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Taxing Multinationals: The GloBE Proposal for a Global Minimum Tax

By Lorraine Eden[*]

Abstract: The 135 member countries in the OECD/G20 Inclusive Framework on BEPS are considering the adoption of a global minimum corporate income tax for taxing multinationals as part of the Pillar Two (GloBE) proposals for taxing the digital economy. This article provides a detailed analysis of the global minimum tax proposal, discusses its benefits and costs, and provides policy recommendations.

I. INTRODUCTION

Taxing the digital economy was first on the OECD's list of 15 Base Erosion and Profit Shifting (BEPS) Action Items but was put aside and addressed last due to its complexity. The issue finally moved to the forefront in January 2019 with a *Policy Note,*[1] which opened the flood gates to an outpouring of tax and transfer pricing policy proposals throughout 2019. The most recent of these proposals is the OECD's November 2019 *Global Anti-Base Erosion Proposal ("GloBE"),* also known as "Pillar Two."[2] The GloBE proposal recommends two new taxes on the profits of multinational enterprises (MNEs) should be adopted by the 135 member countries of the OECD/G20 Inclusive Framework on BEPS.[3] The first is a global minimum tax on corporate profits, the second a tax on base eroding payments. In this article, I review the first GloBE proposed tax, the global minimum tax on MNE profits, which I refer to for simplicity as the "GMinTX."

I start with a brief history of the GloBE/Pillar Two proposal. I next explore the GMinTX using two simple models. The first is a base-case model of the taxes that would be paid by an MNE with foreign affiliates located in three different host countries, under current source and residence tax rules. The second imposes a simple model of a GMinTX and assesses its effects, assuming the current residence and source rules remain in place. Both situations (without and with a GMinTX) allow for worldwide or territorial taxation by the residence country. The models have some interesting and clear implications for how a GMinTX can be designed to work within the existing international tax rules. I also assess the need for, and benefits and costs of, a GMinTX. Lastly, I provide a list of policy recommendations, drawn from the models, for the OECD and the Members of the Inclusive Framework should they decide to move forward with the introduction of a GMinTX.

II. A BRIEF HISTORY OF THE PILLAR TWO (GLOBE) PROPOSAL

The *Policy Note* released by the OECD on January 30, 2019 focused on two proposals or "pillars" for handling taxation of the digital economy: Pillar One on the allocation of tax rights among jurisdictions and Pillar Two on remaining BEPS (base erosion and profit shifting) issues.[4] The *Public Consultation Document* released on February 13, 2019 issued spe-

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[1] OECD, *Addressing the Tax Challenges of the Digitalisation of the Economy — Policy Note: As approved by the Inclusive Framework on BEPS on 23 January 2019.* OECD/G20 Base Erosion and Profit Shifting Project (Paris: OECD 2019).

[2] OECD, Public Consultation Document, *Global Anti-Base Erosion Proposal ("GloBE") — Pillar Two* (8 Nov.-2 Dec. 2019) (Paris: OECD 2019).

[3] OECD, *Members of the OECD/G20 Inclusive Framework on BEPS* (Paris: OECD 2019) (updated Oct. 2019).

[4] OECD, *Addressing the Tax Challenges of the Digitalisation of the Economy — Policy Note: As approved by the Inclusive Framework on BEPS on 23 January 2019.* OECD/G20 Base Erosion and

cific proposals for both Pillars, with Pillar Two split into two proposals: an income inclusion rule and a tax on base eroding payments.[5]

The most detailed outline of Pillar Two is provided in the May 31, 2019 *Programme of Work.*[6] The *Programme of Work* starts with the clarification that, under Pillar Two, each jurisdiction would be free to choose its own tax system and rates but that other jurisdictions would have the right to apply additional tax rules if the source jurisdiction taxed that income below some minimum rate. The Members of the Inclusive Framework agreed to a *Programme of Work,* referred to as the Global Anti-Base Erosion (GloBE) proposal.[7]

The GloBE proposal is focused on designing two interrelated rules: an income inclusion rule and a tax on base eroding payments. The core components of each rule are explained below (all paragraph references are to the *Programme of Work*).

1. **Income inclusion rule (¶¶56–59)**: The income of a foreign branch or a controlled entity would be taxed if that income were subject to tax at an effective rate that was below a minimum rate. The income inclusion rule would operate as a minimum tax where shareholders in a corporation would be required to bring into account a proportionate share of the income of the corporation if the income had not been subject to an effective tax rate above a minimum rate. The income inclusion rule could be in addition to a jurisdiction's controlled foreign corporation (CFC) rules. The income inclusion rule would involve three issues:

    a. **Top up to a minimum CIT rate (¶¶61–62)**: The income inclusion rule would establish a minimum (floor) on tax rates; if the source jurisdiction were lower than the minimum the income inclusion rule to act as a top-up to achieve the minimum rate. The goal would be ensure that the MNE would be subject to tax on its global income at the minimum rate regardless of where it was headquartered. Moreover, if the income benefitted from a harmful preferential tax regime, an exception could be made whereby that income would be taxed at the higher of the minimum rate or the full domestic rate.

