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A New Global Minimum Corporate Tax

Context:

The article discusses the various aspects of implementing a Global Minimum corporate tax and its impact on developing economies including India.

Background:

- The United States (US) Treasury Secretary Janet Yellen made a surprising speech regarding the pressures of tax competition, the erosion of the corporate tax base, and putting down the corporate tax rates to the bottom for three decades. She warned the world about its repercussions. She stated that in competitive economies, a stable tax system is required that will help in the following ways:
    - To raise revenue to deal with a crisis, and
    - To invest in public goods while ensuring that all taxpayers fairly and equitably share the burden of financing the government.
- It was argued by the Finance Secretary that G20 countries that account for the four-fifths of the global Gross Domestic Product (GDP), should agree on a global minimum corporate tax rate so that the practice of global tax shopping should be eliminated by the multinational firms and governments will be able to collect adequate taxes.

Response by various stakeholders:

- The suggestions received mixed responses. Some countries such as France and Germany welcomed the proposal while the President of the World Bank, David Malpass said that this will put restrictions on the ability of the poor countries to attract global capital by reducing the tax rates and he also claimed that the proposal of the US to keep minimum corporate tax rates at 21% is too high.
- Global corporate tax rates have been a matter of global concern for decades. Between 2000 to 2020, rates have fallen across 88 tax jurisdictions and increased in only six tax jurisdictions.
- The share of corporate tax rates above 30% in tax jurisdictions has fallen from approximately two-thirds in 2000 to just one-fifth in 2020.

Reasons for such demand:

- There are many reasons behind the sudden changes in the attitudes on corporate tax rates. These attitudes are opposite to the stances of the multilateral institutions such as the World Bank and the International Monetary Fund which have been supporting developing nations for decades.
- However, the immediate reason behind this change is the US that wants to increase the corporate tax rates from 21% to 28%. The US fears that this action will lead to the shifting of US multinationals to low tax jurisdictions such as Ireland where the rates are as low as 12.5%. But, setting a minimum global corporate tax rate will not lead to such shifting.

- It should be noted that tax avoidance by high-tech companies has been a matter of concern in the US for a long time. Multinational firms in the US avoid tax by driving the profits to low tax jurisdictions.

- However, this is not the sole reason behind the rising demand for the global minimum corporate tax rate. The other equally important reason is the changes in technologies and growth of global trade of services, specifically the digital services which have increased the chances of shifting the profits across countries.
- Multinational corporations have spread their production across several countries and it is difficult to distinguish them on the basis of each country involved in production. Together with this, it is hard to price services and intangibles in intra-group trades that have increased manifold.

- The problem will further increase when the share of global trade in services will increase from 25% to 33.33% by 2040.
- Recent evidence shows that currently, bilateral services trade in low-tax jurisdictions is six times higher than that of high-tax jurisdictions.
- These factors have pushed countries to reimagine the taxation of multinational companies and rework international tax agreements.
- The Organisation for Economic Cooperation and Development (OECD) nations have already voiced their concerns about such harmful tax practices two decades ago.
- The issue gained momentum when OECD countries and G20 nations introduced base erosion and profit shifting to evolve a common approach to deal with tax avoidance and to deny tax relief to multinationals that are registered in tax havens.

Impact of corporate tax cut on India:

- The impact of lowering corporate tax has been very damaging for developing countries. It has been more damaging for India, where tax rates have been reduced substantially. The tax rate has fallen from 40% in 1993–94 to a standard rate of 30% and rates of 22% and 15% for domestic companies which do not avail of tax concessions and new manufacturing companies respectively.
- Although corporate tax cuts increased the ratio of corporate tax collections to GDP, from less than 1% of the GDP in the early 1990s to 3.9% by 2007–08, it has declined to 2.3% at present.
- Along with this, the investment made by the private sector has steadily fallen from a peak level of 28.1% of the GDP in 2007–08 to just 23.4% at present.
- This has put a question mark on the argument of reducing tax rates to boost private sector investment.

- Another harmful impact is the decline in the tax–GDP ratio. Also, the burden of tax shifts from direct taxes which are paid more by the high-income groups to indirect taxes which affects low-income groups more.
- Hence, frequent cut in corporate tax has reduced the ratio of gross tax collections of the central government to GDP from 10.2% in 2011–12 to 9.8% at present.

- The share of indirect taxes in total tax collections has once again exceeded direct tax collections, a large share of which comes from indirect taxes on oil products.

Conclusion:

A global consensus to end competitive cuts in corporate tax rates and efforts to raise them to a reasonable level will boost India's tax mobilisation efforts. It will also help in reducing the tax burden on the poor and enhancing spending on welfare measures.