THE GLOBAL MINIMUM TAX:
A Bridge between Worldwide and Territorial Tax Regimes?

Lorraine Eden

Kondor Global Presentation, November 29, 2022

Research Question

- What is the proposed Global Minimum Tax (GMT) and if adopted, how would it likely affect OECD member and developing countries?

Agenda

- How MNE Profits Are Taxed
- Overview of the GMT
- How the GMT Would Change the International Tax Regime
- Expected effects on OECD Member and Developing Countries

Introductory Comments

- Economist, fields – public finance, international economics and international business
- Professor at universities in Canada and USA
- Publications on transfer pricing and international tax, MNE strategies and structures, MNE-state relations, ethics, Industry 4.0
- Member, UN Subcommittee on Transfer Pricing, 2022-2025

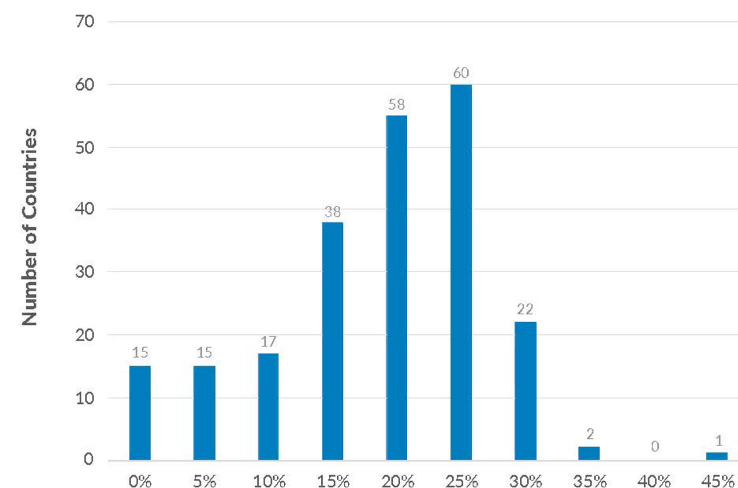
Agenda

I. How MNE Profits Are Taxed

1. International Regime Theory
2. The Current International Tax Regime
3. Worldwide vs. Territorial Tax Regimes
4. BEPS and Global Profit Shifting

II. Overview of the GMT

III. Expected Effects



https://taxfoundation.org/corporate-tax-rates-by-country-2021/

1. International Regime Theory

International regimes are governance structures designed to manage cross-border interdependencies among countries. Their purpose is to encourage cooperation and/or reduce coordination and transaction costs across countries. Regimes establish and encourage functional and behavioral relationships among governments and other actors in specific issue areas (e.g., trade, money, finance, environment, tax) where cross-border interdependencies are significant. These relationships embody the principles underlying the regime, the expected standards of behavior, and the formal rules and procedures as laid out in the international agreements and understandings that form the regime.

An international regime is an international governance structure consisting of principles, norms (standards of behavior), rules, and decision-making procedures.

- *Principles* are implicit and explicit beliefs of fact, causation and rectitude
- *Norms* are standards of behaviour defined as rights and obligations
- *Rules* are specific prescriptions or proscriptions for action
- *Decision-making procedures* are prevailing practices for making and implementing collective decisions and settling disputes

Some regimes have a formal international organization at their center (e.g., WTO in trade, IMF in finance); others an international convention (e.g., Law of the Sea), and others are led and managed by a dominant power in world politics (e.g., hegemon).

2. The Current International Tax Regime: Overview

- **Purpose:** to prevent double or under-taxation of MNE income caused by overlapping tax jurisdictions
- **Principles:** equity, neutrality, transparency, simplicity, administrative feasibility
- **Norms**
  - Separate Entities
  - Water's Edge
  - Arm's Length Standard/Principle
  - Which jurisdiction has the right to tax which income sources
- **Rules**
  - Nexus – right to tax
  - Tax rates for different types of income
  - Definitions of tax bases
  - Taxed on deferral or accrual basis
- **Procedures**
  - Auditing and dispute settlement procedures
  - Bilateral tax treaties (MAP)
  - Exchange of information

The Current International Tax Regime: Norms, Rules and Procedures

- **Business profits** may be taxed by the Residence country (the home country where the firm's owners reside as determined by the parent firm's place of incorporation or seat of management and control) or Source countries (host countries where the MNE's foreign affiliates are located and earn foreign source income (FSI)).
- The **Source** country may tax the profits earned by a foreign-owned or controlled affiliate only if the entity is incorporated or has a permanent establishment (physical presence or dependent agent) in that country.
- The **Residence** country may tax all worldwide income of its resident MNEs.
- **First Crack Principle**: If both the Residence and Source countries tax FSI, the Residence country must provide double tax relief for Source country income taxes, either by exempting FSI from tax or providing a foreign tax credit (FTC) for the Source tax against the Residence tax; i.e., Source has "first crack" at taxing the FSI of MNEs earned in its jurisdiction.
- **Other sources of business income** (e.g., royalties, management fees) are allocated to the firm's owners and taxed by the Residence country.
- **Bilateral tax treaties** handle disputes and limit Source country withholding tax (WHT).

3. Worldwide vs Territorial Tax Regimes

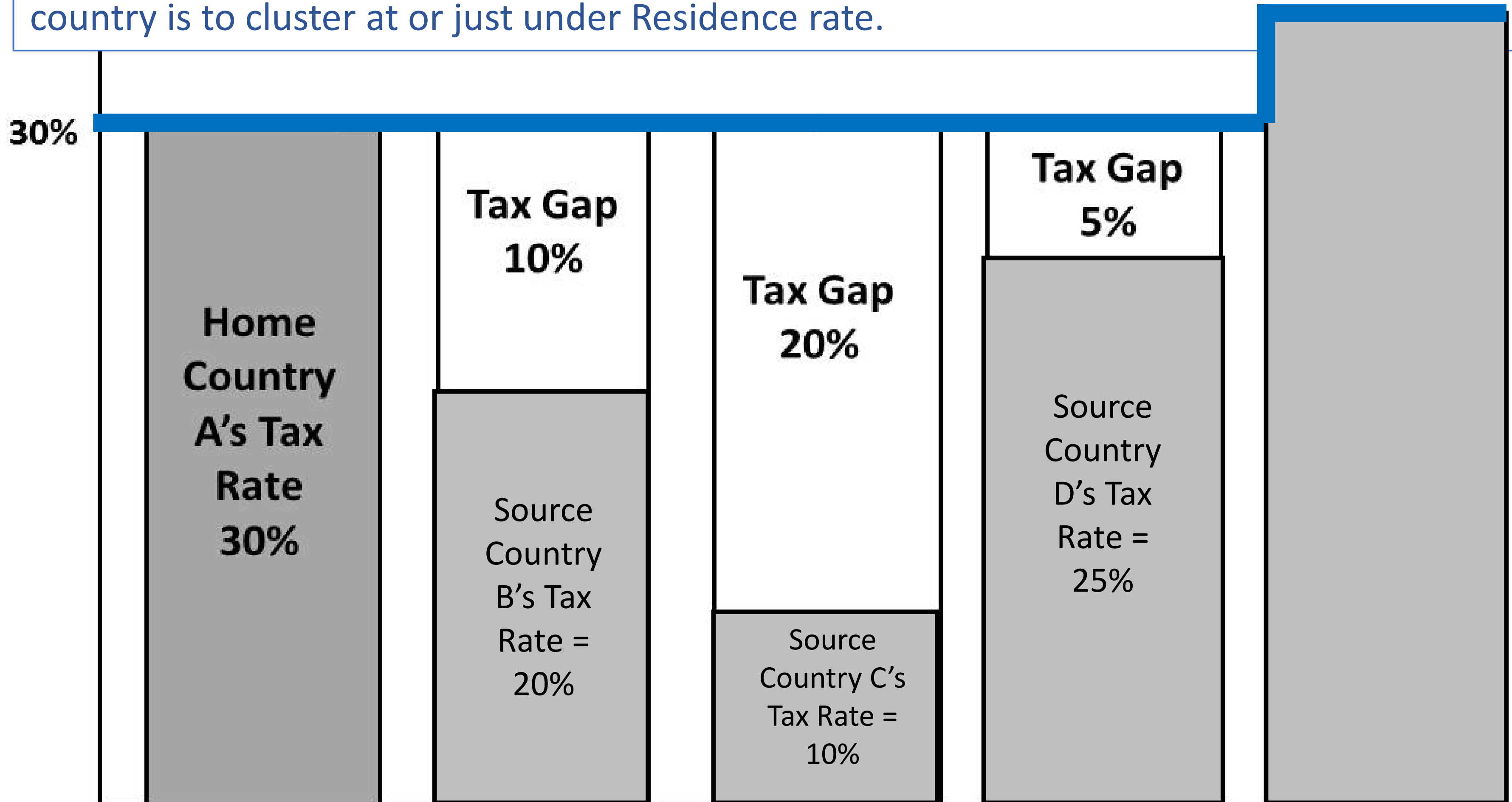
- **Worldwide Tax Regime** – Residence countries tax MNE global profits (domestic + FSI) and provide foreign tax credit for Source country income taxes. The Residence country may choose to tax FSI on either an accrual (as earned) or deferral (when repatriated) basis.

- **Territorial Tax Regime -** Residence countries exempt FSI from taxation and only tax domestic MNE profits.

