Domestic Corporate Tax Reform Under Pillar 2

Michael Keen [*]

[*]Tokyo College, University of Tokyo; CERDI

12th IMF-Japan High Level Tax Conference for Asian Countries
Tokyo, October 25, 2022

To Remember

- Only applies to entities in large multinationals ($\geq$ €750 million)
- The carve out: A (decreasing) proportion of tangible assets and payroll is excluded from base of the topup tax
- The rules apply on an entity basis
- No escape! With adoption by large capital exporters, there are:
  - Direct effects, when the minimum bites, and
  - Indirect effects, when it does not: less outward profit shifting

To do

- Adopt a QDMTT
  - Possible issues with Investment Agreements, stability clauses
- Check which entities would currently be affected
- Think about:

Four Key Design Issues

Investment Incentives

Model rules are remarkably strict in negating the impact of special exclusions from the tax base. Broadly:

- Provisions that are essentially timing differences are unaffected
  - e.g. accelerated depreciation, losses
- Scope for 'refundable tax credits'
- Reduced rates, holidays and the like will be partly offset, as they reduce covered taxes
  - 'partly' because some effect will remain, because of the carve out

Note too:

- Only entities of large MNEs are affected
  - Nonetheless, a case to review tax incentives more broadly
- Spending-based incentives may become more prevalent
  - which brings its own concerns

Rates and Tax Competition

- The'absolute minimum'(-ish)[1] is 15 % of 'excess profit'—which can be achieved by setting corporate tax rate to zero[2]
  - which some claims makes tax competition worse: misleadingly, as there is now a floor on the effective rate

- Will the minimum be a floor or a ceiling?
  - Experience is that countries react to rate increases elsewhere by increasing their own rate (with possibly big impact: IMF (2022))...
  - ...but we have never had a global minimum before

[1]'-ish' because it may be possible to go lower using qualifying refundable tax credit.
[2]With QDMTT assuring that revenue is not ceded to a parent country.

Non-covered Taxes

Royalties and turnover-type minimum taxes that are not income-related will not be 'covered'

- Consider converting these to covered form?

Implications for Structural CIT Reform

Does Pillar 2 make it easier/harder to change the CIT to a tax on 'rents' (i.e. returns above minimum required)? Two main candidates:

- *Allowance for Corporate Equity* (i.e. deduction for normal return to equity): Is the carve out a reasonable approximation to this? Could the approximation be made better?
- *Cash flow tax* (i.e immediate expensing): This is just extremely accelerated depreciation—but very different economically

Some want more destination-based taxation: Pillar 1 a first step?

References/Reading

Boadway, Robin and Jean-Francois Tremblay (2022). "The implications of Pillar 2 for corporate tax reform." Mimeo, Queens University Canada.

Devereux, Michael, Alan Auerbach, Michael Keen, Paul Oosterhuis, Wolfgang Schön and John Vella (2021), *Taxing Profit in a Global Economy* (Oxford University Press).

Devereux, Michael, John Vella and Heydon Wardell-Burrus (2022). "Will Pillar 2 achieve its objectives?" Oxford University Centre for Business Taxation.

IMF (2022). "Coordinating taxation across borders." Chapter 2 in *Fiscal Monitor: Fiscal Policy from Pandemic to War*, April.

Mintz, Jack (2022). "The global corporate minimum tax: A cure or not?" Mimeo, University of Calgary.

UNCTAD (2022), "The impact of a global minimum tax on FDI." Chapter 3 in *World Investment Report 2022.*