    b. **Fixed percentage (¶¶64–67)**: The recommended approach would be a (to be determined) fixed percentage tax rate or range of rates rather than a percentage of the residence jurisdiction's CIT rate, both for simplicity and to avoid variations in the minimum rate across jurisdictions.

    c. **Simplications (¶¶68–71)**: Where possible, simplications would be used to improve compliance, administrability, transparency, and coordination across jurisdictions. Examples could include:

        i. **Accounting rules for measuring the tax base (¶¶68–71)**: In principle, the residence jurisdiction's rules for determining the income of a foreign subsidiary under either CFC rules or domestic tax rules would be used to determine whether the source jurisdiction's rate was above or below the minimum tax rate. Issues such as the appropriate accounting method (GAAP, IFRS), treatment of carryforward losses, timing of recognition of income and expenses, translation of foreign exchange losses, and so on, would need to be taken into account.

        ii. **Switch-over rule (¶72)**: In order for the income inclusion rule to apply to foreign branches (permanent establishments (PEs)) as well as foreign subsidiaries, a switch-over rule would be needed to turn off the exemption benefit for income of a branch and replace the exemption with a foreign tax credit. To accomplish this, double tax treaties would need modification to add a switch-over rule permitting a residence jurisdiction to switch from tax exemption to a foreign tax credit method where profits attributable to a PE or derived from immovable property not part of the PE were subject to tax below some minimum rate.

2. **Tax on base eroding payments (¶¶73–77)**: Complementing the income inclusion rule would be a tax on base eroding payments that would enable a source jurisdiction to protect itself from base erosion. The tax on base eroding payments would have two parts: undertaxed payments and a subject-to-tax rule.

    a. **Undertaxed payments rule (¶¶73–74)**: Either a tax deduction would be denied or taxation at source (including withholding tax), together with any necessary changes in double tax treaties, would be imposed on payments made to a related party unless the payments were subject to tax at or above a minimum rate.

    b. **Subject-to-tax rule (¶73, ¶¶75–77)**: The undertaxed payments rule would be accompanied

Profit Shifting Project (Paris: OECD 2019).

For my November 2019 Commentary on the OECD Pillar One proposals, see Eden and Treidler, *Taxing the Digital Economy: Pillar One Is Not BEPS 2,* 48 Tax Mgmt. Int'l J. 603 (Dec. 13, 2019).

[5] OECD, *Corporate Tax Statistics, First Edition* (Paris: OECD 2019).

[6] OECD, *Programme of Work to Develop a Consensus Solution to the Tax Challenges Arising from the Digitalization of the Economy,* OECD/G20 Inclusive Framework on BEPS (Paris: OECD 2019).

[7] *Id.*

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by a subject-to-tax rule that could deny eligibility for certain treaty benefits, and subject the payment to withholding or other taxes at source, in situations where the payment was not subject to tax at a minimum rate. Priority would be given to interest and royalty payments, and possible revisions to Articles 7, 9–13 and 21 of the OECD Model Tax Convention.

Lastly, the work program for Pillar Two was tasked with exploring coordination, simplification, thresholds, and compatibility with international obligations, specifically, coordination among the new rules, thresholds and care-outs, and compatibility with international tax treaties and other obligations.

On November 8, 2019, the OECD released a *Public Consultation Document,* which in the ''Background'' to the document, stated that it would welcome comments by 2 December 2019 on ''all aspects of the Programme of Work on Pillar Two.''[8] Stakeholders, however, were specifically requested to address three technical design aspects of the first GloBE proposal — the income inclusion rule.[9] None of the specified questions are directed to the second GloBE proposal — the tax on base eroding payments. The document suggests that more work is needed by the Inclusive Framework before sufficient consensus is reached to warrant another public consultation ''at a future point in time.''[10] Any discussion of the minimum tax rate was also deferred until after ''key design elements of the proposal are fully developed.''[11]

The bulk of the *Public Consultation Document* is directed at three specific questions with respect to the income inclusion rule:[12]

1. **Tax base determination (Chapter 2)**: Using financial accounts as a starting point for determining the tax base, as well as different mechanisms to address timing differences;

2. **Blending (Chapter 3)**: The extent to which multinational enterprises (MNEs) can combine high-tax and low-tax income from different sources in determining an effective (blended) tax rate; and

3. **Carve-outs (Chapter 4)**: Stakeholders' experience with and views on any carve-outs and thresholds that should be considered as part of the GloBE proposal.

Each of the three chapters repeats and develops the earlier *Programme of Work*[13] arguments on the income inclusion rule of the GloBE proposal and asks a series of detailed implementation questions that are primarily financial accounting in nature. A few accounting examples are presented in Annex A. Annex B simply reproduces the Pillar Two section of the *Programme of Work.*

I now turn to my analysis of the GloBE proposal by the OECD.[14] For simplicity, in my analysis I refer to the ''income inclusion rule,'' the second component of the Pillar Two proposal, as *GMinTX* — a Global Minimum Tax Rate (the income inclusion rule). My comments are restricted to GMinTX, given that all the OECD questions are directed to this topic. I intend to review the second component of Pillar Two — a tax on base eroding payments — at a later date.