- **Hybrid Regime -** Aspects of both regimes
  - <u>Territorial</u>
    - Exempt FSI that is deemed "active business income"
    - Deferral of Residence tax on FSI ≈ exemption
  - <u>Worldwide</u>
    - Residence country taxes FSI deemed "passive income" on an accrual basis with a FTC. [Example: US Subpart F rules for Controlled Foreign Corporations (CFC)]

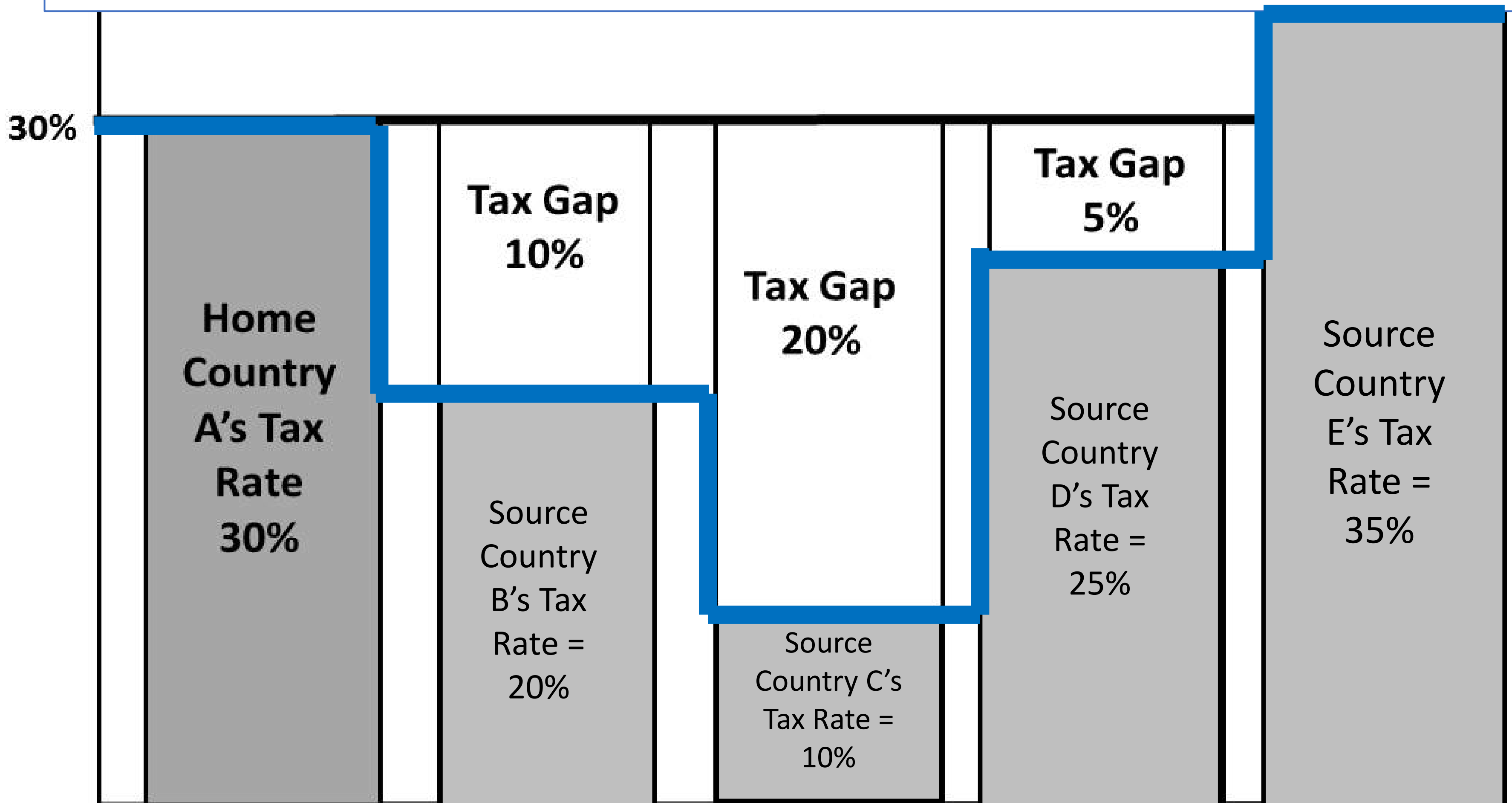
Worldwide Taxation: Residence Country Taxes FSI on an Accural Basis with a Foreign Tax Credit

Residence country offers de facto "umbrella" by providing FTC up to Residence rate. MNE global tax = $t^{Res} + (t^{Source} - FTC) \approx t^{RES}$ → First Crack Principle: Optimum policy for source country is to cluster at or just under Residence rate.



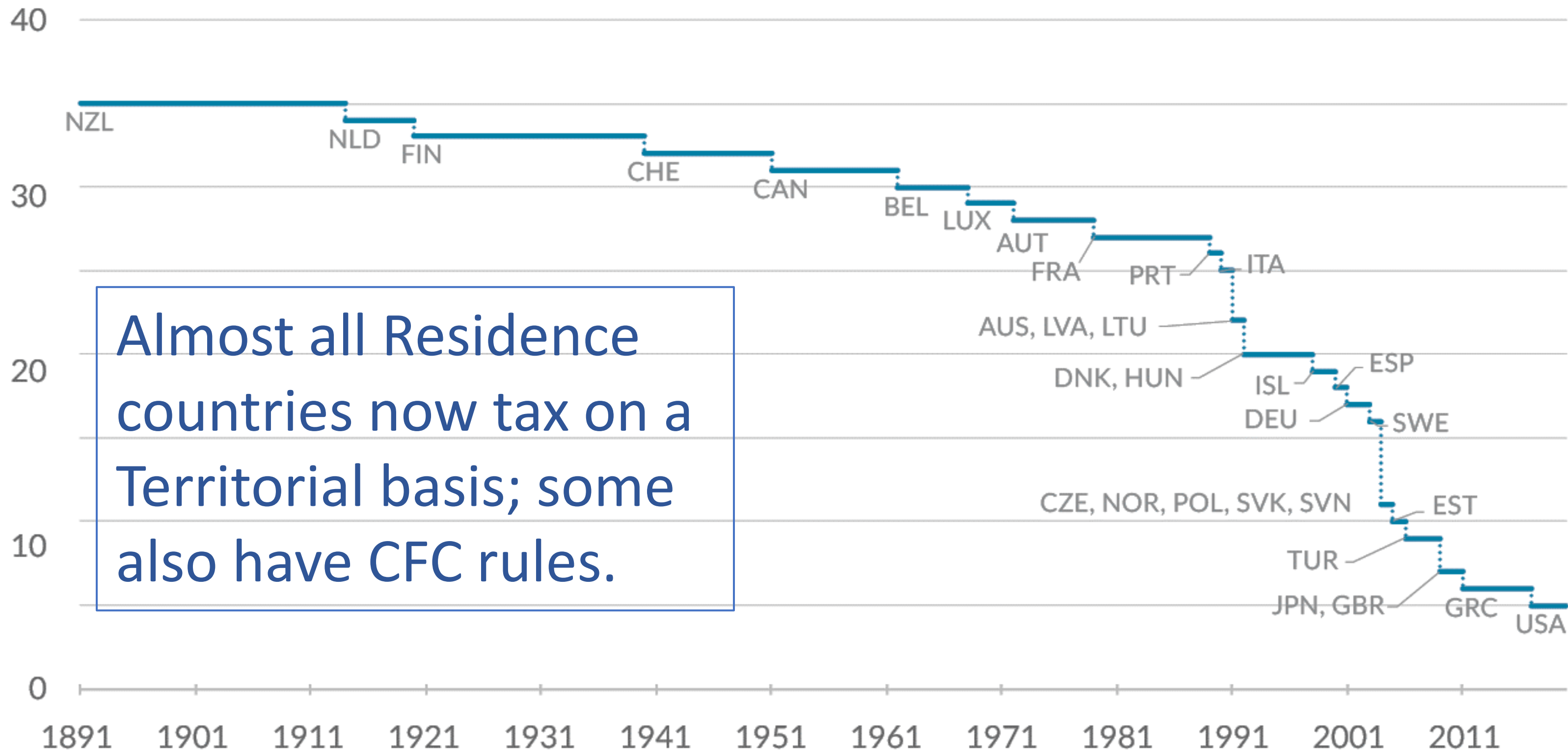
Territorial Taxation: Residence Country Exempts FSI from Tax so Effective Rate on FSI Is Source Country Rate

Without "umbrella" differences in source country tax rates affect location and size of inward FDI, encouraging tax competition among host countries and race to bottom.



The Shift from Worldwide to Territorial Taxation Among OECD Countries

Number of OECD countries with worldwide system, 1891-2020



Almost all Residence countries now tax on a Territorial basis; some also have CFC rules.

