Historic restructuring?

What the global tax reform means for developing countries

by Sabine Laudage and Christian von Haldenwang,
German Development Institute /
Deutsches Institut für Entwicklungspolitik (DIE)

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A total of 140 states have spent the past few years negotiating an overhaul of the international tax system under the umbrella of the Organisation for Economic Co-operation and Development (OECD). 136 of the 140 member states of the Inclusive Framework on Base Erosion and Profit Shifting (BEPS), which was originally established by the Group of 20 largest economies (G20), agreed on 8 October on the basic tenets of a global tax reform.

The two main hopes attached to this reform are higher tax revenues and greater fairness in the international distribution of corporate taxing rights. In theory, it should also benefit middle- and low-income countries, which depend to a larger extent than industrialised nations on corporate tax revenues and thus suffer accordingly as a result of the tax avoidance practices of multinational companies. Whether these hopes will be fulfilled, however, is questionable.

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The reform certainly contains elements of what could be considered a historic restructuring of the international tax system. Where previously the principle was to tax corporate profits in the country in which the company was headquartered, in future, the market states, in which the revenues are generated, will be granted more rights over the taxation of the world's 100 largest multinationals. Today, governments are estimated to be losing some USD 200 billion in revenue, as companies relocate their headquarters – or the head offices of especially profitable subsidiaries – to tax havens, where few or no taxes are levied. This reform pillar should redistribute approximately USD 125 billion in profits to market states from 2023 and thus generate greater revenues there.

A second innovation concerns the introduction of a global minimum tax rate of 15 per cent for companies with revenues exceeding EUR 750 million. This should stop the global downward trend in corporate income tax rates. An OECD study shows that this minimum tax could generate around USD 150 billion in additional revenue for state coffers. At the G20 Rome Summit on 30 and 31 October, German Chancellor Angela Merkel described the minimum tax as "a clear signal of justice in times of digitalisation".

It would appear that the reform has come at just the right time. Governments worldwide are looking for additional sources of revenue for combating the impact of the COVID-19 pandemic and global climate change. It is now finally time for the major digital firms, which have largely managed to avoid taxation up until now, to make their contribution.

So far, so good, then? Unfortunately not. International NGOs and independent experts are rather sober in their assessment of the outcome of the negotiations, not least because a ten-year transition period with generous substance carve-outs was incorporated into the agreement at last minute. Added to this is the fact that additional revenue from the minimum tax will be collected primarily in countries in which companies have their headquarters. In the EU, for instance, this equates to around EUR 63 billion in 2023. By contrast, looking at the group of developing countries, the benefits of the minimum tax will be largely limited to a small number of emerging economies.

The redistribution of tax rights to the market states also principally benefits the wealthy and/or populous countries with large sales markets. The OECD declaration states that developing countries will experience greater gains "as a proportion of existing revenues". However, these revenues are far lower on average than those of OECD member states. Incidentally, all participating states will have to forego the imposition of their own taxes on digital companies in future. This could give rise in some cases to considerable tax shortfalls. One way around this could be to continue to levy a national digital tax on firms other than the largest one hundred companies. However, the current reform draft does not provide for such an approach.

But why then have developing countries largely approved the reform paper? On the one hand, organisations such as the African Tax Administration Forum (ATAF) have succeeded in getting a number of arrangements incorporated into the reform that serve the interests of developing countries. These arrangements include lower thresholds (EUR 250,000 instead of EUR 1 million) for sales from which tax rates for market states apply in states with a gross domestic product (GDP) of less than EUR 40 billion. This should allow many low- and lower-middle income countries to generate additional revenues, provided they are in a position to implement the complex rules.

On the other hand, some governments are actually hoping for a curbing of ruinous international tax competition. However, a minimum tax rate of just 15 per cent could have the overall effect of worldwide corporate income tax rates converging to this value, particularly those of developing countries. Consequently, this reform does not mark an end to the search for an effective and fair international tax system, but rather should lead on to a new round of negotiations.

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