III. MODELING A GLOBAL MINIMUM EFFECTIVE TAX RATE (GMinTX)

I start by reviewing the current international tax system where almost all residence countries exempt their MNEs' foreign-source income from further taxation. I then turn to an analysis of the GMinTX proposal for taxing MNE worldwide profits, comparing GMinTX with the current international tax system.

A. Current International Tax System

The current international tax system allocates different types of income to either the residence country (where the owner resides), the source country (where the income is earned) or both jurisdictions. In terms of corporate profits, both source and residence countries have the right to tax MNE profits. The source (host) country is given ''first crack'' at taxing MNE profits where earned. The residence country then chooses whether to top up the foreign tax with its own tax (i.e., worldwide taxation) or exempt the foreign-source income (FSI) from further taxation (i.e., territorial taxation). If the residence country taxes the MNE's profits on a worldwide basis, the country must provide ''tax room'' for the source country to avoid double taxation of MNE profits. Normally, a foreign tax credit (FTC) is given for the foreign CIT and any withholding taxes up to the level of the residence country's CIT rate. Foreign subsidiaries are treated as separate entities (stand-alone legal entities) in the host country and separate accounting is used to determine their CIT payments. Foreign branches may also be treated as de facto separate entities if they meet the permanent establishment test.

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[8] OECD, Public Consultation Document, *Global Anti-Base Erosion Proposal (''GloBE'') — Pillar Two* (8 Nov.-2 Dec. 2019) (Paris: OECD 2019).

[9] *Id.,* ¶11.

[10] *Id.*

[11] *Id.,* ¶9.

[12] OECD, Public Consultation Document, *Global Anti-Base Erosion Proposal (''GloBE'') — Pillar Two* (8 Nov.-2 Dec. 2019) (Paris: OECD 2019).

[13] OECD, *Programme of Work to Develop a Consensus Solution to the Tax Challenges Arising from the Digitalization of the Economy,* OECD/G20 Inclusive Framework on BEPS (Paris: OECD 2019).

[14] OECD, Public Consultation Document, *Global Anti-Base Erosion Proposal (''GloBE'') — Pillar Two* (8 Nov.-2 Dec. 2019) (Paris: OECD 2019).

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In an earlier article,[15] I provided a simple example illustrating the differences between worldwide and territorial taxation. I update and summarize those arguments here as they are useful for understanding the effects of a global minimum tax (the GMinTX proposal). See Figure 1 and Table 1.

[15] Eden, L., *The Arm's-Length Standard Is Not the Problem,* 48 Tax Mgmt. Int'l J. 499 (Oct. 11, 2019).

Figure 1: Worldwide Taxation with First Crack and the Umbrella Effect

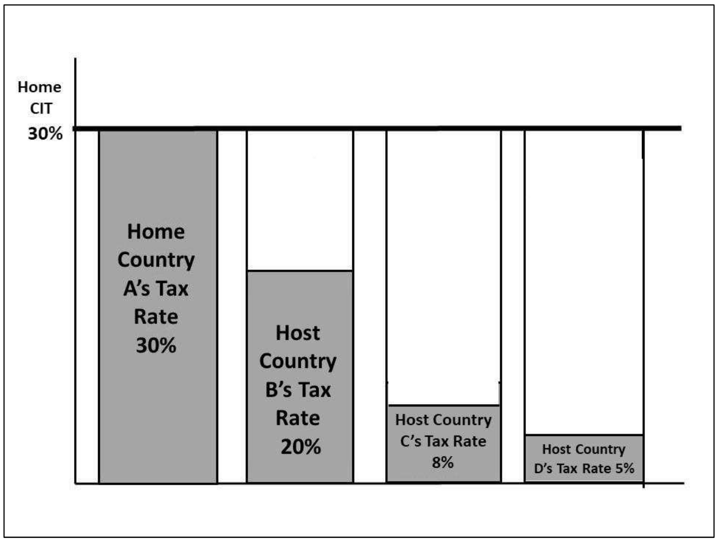

Table 1: Effective Tax Rates on Foreign Source Income when Home Tax Rate t^A = 30%

		Worldwide Taxation		Territorial Taxation	
Host Country	Effective Tax Rate in Host Country	Additional Home Tax on FSI	Effective Worldwide CIT Rate	Additional Home Tax on FSI	Effective Worldwide CIT Rate
B	$t^B + w^B (1 - t^B)$ = 20%	t^A - [$t^B + w^B (1 - t^B)$] = 10%	30%	Zero	20%
C	$t^C + w^C (1 - t^C)$ = 8%	t^A - [$t^C + w^C (1 - t^C)$] = 12%	30%	Zero	8%
D	$t^D + w^D (1 - t^D)$ = 5%	t^A - [$t^D + w^D (1 - t^D)$] = 25%	30%	zero	5%

