AIR Spotlight - Rationale and Implications of India Joining Global Minimum Tax

AIR Spotlight is an insightful programme featured daily on the All India Radio Newsonair. In this program, many eminent panelists discuss issues of importance which can be quite helpful in IAS exam preparation. In this article, the topic of discussion is the rationale and implications of India joining the global minimum tax regime.

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Context:

130 countries including India agreed to a global minimum tax of 15 percent to be levied on large multinational companies as nations try to rein in large profitable global tech firms who only pay a small percentage of their profits as taxes.

What is the Global Minimum Tax?

- The Concept of the **"Global Minimum Tax"** requires all countries to impose at least a minimum tax of 15 percent on global companies. This tax has been proposed by the US as a measure to counter efforts by major global multinational firms to escape taxes in their country of operations.
- It aims for developing a taxation structure that is relevant for a digital and globalized world. It is part of the inclusive framework on Base Erosion and Profit Shifting agreed upon by G20 countries and the Organisation for Economic Cooperation and Development.
- It rests on two pillars:
    - Re-allocation of an additional share of profit to the market jurisdictions, and
    - Minimum tax.

Two pillars of the Global Minimum Tax Agreement:

    - The agreement consists of two pillars to prevent companies from establishing bases in countries with low taxes to maximize profits earned elsewhere.

- **Pillar 1:**
    - Pillar one would give countries a share of the taxes on profits earned there, though the tax would still be collected where the company has its fiscal base.
    - Multinationals operate in many countries. For example, oil giant BP is present in 85, but usually, pay taxes on profits only in their tax home.
    - This provision would initially apply only to the top 100 or so companies, before expanding after seven years.
- **Pillar 2:**

- Pillar two is a global minimum corporate tax rate to stop competition between countries over who can offer companies the lowest rate in what critics call a “race to the bottom”.

- The OECD deal set a minimum rate of 15 percent.

The reason behind the introduction of the Global Minimum Tax:

- This tax has been introduced specifically to ensure that big technology firms are brought under the tax net.
- Since these firms do not have a significant physical presence in any country like a factory or place of business, they can route their earnings from their digital operations to low tax jurisdictions thus saving taxes on the profits they earn.
- The attempt to ensure a basic minimum tax rate across countries came after scrutiny increased on the huge profits earned by global firms like Facebook, Google, and Amazon.

What are the Challenges in implementing this tax?

- While a broad agreement has been reached, many of the aspects are still to be agreed upon and finalized. The aim is to settle the framework by October this year and implement the same from 2023.
- The current agreement essentially entails that even if a country doesn’t have an establishment in any country where it is selling its product, that country will now under this international agreement be allowed to tax and the company cannot deny this tax if its sale is above the threshold level.
- The issue with this is whether this will be implemented by a year or by the end of 2-3 years. The problem that comes along is when we say that we are measuring sales, not every country has the ability, typically the developing country, to bring in the scale of measurement that is required to measure this transition.
- Specifically looking at India, it has already established very strong rules of taxation within the country on the basis of its own established tax laws.
- Many of those tax laws now need to be changed and direct tax laws are changed only with the budget every year. Hence, India has to eliminate the taxes and bring in new tax laws as per the new norms.

Treaty Shopping and Tax Havens:

- Apart from low-tax jurisdictions, the proposal for a minimum corporate tax is tailored to address the low effective rates of tax shelled out by some of the world’s biggest corporations.
- These companies typically rely on complex webs of subsidiaries to hoover profits out of major markets into low-tax countries such as Ireland or the Caribbean nations such as the British Virgin Islands or the Bahamas, or to central American nations such as Panama.
- They establish their headquarters in low tax jurisdiction countries and they claim that the country in which they are selling the products cannot tax them because they have their headquarters in the country which has a low tax rate. This is known as **treaty shopping**.
- The US Treasury loses nearly $50 billion a year to tax cheats, according to the Tax Justice Network report, with Germany and France also among the top losers.

- India's annual tax loss due to corporate tax abuse is estimated at over $10 billion, according to the report.
- With the introduction of this global minimum tax, a company cannot deny the tax imposed by the globally agreed agreement. With this move, the concept of treaty shopping and tax havens will be eradicated.

Problems for developing countries:

- Apart from the challenges of getting all major nations on the same page, especially since this impinges on the right of the sovereign to decide a nation's tax policy, the proposal has other pitfalls.
- A global minimum rate would essentially take away a tool that countries use to push policies that suit them. For instance, in the backdrop of the pandemic, 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.
- A lower tax rate is a tool they can use to alternatively push economic activity.
- Let us take an example: In India, Reliance industries are considered as the biggest company and most of its sale happens in India. Hence, it will be taxed according to the Indian tax laws. But an overseas company such as Amazon whose large amount of sales happens in other countries will be taxed somewhere else at the global rate.
    - This is going to reduce the taxability of the developing countries because they use this tool to strengthen their economic activity.

India's stance on this matter:

- India has been a staunch proponent of taxing large digital companies that earn a substantial share of their revenues on account of their large user base in India. It was the first country that introduced an equalization levy. It required entities making a payment to a non-resident company for online advertisements to deduct this tax before making the payment.
- However, it is not completely on board the current proposal and has some reservations. The Indian Finance Ministry said that significant issues including the share of profit allocation still remain to be decided. This means that it is still to be ascertained how the profits earned by these large tech firms will be apportioned between the countries for taxation purposes.
- India is in favor of a consensus solution that is simple to implement and simple to comply with. At the same time, the solution should result in the allocation of meaningful and sustainable revenue to market jurisdictions, particularly for developing and emerging economies.

Equalization levy and Global Minimum Tax:

- To address "the challenges posed by the enterprises who conduct their business through digital means and carry out activities in the country remotely", the government has the **'Equalisation Levy'**, introduced in 2016 following a recommendation by a panel constituted to deliberate on taxation of the digital economy.
- In the coming years, when this global minimum tax will be implemented, the concept of equalization levy will be phased out because the two systems cannot run simultaneously.

Tax rates for digital companies:

- The current equalization levy on a digital company that has no establishment in India is 2 percent and the minimum rate set for global minimum tax is 15 percent. Here a question that arises is will these digital companies pay more taxes after the implementation of the global minimum tax?
- In total, the tax will be lower. Right now 2% tax needs to be paid on total sales. Now, tax has to be paid at a rate of 15% depending on two things, if the profit is above 10% of the total global sale and the company comes in the group of top 100.
- Within the group of top 100, the agreement says that MNCs (particularly big tech companies that have a limited physical presence) with at least a 10 percent profit margin would have to reallocate 20 percent of the profit above the 10 percent margin across countries, and this would be subject to taxes in those countries. Therefore the base of the taxation is shifting from sales to profit.
- The companies which are under the framework will have a much stronger say in ensuring where they are being taxed.
- Even after this taxation system comes in, it is not that every country will have a similar rate of tax. So it will have to be worked out how companies manage their global sales and turnover issues.
- It is definitely true that India will get some amount of the tax. Now, whether it will be more than a digital levy needs to be examined by the tax authorities. More clarity will emerge when the actual tax rate is settled.