The Big Picture: Global Corporate Tax and India

Why in News

Recently, the Finance Ministers of the G7 advanced economies secured a landmark deal on taxing multinational companies by fixing a **Global Minimum Corporate Tax Rate (GMCTR)**

- The decision would be placed before the **G20** countries, a group of developing and developed nations, in July 2021.

Key Points

- **Aim:** The deal is aimed at modernizing the century-old international tax code and reducing the transatlantic tensions that threatened to spill into a trade war.
- **Paving Way for Taxes:** The agreement paves way for levies on Multinational Companies (MNCs) in countries where they operate, instead of just where they are headquartered.
- **Countries' Right to Tax:** Under the new agreement, countries where big firms operate would get the right to tax at least 20% of profits exceeding a 10% margin which would apply to the largest and most profitable multinational enterprises.
- **Efforts by OECD:** The **Organization for Economic Cooperation and Development (OECD)** has also been coordinating tax negotiations among 140 countries for years on rules for **taxing cross-border digital services** and curbing tax **base erosion**, including a global corporate minimum tax.

Global Minimum Corporate Tax Rate (GMCTR)

- **Corporation tax:** It is a direct tax imposed on the net income or profit that enterprises make from their businesses.
    - The G7 Finance Ministers have called for a global minimum corporation tax rate of **at least 15%.**
- **Need of GMCTR:**
    - **Low Tax Jurisdictions:** MNCs follow the system of locating the headquarters wherever the tax is the lowest so that the company ends up paying the tax at a much lower rate. Therefore the smaller countries such as Ireland were at advantage but the bigger countries lost out on tax revenues.
        - G7 countries have announced a minimum 15% tax rate on all MNCs irrespective of whichever place they are so that the advantage of country shifting does not remain.
        - There GMCTR must be fixed to avoid countries undercutting each other.
    - **To Bring Uniformity:** GMCTR will end a decades-long race to the bottom in which countries have competed to attract corporate giants with ultra-low tax rates and exemptions. And it will bring uniformity in corporate taxation worldwide.
    - **Multilayering by MNCs for Profits:** Digital giants such as Apple, Alphabet and Facebook, as well as many other major corporations typically rely on complex webs of subsidiaries to hoover profits out of major markets into low-tax countries such as Ireland or Caribbean

nations such as the British Virgin Islands or the Bahamas, or to central American nations such as Panama.

- **GMCTR and India:**
    - **Bringing Equality:** In the Indian context, the GMCTR will bring equality to those people maybe operating in India but not located in India and therefore not paying any taxes.
    - **Attract Investments:** India is likely to benefit from the global minimum 15% corporate tax rate pact as the effective domestic tax rate (other than in Special Economic Zones) is above the threshold.
        - In all probability the concessional Indian tax regime would still work, and India would continue to attract investments.
    - **India at Advantage:** Due to India's tax rates too, it will be in an advantageous position because Indian tax rates have come at a position where India can afford to give concessions to big companies and yet not fall down at the international tax rates.
    - **Challenge:** Although the 15% GMCTR will not affect the current investments in India, setting up more SEZs or giving incentives to companies to invest in India will be a challenge.

Challenges Associated

- **Bringing Global Consensus:** Bringing all the major nations on the same page, especially since the pact impinges on the right of the sovereign to decide a nation's tax policy.
    - A global minimum rate would essentially take away a tool that countries use to push policies that suit them.
- **Issues to Smaller Countries:** Countries like Ireland, which has a tax rate of 12.5%, has come out against the global minimum tax, arguing that it would be disruptive to its economic model.
- **Issues to Developing Countries:** IMF and World Bank data suggest that developing countries with less ability to offer mega stimulus packages may experience a longer economic hangover than developed nations.
    - Considering the countries like Bangladesh which do not have too many advantages to offer besides a Special Economic Zone, this decision of G7 countries might not be very conducive.
- **Tackling Tax Evasion:** A lower tax rate is a tool the countries can use to alternatively push economic activity. Also, a global minimum tax rate will do little to tackle tax evasion.
- **Rigidity in Rules:** Once an international commitment has been made for 15%, it will be very difficult for the national governments to say who stays on 15% and who doesn't. It will introduce a rigidity in the rules which might not be as favourable for countries' economies.

Way Forward

- **Effective Implementation:** The idea of fixing a GMCTR is good but it needs to be ensured that the way it is implemented is transparent so it doesn't involve people looking for leverage for different loopholes.
- **Proper Coordination:** There should be appropriate coordination between the application of the new international tax rules including the Digital Services Taxes. Any final agreement could have major repercussions for low-tax countries and tax havens.
- **Way Ahead for India:** Once this deal comes through, India shall be at an advantageous position at the G20 summit to negotiate its double taxation avoidance agreements.
    - India shall take the opportunity that will be provided by this agreement as India's double tax avoidance agreements have not been signed by many countries in the west with which India has been negotiating for years.

Conclusion

- This initiative of the G7 countries is a welcome move to address the different challenges that many countries are facing.
- Putting in place a global corporate tax at the minimum slab fixed by the G7 will majorly impact the developing economies.