SOUTH CENTRE

TAX COOPERATION POLICY BRIEF

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Global Minimum Tax Rate: Detached from Developing Country Realities

By Sebastien Babou Diasso *

Abstract

Under the umbrella of the G20 and the OECD, the Inclusive Framework adopted on 8 October 2021 a two-pillar solution to address tax challenges arising from the digitalization of the economy. However, these solutions do not respond to the needs of many developing countries, in particular the global tax minimum rate of 15%, in a context where most developing countries, defined as Member States of the South Centre and the G-77+China, have an average effective tax rate higher than the adopted rate. This policy brief provides information of the current effective tax rates in some developing countries, and highlights why the minimum rate of 15% in Pillar Two is insufficient for them. Tax revenue mobilization is important for developing countries to achieve the sustainable development goals. It is thereby recommended that developing countries simply ignore Pillar Two and maintain their current higher rate or increase their rate to an appropriate level and enforce it through unilateral measures rather than the rule order under Pillar Two, which they will have to follow if they decide to implement it.

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Sous la direction des pays du G20 et de l'OCDE, le cadre inclusif sur la réforme de la fiscalité internationale a adopté le 8 octobre 2021 une solution à deux piliers visant à résoudre les défis auxquels sont confrontés les pays dans le système fiscal actuel au niveau international. Cependant, le moins que l'on puisse dire, c'est que ces solutions n'apportent pas de réponses aux préoccupations de nombreux pays en développement, en particulier l'impôt minimum de 15% dans un contexte où la plupart des pays en développement membres de Centre Sud et du G-77+Chine ont déjà des taux effectifs bien au-dessus de ce minimum. Cette note vise à informer sur les niveaux actuels des taux d'imposition effectifs dans les pays en développement, pour lesquels les données sont disponibles, et à montrer pourquoi il ne serait pas pertinent de prendre en compte ce taux minimum adopté. Mobiliser plus de ressources fiscales des entreprises multinationales est important pour les pays en développement pour la réalisation des objectifs de développement durable. Nous recommandons donc que les pays en développement ignorent simplement le pilier deux et maintiennent leurs taux d'imposition actuels, ou les augmentent à des niveaux plus adaptés à travers l'application de mesures unilatérales plutôt que de suivre la procédure indiquée dans le pilier deux s'ils décident de l'appliquer.

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El Marco Inclusivo del G20 y la OCDE adoptó el 8 de octubre de 2021 una solución de dos pilares para abordar los desafíos fiscales derivados de la digitalización de la economía. Sin embargo, esta solución no atiende las necesidades de numerosos países en desarrollo, en particular el tipo impositivo mínimo del 15 %, en un contexto en el que la mayoría de los países en desarrollo, definidos como Estados Miembros del Centro del Sur y el G-77+China, tiene un tipo impositivo efectivo promedio mayor que el tipo adoptado. En este informe de políticas se facilita información sobre los tipos impositivos efectivos que están en vigor actualmente en algunos países en desarrollo, y se ponen de relieve las razones por las que el tipo mínimo del 15 % recogido en el Segundo Pilar es insuficiente para ellos. La movilización de los ingresos tributarios es importante para que los países en desarrollo logren los objetivos de desarrollo sostenible. De este modo, se recomienda que los países en desarrollo simplemente ignoren el Segundo Pilar y mantengan su tipo superior actual o aumenten su tipo hasta un nivel adecuado, y lo apliquen a través de medidas unilaterales en lugar de mediante la regla del Segundo Pilar, que tendrán que seguir si deciden implementarla.

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1. Introduction

The propositions for international tax reform made in the Organisation for Economic Co-operation and Development (OECD)/Group of Twenty (G20) Inclusive Framework on Base Erosion and Profit Shifting through a Two-Pillar solution have been adopted on 8 October 2021[1]. In a historic development, under Pillar Two, a global minimum effective tax rate of 15% for Multinational Enterprises (MNEs) which meet the threshold (USD 750 million) in annual revenues has been adopted.

Some of these propositions have been adopted without considering the demands of developing countries for tax justice[2] through the setting of a higher rate of at least 20% as recommended by the African Tax Administration Forum (ATAF) and the African Union (AU), and 25% as demanded by countries like Argentina[3] as well as civil society groups such as the Independent Commission for Reform of International Corporate Taxation (ICRICT), Global Alliance for Tax Justice, Tax Justice Network, Oxfam and others.

