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Designing a minimum tax that works for developing countries: Open questions, possible solutions, and an agenda for empirical research

Heitmüller, F.

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Designing a minimum tax that works for developing countries

Open questions, possible solutions, and an agenda for empirical research

Frederik Heitmüller

PhD Candidate, Leiden University

The Global Minimum Tax and its effects on countries'
tax regimes

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GLOBTAXGOV

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Problem: Is a global minimum tax good or bad for developing countries?

- Future reforms
 - A lower or a higher minimum tax rate?
 - More or less substance-based carve outs?
 - Which sectoral carve-outs?
- Diverging opinions
 - See e.g., ICRICT 2020 in favour of 25% rate, but criticism among academics
- For purposes of this presentation, „good“ means maximizing both foreign direct investment and tax revenue generation for developing countries

Decomposing tax competition

- Why do developing countries adopt lower tax rates to attract foreign investment?
- Compensation effect vs. beggar-thy-neighbor effect

Compensation for lack of in other factors that attract investors (most of them related to level of development)
E.g., market size, infrastructure, geography, security, skills

Competition with other jurisdictions that have a similar level in other factors relevant for investment (beggar-thy-neighbor)

- For maximizing investment and tax revenue in developing countries, the first effect is beneficial, but the second can be eliminated
- How big is each component (in which sectors)?

Technical implementation: Lower minimum tax for investment in developing countries

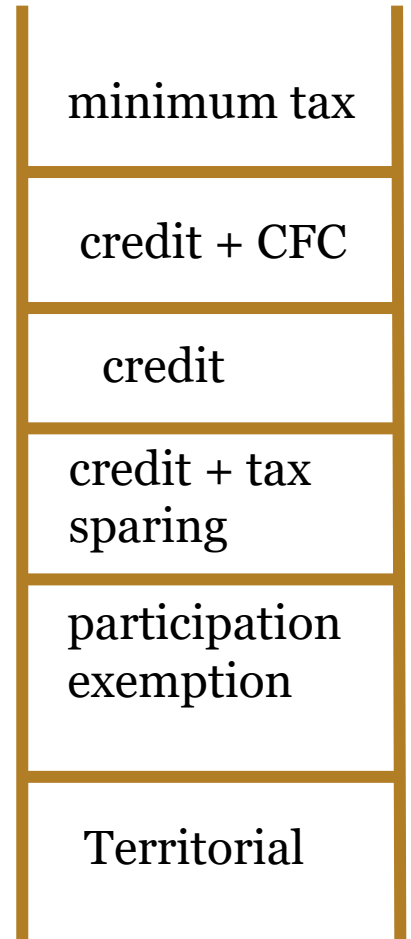
- Yoram Margalioth (2003): “Transfers from rich to poor countries further benefit by imposing limitations on rich countries' abilities to engage in tax competition with poor countries. [...] For example, Ireland would be required to raise its current corporate tax rate of 12.5% in order to decrease the relative disadvantage that developing countries have when competing with Ireland for FDI. [...] With the application of anti-tax competition rules to developing countries, we establish **two different harmonized tax levels** - one for developed countries and the other for developing countries.”
- Afton Titus (2022): “Developed countries should implement initiatives such as Pillar Two to eliminate tax competition in all forms between them. In adhering to the principle of inter-nation equity, **developing countries should be exempted** from the application of Pillar Two and, in so doing, will be able to continue engaging in real tax competition.”

What empirical approaches can we take?

- Justification for minimum tax rely broadly on evidence that tax incentives may not be very effective
- But: effect may be highly context dependent
- Studying the effect of different systems for taxing foreign source income on MNE's investment patterns / development outcomes
- Studying the effect of different degrees of subnational corporate tax autonomy on the distribution of investment (and other relevant indicators) in subnational units
- Potentially: Qualitative approaches, focused on sector or firm case studies

Effect of different systems for taxing foreign income

- Minimum tax as highest step on a ladder of different systems
- Buettner and Holzmann (2019) / Matheson, Perry, Veung (2014): After a switch to a territorial regime, FDI becomes more sensitive to statutory tax rates of host countries
- Azémar and Delios (2008) / Azémar and Dharmapala (2018): Investment is sensitive to tax sparing clauses
- Problems:
 - Effect of global minimum tax might be qualitatively different, especially if adoption by wide range of countries
 - Studies do not focus on impact on aggregate investment into developing countries



Subnational tax competition

- Buettner and Poehnlein 2022 (Germany): Introduction of the minimum rate had little effects on the rate of jurisdiction adjacent to those that had to increase their rate
- Blöchliger and Pinero Campos (2011): Less inter-regional differences in tax raising capacity in countries with more sub-central fiscal autonomy (observation only based on correlation, result should be treated with caution)
- Competition within a jurisdiction may be qualitatively different, e.g. because of fiscal equalization schemes

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Thank you!

Questions? Comments?

f.heimuller@law.leidenuniv.nl

Twitter: @heimuellerf
<https://globtaxgov.weblog.leidenuniv.nl/>



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