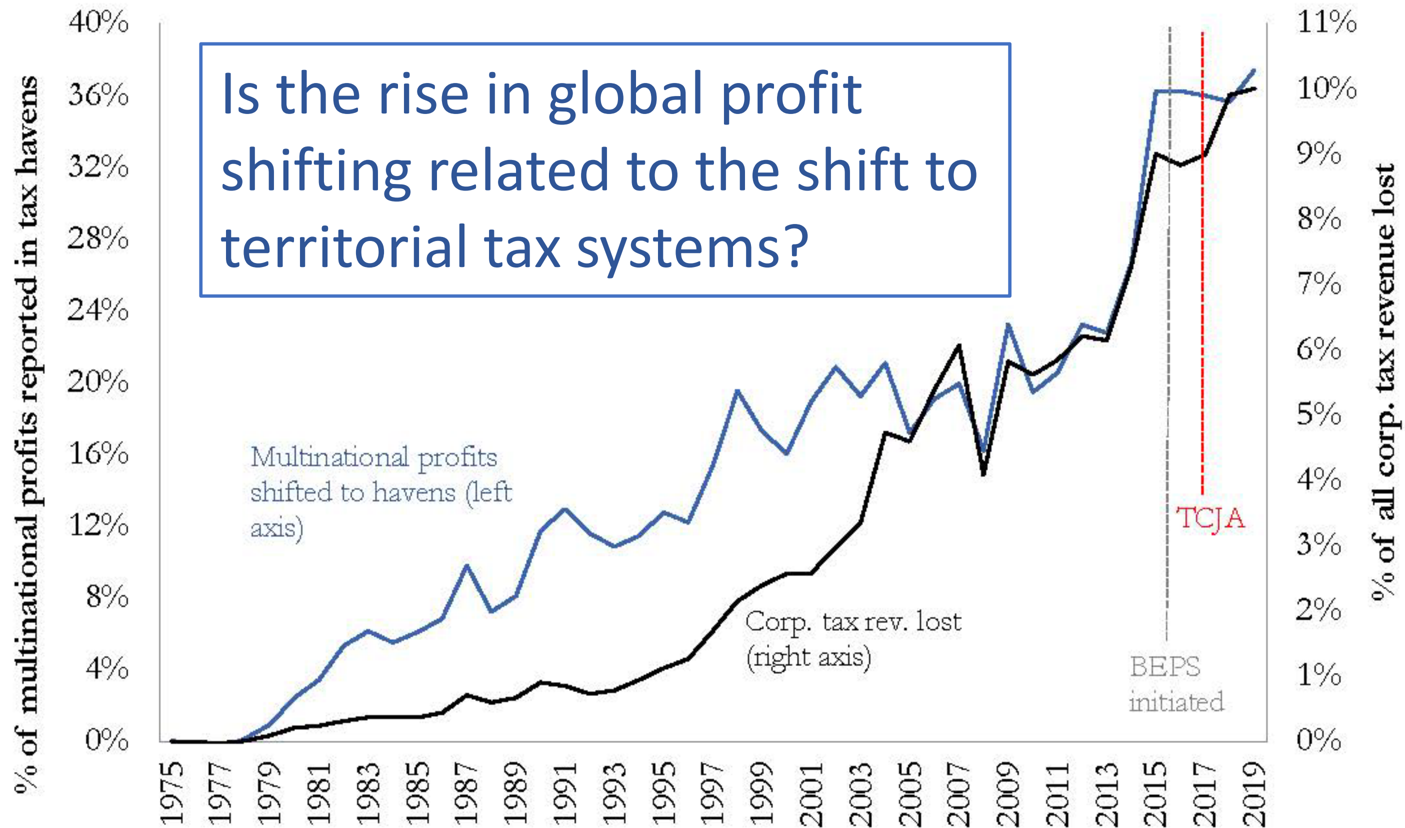
Note: New Zealand and Finland effectively repealed (in 1988 and 1990, respectively) and reinstated (in 2009 and 2005, respectively) territorial

Readings

https://www.elibrary.imf.org/display/book/9781513511771/ch003.xml
https://www.imf.org/external/pubs/ft/wp/2013/wp13205.pdf
https://taxfoundation.org/territoriality-tax-systems-europe-2021/
https://taxfoundation.org/global-perspective-territorial-taxation/ https://taxfoundation.org/territorial-tax-system-oecd-review/

4. BEPS and Global Profit Shifting

Figure 4: Multinational profits shifted to tax havens and corporate tax loss, 1975–2019



Note: the blue line (left axis) shows the share of multinational profits (as defined in the text) shifted to tax havens. This share increased from about 2% in the late 1970s to about 37% in 2019. The black line (right axis) shows our estimate of the amount of corporate tax revenue lost due to profit shifting globally, expressed as fraction of global corporate tax receipts.

Source: L.S. Wier and G. Zucman. "Global Profit Shifting, 1975-2019", NBER Working Paper 30673, Nov 2022, p.12.

BEPS Factors that Encourage MNE Profit Shifting

- **Territorial tax regime** → inward FDI responds to Source country tax rates and lack of Worldwide "umbrella" → wider tax rate differences across countries. BEPS activities exacerbated by:
  - Most countries with territorial tax systems lack CFC regimes so no FSI is taxed at home
  - Pre 2017, US on Worldwide system but deferral of CIT on active business income → profits offshore → Source rate matters
  - US Subpart F (CFC rules) on passive income eviscerated by "check the box" rules
- **Competition for Inward FDI**
  - Rise in number of tax havens setting statutory rates close to zero
  - Rise in number of Source governments offering tax preferences to encourage inward FDI (beauty contests) → Statutory higher than Effective tax rates
- **Lack of information and coordination among tax authorities** → bargaining power with MNEs
- **Loopholes in the international tax regime** encourage sophisticated tax avoidance strategies
  - Avoid nexus (permanent establishments) in Source countries
  - Exploit hybrid mismatch; e.g., definitions of "residence", equity vs debt
  - Tax treaty abuse - financial transactions (Dutch sandwich) reduce withholding taxes
  - Aggressive transfer pricing
    - Excessive intercorporate interest charges and management fees
    - IP migration to move IP ownership to tax havens and investment hubs

Addressing the Loopholes: BEPS 1 Action Items (2015)

Reduce loopholes in current international tax regime

1. Addressing tax challenges of digital economy
2. Neutralizing effects of hybrid mismatch arrangements
3. Strengthening rules on controlled foreign corporations
4. Limiting base erosion via interest deductions & other financial payments
5. More effectively countering harmful tax practices
6. Preventing tax treaty abuse
7. Preventing artificial avoidance of permanent establishment status
8. Making transfer pricing outcomes reflect value creation – intangibles
9. Making transfer pricing outcomes reflect value creation – risks & capital
10. Making transfer pricing outcomes reflect value creation – high-risk transactions

More information and coordination among tax authorities

11. Establishing methods to collect & analyze BEPS data
12. Requiring taxpayers to disclose aggressive planning arrangements
13. Re-examining transfer pricing documentation
14. Making dispute resolution mechanisms more effective
15. Developing a multilateral tax treaty

BEPS 2 → Perception that BEPS 1 was not enough. Need to address digital economy (#1) plus remaining loopholes in the international tax regime

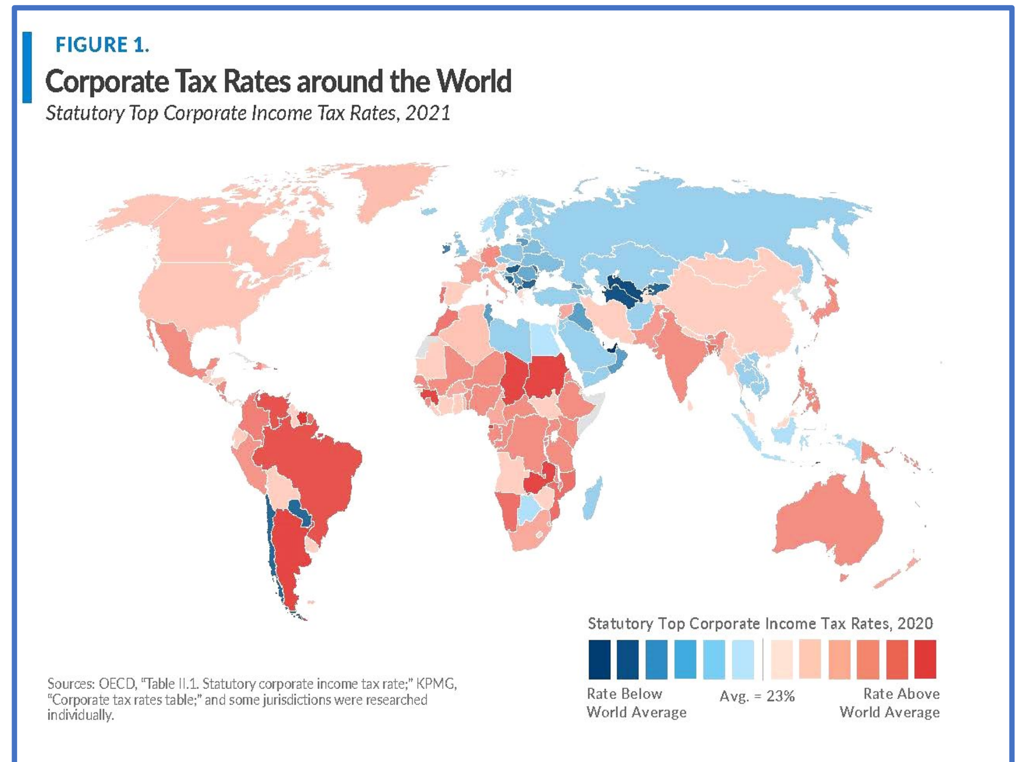
Agenda

I. How MNE Profits Are Taxed

II. Overview of the Global Minimum Tax

1. Pillar Two Timeline
2. GloBE Overview

III. Expected Effects



https://taxfoundation.org/corporate-tax-rates-by-country-2021/

II. OVERVIEW OF THE GLOBAL MINIMUM TAX

1. Overview of Pillar Two	2. GloBE Scope	3. Effective Tax Rate (ETR)	4. Top-up Tax
5. Carveouts and Exclusions	6. Income Inclusion Rule (IIR)	7. Under Taxed Payments/Profits Rule (UTPR)	8. Implementation and Other Matters

