IS THE OECD 2021 CORPORATE TAX DEAL FAIR?

eurodad

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1. Focus

Tax avoidance--the arrangement of financial affairs to minimize tax liability within the law--through MNE's assignment of profits to low-tax jurisdictions. Kleinbard (2011):

(i) derived for tax purposes by a MNE from activities outside the domicile of the group's parent;

(ii) subject to tax in a jurisdiction that is neither the location of its customers nor factors of production nor domicile of parent company.

Made possible by "sinks" (low-tax jurisdictions, e.g, Bermuda) and "conduits" (pass-through countries, e.g., Netherlands) (Garcia-Bernardo et al., 2017)

2. Four Principles of Fairness

2.1 Block free riding by MNEs on tax-financed collective goods in countries where they operate.

2.2 Respect other countries' fiscal autonomy (Dietsch 2015).

The "policy opportunity set" of governments: the money they *could* raise, the redistribution and services they *could* undertake if they so chose.

2.3 Reduce "brute luck inequality"

Lower rates on profits (returns to capital) generate higher brute luck inequality because majority of wealth is inherited (or due to other factors for which individuals not fully responsible).

Applies across borders.

2.4 Reduce threats to "democratic equality":

Inequalities are bad when and because they undermine individuals' ability to live as free citizens who are willing and able to participate in social life and contribute to public decision-making on equal terms. Requires inclusive, transparent decision-making.

Domination and marginalization, both domestic and international, are at odds with such equality.

3. The new OECD tax deal

- Proposed by the G7, with a steer from the US
- Adopted by the OECD’s ”Inclusive Framework”. The framework has 141 members:
  - 124 countries
  - 17 jurisdictions
- 4 members decided not to join: Nigeria, Kenya, Sri Lanka and Pakistan.

Pillar 1: Unitary taxation: Reallocation of corporate profits to “market jurisdictions”.

Pillar 2: A new minimum corporate tax rate of 15%.

The Guardian 8 Oct. 2021:

“Almost 140 countries have taken a decisive step towards forcing the world’s biggest companies to pay a fair share of tax, with plans for a global minimum corporate tax rate of 15% to be imposed by 2023.

[The OECD] described the landmark deal as a milestone towards ending decades of countries undercutting their neighbours on tax”.

- **Pillar 1: Reallocation of corporate profits to ”market jurisdictions”**
  - Very limited scope: Covers corporations with global turnover above 20 billion euros and profitability above 10%. Extractive industries and Financial Services are excluded. Expected to cover approximately 100 corporations
  - Limited revenue for countries: 25% of profit in excess of 10% of revenue to be reallocated and shared by market jurisdictions (potentially a large group of countries)
  - Difficult to implement - the US might not join the binding agreement to implement
  - Condition: Countries are not allowed to use ”Digital Services Taxes” to tax multinational corporations

- **Pillar 2:**
  - Minimum corporate tax rate of 15%
  - When profits are “undertaxed” in one jurisdiction, one or more other jurisdictions can tax those profits
  - Which jurisdictions can collect the minimum tax?

    i. Home jurisdictions

    ii. If the home jurisdiction does not collect the minimum tax, it can potentially be collected by other jurisdictions where the corporation operates
  - New rule introduced in December 2021 means low-tax jurisdictions can collect the minimum tax ad hoc without increasing their corporate tax rate (Devereux, Vella and Wardell-Burrus 2022)

Concerns:

- Rich over poor: Favours home countries of multinational corporations and large economies with many consumers.
- Race to minimum: 15% (+ carveouts) is very low.
- Limited scope:

  Pillar 1: approx. 100 corporations.

  Pillar 2: corporations with a turnover of minimum €750 million per year – meaning 85-90% of multinational corporations are not covered.
- Carve-outs & compensation: an amount of income that is 5% of the carrying value of tangible assets and payroll can be excluded – meaning the effective tax rate can be significantly less than 15%. Countries can also choose to ”compensate” corporations with new public subsidies.
- Increasing complexity of the international tax system.

multinational corporations must now pay a minimum corporate tax rate of 15%

Some multinational corporations must now pay a minimum ~~corporate~~ tax rate of ~~15~~?%

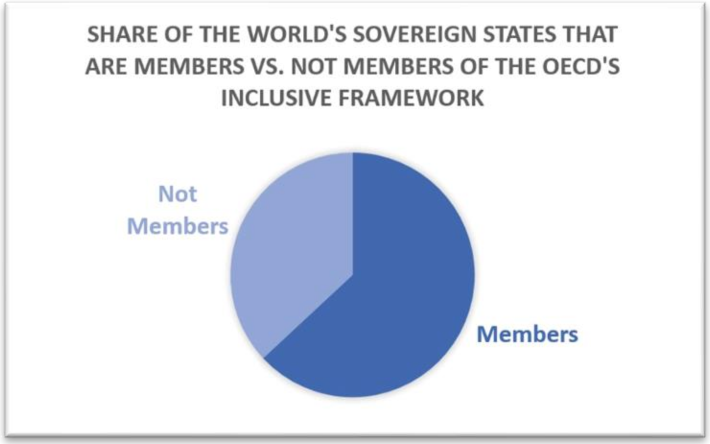
Democratic concerns:

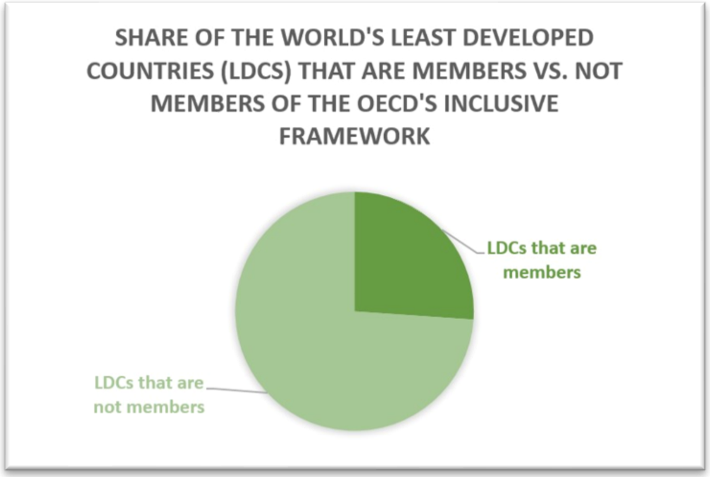
- Negotiations are closed to the public and statements are published after they have been agreed
- The speed of the decision-making
- Last public impact assessment is from 2020
  - Concerns grow now that the OECD minimum tax agreement is being proposed as binding EU law, potentially supplemented with an EU blacklist for countries that do not follow the rules

Who decides global tax norms?

State of play:
OECD hosts the negotiations, but all countries can join <u>if</u> the commit to following the OECD/G20 standards from 2015.

Over a third of the world's countries have decided <u>not</u> to join. For the least developed countries, it is over two thirds.





Who decides global tax norms?

OECD

G20

Least Developed Countries

4. Conclusion

The deal, even if implemented, is unlikely to substantially improve the fairness of the global system of corporate taxation along the four dimensions considered:

2.1 No free riding – scope is too narrow.

2.2 Respect fiscal autonomy – little effect on countries' ability to raise tax; undue pressure on those who do not "sign up" to drop digital sales tax.

2.3 Reduce brute luck inequality – ineffectiveness limits effect, favours rich countries.

2.4 Support democratic equality – exclusionary process of decision-making.