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Editor-in-Chief: Karl P. Sauvant (karlsauvant@gmail.com)
Managing Editor: Chioma Menankiti (clm2249@columbia.edu)

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The global minimum corporate tax: outcomes and options

by

David Bradbury and Pierce O'Reilly*

In October 2021, over 135 countries reached an agreement to enact a global minimum tax (GMT) on the profits of MNEs around the world. The tax will ensure that MNEs with revenues above EUR 750 million are subject to a 15% effective minimum tax rate wherever they operate. The GMT represents the most significant globally coordinated effort to address profit shifting ever agreed.

Jurisdictions are moving quickly to implement the minimum tax, with more than 35 jurisdictions implementing the GMT with effect from 2024, and many more planning to implement it from 2025 and 2026. Given the interlocking nature of the GMT's rules, if a jurisdiction fails to assert its taxing rights over low-taxed profit, others will have the right to collect the top-up tax. This will ensure the GMT is effective, even if not all countries implement it. Based on the jurisdictions currently implementing the tax, or taking steps to do so, 90% of large MNEs globally are expected to be in-scope of the tax by the end of 2025.

Two recent papers contain an updated assessment of the GMT's economic impact. The GMT is an unprecedented global policy development, so assessing its impact is subject to some uncertainty. We assess that the GMT will reduce effective tax-rate differentials among jurisdictions. Very low tax rates in some jurisdictions have given rise to differentials in tax rates that, in turn, have incentivized MNEs to shift profits to low-tax jurisdictions. By creating a multilaterally agreed floor, the GMT is estimated to reduce the average tax-rate differential among investment hubs[1] and other jurisdictions by about 50%.

Reducing tax-rate differentials will lessen MNE incentives to shift profit. It should also reduce the role tax plays in the investment decisions of MNEs—meaning that capital may be allocated to its most productive and efficient location.

The estimated revenue gains from the GMT are between US$155-192 billion per year, which is approximately 6.5-8.1% of global corporate income tax revenues. Around two-thirds of these revenue gains are expected to be collected directly from the GMT, while around one-third is expected to arise indirectly through reduced profit-shifting.

Some studies have suggested that, given the rule order of the GMT (which provides foreign affiliate jurisdictions priority in collecting top-up tax), the high statutory tax rates in many developing countries would mean that they would benefit less from the GMT. OECD analysis has highlighted the presence of low-taxed profits in many jurisdictions with otherwise high tax rates, due to tax incentives. That analysis estimates that about half (53%) of all low-taxed profits globally are located in high-tax jurisdictions, that is, those with an average effective tax rate above 15%. As a result, revenue gains are likely to be of a similar order of magnitude across most jurisdictions, with gains of between 5.1% and 8% of corporate income tax for developed economies and 3.6% - 7.8% for developing economies.

How should countries respond to the tax? The GMT is a common approach, so jurisdictions can choose whether or not to implement it, provided they respect the rules where they have been implemented by other jurisdictions. Jurisdictions may choose whether they implement through the income inclusion rule, qualified domestic minimum top-up tax or undertaxed profits rule. There is a strong case for jurisdictions to act because those not implementing the rules may forego revenues that would otherwise accrue to them. The OECD, as well as other partner organizations, are actively assisting jurisdictions in considering how countries could respond. Of course, implementing the GMT does not obviate the need for tax-incentive reform in many countries, or improved design of their corporate income systems and their investment policies in general.

For many jurisdictions, implementing a qualified domestic minimum top-up tax is an option to ensure that they collect any tax under the GMT arising in their jurisdictions. OECD analysis suggests that, for many developing countries, the widespread use of incentives such as tax holidays and corporate income tax exemptions may mean that some top-up tax may be generated by the GMT, making a qualified domestic minimum top-up tax beneficial. However, this option may not be appropriate for all jurisdictions; for example, those with very broad tax bases, high statutory rates and no or limited tax incentives may not need a qualified domestic minimum top-up tax. Other jurisdictions may choose to address low-taxed profits in their jurisdictions by implementing broader tax-incentive reform or otherwise raising their statutory and effective tax rates.

Importantly, the qualified domestic minimum top-up tax should not be a substitute for a broader look at corporate tax systems, tax incentives and investment policy, as the GMT can impact incentive types in many different ways. Evidence-based corporate income tax design for firms in and out of scope of the GMT remains important for countries' investment policy mixes. Overall, the minimum tax can ensure that jurisdictions strike a better balance between supporting investment and mobilizing domestic revenue.

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[*] Professor David Bradbury (david.bradbury@oecd.org) is s an Honorary Professor at the Australian National University's Crawford School of Public Policy; Pierce O'Reilly (pierce.oreilly@oecd.org) is Head of the Business and International Tax Unit in the Tax Policy and Statistics Division of the OECD Centre Tax Policy and Administration. The authors wish to thank Daniel Bunn, Hania Kronfol and Sol Picciotto for their helpful peer reviews.

[1] An "investment hub" is defined as a jurisdiction with an FDI-to-GDP ratio of at least 150%.

For further information, including information regarding submission to the *Perspectives*, please contact: Columbia Center on Sustainable Investment, Charles Denis, at cd3427@columbia.edu.

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