1. Pillar Two Timeline, 2015-2022

- Oct 2015: BEPS Action 1 - Addressing the Tax Challenges of the Digital Economy
- March 2018: Delivery of the Interim Report
- Jan 2019: Delivery of Policy Note
- Feb-March 2019: Public Consultation
- May 2019: **Programme of Work** to Develop a Consensus Solution to the Tax Challenges Arising from the Digitalisation of the Economy
- **Dec 2019: Public Consultation - Global Anti-Base Erosion (GloBE) Proposal under Pillar Two**
- **Jan 2020:** Statement by the OECD/G20 Inclusive Framework on BEPS on the **Two-Pillar Approach** to Address the Tax Challenges Arising from the Digitalisation of the Economy
- **Oct 2020**: Statement by the OECD/G20 Inclusive Framework on BEPS and delivery of the Pillar One Blueprint, **Pillar Two Blueprint,** and **Economic Impact Assessment**
- Oct-Dec 2020: Call for Public Consultation on the Pillar One and **Pillar Two Blueprints**
- Jan 2021: Public Consultation Meetings on the Pillar One and **Pillar Two Blueprints**
- **July 2021**: Statement on a **Two–Pillar Solution** to Address the Tax Challenges Arising from the Digitalisation of the Economy
- **Oct 2021**: Statement on a **Two-Pillar Solution (update)**
- **Dec 2021**: **Model GLOBE Rules**
- **March 2022**: (1) **Commentary to the GLOBE Rules (2) Illustrative Examples (3) Model Rules in a Nutshell (4) Fact Sheets and (5) Frequently Asked Questions**
- **April 2022**: Public Consultation Meeting on the **Global Minimum Tax**

Source: https://www.oecd.org/tax/beps/tax-challenges-arising-from-the-digitalisation-of-the-economy-global-anti-base-erosion-model-rules-pillar-two.htm

2. GloBE Overview

1. Overview of Pillar Two

Purpose: Ensure large MNEs pay a minimum level of tax regardless of where their Ultimate Parent Entity (UPE) or constituent entities (subsidiaries and permanent establishments) are located.

Mechanism #1: GloBE Rules (IIR and UTPR)

- 15% minimum jurisdictional tax rate. Enforced by (in priority):
- Income Inclusion Rule (IIR) - Domestic rule that ensures UPE pays a minimum tax in jurisdictions where its constituent entities are located.
- Under Taxed Payment Rule (UTPR) – Back-stop to IIR permitting Source jurisdictions to collect the top-up tax by denial of deductions, making equivalent adjustments, or additional cash tax expenses.

Mechanism #2: Subject to Tax Rule (STTR)

- Treaty-based rule that permits Source jurisdictions to impose a withholding tax at 9% on certain related party payments that are subject to low tax rates in the Residence jurisdiction and no IIR is levied.

Overview of Pillar Two: GloBE Calculation

Step 1 – Constituent Entities within scope

- Identify Groups within Scope and the location of each Constituent Entity within the Group

Step 2 – GloBE Income

- Determine Income of each Constituent Entity

Step 3 – Covered taxes

- Determine taxes attributable to Income of a Constituent Entity

Step 4 – Effective Tax Rate and Top-up Tax

- Calculate the Effective Tax Rate of all Constituent Entities located in the same jurisdiction and determine resulting Top-up Tax

Step 5 – IIR and UTPR

- Impose Top-up Tax under IIR or UTPR in accordance with agreed rule order

Source: https://www.oecd.org/tax/beps/pillar-two-model-rules-in-a-nutshell.pdf

2. GloBE Scope

- Applies to **MNE Groups and their constituent entities with annual gross revenues ≥ €750M in the consolidated financial statements of the Ultimate Parent Entity (UPE)** of the MNE group in 2 or more of the four prior fiscal years

- Constituent entities (subsidiaries and permanent establishments (PEs))

- Applies to international groups (low-taxed companies that are outside the jurisdiction of the parent entity; however, **jurisdictions can choose to extend GloBE to cover entities inside the parent jurisdiction if they are within scope** (the EU Commission's proposed directive extends GloBE to both international and domestic groups)

- **Exclusions from GloBE**
  - Pension, investment and real estate funds
  - Small and Medium-Sized MNEs (FA/TA ≤ €50M & NFCO ≤ 5) max 5 yrs.

3. Calculating the Effective Tax Rate (ETR)

- **Effective Tax Rate (ETR) = Σ Covered Taxes / Σ Net GloBE income**

where

- Use **group financial statements** with agreed adjustments to calculate Profits and Taxes on a jurisdiction-by-jurisdiction basis

- Entities in the same jurisdiction must be **blended to calculate the jurisdictional Effective Tax Rate (ETR**); this includes blending the substance-based income exclusion

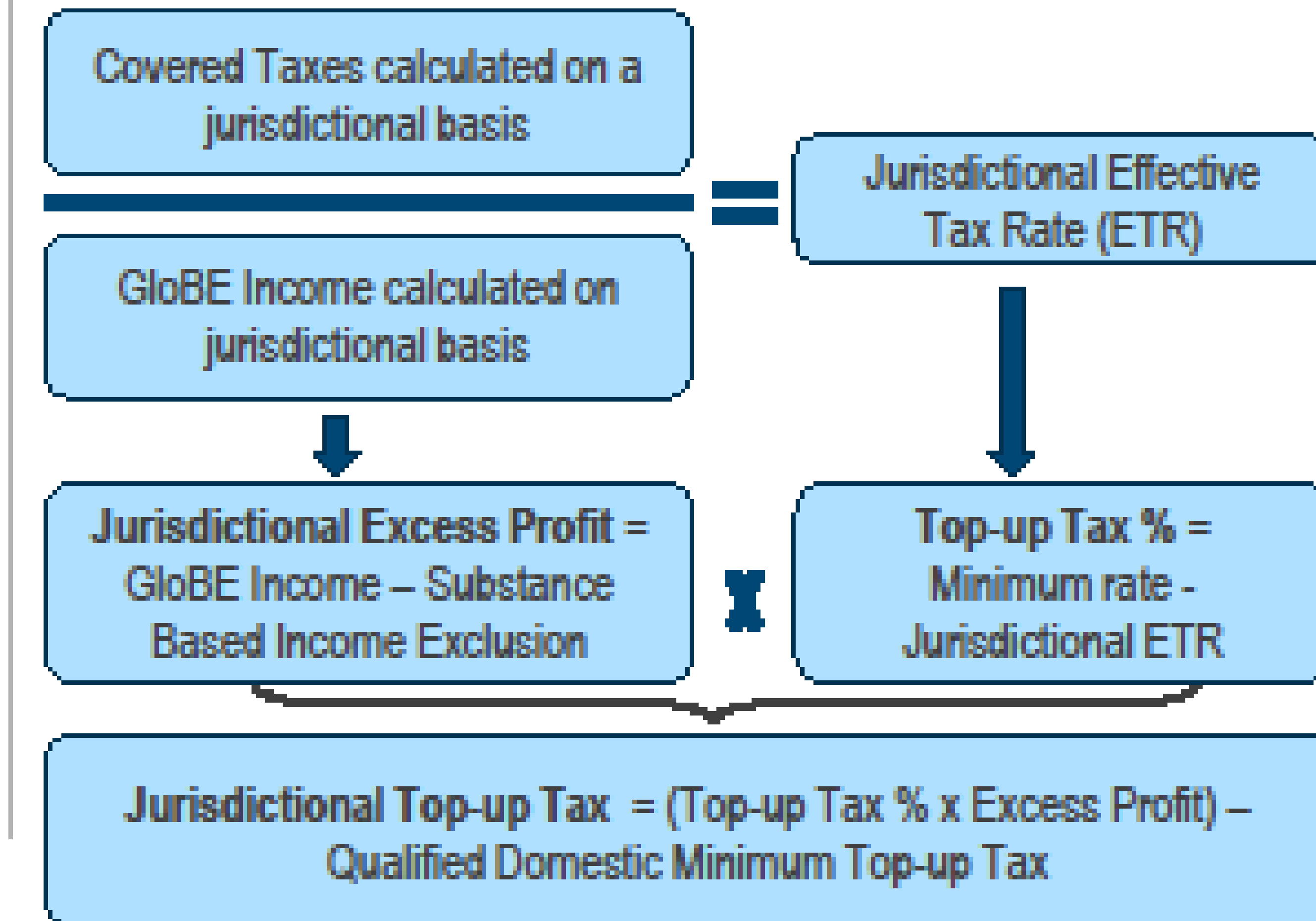
- **Net GloBE Income is summed income (+/-) for all constituent entities of MNE group**

- **Covered Taxes**: Current and deferred taxes on income (e.g., CIT, withholding) with adjustments

4. GloBE Top-up Tax

- Top-up Tax is calculated on MNE Excess Profit on jurisdiction-by-jurisdiction basis
- Excess Profit = Net GloBE income minus Substance-based Carve-out
- Effective Tax Rate (ETR) = Σ Adjusted Covered Taxes / Σ Net GloBE income
- Top-up Tax Rate (TTR)= 15% - ETR (e.g., if ETR = 9%, TTR = 6%)
- Top-up Tax = TTR * Excess Profit

