

Global Minimum Corporate Tax: A Blow to Tax Competition & Its Implications on The Indian Sovereign

by

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Abstract

Race to the bottom prompts governments to reduce the tax burden in order to attract investments, which gives birth to low tax jurisdictions or no tax jurisdictions. Global minimum tax aims to put an end to undercutting of taxes and the subsequent tax competition. The paper aims at understanding the impact and implementation of the new global tax regime within India. The findings of this paper indicate that the overarching impact is positive but the implementation and incorporation is difficult but certainly possible. This is a revolutionary step and will surely leave its mark on the world.

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INTRODUCTION

India has a significant stake in the ongoing discourse at the International platform regarding reaching a consensus-based solution to curb the decades old race to the bottom. The primary reason for this is that India is presently a developing economy, by reason of which it is highly dependent on taxes as a source of the revenue budget. This means that India needs its taxes and as much as it can procure of it. However, the said race to the bottom prompts governments to reduce the tax burden in order to attract investments, which gives birth to low tax jurisdictions, tax havens, and tax treaty heavens. This allows MNC's and other large firms to engage in fruitful tax planning and shift their profits to such low tax or no tax jurisdictions and keep a good sum of their taxable profits to themselves. A major consequence of this is that often "countries will attempt to undercut one another in tax burdens"¹, to attract foreign investment. This can lead down to a downward spiral in taxes across economies, "Corporate tax rates have indeed fallen globally from an average of around 50 percent in 1975 to an average below 30 percent in 2005"² and over the period of time "countries have shifted to a tax rate below 30%. In 2020 the average corporate tax rate measured across 177 jurisdictions is 23.85%".³ Cutting down tax rates is causing governments to loose out on major revenues because according to OCED, "Taxes paid by companies remain a key source of government revenues, especially in developing countries"⁴. Now, to curb this trend of downward spiral, the concept of global minimum corporate tax (hereinafter referred to as GMCT) has been introduced. This paper through its research aims at studying the GMCT concept corresponding to its consequence and execution with respect to the Indian sovereign by focusing on fundamental questions such as - What is GMCT? Why is GMCT required? And lastly how will GMCT be implemented?

THE AMERICAN PROPOSAL: WHAT'S? AND WHY'S? OF THE GMCT

The negotiation on GMCT has been ignited by the US and is been administered by the OECD (organisation for economic cooperation and development) as a part of its scheme to tackle base erosion and profit shifting of domestic taxes by multinational corporations. "On the 5th of April 2021, the US Secretary of Treasury Janet L. Yellen announced that the US was in talks with G20 to bring

¹ Thomas Rixen, 'Tax Competition And Inequality - The Case For Global Tax Governance' [2010] SSRN Electronic Journal <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1488066> accessed 16 October 2021.

² Ibid

³ Moryani P, 'The Case For Minimum Taxation' <<https://www.taxmann.com/research/search?search-Data=global%20minimum%20tax>> accessed 31 October 2021

⁴ Corporate Tax Remains A Key Revenue Source, Despite Falling Rates Worldwide - OECD' (*Oecd.org*, 2021) <<https://www.oecd.org/tax/corporate-tax-remains-a-key-revenue-source-despite-falling-rates-worldwide.htm>> accessed 31 October 2021.

out a global minimum corporate tax rate”⁵. There were several concerns regarding its success, however, US won the first round of battle because as of 8th October 2021, 136 nations out of 140 have backed the initiative led by US and are willing to reach a consensus rate on GMCT. The main reason for proposing a GMCT was to put an end to the race to the bottom, which is a ramification of tax competition and to prevent multinationals from engaging in low tax or no tax jurisdiction shopping. “Biden said that, this accord would ensure that profitable corporations pay their fair share, and provide governments with the resources to invest in their workers and economies.”⁶. Apart from the general good that GMCT is going to bring, US has a special incentive to push for GMCT along with its top up tax application because “in 2008 there was a report by the US Government Accountability Office wherein it was noted that 83 out of 100 of the US's biggest MNCs had subsidiaries in tax havens”⁷. This will allow US to recover the taxes it has been losing to tax havens for all these years. Now, the current consented minimum rate is 15%, so while countries as being sovereign in the eyes of the international law can choose whichever rate they want to domestically, a minimum of 15% of multinationals taxable income will have to be paid by them. Now, how will this 15% minimum tax be imposed and applied ? Will be discussed in the section hereinafter.

THE BLUEPRINT: HOW WILL GMCT BE IMPLEMENTED?

There are four rules which will be governing the application of the said GMCT. The rules have been covered quite extensively by the blueprint taking in accordance all the complexities that can hinder the fair application of the GMCT. However, This paper will only be discussing each rule briefly so as to form an understanding regarding GMCT's working.

