13th IMF- Japan High-Level Tax Conference for Asian Countries

Pillar Two: Implications & Responses

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BEPS and Pillar 2

- **BEPS 1.0** addressed egregious forms of profit shifting, but left the international tax system unchanged.

- **Two-pillar solution** is major departure from century-old norms:
  - P1: formulary – destination-based
  - P2: coordination on minimum rate

- **Pillar 2** sets minimum effective tax rate at 15%:
  - Combination of GloBE rules
  - Optional for countries – no mandated minimum
  - Common approach – accept rules by others
## Progress with implementation P2

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<th>Final Legislation</th>
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Source: Earnst & Young Pillar 2 Tracker
Direct revenue effect from P2

- **P2 raises approximately $150 bn globally in direct revenue (≈ 6% CIT or 0.15% GDP)**
  - Closer to $200 bn without SBIE
  - Approximately similar in latest OECD update

- **Country-specific revenue effect is harder to predict as depends on**
  - What GloBE rules a country itself adopts
  - What GloBE rules all other countries adopt
  - How will firms respond
  - How other countries change domestic policies
  - How country itself will change its policies

- If there is no response and all countries adopt the QDMTT, **low-tax countries** will get the revenue

*The minimum tax is expected to raise global revenue

Source: IMF (2023) and IMF (2022).*
Dynamic Effects Critical
Effects on profit shifting

- Profit shifting causes global revenue loss
  - Estimates vary, but might be $200 bn

- Profit shifting to countries with effective tax rates < 15% will decline as offset by top-up tax
  - Using an average elasticity, this is estimated to add 1% of CIT in revenue (∼ $25 bn globally)
  - Effect might be larger, as shifting tends to rise more than proportionally in the tax rate differential (raising the lowest rates has bigger effect)

- Effect varies by country
  - Largest in countries with high CIT rates
  - Low-tax jurisdictions might see their tax base decrease
Effects on tax competition

- Countries undercutting each other to attract tax base (or prevent eroding their tax base)
  - Rates declined from > 40% in 1980 to < 25% today
  - 15 countries have no CIT; 20 have < 15%
  - Countries use ample tax incentives that reduce the rate < 15%

- Impact of GloBE
  - Low-tax countries will likely respond – introducing QDMTT, remove tax incentives
  - High-tax countries may subsequently respond to the reduced pressure of tax competition – tax rates as strategic complements (Keen and Hebous 2021)

- Estimated impact > 8% of CIT revenue (> $200 bn)
  - In the new equilibrium, high- and low-tax countries increase rates by almost 2pp
Effects on foreign investment

- **Effect of GMT on global foreign investment likely small**
  - All other countries raise their taxes too
  - Note that UNCTAD estimates a larger decline 1-4% ↓

- **Relocation effect might be bigger**
  - Low-tax countries will lose competitive advantage, while high-tax countries gain
  - Keen, Liu and Palan (2023) – using foreign affiliate investment (= real capital)
    - High and large effect of statutory rate in host country on real investment: semi-elasticity of –3.6 is much larger than previous studies
How should (large) advanced countries respond?

1. What GloBE rules to adopt?
   - IIR and UTPR – to enforce the minimum tax
   - QDMTT typically desirable, but less if tax rate high

2. How to modify domestic policy?
   - Reconsider tax incentives, e.g. for R&D
   - Recalibrate the CIT rate

3. How to deal with tax administration?
   - Expand international tax division
How should developing countries respond?

1. What GloBE rules to adopt?
   - QDMTT typically desirable
   - IIR and UTPR – country-specific assessment needed

2. How to modify domestic policy?
   - Reconsider investment tax incentives
   - Recalibrate the CIT rate
   - Assess (existing) alternative minimum tax

3. How to deal with tax administration?
   - Build basic capacity to deal with international tax issues (see new IMF tool – FITAS)
   - Carefully assess the role of tax treaties
How should investment hubs respond?

What GloBE rules to adopt?

• QDMTT typically desirable – can significantly boost revenue
• IIR and UTPR require case-by-case assessment

How to modify domestic policy?

• If no CIT, consider introducing one, plus QDMTT (see new WP)
• Diversify the economy

How to deal with tax administration?

• Build capacity to administer corporate tax
Thank You!