Calculating the Top-up Tax



Source: https://www.oecd.org/tax/beps/pillar-two-GloBE-rules-fact-sheets.pdf

5. GloBE Carveouts and Exclusions

SUBSTANCE-BASED CARVEOUT

- Carve-out for 5% tangible assets and payroll (with a 10 year transition (8%/10%)) calculated as the summed exclusions for each entity in the jurisdiction
- Carveout reduce tax base for entities with employees and tangible assets and permit tax incentives on investments without triggering GloBE

➢ A problem is that both MNEs and Source jurisdictions may want to keep carveouts – or get around the rules by replacing them with various "in kind" incentives

EXCLUSIONS

- No Top-up Tax if earnings are distributed within 4 years and taxed ≥ minimum rate.
- **De minimus exclusion**: No Top-up Tax for a constituent entity if average GloBE revenue < €10M and income < €1M in jurisdiction in current & two previous years

6. Income Inclusion Rule (IIR)

Once Top-up Tax has been calculated for each jurisdiction, the MNE must decide which entity in the MNE group will pay the Top-up Tax. **Two Methods: Income Inclusion Rule (IIR) and Under Taxed Payment Rule (UTPR) with IIR having priority over UTPR.**

INCOME INCLUSION RULE (IIR)

- Top-up Tax is allocated based on ownership of the MNE group.
- The **Ultimate Parent Entity (UPE) of the MNE group is liable** for the Top-up Tax on its allocable share of income of any low-tax constituent entity in which the UPE has a direct or indirect ownership interest
- **Order of priority is top down**: the UPE jurisdiction has first priority to pay the Top-up Tax; if the UPE is does not pay the Top-up Tax, an intermediate parent entity will be charged.

7. Under Taxed Payment Rule (UTPR)

- **Backstop rule:** If the IIR method is not used to collect the Top-up Tax, the UTPR is used to collect the Top-up Tax and allocate that amount among all UTPR jurisdictions.

- **UTPR is "bottom up".** Jurisdictions where the MNE Group has foreign affiliates that have nexus (subsidiaries and PEs) and substance have the right to a share of the Top-up Tax if no IIR is levied.

- **UTPR allocation is based on an equal-weight two-factor formula based on the location of MNE tangible assets and employees.** So if Top-up Tax is 8% * $100M and a UTPR jurisdiction's share of the MNE group's assets and employees in all UTPR jurisdictions is 20%, the Top-up Tax allocation to that UTPR jurisdiction is $1.6M. UTPR allocation rules were first added to GloBE rules in Dec. 2021.

- Entities are allocated additional cash tax expenses equal to their share of the Top-up Tax. The adjustment mechanism (e.g., deny deduction, cash tax expense) is left up to domestic law in the UTPR jurisdiction.

8. GMT Implementation and Other Issues

- GloBE has **"common approach"** for Inclusive Framework (IF) members:
  - IF members are **not required to adopt GloBE** but if they do, they must implement and administer the rules consistent with Pillar 2.
  - **IF members must accept application of GloBE rules applied by other IF members even if they do not adopt the GloBE rules themselves.**

- **How GloBE rules are to work with US GILTI rules still to be determined.**

- **EU Proposed Directive** issued in Dec 2021 must have unanimity before implementation. Some EU members moving unilaterally to introduce GloBE.

- OECD argues **multilateral instrument** to coordinate GloBE rules is not necessary but MNEs and states are concerned about differences in rules, administrative costs and likely cross-border disputes.

- **Will jurisdictions join GloBE? See Gvt of Jersey "Reflections on OECD Pillars One and Two" (April 2022) for useful discussion of options.**

8. GMT Implement and Other Issues (cont'd)

GloBE and GILTI

- **Differences between GloBE and GILTI remain to be harmonized**:
  - GloBE is jurisdiction-by-jurisdiction; GILTI allows global pooling
  - GloBE and GILTI have tax bases, carveouts and minimum rates

- **If GILTI and GloBE are harmonized and GILTI deemed ≥ 15%:**
  - Neither the QDMTT nor UTPR would apply to foreign subsidiaries and branches of US MNEs that are subject to GILTI
  - UTPR would still apply to low-taxed MNE profits earned in the USA by (1) MOUSAs or (2) domestic subsidiaries of US MNEs - unless US government levied a QDMTT ≥ 15% on these low-tax profits

- **If GloBE and GILTI are not harmonized:**
  - Either UTPR or QDMTT could also apply to foreign subsidiaries of US MNEs that are subject to GILTI

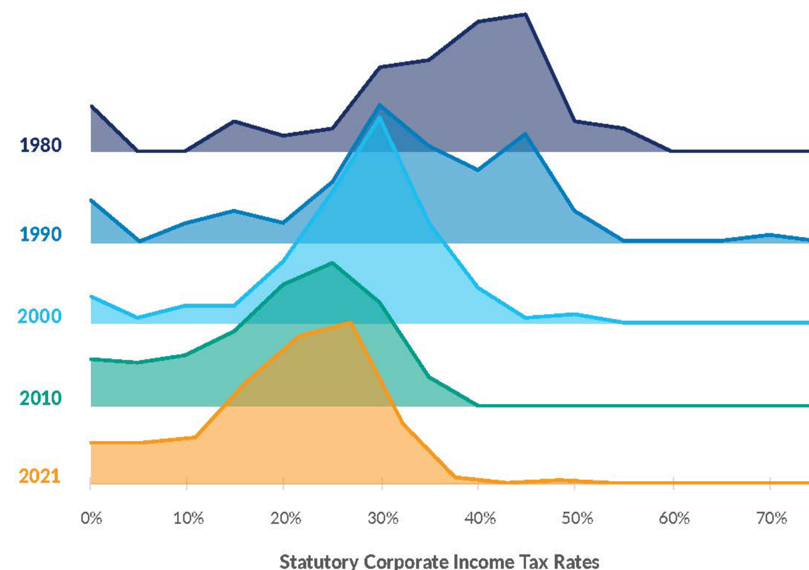
Agenda

I. How MNE Profits Are Taxed

II. Overview of the GMT

III. Expected Effects

1. GloBE Rank Ordering Matters
2. Impacts on the Current International Tax Regime
3. Impacts on Profit Shifting and FDI Location
4. Tax Preferences and FDI Location



https://taxfoundation.org/corporate-tax-rates-by-country-2021/

1. GloBE Rank Ordering Matters

- **IIR**: Under the Income Inclusion Rule, the Residence jurisdiction where the Ultimate Parent Entity (UPE) resides has priority for collecting the Top-up Tax.

- **QDMTT**: If a Source jurisdiction levies a **Qualified Domestic Minimum Top-up Tax (QDMTT) on low-tax profits within its own borders that is** calculated on same basis as the GloBE rules, the QDMTT is creditable against the GloBE Top-up Tax for that jurisdiction.

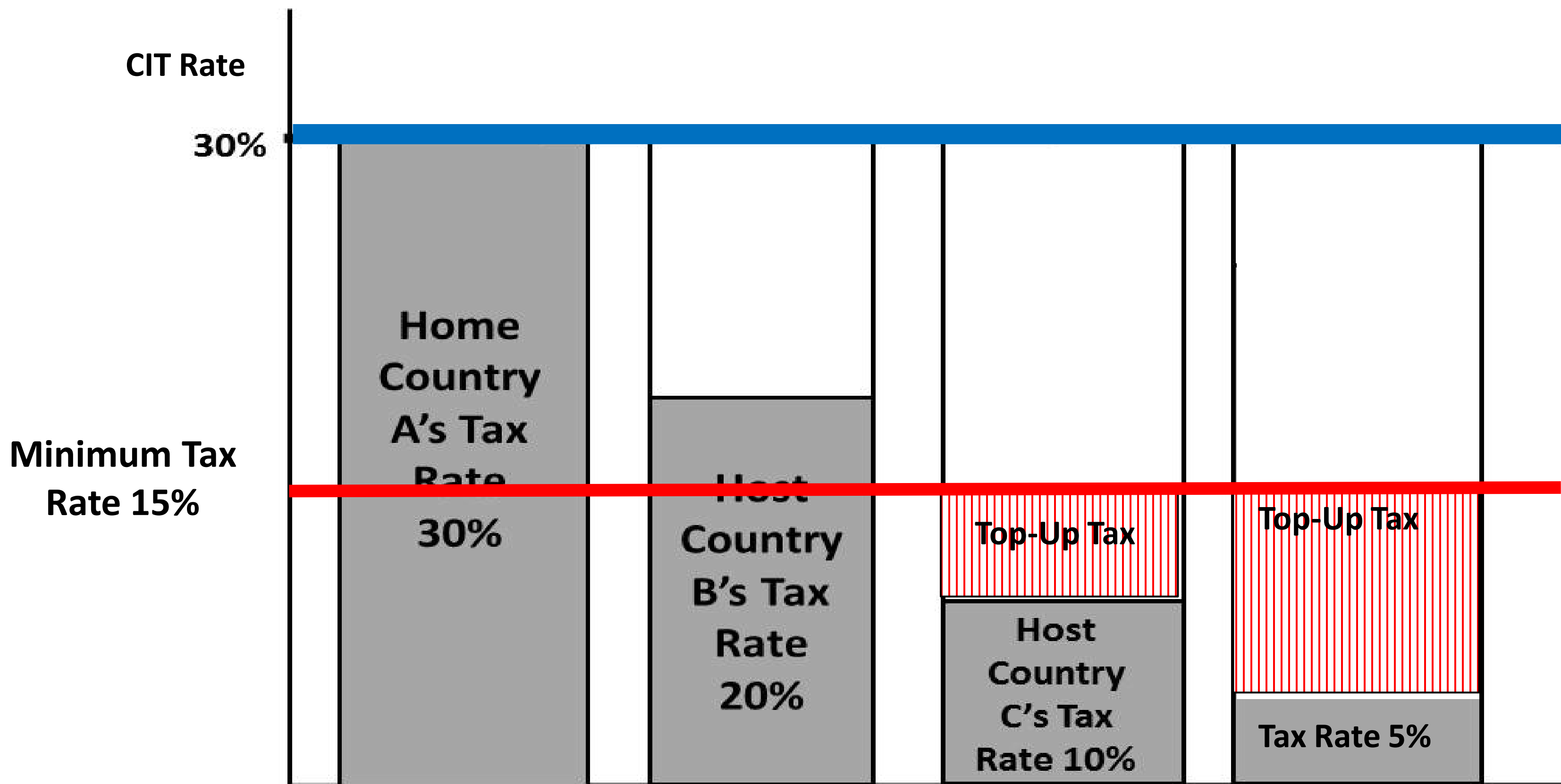
- **UTPR**: If the Residence jurisdiction fails to collect the Top-up Tax, all other entities in the MNE group have a right to a share of the Top-up Tax based on their jurisdiction's share of the UTPR group's employees and capital.