The first thing that should be highlighted is that the rule order in Pillar Two that is set is not going to benefit developing countries. Through this rule order, priority is given first to the jurisdiction where the ultimate parent entity (UPE) is based, which are usually developed countries. For example, major tech giants such as Facebook, Google, Apple, etc. all have their UPE in the United States. If this jurisdiction refuses to exercise the right of taxing the undertaxed income, the rule order gives the second "chance" to the intermediate parent jurisdiction of MNEs for top-up taxation on under-taxed profit[4]. Only if both jurisdictions refuse to collect this amount does the source jurisdiction where the income arose get its turn. This makes unlikely the possibility for source countries to benefit from the minimum tax.

A second thing is that this low level of effective tax rate, in addition to not reflecting the reality of developing countries, presents a clear risk of decreasing tax revenues if these recommendations are considered by developing countries. According to some estimates, the Pillar Two proposals are going to benefit mainly Group of Seven (G7) countries, which with only 10% of the world's population will be collecting 60% of revenues from the minimum tax[5]. Further, a minimum rate of at least 21% would have allowed the recovery of more than $540 billion[6], while an alternative civil society proposal known as the Minimum Effective Tax Rate (METR) was estimated to generate $640 billion,[7] which would have provided more financing to governments for achieving the Sustainable Development Goals. A rate of 15% as proposed by the OECD will allow for only an additional $150 billion.[8]

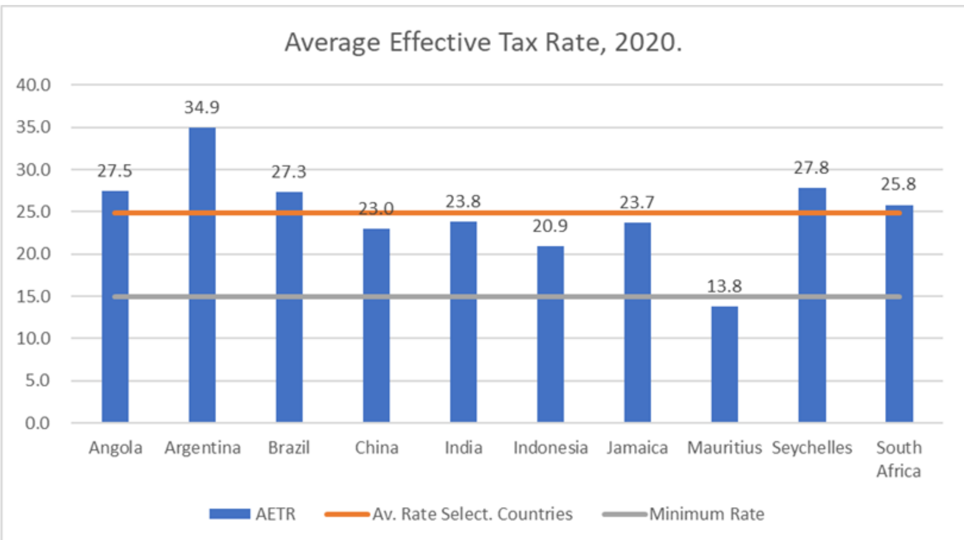
2. Average Effective Tax Rate (AETR) in developing countries

This Policy Brief, with a data-focused analysis, aims to share evidence on the huge difference between the minimum effective tax rate of 15% agreed by the OECD/G20 Inclusive Framework and the effective tax rates in developing countries. It seeks to show that the Inclusive Framework's minimum rate is far too low to be helpful for developing countries and is out of sync with their realities for sustainable resource mobilization. Our analysis is based on countries for which data is available in the OECD's corporate tax statistics database,[9] in particular data on average effective tax rates. The focus is primarily on developing countries, defined as members of the South Centre, but also includes some other members from the Group of 77 (G-77)+China.