Worldwide Taxation: Assume country A (the residence country) has a 30% CIT rate. An MNE resident in country A has foreign subsidiaries in countries B, C, and D where the effective CIT rates (inclusive of withholding taxes) are 20%, 8%, and 5%, respectively.[16]

Each foreign subsidiary first pays a foreign CIT on its pre-tax income earned in the source country. The affiliate is then deemed to distribute the full amount of foreign pre-tax earnings to its MNE parent in country A. Country A taxes the grossed-up FSI on a worldwide basis annually (no deferral), and then provides tax room to the source countries through an FTC up to A's CIT rate. As a result, the foreign subsidiaries in B, C and D pay the same 30% overall CIT rate regardless of where they are located.[17]

In effect, country A provides a ''tax ceiling'' for its host country partners, enabling the source jurisdictions — without any cost to themselves in terms of deterring inward foreign direct investment (FDI) or loss of employment — to raise their effective tax rates up to the creditable level in the home country. If a host country raises its effective CIT rate above country A's CIT rate, however, no additional room is provided. Thus, the tax incentive for source countries is to cluster their effective CIT rates just below (no higher than) the creditable level in the residence country. I call this the ''umbrella effect'' of worldwide taxation, that is, smaller host countries can cluster their tax rates without fear of negative repercussions

[16] That is, if t^S is the source country's CIT rate and w^S is the source country's withholding tax rate on dividends remitted to the MNE parent firm, the effective CIT rate in the source country is $t^S + w^S (1 - t^S)$.

[17] The results are slightly different depending on whether the foreign subsidiary repatriates its FSI to the home country (triggering a withholding tax) or reinvests its earnings in the host country (so there is no withholding tax). I have ignored that difference here and simply refer to the ''effective CIT rate.''

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on FDI inflows or employment under the umbrella of their key residence country's CIT rate; for example, Canada and Mexico tend to cluster their effective CIT rates below the U.S. rate.

However, suppose the key residence country lowers its CIT rate. Should that happen, closely tied source jurisdictions may now have tax rates that are above the umbrella. Should that happen, the affected source countries are likely to follow by lowering their own rates so as to stay under the umbrella. This effect can be seen in Figure 2 and Table 2 where country A's tax rate is assumed to fall from 30% to 18%. As a result, country B's tax rate at 20% is now 2% above the maximum creditable tax ceiling in country A. Both host countries C and D have worldwide effective tax rates at 18%. Country B is therefore likely to drop its own effective CIT to avoid discouraging inward FDI and keep below country A's tax umbrella.

Figure 2: Reduction in the Home Country Tax Rate

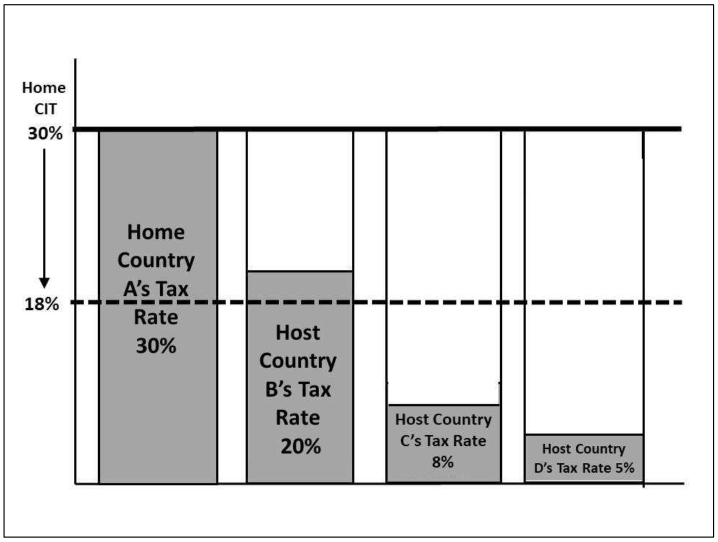

Table 2: Effective Tax Rates on Foreign Source Income when Home Tax Rate t^A = 18%

		Worldwide Taxation		Territorial Taxation	
Host Country	Effective Tax Rate in Host Country	Additional Home Tax on FSI	Effective Worldwide CIT Rate	Additional Home Tax on FSI	Effective Worldwide CIT Rate
B	$t^B + w^B (1 - t^B)$ = 20%	t^A - [$t^B + w^B (1 - t^B)$] = zero	20%	Zero	20%
C	$t^C + w^C (1 - t^C)$ = 8%	t^A - [$t^C + w^C (1 - t^C)$] = 10%	18%	Zero	8%
D	$t^D + w^D (1 - t^D)$ = 5%	t^A - [$t^D + w^D (1 - t^D)$] = 13%	18%	zero	5%

The umbrella effect is much weaker if the residence country defers its tax on FSI until the income is repatriated (i.e., practices tax deferral). With deferral, the effective CIT rate is the source country rate as long as profits are not repatriated, and often MNEs never bring the profits home so that the near-term rate becomes the permanent one. With tax deferral, the overall effect is much closer to territorial taxation, which we discuss below.