→ QDMTT has "first crack" at the Top-up Tax if the Source country chooses to levy the QDMTT because (1) the tax would be creditable against the IIR and (2) the QDMTT would reduce the Top-up Tax to zero so the UTPR would not apply.

Income Inclusion Rule (IIR)

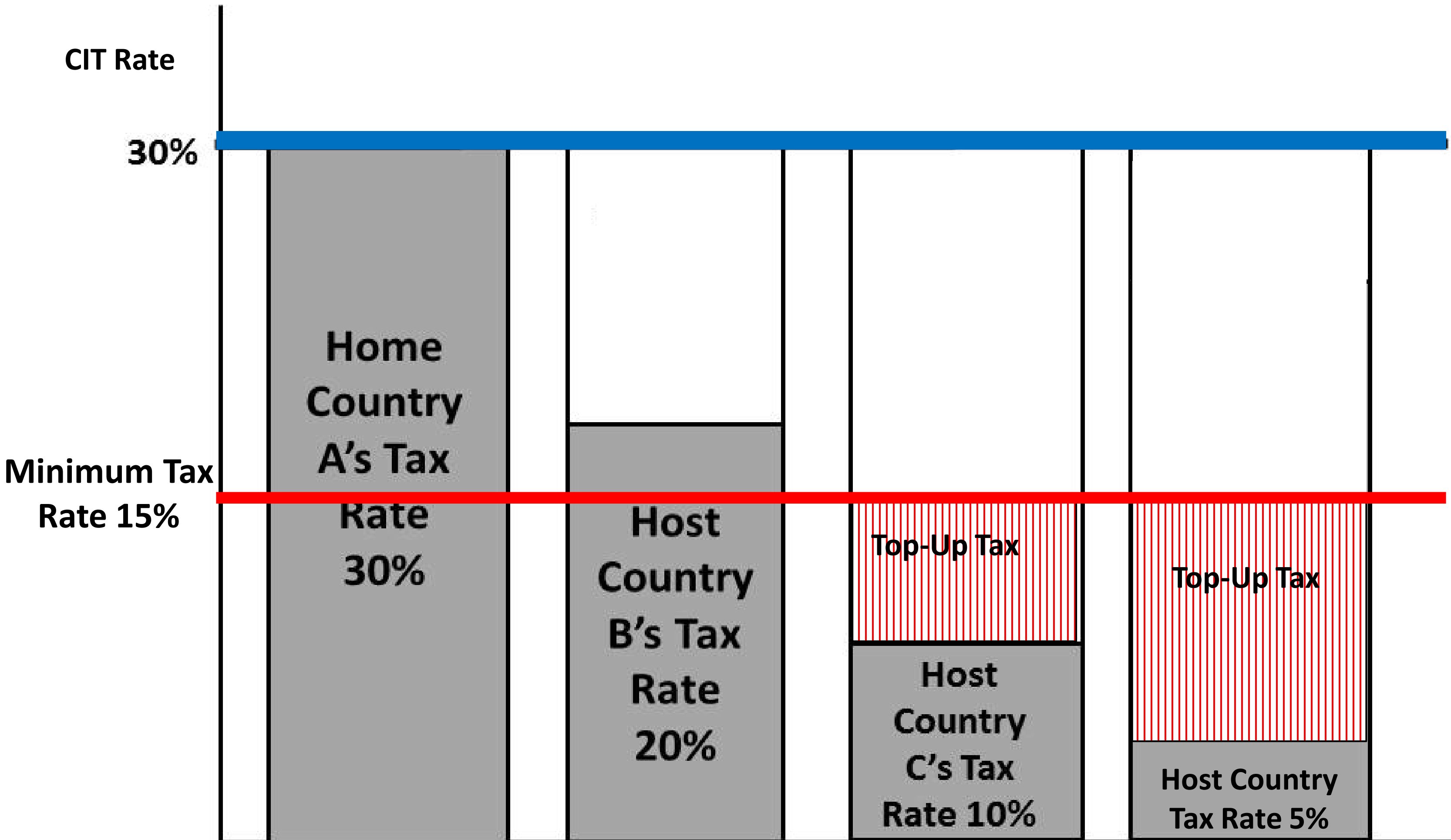
IIR = Residence Country of Ultimate Parent Entity (UPE) levies IIR (or defaults to next tier(s) down in MNE Group)

Most jurisdictions tax on territorial basis so Residence jurisdictions must now tax FSI at least up to Top-up Tax on an accrual basis for both active and passive income. Here the Top-up Tax goes to the Residence country under the IIR.



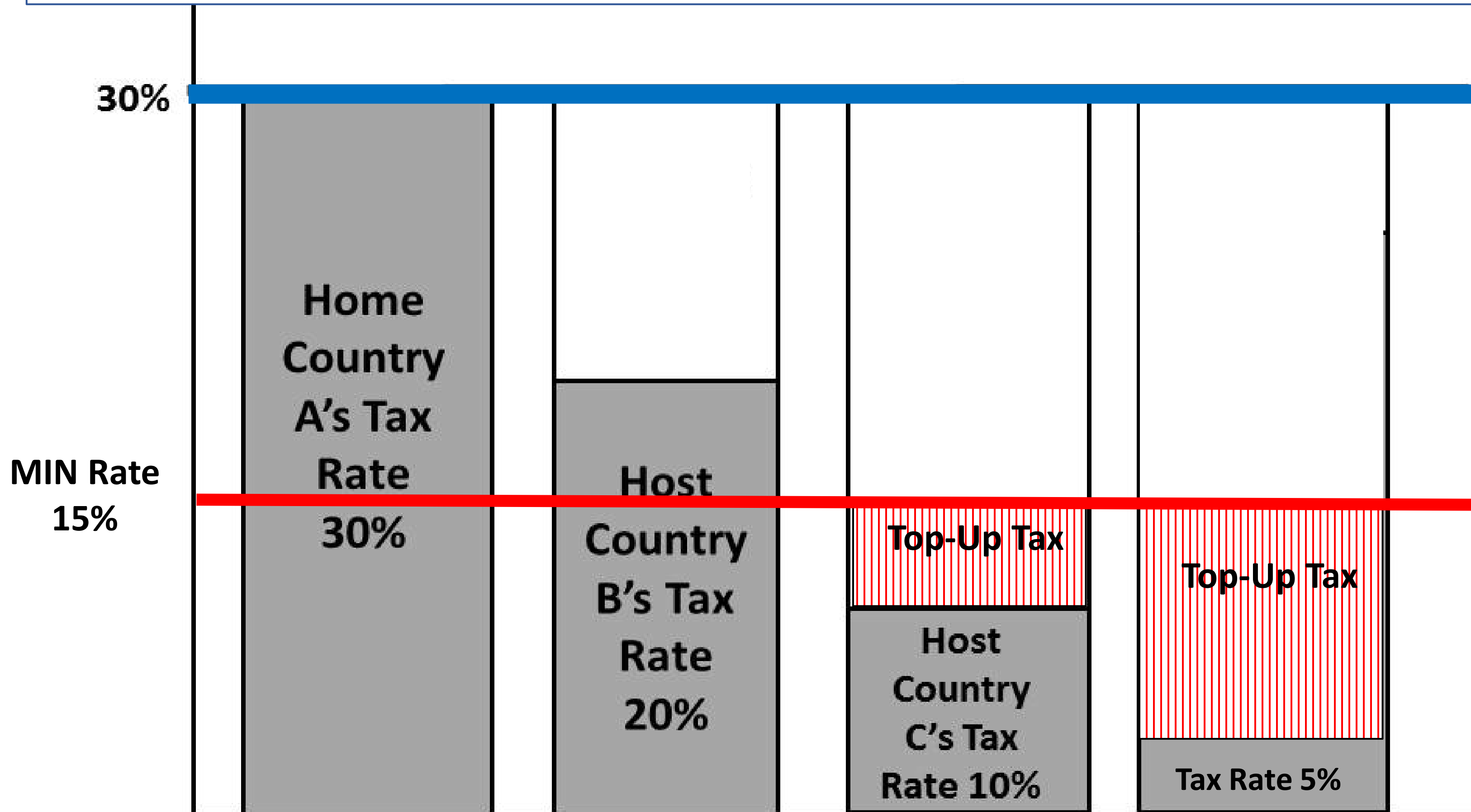
Qualified Domestic Minimum Top-up Tax (QDMTT)

First crack principle: If the Source jurisdiction levies a QDMTT then the Residence jurisdiction must credit the QDMTT and no IIR applies. Each Source country gets its own Top-up Tax under the QDMTT.