2.1. Average Effective Tax Rates of select South Centre Member States

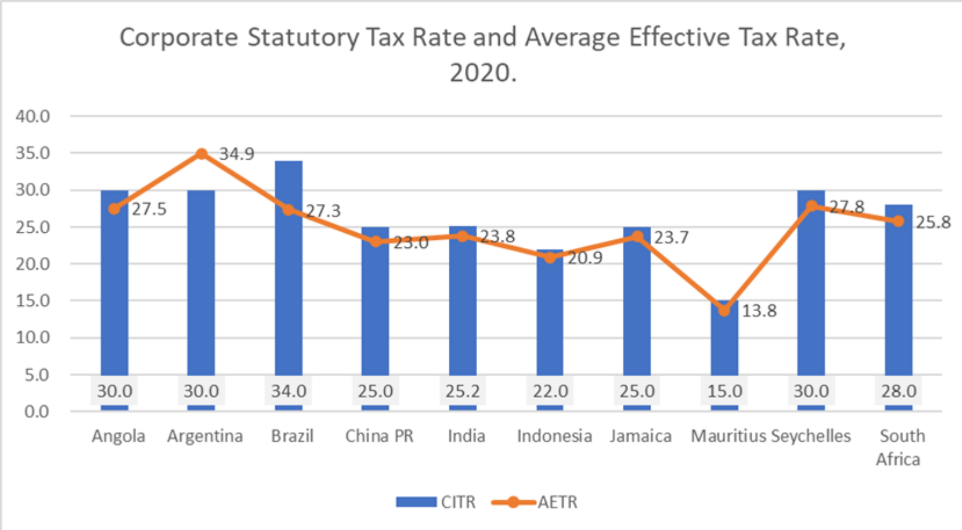
Many developing countries already have an average effective tax rate well above the adopted minimum rate of 15%. Figure 1 contains an analysis of these rates for South Centre members for which data is available.

Figure 1: Effective Average Tax Rates for South Centre Member States



Source: OECD corporate tax statistics database.

Figure 2: Corporate Income Tax Statutory Rates and Average Effective Rates for South Centre Member States



Source: OECD corporate tax statistics database.

As shown in Figure 1, the average effective tax rate for these countries is 25%, which is 10 percentage points above the minimum rate of 15%. Countries such as Argentina (34.9%), Seychelles (27.8%), Angola (27.5%), and Brazil (27.3%) have effective rates above the average rate, and which are quite higher. All these countries apart from Mauritius have effective rates above 20%.

While the statutory corporate income tax rate represents the basic and non-targeted central government statutory rate for corporations, the average effective tax rate represents the average tax contribution a firm makes on an investment project earning above zero economic profits according to the OECD definition. The former shows the headline tax rate faced by corporations and is used to compare the standard tax rate on corporations across jurisdictions and over time. The latter takes into account features such as fiscal depreciations as well as other allowances and deductions for corporations.[10]

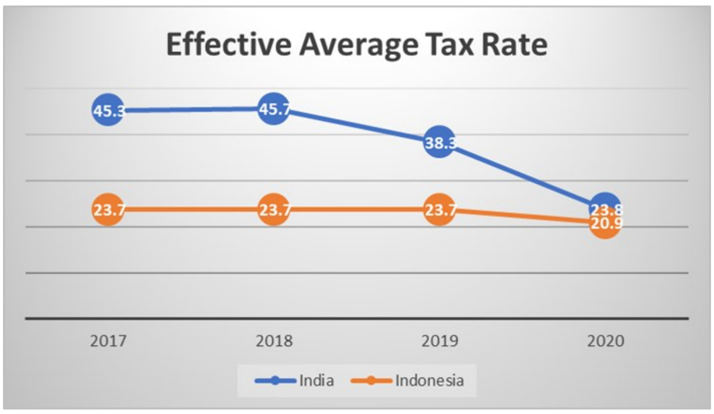
Apart from Argentina, all these countries have Average Effective Tax Rates (AETR) lower than the Corporate Income Statutory Tax Rate (CITR), as can be seen in Figure 2. This means some incentives in terms of lower effective tax rates in some specific industries have already been provided by these countries to investors.

Furthermore, countries such as India which had high effective rates earlier have considerably reduced the rate over time as shown in Figure 3. This means efforts have already been taken to motivate investors. Seeking to lower the effective rate to a minimum of 15% is an excessive reduction and will not allow for sustainable revenues to developing countries.