1. **Income Inclusion Rule (IIR)** : This rule targets the low tax result, irrespective of how they have been achieved. Under this, the jurisdiction in which eventual parent company is situated becomes the eventual jurisdiction to exercise taxing rights over income earned in low tax or no tax jurisdictions. This is applied by sorting out the difference between the effective tax rate of the low tax jurisdiction and the global minimum tax rate and then that difference is transferred to the eventual parent company, (AKA, top up tax). This rule applies in a top down approach, so if the jurisdiction where this eventual parent company is situated refuses to apply IIR, the same taxing

⁵ Remarks by Secretary of the Treasury Janet L. Yellen on International Priorities to The Chicago Council on Global Affairs, US Department of Treasury, April 2021 <<https://home.treasury.gov/news/press-releases/jy0101>> accessed 31 October 2021.

⁶ Corporate Tax Remains A Key Revenue Source, Despite Falling Rates Worldwide - OECD' (*Oecd.org*, 2021) <<https://www.oecd.org/tax/corporate-tax-remains-a-key-revenue-source-despite-falling-rates-worldwide.htm>> accessed 31 October 2021.

⁷ 'Corporate Tax Remains A Key Revenue Source, Despite Falling Rates Worldwide - OECD' (*Oecd.org*, 2021) <<https://www.oecd.org/tax/corporate-tax-remains-a-key-revenue-source-despite-falling-rates-worldwide.htm>> accessed 31 October 2021.

rights will be passed to owners down the chain, till the point where the owners company is situated in a jurisdiction which applies the IRR.

2. **Undertaxed Payment Rule (UTPR)** : UTPR can said to be an extension of IIR, it can be applied to make companies located within low tax or no tax jurisdictions to fall in line with the GMCT in circumstances, where IRR rule cannot be applied. There are two caps of protection, under first one the top up tax is allocated on pro-rata basis to companies who make deductible payments to the company located in a low tax jurisdiction among the group. Provided that these companies making payments are not themselves located in a low tax jurisdiction and that they have implemented the UTPR. The first cap applies only to the extent of the local tax effect. The second cap on the other hand is applicable either when the company making payments is itself located in a low tax jurisdiction or when the local tax effect has reached its cap. This applies only between companies situated in low tax jurisdiction having net intra group deductions.
3. **Switch Over Rule (SOR)** : This rule is important for the implementation of the GMCT as this allows for revision of double taxation treaties because they sort of remove the distinction between the income of the parent company and the subsidiaries so that they are not taxed in both the jurisdictions, thereby creating exemptions under the treaty. However, for the applicability of GloBE rules that distinction is necessary to identify the top up taxes.
4. **Subject To Tax Rule (STTR)** : This rule operates separately from the other three, it targets the source of the covered payments that showcase a high chance of base erosion and profit shifting taking place. This often includes inter alia royalties, insurances, brokerages and payments for agency services. STTR will apply when the jurisdiction in which such payment is received applies a tax which is less than the nominal trigger rate, in such cases the jurisdiction from which the payment is made can apply a top-up tax. Again, for its application change in current exemptions provided under the BIT's will be required such that the local tax rate and/or its combination with the payers tax rate is equivalent to the minimum rate.

Taking in consideration the rules hereinbefore mentioned, one can say that the blueprint has elaborated a comprehensive framework to remove all the loopholes, which were being used by the multinationals to avoid paying their taxes through fruitful tax planning.

GMCT'S IMPACT ON THE INIDAN SOVEREIGN

GMCT proposal is said to target those jurisdictions that have engaged in the race to the bottom and created safe harbours for tax avoidance. "Tax Haven jurisdictions have contributed in distorting

the line between tax avoidance and tax evasion”⁸. The totally legal means to avoid taxation are sometimes considered abusive in nature, India permits tax avoidance but criminalises tax evasion. However, even within tax avoidance there are certain issues regarding legitimate and illegitimate tax avoidance techniques. The primary case that dealt with the issue was the McDowell’s Case⁹, in this it was held that, “colourable devices cannot be a part of tax planning and it is wrong to encourage the belief that it is honourable to avoid payment of tax by resorting to dubious methods”¹⁰. This case allowed for tax avoidance provided that it was within the four corners of the legal framework. However, a slightly different approach was taken in Azadi Bachao Case¹¹, wherein the Westminster principle was used, by virtue of which, “Every tax-payer is entitled to arrange his affairs so as to reduce the tax liability. The fact that the motive for a transaction is to avoid taxes does not invalidate it unless a particular enactment so provides”¹². The same principle was used in the very recent Vodafone case¹³, which makes one wonder, whether India has also been somewhere promoting this safe harbouring to attract investments and thereby engaging in race to the bottom?