Under Taxed Payment Rule (UTPR)

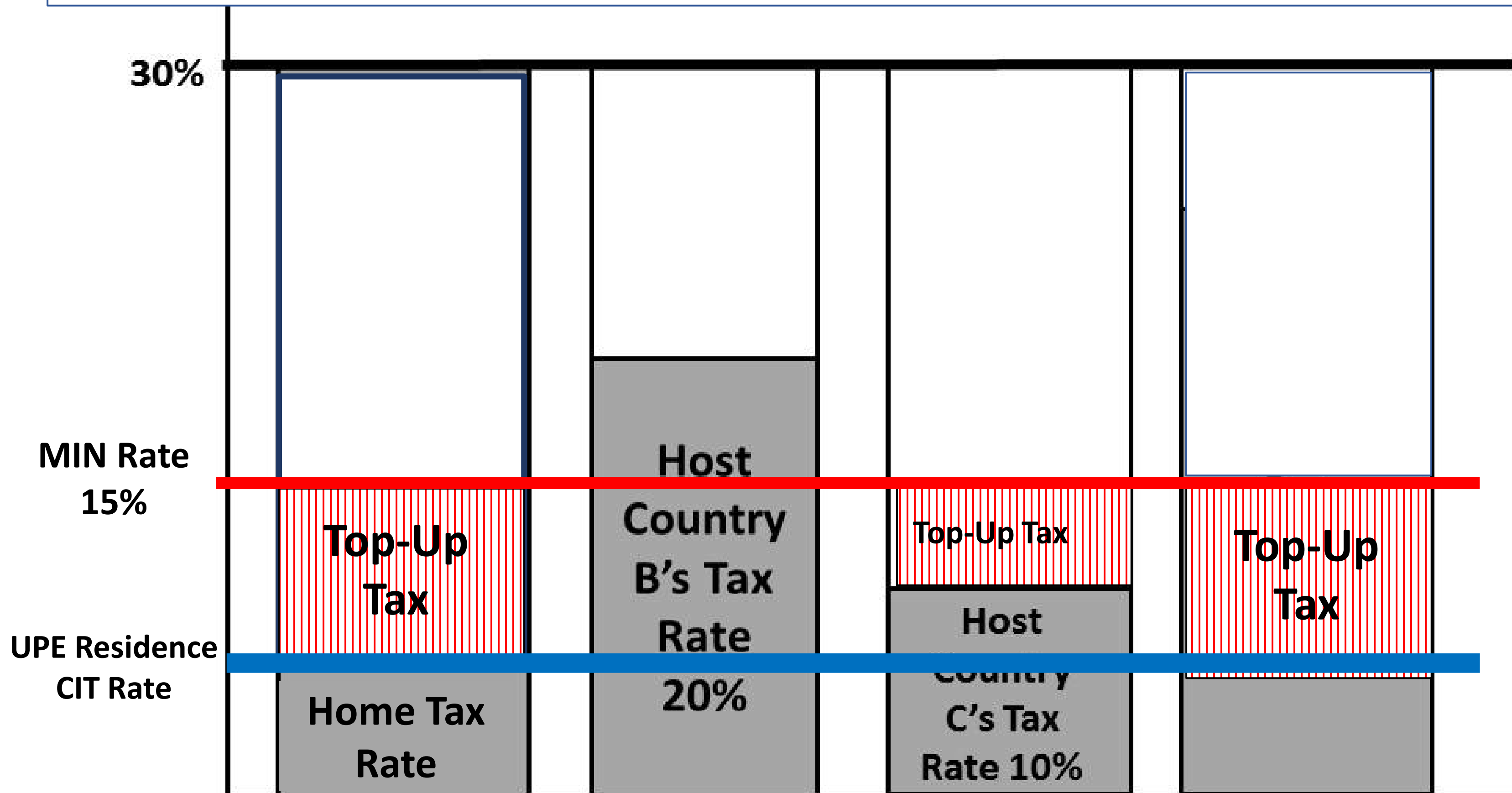
If the Residence country does not levy the IIR and the Source jurisdiction does not levy the QDMTT, then other jurisdictions that host MNE subsidiaries and PEs can split the Top-Up Tax based on their Shares of MNE Assets and Payroll. Creates odd situation that Country C could collect D's Top-up Tax and vice versa.



IIR when Residence Rate Is less than 15 Percent

Who gets the Top-up Tax in the Residence country? Two possibilities:

- Residence jurisdiction levies an IIR on GloBE income on both foreign and domestic entities in MNE Group so adds, in effect, both the IIR and the QDMTT
- Other jurisdictions can apply the UTPR to collect the Top-up Tax based on formulary apportionment of the MNE's employees and capital in UTPR jurisdictions.



2. Impacts on Current International Tax Regime

- The GMT puts a 15% tax floor – based on GloBE profits and taxes – on MNE profits for Residence and Source countries
- The IIR acts as a Residence country "15% tax umbrella", encouraging Source countries to set domestic tax rates to 15% (on GloBE basis) or to levy a QDMTT equal to the Top-up Tax that would have been collected by the IIR.
- The IIR + QDMTT reinstates the First Crack Principle for Source countries but with a fixed ceiling of 15% → the combination is a movement towards a Worldwide Tax Regime.
- The UTPR is a "Fail Safe Mechanism" that gives Source jurisdictions access to MNE tax base outside their water's edge with no nexus or transaction connection – ignores separate entity rules, water's edge and nexus rules. This is a movement away from the existing international tax regime (CFC rules are different from UTPR) and towards anarchy. Also introduces formulary apportionment as allocation mechanism. US Congress is unlikely to sign onto GloBE if UTPR is part of the package.
- Absence of a multilateral instrument could be problematic. Reliance on domestic law is faster but generates greater differences and more international disputes.

3. Impacts on Tax Rates and FDI Location

- The tax rate that affects the MNE's location of its next foreign direct investment is the average effective tax rate (AETR) on a particular FDI opportunity taking account of profit shifting opportunities. The key tax rate is:
  - Not the statutory tax rate (STR) in country J
  - Not the AETR in country J (which equals Tax Paid in J /Profit Declared in J)
  - But the **BEPS Effective Tax Rate (BETR**), which is a combination of the tax paid in J on profit declared in J plus the taxes paid in other (lower taxed) countries on the J's tax base that has been moved into tax havens and investment hubs via profit shifting.
- The easier it is to shift profits out of J and into low-tax locations, and the greater the tax rate gap, the lower will be the BETR on that investment and the more the MNE will invest in J.

See UNCTAD. *World Investment Report,* 2022, Ch. 3 "Impact of a Global Minimum Tax on FDI"

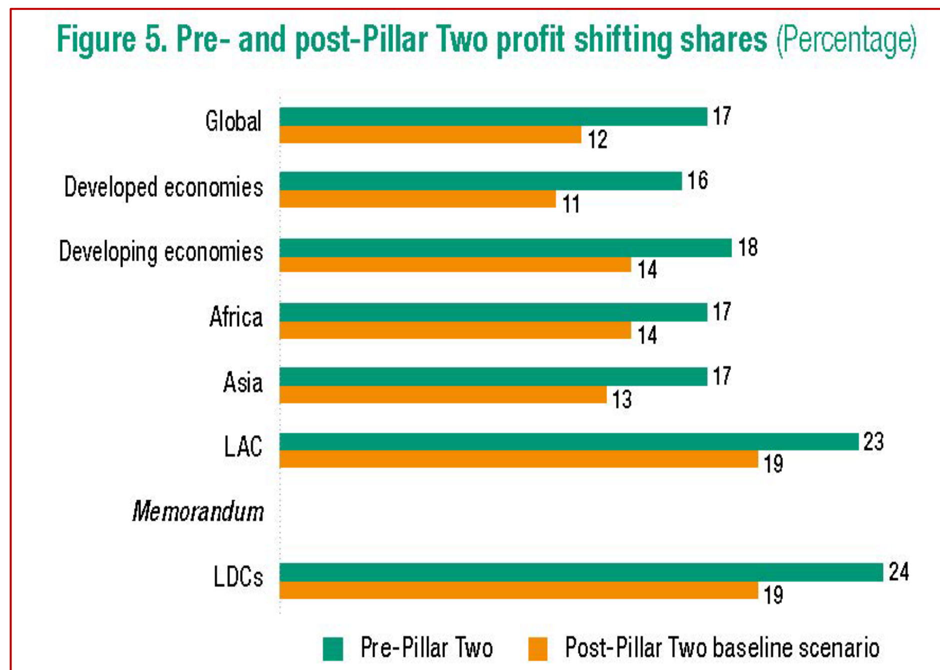
Impacts on Tax Rates and FDI Location (cont'd)

- **Implications**
  - A country with a high statutory tax rate – or even a high AETR – can still have a very low BETR if the tax base can be easily shifted outside that country and the tax rate savings from profit shifting are large. The low BETR therefore continues to attract inward FDI – even if the country has little to no non-tax locational advantages.
  - GloBE will reduce profit shifting opportunities → BETR will rise in countries that allowed outbound profit shifting (to create jobs) → will discourage inward FDI in high tax locations that do not have non-tax locational advantages.
  - Thus, location advantages other than tax (e.g., educated work force, natural resources, digital infrastructure) will have more impact on FDI location than before.