Further, the argument claiming that reducing tax rates leads to increased investment is questionable. Indeed, the rationale behind lowering the tax rate assumes that all considerations other than tax, the non-tax factors, are equal to the investors, and given the possibility of high mobility, they may locate investments in countries with the lowest tax burden. However, these non-tax factors are also important to investors when they make decisions. Various studies have shown that non-tax factors, understood as the basic economic and institutional factors such as the cost of labor, access to infrastructure, size of the market, access to raw material, transportation cost, political stability and the legal framework for a market economy are critically important for investors[11].

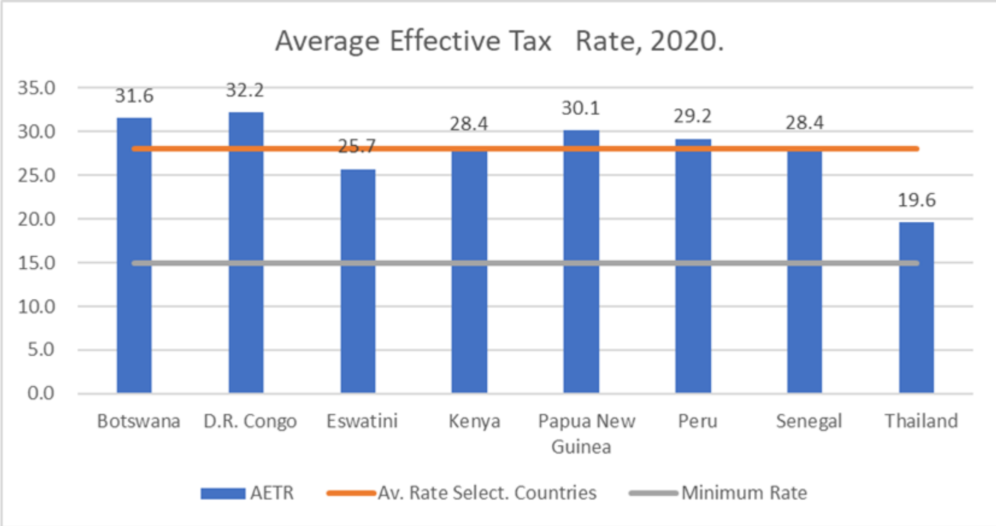
These factors moderate the relationship between corporate taxation and investment and are critical for whether investment will be more sensitive to the corporate tax rate or not. Investors need a basic level of these factors in a country and the availability of certain public goods which a low taxation rate alone cannot compensate. Tax revenues are needed to raise the non-tax factors to an acceptable level. Lowering the tax rate to compensate for their underdevelopment has triggered a vicious 'race to the bottom' and made developing countries unable to reach the required "investment climate" and has kept them in the so-called vicious circle of poverty[12].

Figure 3: Average Effective Tax Rate for India and Indonesia



Source: OECD corporate tax statistics database

Figure 4: Average Effective Tax Rate for select G-77+China countries



Source: OECD corporate tax statistics database.