Territorial Taxation: Under an exemption system, the residence country does not tax the foreign-source income of its MNEs and does not provide an FTC for source country taxes. Assume country A's CIT rate is 30%. Without the tax umbrella offered by country A, the three host countries B, C, and D now offer A's MNEs very different effective CIT rates. As Tables 1 and 2 show, the residence country's additional tax on FSI (and its FTCs for host country taxes) fall to zero. The tax umbrella is gone and the "fresh winds of tax competition" are launched. The effective host country tax rates are now their original rates: 20%, 8%, and 5%, respectively. Since tax rates can and do affect FDI location, competition among the three source jurisdictions to attract inward FDI from country A is likely to precipitate a CIT war, leading to the "race to the bottom."

This, of course, is one of the key arguments behind Pillar Two — the fear that source countries in their quest for inward FDI have been engaged for the past 20-30 years in "beggar thy neighbor" tax policies, offering wasteful tax preferences and setting themselves up as offshore financial centers and tax havens. In addition, tax competition among jurisdictions has encouraged abusive transfer pricing practices. The combination of detrimental tax policies and practices created a "wicked problem" that led the OECD to launch the original BEPS project in 2013. Given that all countries now follow territorial or quasi-territorial tax

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systems (including the United States) — and no countries follow a pure worldwide system — it is not surprising that these fears prompted the BEPS project. Coupled with worries over how to tax the emerging digital economy, again it is not surprising that the OECD and Members of the Inclusive Framework launched the Pillar One and Pillar Two projects.

B. The GMinTX Proposal

Let us now turn to modeling the Global Minimum Tax (GMinTX) proposal, the "income inclusion rule" that is the first prong of the Pillar One GloBE proposals. I am going to assume (and argue for) modeling the GMinTX in as close as possible to my explanation of worldwide and territorial income taxation in Figures 1-2 and Tables 1-2. Figure 3 and Table 3 therefore start from the same assumptions as the base case, that is, residence country A's CIT rate is 30% and source countries B, C, and D have 20%, 8%, and 5% effective tax rates, respectively.

Figure 3: The Global Minimum Tax Rate (GMinTX) Proposal

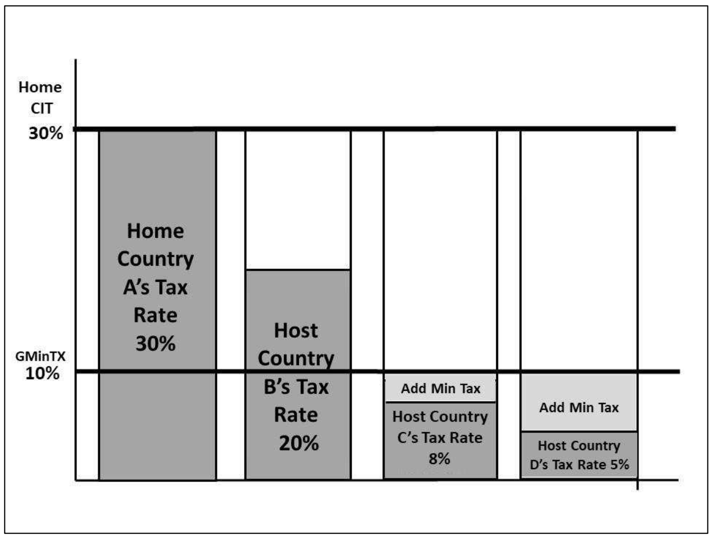

Table 3: Effective Tax Rates on Foreign Source Income when Home Tax Rate t^A = 30% and GMinTX = 10%

		Worldwide Taxation			Territorial Taxation		
Host Country	Effective Tax Rate in Host Country	Add Min Tax	Additional Home Tax on FSI	Effective Worldwide CIT Rate	Add Min Tax	Additional Home Tax on FSI	Effective Worldwide CIT Rate
B	$t^B + w^B (1 - t^B)$ = 20%	Zero	t^A - [$t^B + w^B (1 - t^B)$] = 10%	30%	Zero	Zero	20% + 0% = 20%
C	$t^C + w^C (1 - t^C)$ = 8%	2%	t^A - [$t^{CMIN} + w^C (1 - t^C)$] = 20%	30%	2%	Zero	8% + 2 % = 10%
D	$t^D + w^D (1 - t^D)$ = 5%	5%	t^A - [$t^{DMIN} + w^{DMIN} (1 - t^{DMIN})$] = 20%	30%	5%	zero	5% + 5% = 10%

Assume that the OECD and Members of the Inclusive Framework have decided to set the global minimum effective tax rate (GMinTX) at a fixed rate of 10%, which is below the 15.75% average CIT across the four jurisdictions but above the effective CIT rates in countries C and D. Source countries C and D therefore face a possible minimum CIT levied by residence country A. Assume that country A does levy the GMinTX so an additional tax on FSI of 2% is levied on country C and 5% in country D, bringing their effective CIT rates up to the GMinTX of 10%.