The answer to this is in India’s current tax regime, which is quite comprehensive. Under this, the companies located in India as well foreign companies are taxed on their income irrespective of how this income is generated. Domestic companies are charged on their worldwide income and foreign companies are charged tax on income generated through their Indian operations. The tax rates as applicable in India are as follows :

Particulars (conditions applied)	Tax Percentage (Basic rates, excluding education cess and Surcharge)
Domestic companies not exceeding 400 billion turnover in previous year	25%
Other domestic companies	30%
Companies which are not seeking and exemptions or incentives	22%
Manufacturing companies registered on or after October 31, 2019 and commencing business before March 31, 2023.	15%
Foreign companies	40%

⁸ Moryani P, 'The Case For Minimum Taxation' <<https://www.taxmann.com/research/search?search-Data=global%20minimum%20tax>> accessed 31 October 2021

⁹ Mc Dowell & Company Limited vs The Commercial Tax Officer 1986 AIR 649

¹⁰ Ibid

¹¹ UOI v. Azadi Bachao Andolan (2003) 263 ITR 706/132 Taxman 373/184 CTR 450 (SC)

¹² INDRANEEL R. CHAUDHARY, 'From McDowell To Vodafone' (@businessline, 2021) <<https://www.thehindubusinessline.com/news/education/From-McDowell-to-Vodafone/article20407537.ece>> accessed 31 October 2021.

¹³ Vodafone India Services Pvt. Ltd vs Union Of India, Ministry Of Finance and Anr. (2008)220CTR(Bom)649

In addition to this India possesses sizeable tax rights with respect to active and passive incomes, which are prone to base eroding and profit shifting such as royalty and dividends. Furthermore, in the previous years India has introduced several checks and anti abuse provisions such as POEM (place of effective management), GAAR (General anti-avoidance rules), and EQ (equalisation levy). Overall, it can be deduced that, “India is not indulging in race to the bottom”¹⁴. Now, taking into the consideration the current consented rate, i.e. 15% and comparing it with the current CTR in India, it can be said that India’s current rate is greater than the proposed rate and therefore it will not be negatively impacted in any manner. In fact “according to the Tax Justice Network, India's estimated to lose more than 10.3 \$ billion in revenue each year to global tax abuse by multinationals”¹⁵. All in all India is going to be benefited from the GMCT regime because even though sometimes India slips into the cracks to promote tax avoidance through loopholes within the system, there is still tight control over its tax base to ensure that it gets its taxes. It provides just the right amount of flexibility with respect to the tax burden.

EXECUTION OF GMCT WITHIN THE INDIAN SOVEREIGN

The execution of the GMCT will have to be done by amending rules within the domestic legislation as well as DTAA's. As per the current consensus the countries have the freedom to apply IIR standalone to multinationals within their jurisdiction even if the current threshold, i.e. € 750 million is not met. The major concern is however the clashing of GloBE rules with the domestic anti abuse provisions such as POEM or EL because if proper execution is not done, then there are high chances of disputes arising from double taxation. “Implementing GloBE rules would be a challenge”¹⁶. Careful consideration has to be given as to how India will proceed about it. In fact, it is expected that Indian tax authorities will “issue a discussion paper to get stakeholder inputs on the potential GloBE provisions in the domestic law to help arrive at a set of rules that are simple and predictable in their design and application”¹⁷

¹⁴ Shweta Pai, 'India Perspective On Of Pillar Two Of BEPS 2.0' (*Ernst & Young*, 2021) <https://www.ey.com/en_in/tax/india-tax-insights/india-perspective-on-pillar-two-of-beps-2> accessed 31 October 2021.

¹⁵ Prabhakar K.S., 'GMT – Global Taxing Thoughts' (<https://mgst.taxmann.com>, 2021) <<https://www.taxmann.com/research/international-tax/top-story/10501000000020961/gmt-%E2%80%93-global-taxing-thoughts-experts-opinion>> accessed 31 October 2021.

¹⁶ Shweta Pai, 'India Perspective On Of Pillar Two Of BEPS 2.0' (*Ernst & Young*, 2021) <https://www.ey.com/en_in/tax/india-tax-insights/india-perspective-on-pillar-two-of-beps-2> accessed 31 October 2021.

¹⁷ Ashutosh Dikshit and Gokul Chaudhri, 'Tax And Regulatory Services | Expert Opinions On Tax | Deloitte India' (*Deloitte India*, 2021) <<https://www2.deloitte.com/in/en/pages/tax/articles/deloitte-india-tax-publications.html>> accessed 31 October 2021.

CONCLUSION

GMCT will leave its mark on the world, once successfully executed. This is surely a step forward from a global perspective. “Taxing profits of companies, particularly large, successful corporations, is one of the most progressive forms of taxation. It raises more income for national budgets, and when this revenue is invested in public services, it reduces inequality”¹⁸. GMCT through its multilateral consensus will finally put limitations on the tax competition and developing economies such as India will thrive and be able to recover the revenues they have been losing all these years to low tax or no tax jurisdictions.



¹⁸ Esmé Berkhout, 'TAX BATTLES The Dangerous Global Race To The Bottom On Corporate Tax' (Www-cdn.oxfam.org, 2021) <<https://www-cdn.oxfam.org/s3fs-public/bp-race-to-bottom-corporate-tax-121216-en.pdf>> accessed 31 October 2021.