2.2. Analysis of select countries from the G-77 + China

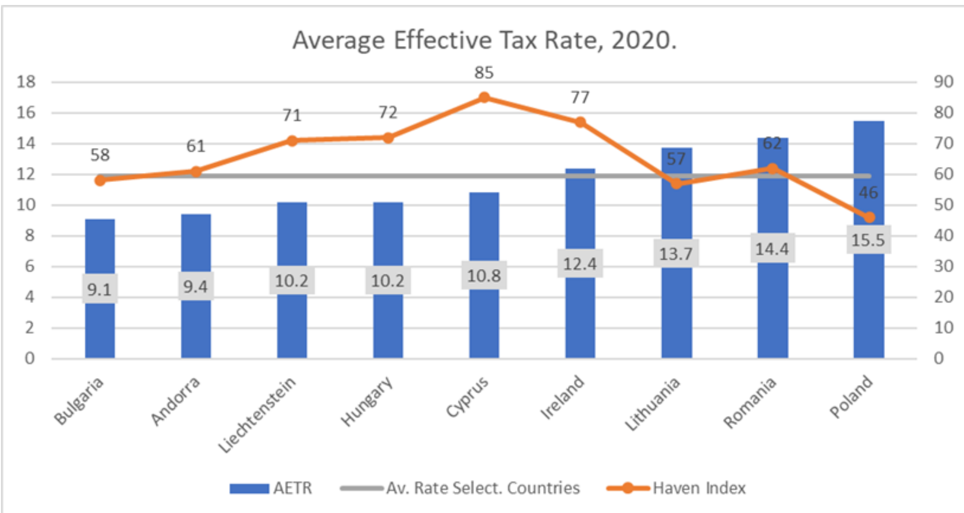
Apart from members of the South Centre, other developing country members of the G-77+China are also affected, which is examined in this section. Two filters are applied for this analysis. The first is G-77+China members for which data is available on the OECD corporate tax statistics database. The second is a gross national income (GNI) per capita of USD 12,353, which has been used to define developing countries in Pillar Two[13]. The results show the same realities as for South Centre Member States. In Figure 4, the average effective tax rate for these eight countries is 29%, which is 14 percentage points higher than the minimum rate of 15%. Countries such as Botswana (31.6%), the Democratic Republic of Congo (32.2%), and Peru (29.2%) have effective tax rates of approximately double the adopted minimum rate. None of these countries has an effective rate of less than 20% apart from Thailand (19.6%).

Averaging the effective tax rate for all developing countries that are members of the South Centre and members of the G-77+China referred to in Figures 1 and 4, the average effective tax rate in 2020 was 26.3%, higher than the minimum rate by 11.3 percentage points.

2.3. Countries with a high 'tax haven' score

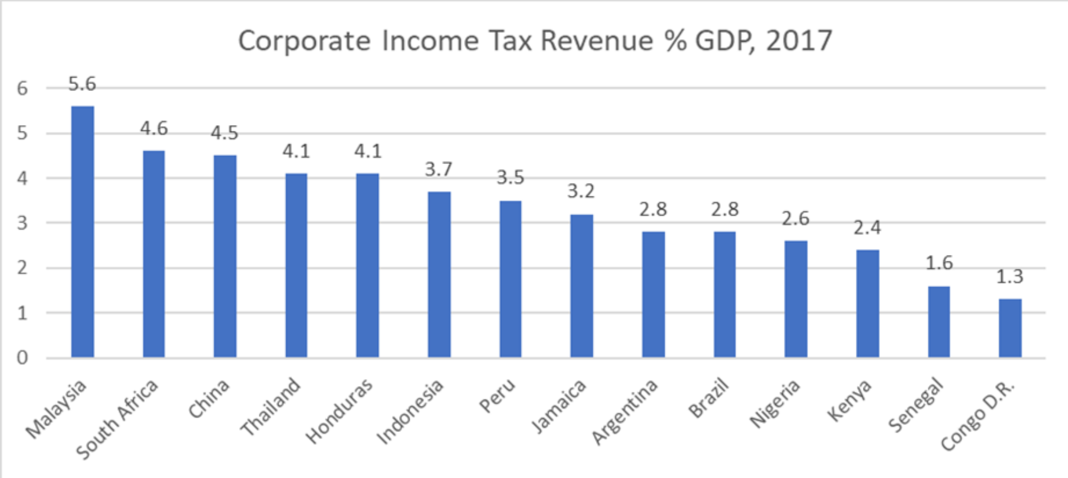
Figure 5 shows countries with a low average effective tax rate. The average rate for these countries is 12%, 3 percentage points lower than the minimum rate of 15%[14]. It can also be seen that those jurisdictions with low effective rates are also those which have a high haven score (HS), meaning countries with a non-zero rate but lower than 15%. The jurisdiction's haven score, issued by the Tax Justice Network, is a measure of how much scope for corporate tax abuse the jurisdiction's tax and financial system allows. A minimum rate of 15% seems to appease tax havens and does not reflect the needs and demands of most developing countries.

Figure 5: Countries with low Average Effective Tax Rate



Source: OECD corporate tax statistics database and Tax Justice Network corporate tax haven index.