What happens next depends on whether country A follows the worldwide or territorial tax principles. Assume initially that country A taxes FSI on a worldwide basis and provides an FTC up to its own CIT rate. As Table 3 shows, FSI earned in country B faces a 10% additional tax, given B's 20% effective CIT rate. However, the additional residential CIT rate due on FSI earned in countries C and D has changed. It should be calculated as the gap between country A's CIT rate and the GMinTX. The effective worldwide tax rate on all three source countries is 30% (the home country rate); that is, they all now have the same effective CIT rate due to the umbrella effect.[18]

The two low-taxed jurisdictions (C and D) now face two separate taxes levied by the home country — first, the top-up to the GMinTX; and second, the additional tax on FSI equal to the gap between the resi-

[18] For a somewhat similar example, see Shay, S.E., Fleming, J.C., and Peroni, R.J., *Designing a 21st Century Corporate Tax — An Advance U.S. Minimum Tax on Foreign Income and Other Measures to Protect the Base,* Fla. Tax Rev. 17.9 (2015), 669-723: 707.

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dence country's tax rate and the GMinTX. Given that their overall worldwide tax rate will be 30% (the home country rate) regardless of their own CIT rates, both jurisdictions have a "first crack" incentive to raise their own tax rates — first, to the GMinTX; and second, up to the home country tax rate. The GMinTX therefore acts a new form of the "first crack" principle, encouraging host countries to set their rates at the GMinTX rate without fear of deterring inward FDI.

The situation is different if country A follows the territorial approach and does not tax FSI, nor provide an FTC for source taxes. As Table 3 shows, the top-ups to the GMinTX in countries C and D are the only additional taxes due in residence country A. The gap in effective tax rates across the three source jurisdictions has been reduced to 10% (the gap between B's 20% tax rate and the GMinTX) but not eliminated.

IV. BENEFITS AND COSTS OF A GLOBAL MINIMUM TAX ON MNE PROFITS

My analysis has several clear implications for a GMinTX, first in terms of whether or not it is needed, and second, if a GMinTX were to be adopted how it should be designed. I look first at the need for a GMinTX and its potential benefits and costs in this section. I turn to policy recommendations in the next section.

Recommending a global minimum CIT appears to be a marked change in policy direction from the OECD's 2013 *Action Plan on Base Erosion and Profit Shifting,*[19] which argued that "No or low taxation is not *per se* a cause of concern, but it becomes so when it is associated with practices that artificially segregate taxable income from the activities that generate it."[20] Why has the OECD apparently moved to stamp out no- and very-low-tax jurisdictions, taking away countries' sovereign right to set whatever CIT rate (including a zero rate) they wish?

Paragraph 54 of the *Programme of Work*[21] explains that the motivation behind the Pillar Two (GloBE) proposals is the need for coordinated multilateral action by tax authorities to "stop a harmful race to the bottom" on corporate income tax (CIT) rates by ensuring that MNE profits are subject to a minimum rate of tax on a worldwide basis.

Building on the arguments in the OECD *Programme of Work,*[22] a worldwide minimum CIT can be justified on at least two grounds. First, as long as there are jurisdictions where MNE profits are subject to zero or low CIT rates (e.g., tax havens and offshore financial centers), there will be incentives for MNEs to engage in BEPS activities. The BEPS Action Items, even when fully implemented, can reduce but not completely offset this problem as long as individual tax authorities can exercise their sovereignty and create "no-tax/low-tax islands." Thus, the loss of some national sovereignty, by restricting the minimum CIT rate that a jurisdiction can levy, is seen as a lower price to pay than coping with the negative externalities imposed on other jurisdictions by "tax renegade states."[23]

Second, the desire of developing country governments to attract inward foreign direct investment (FDI) has generated, in effect, "beauty contests" where jurisdictions compete for FDI by offering more and more generous fiscal and financial incentives. Such "tax preference races" should ultimately be self-defeating. They are examples of the Prisoner's Dilemma problem whereby the defection of one player (lowering its tax rate) causes others to follow (lowering their rates) and everyone ends up worse off than before (except the MNE, which benefits from paying less worldwide taxes). A global anti-base erosion (GloBE) initiative could lessen the incentive for tax jurisdictions to engage in such tax competitive races.

Empirical evidence for these theoretical arguments is not presented in the OECD's Pillar One or Two documents. However, some evidence can be found in the new OECD *Corporate Tax Statistics,* which provides data on statutory and effective CIT rates for 94 countries over the 2000–2018 time period. The report shows a drop in the average statutory CIT rate from 28.6% in 2000 to 21.4% in 2018.[24] Comparing 2000 with 2018, 76 countries had lower CIT rates, 12 the same rate, and 6 had higher rates. Fifty-eight countries had statutory CIT rates of at least 30% in 2000; whereas only 18 did in 2018. Thus, statutory CIT rates have clearly fallen over the period.

