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

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

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

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GLOBTAXGOV
A NEW MODEL OF GLOBAL GOVERNANCE IN INTERNATIONAL TAX LAW MAKING

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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

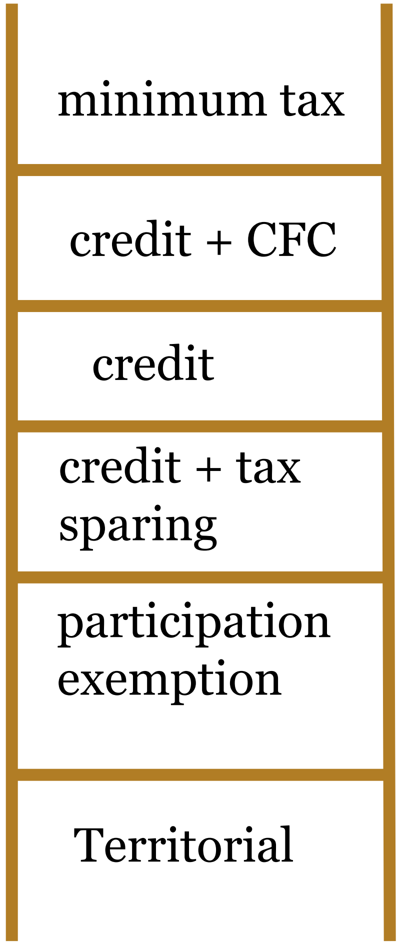
- Yoram Margalioth (2003): “Transfers from rich to poor countries further benefit by imposing limitations on rich countries' abilities to engage in tax competition with poor countries. […] For example, Ireland would be required to raise its current corporate tax rate of 12.5% in order to decrease the 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?

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