Figure 6: Corporate Income Tax Revenue in % of GDP



Source: OECD corporate tax statistics database

3. Corporate Income Tax Revenue mobilization

Corporate Income Tax (CIT) is an important revenue source for developing countries. The African Tax Administration Forum (ATAF) has shown in the African Tax Outlook (ATO) report in 2019[15] that corporate income tax rates are considerably different from one country to another in Africa. Rates range from 15% (Mauritius with the lowest rate) to 35%, with many countries applying different sector-based rates to attract investments. This has led to a low level of corporate tax revenue in African countries covered by the ATO report. However, corporate income tax revenue remains an important part of tax revenue for African countries according to the ATO report. It represented on average 15.6% of tax revenue in 2017 in 34 African countries with some differences between economic regions. It represented 22% in the Southern African Customs Union (SACU) countries, 18% in Southern African Development Community (SADC) countries, 15% in Economic Community of West African States (ECOWAS) countries, and 12% in other regions according to the ATO report 2019. Data from OECD corporate tax statistics has shown that Asia-Pacific, and Latin American and Caribbean countries respectively receive 20.1% and 15.3% as corporate income tax revenue in percent of tax revenue[16].

However, corporate income tax revenue remains low and there is potential to increase collection. In terms of gross domestic product (GDP), corporate income tax revenue remains very low in African countries covered by the ATO report with an average of 2.4% of GDP in 2017. For Asian-Pacific countries, and Latin American and Caribbean countries corporate income tax revenue represented in 2017 respectively 3.7% and 3.3%[17].

An argument often made by opponents of raising the global minimum effective rate is that the tax base can be expanded instead of further seeking to "burden" MNEs. In African countries, 78% of total tax revenue is collected from a small number of taxpayers, which tend to be MNEs[18]. However, this argument is flawed for various reasons.

First the 78% referenced is that of total tax revenue which includes Value Added Taxes (VAT) and Pay As You Earn (PAYE) taxes that the corporates have collected. Second, most developing countries have a large informal sector, representing between 50% and 80% of GDP.[19] It is quite difficult to collect tax revenues since the entities are not registered and are very small players compared to the MNEs. Third, having a higher global minimum rate would mean that foreign multinationals will pay the same taxes as domestic companies, diminishing the competitive disadvantage for the latter. For example, an MNE based in Ireland paying an effective rate of 15% enjoys an advantage over an MNE based in South Africa which would pay a higher rate of 25.8%. If the global minimum tax rate were 25%, both would pay the same amount of taxes, leveling the playing field.

Thus, it is essential that the minimum rate be higher. Since the average effective tax rate for the South Centre's members and other G-77+China countries assessed here is 26.3%, the minimum rate should be at least 25%. This data analysis gives an overview on how low corporate income tax revenues in developing countries are, in a context where they need to mobilize more resources to be able to reach the Sustainable Development Goals. This also points out the negative impact a lower effective tax rate like the one adopted by the OECD Inclusive Framework will have on developing countries' domestic resource mobilization.

4. Conclusion

The minimum rate of 15% that has been adopted is clearly unsuitable and cannot be a stable and durable solution for developing countries who seek to increase domestic resource mobilization to meet their people's socio-economic needs and to increase its public investment for development. Fortunately, whereas the Inclusive Framework members have agreed to implement Pillar One, Pillar Two remains optional. It is thereby recommended that developing countries simply ignore Pillar Two and maintain their current higher rate or increase their rate to an adapted level and enforce it through unilateral measures rather than the rule order under Pillar Two, which they will have to follow if they decide to implement it. In fact, it will be beneficial for developing countries to not be distracted by the proposed minimum effective tax rate and maintain an effective tax rate that reflects their realities and their needs and can help them mobilize the revenues needed to achieve the Sustainable Development Goals.

Endnotes:

1 See OECD statement on the two-pillar solution adoption (8 October 2021) at https://www.oecd.org/tax/beps/statement-on-a-two-pillar-solution-to-address-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-october-2021.pdf; statement by South Centre on the two-pillar solution (13 October 2021) at https://www.southcentre.int/wp-content/uploads/2021/10/SC-Statement-on-IF-Two-Pillar-Solution-13-Oct-2021.pdf.

2 See "Developing Country Demands for an Equitable Digital Tax Solution" at https://www.southcentre.int/wp-content/uploads/2021/10/TCPB19_Developing-Country-Demands-for-an-Equitable-Digital-Tax-Solution_EN.pdf.