See UNCTAD. *World Investment Report,* 2022, Ch. 3 "Impact of a Global Minimum Tax on FDI"

4. Impacts on Profit Shifting and FDI Location

- Altering the order of the rules affects the distributional effects of GloBE → Source countries should benefit more and Residence countries less than in early estimates of GloBE (e.g., Economic Impact Assessment).
- Global profit shifting should be reduced as the tax gap narrows across countries.
- Tax competition among Source countries to attract inward FDI should be reduced by setting a floor how far tax rates can fall.



Source: UNCTAD, WIR 2022, p. 127

Source countries will still be incentivized to attract inward FDI by offering preferences that do not affect the Top-up Tax. The type of tax incentives Source countries offer to attract inward FDI is therefore likely to change.

With a higher CIT as a floor, there should be LESS base erosion (income declared = income earned) and LESS profit shifting (into havens and out of high-tax locations).

Impacts on Profit Shifting and FDI Location (cont'd)

- **Implications**

  - AETRs should be more accurate predictors of FDI and more likely to affect the location and scale of FDI.

  - Real factors that affect location – country specific advantages like educated workforce, strong institutions, rule of law - should have more influence on location and scale.

  - Offshore financial centers and tax havens will be differentially affected depending on their non-tax locational advantages. Those with few non-tax locational advantages will be in trouble and will need help.

  - Also means that the First Crack Principle, which has been effectively dead for many years, may now provide a real source of income for developing countries. But IF AND ONLY IF inward FDI STAYS in that location.

  - Now non-tax locational advantages will matter TWICE – once in retention of FDI and second in the generation of tax revenue for host countries that can be used to fund public goods and infrastructure (and thus create locational advantages that attract employment and high-value added activities).

5. Impacts on Tax Preferences and FDI Location

- Source countries will still be incentivized to attract inward FDI by offering preferences that do not affect the Top-up Tax. The types of tax incentives Source countries offer to attract inward FDI are therefore likely to change.

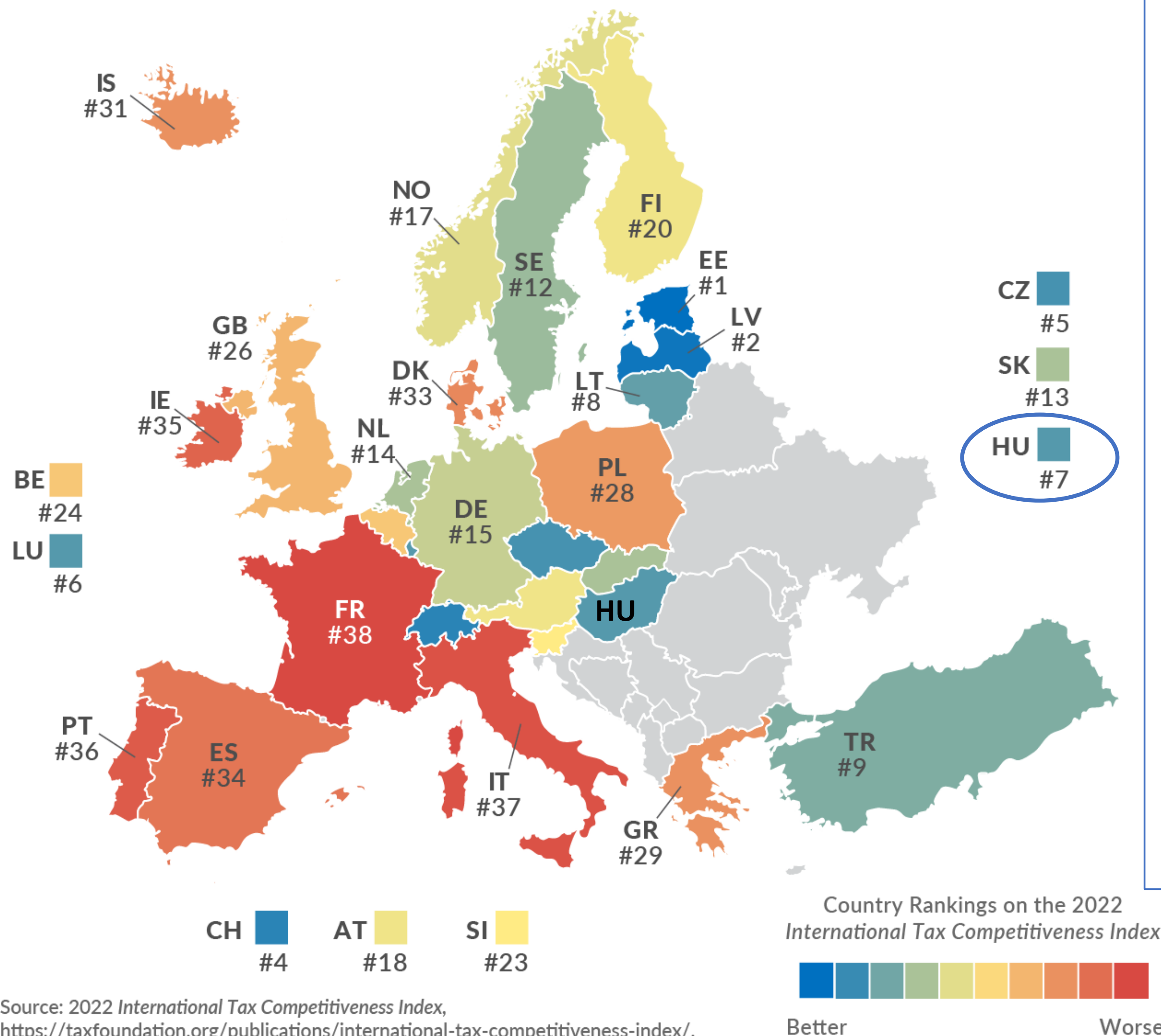
- Tax preferences reduce the AETR but not all tax incentives are the same:
  - Tax holidays and exemptions cause a big drop in the AETR → trigger Top-up Tax.
  - Special economic zones and one-stop shops may affect AETR → trigger Top-up Tax
  - Patent boxes have a lesser impact.
  - Accelerated depreciation and loss carry forwards have little to no impact.

- This means that a developing country that continues to offer a tax holiday will likely find the benefits of that holiday clawed away by another country through the IIR (home) or the UTPR (a group of other host countries).

- Countries must therefore change their mix of tax preferences so as to avoid GloBE but this is not easy.

- In addition, many countries are locked in by the International Investment Agreements and may not be able to change existing commitments, or if they change them find they have more ICSID investment disputes.

See UNCTAD. *World Investment Report,* 2022, Ch. 3 "Impact of a Global Minimum Tax on FDI"



Hungary ranks 7th among the European OECD Countries on the Tax Foundation's 2022 International Tax Competitiveness Index

What are the implications of GloBE for Hungary?

WRAP-UP AND THANK-YOU

Please share your comments and questions
leden@tamu.edu

Additional Eden Pubs on Int'l Tax Regime and Global Minimum Tax

- Eden, L. 1988. Equity and Neutrality in the International Taxation of Capital. *Osgoode Hall Law Journal*. 26.2 (Fall): 367-408.
- Eden, L. 1988. The Impacts of Tax and Tariff Reforms on U.S. Direct Investments in Canadian Manufacturing. In *Canada/U.S.A.: The Economic Relationship*, edited by David McKee. New York: Praeger Publishers, pp. 121-51.
- Eden, L. 1991. Free Trade, Tax Reform, and Transfer Pricing. *Canadian Tax Journal*, 39.1: 90-112.
- Eden, L. 1998. Ch. 2, The International Tax Transfer Pricing Regime. In L. Eden, *Taxing Multinationals: Transfer Pricing and Corporate Income Taxation in North America,* University of Toronto Press, pp. 63-122.
- Kudrle, R. & L. Eden. 2003. The Campaign against Tax Havens: Will It Last? Will It Work? *Stanford Journal of Law, Business and Finance*, 9.1: 37-68.
- Eden, L. &, R. Kudrle. 2005. Tax Havens: Renegade States in the International Tax Regime. *Law and Policy,* 27.1: 100-127.
- Eden, L. 2009. Taxes, Transfer Pricing and the Multinational Enterprise. In A.M. Rugman (editor). *Oxford Handbook of International Business, 2nd Edition*. Oxford University Press, pp. 591-619.
- Eden, L. 2016. The Arm's Length Standard: Making It Work in a 21st Century World of Multinationals and Nation States. In T. Pogge & K. Mehta, eds. *Global Tax Fairness,* Oxford University Press, pp. 153-172.
- Eden, L. 2019. The Arm's Length Standard Is Not the Problem. *Tax Management International Journal*, 48.10 (October 11).
- Eden, L. 2020. Taxing Multinationals – The GloBE Proposal for a Global Minimum Tax. *Tax Management International Journal*, January.