A second set of evidence is provided in a 2019 *World Investment Report*[25] from the United Nations Conference on Trade and Development (UNCTAD), which argues that increasing competition for FDI is the reason for the worldwide boom in special economic zones. UNCTAD reports that in 2018 there were 5,400 zones (and another 500 in the planning stages), up from 4,300 zones in 2014 and 3,000 zones in 2002. Special economic zones provide fiscal and regulatory incentives and infrastructure support with the goal of attracting high-value-added FDI. However, the race to provide fiscal and financial incentives can backfire if all countries are offering the same sets of incentives.

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[19] Paris: OECD 2013.

[20] *Id.,* at 10.

[21] OECD, *Programme of Work to Develop a Consensus Solution to the Tax Challenges Arising from the Digitalization of the Economy.* OECD/G20 Inclusive Framework on BEPS (Paris: OECD 2019).

[22] *Id.*

[23] Eden, L., *Taxing Multinationals: Transfer Pricing and Corporate Income Taxation in North America* (Toronto: Univ. of Toronto Press 1998); Eden, L., and Kudrle, R.T., *Tax Havens: Renegade States in the International Tax Regime?* Law and Policy, 27.1 (Jan. 2005): 100-127.

[24] OECD, *Corporate Tax Statistics, First Edition* (Paris: OECD 2019): 8.

[25] UNCTAD, *World Investment Report 2019: Special Economic Zones* (Geneva: U.N. 2019), p. 129.

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A third piece of evidence as to whether a GMinTX is needed or not can be gleaned by comparing the three Figures and Tables in this Commentary. Today, most MNEs remain headquartered in OECD countries, which typically exempt their MNEs' foreign-source income from taxation and provide no "tax umbrella" for source country taxation. As a result, source countries (particularly developing countries) are much more likely to engage in tax competition, lowering their own tax rates in an (often futile) attempt to attract inward FDI. The potential benefits of a global minimum effective tax rate (GMinTX) designed along the lines I have outlined above, thus, also provide some additional support for the adoption of a GMinTX.

Below, I summarize the key insights that can be gleaned from my figures and tables. I also refer readers to the GloBE benefits discussion in Englisch and Becker (2019), which reviews the potential benefits and costs of a worldwide minimum CIT.

1. If the key residence countries (those home to the bulk of the world's MNEs) (i) have CIT rates above the GMinTX and (ii) tax FSI on an annual worldwide basis (no deferral), there is no need for a GMinTX. Host tax jurisdictions are sheltered by the home country "tax umbrella" and pay taxes at the residence country rate. Thus, the first best solution is *not* the adoption of a GMinTX but rather that key residence countries move back to worldwide income taxation on an annual basis with no tax deferral.[26]

2. In the situation where a key residence jurisdiction either (i) follows the worldwide tax principle but has a CIT rate below the GMinTX (e.g., is a tax haven) or offers tax deferral until the FSI is repatriated, or (ii) follows the territorial tax principle and does not tax FSI, differences in effective CIT rates across jurisdictions will remain. In these situations, a GMinTX — even under territorial taxation — reduces the differential in effective tax rates across jurisdictions.

3. Moreover, the reduced tax differential across jurisdictions due to the GMinTX has several *potential benefits*:

a. The incentives for MNEs to (i) locate new investments and relocate old investments into low-tax jurisdictions and (ii) engage in transfer price manipulation designed to shift income out of high-tax and into low-tax jurisdictions are reduced. The reduced incentives should in both cases encourage more efficient capital allocation across countries.

b. The incentive for governments to lower their tax rates to attract inward FDI are reduced; thus, less tax competition should occur.

c. Developing countries and tax havens can raise their tax rates up to the GMinTX without fear of discouraging inward FDI, providing a new form of "first crack" principle. The original "first crack" principle encouraged source countries to set their CIT rates just below the residence country CIT rate (ceiling). This new form of the "first crack" principle is less generous but still functioning: it encourages source countries to tax up to the GMinTX (floor).

4. However, there are also *potential costs* involved in adopting a GMinTX.

a. The first cost is some loss of sovereignty at the national level since there is now a global lower bound on CIT rates applicable to all jurisdictions.

b. If the source country is unable or unwilling to either establish a CIT (if its rate is currently zero) or raise its CIT rate to the GMinTX, the additional tax proceeds are captured by the residence country of the foreign MNE. Thus, the benefits to the source country from GMinTX are not realized.

c. Moreover, if the GMinTX is set inappropriately or incorrectly or can be manipulated, there can be efficiency and distributional losses.

In sum, there is some evidence for the establishment of a global minimum effective tax rate. It is not a first best solution but may provide a useful and necessary backstop if countries continue to exempt foreign-source income from taxation.