3 See Argentinian Finance Minister's remarks at https://www.reuters.com/business/argentina-says-15-global-minimum-corporate-tax-rate-too-low-2021-06-28/.

4 See "Issues for developing countries in negotiations on the taxation on the digital economy", 3 August 2021 at https://us5.campaign-archive.com/?u=fa9cf38799136b5660f367ba6&id=633f158717.

5 See « Impôt mondial : les pays du Sud veulent un taux d'au moins 21% », le 29 juin du 2021 at https://www.lefigaro.fr/conjoncture/impot-mondial-les-pays-du-sud-veulent-un-taux-d-au-moins-21-20210629.

6 See "Biden tax plan can recover $640bn but OECD proposal would shrink gains and reward worst perpetrators", 15 April 2021 at https://www.taxjustice.net/press/biden-tax-plan-can-recover-640bn-but-oecd-proposal-would-shrink-gains-and-reward-worst-perpetrators/.

7 See "A less complex and fairer tax reform: the Minimum Effective Tax Rate (METR) for Multinational Corporations" at https://datawrapper.dwcdn.net/2BhFm/5/ (accessed 12 October 2021).

8 See "International community strikes a ground-breaking tax deal for the digital age", 8 October 2021 at https://www.oecd.org/tax/beps/international-community-strikes-a-ground-breaking-tax-deal-for-the-digital-age.htm.

9 See OECD corporate tax statistics database (2021) at https://stats.oecd.org/Index.aspx?DataSetCode=CTS_CIT.

10 See *Corporate Tax Statistics*, Third edition at https://www.oecd.org/tax/tax-policy/corporate-tax-statistics-third-edition.pdf.

11 See "Income tax incentives for investment" at https://olc.worldbank.org/system/files/Income%20Tax%20Incentives%20for%20Investment.pdf; *Tax Incentives for Investments - A Global Perspective: experiences in MENA and non-MENA countries* at https://www.oecd.org/mena/competitiveness/38758855.pdf;

"The effectiveness of tax incentives in attracting investment: evidence from developing countries" at https://www.cairn.info/revue-reflets-et-perspectives-de-la-vie-economique-2012-3-page-129.htm.

12 See "Interaction of Transfer Pricing and Profit Attribution: Conceptual and Policy Issues for Developing Countries" at https://www.southcentre.int/wp-content/uploads/2018/08/TCPB3_Interaction-of-Transfer-Pricing-Profit-Attribution_EN.pdf.

13 See OECD/G20 Inclusive Framework statement on the two-pillar solution (8 October 2021) at https://www.oecd.org/tax/beps/statement-on-a-two-pillar-solution-to-address-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-october-2021.pdf.

14 See Tax Justice Network corporate tax haven index at https://cthi.taxjustice.net/en/ (accessed 21 October 2021).

15 See African Tax Administration Forum's African tax outlook report 2019 at https://events.ataftax.org/index.php?page=documents&func=view&document_id=49.

16 See OECD corporate tax statistics database (2021) at https://stats.oecd.org/Index.aspx?DataSetCode=CTS_CIT#.

17 See OECD corporate tax statistics database (2021) at https://stats.oecd.org/Index.aspx?DataSetCode=CTS_CIT#.

18 See "Global economic havoc underlines urgency of broadening the tax base in African countries", 25 March 2020 at https://www.ataftax.org/global-economic-havoc-underlines-urgency-of-broadening-the-tax-base-in-african-countries; "The Role of International Soft Law in Tax Reform: Multilateralism at the Seams", 6 August 2021 at https://www.afronomicslaw.org/category/analysis/role-international-soft-law-tax-reform-multilateralism-seams.

19 See "Hustle: A case for informal enterprise in the African Continental Free Trade Area", 2 May 2020 at https://www.afronomicslaw.org/2020/05/02/hustle-a-case-for-informal-enterprise-in-the-african-continental-free-trade-area.

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Efforts to reform international cooperation in tax matters are exhibiting a distinct acceleration. The direction of change must recognize and incorporate innovations in developing country policies and approaches, otherwise the outcomes will obstruct practical paths to development.

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***** The views contained in the policy briefs are personal to the authors and do not represent the institutional views of the South Centre or its Member States.**

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