billion.
- The framework of GMT aims **to discourage nations from tax competition through lower tax rates** that result in corporate profit **shifting and tax base erosion.**

What are the Key Points of the Plan?

- **Two Pillar Plan:**
  - **Pillar 1:**
    - 25% of profits of the **largest and most profitable Multinational Enterprise (MNEs) above a set profit margin would be reallocated** to the market jurisdictions **where the MNE's users and customers are located.**
    - It also provides for a simplified and streamlined approach to the application of the arm's length principle to in-country baseline **marketing and distribution activities.**
    - It includes **features to ensure dispute prevention and dispute resolution in order to address any risk of double taxation,** but with an elective mechanism for some low-capacity countries.
    - It also **entails the removal and standstill of Digital Services Taxes (DST)** and similar relevant measures, to prevent harmful trade disputes.
  - **Pillar 2:**
    - It provides a **minimum 15% tax on corporate profit,** putting a floor on tax competition.
    - This will apply to multinational groups with annual global revenues of over **750 million euros.** Governments across the world will impose additional taxes on the

foreign profits of MNEs headquartered in their jurisdiction at least to the agreed minimum rate.
        - This means that if a company's earnings go untaxed or lightly taxed in one of the tax havens, their home country would impose a top-up tax that would bring the effective rate to 15%.
- **Objectives:**
    - It aims to ensure that **big businesses with global operations do not benefit by domiciling themselves in tax havens** in order to save on taxes.
    - The minimum tax and other provisions **aim to put an end to decades of tax competition between governments** to attract foreign investment.

What is the Significance of the Move?

- **End of Race to the Bottom:**
    - It tries to **put an end to the "race to the bottom" which has made it harder for governments to shore up the revenues required** to fund their rising spending budgets.
        - **A race to the bottom** refers to **heightened competition between nations, states, or companies,** where product quality or rational economic decisions are sacrificed in order to gain a competitive advantage or reduction in product manufacturing costs.
- **Stopping Financial Diversion to Tax Havens:**
    - Increasingly, income from intangible sources such as drug patents, software and royalties on intellectual property has migrated to Tax Havens, **allowing companies to avoid paying higher taxes in their traditional home countries.**
- **Mobilising Financial Resources:**
    - With budgets strained after the Covid-19 crisis, **many governments want more than ever to discourage multinationals** from shifting profits – and tax revenues – to low-tax countries regardless of where their sales are made.
- **Global Tax Reforms:** Since the inception of the **Base Erosion and Profit Shifting (BEPS) programme,** the proposal for GMT is another positive step towards global taxation reforms.
    - BEPS refers to tax avoidance strategies that exploit gaps and mismatches in tax rules to artificially shift profits to low or no-tax locations. OECD has issued 15 Action Items to address this.
- **Counters Global Inequality:**
    - The minimum tax proposal is particularly **relevant at a time when the fiscal state of governments across the world has deteriorated** as seen in the worsening of public debt metrics.
- It is believed that the plan will also help **counter rising global inequality by making it tougher for large businesses** to pay low taxes by availing the services of tax havens.

What are the Issues?

- **Threat of tax Competition:**
    - It is considered the threat of tax competition **that keeps a check on governments which would otherwise tax their citizens heavily** to fund profligate spending programs.
- **Impending Sovereignty:**
    - It impinges on the **right of the sovereign to decide a nation's tax policy.**
    - A global minimum rate would essentially **take away a tool country use to push policies that suit them.**
- **Question of Efficacy:**
    - The deal has also been criticized for **lacking teeth: Groups such as Oxfam said the deal would not put an end to tax havens.**

What is the Organization for Economic Cooperation and Development?

- The OECD is an **intergovernmental economic organisation,** founded to stimulate economic

progress and world trade.
- **Founded:** 1961.
- Headquarters: Paris, France.
- Total Members: 36.
- India is not a member, but a key economic partner.

Way Forward

- Since the OECD's plan essentially tries to form a global tax cartel, **it will always face the risk of losing out to low-tax jurisdictions outside the cartel** and cheating by members within the cartel.
- After all, countries both within and outside the cartel **will have the incentive to boost investments and economic growth within their respective jurisdictions** by offering lower tax rates to businesses.
- This is a structural problem that will persist as long as the global tax cartel continues to exist.

UPSC Civil Services Examination, Previous Year Question (PYQ)

Q. The term 'Base Erosion and Profit Shifting' is sometimes seen in the news in the context of (2016)

(a) mining operation by multinational companies in resource-rich but backward areas
(b) curbing of the tax evasion by multinational companies
(c) exploitation of genetic resources of a country by multinational companies
(d) lack of consideration of environmental costs in the planning and implementation of developmental projects

Ans: (b)

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