IV. POLICY RECOMMENDATIONS

If the decision of the OECD and Members of the Unified Approach is to implement a global minimum effective tax rate (GMinTX), I make the following recommendations, adapting the information from Figures 1-3 and Tables 1-3:[27]

1. The GMinTX Rate

a. The GMinTX rate should be *a fixed percent* of a tax base (such as EBIT). The percent should be *sufficiently low that most countries (90% or*

[26] *See also* Eden, L., *The Arm's Length Standard: Making It Work in a 21st Century World of Multinationals and Nation States. In* T. Pogge and K. Mehta, editors. *Global Tax Fairness* (Oxford Univ. Press: Oxford, U.K. 2016), pp. 153–172; Eden, L., *The Arm's-Length Standard Is Not the Problem,* 48 Tax Mgmt. Int'l J. 499 (Oct. 11, 2019).

[27] See also Shay, S.E., Fleming, J.C., and Peroni, R.J., *Designing a 21st Century Corporate Tax — An Advance U.S. Minimum Tax on Foreign Income and Other Measures to Protect the Base,* Fla. Tax Rev. 17.9 (2015), for somewhat similar proposals.

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more) would have an average effective tax rate above the GMinTX.

b. The GMinTX rate should be fixed with *no exception given for entities with "substance."* This is to discourage both MNEs and tax authorities from "gaming" the substance rules so as to escape from the GMinTX. For example, an MNE should not be encouraged to re-domicile by creating an offshore principal center in a jurisdiction that has substance rules but a very low effective tax rate.

2. Calculation of the Source Country Effective Tax Rate

a. The effective tax rate on the foreign source income (FSI) of each MNE resident in country A should be determined on a *per-country basis* for each of the host countries where the MNE has one or more foreign subsidiaries.

b. Because foreign subsidiaries are separate legal entities from their MNE parent firm, they are required to maintain separate books and records in the host jurisdiction and to track host-country taxes by income category. It should therefore be possible to *calculate an effective tax rate on the FSI by foreign subsidiary and by host country.*

c. *A presumption should be made in favor of IFRS* as the appropriate accounting standard except in situations where all of the MNE's affiliates and the parent firm are using GAAP and switching to IFRS would create substantial additional financial and administrative costs.

d. *Foreign subsidiaries and branches (permanent establishments) should be treated similarly* in terms of calculating their effective host country tax rates.

e. For each MNE resident in country A, the *simple average of all of its foreign affiliates' effective tax rates on a per-country basis* should be used as the average effective tax rate on the MNE's FSI earned in a particular host country.

3. Determination of the Top-Up to the GMinTX

a. For each MNE resident in country A, *the average effective per-country tax rate should then be compared with the GMinTX* to determine whether a top-up to the GMinTX is required or not for that MNE in that host country. For example, based on the numbers in Figure 3 and Table 3, if the average effective tax rate for the MNE's foreign affiliates in host country C is 8%, a top-up of 2% is needed to bring the average effective tax rate up to the GMinTX. For country D, the necessary top-up is 5%. In each case, the foreign affiliates on a per-country basis should be treated as distributing the portion of their earnings that would yield a residual residence-based tax equal to the GMinTX.

b. Source jurisdictions, particularly developing countries, should be encouraged to take advantage of the "*first crack" principle* created by the GMinTX and set their effective CIT rates at least equal to the GMinTX rate. If a global floor for taxing MNEs is adopted by all 135 member countries of the Inclusive Framework, with policing to discourage defectors, the additional tax revenues should prove an attractive revenue source, even for zero-rate tax havens and offshore conduit jurisdictions.

c. For MNEs with *multi-tiered participation structures,* the question of which country is the appropriate residence country for purposes of determining the top-up to the GMinTX must be addressed. The method selected should minimize opportunities for "gaming" by the MNE. Englisch and Becker,[28] for example, recommend a "top-down priority rule."

4. Determination of Additional Residence Country Taxes

a. After the top-up to the GMinTX is paid to country A, these FSI earnings and taxes would be treated as having been taxed and could be repatriated to the US at the GMinTX. If the FSI is repatriated to country A and country A taxes on a worldwide basis, an additional tax would be due equal to the difference between A's tax rate and the GMinTx. If country A taxes on a worldwide basis with tax deferral, as long as the FSI is held offshore no additional tax would be due in country A until the FSI is repatriated. If country A taxes on a territorial basis, no further tax in country A would be due. The effective additional tax in country A on the FSI of its MNEs would therefore be calculated very similarly to the current rules, with *the exception that the GMinTX is calculated and paid first and then used as the host country effective tax rate.*

V. CONCLUSIONS

The OECD and Members of the Inclusive Framework have proposed a novel way to reduce the oppor-

[28] Englisch, J., and Becker, J., *International Effective Minimum Taxation — the GLOBE Proposal.* World Tax J. 11.4. (2019).

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tunity for MNEs to shift profits to ''no tax'' jurisdictions. The method — creating a global minimum effective corporate income tax (GMinTX) — should also discourage tax competition for inward FDI among these jurisdictions. In this Commentary, I have explored a basic GMinTX and showed how it could be integrated into the existing international source and residence based rules.

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