A far-reaching tax measure

The U.S. push for a global minimum corporate tax may help India, but it can also cause international disagreements

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The Pillar Two proposal was the Organisation for Economic Co-operation and Development's (OECD) plan to plug the remaining Base Erosion and Profit Shifting (BEPS) issues and provide jurisdictions the right to "tax back" where other jurisdictions have either not exercised their primary taxing right or have exercised it at low levels of effective taxation. The move intends to achieve minimum effective taxation of more than 10%, possibly up to 15%, given the latest proposal put forward by the United States. The objective is to minimise tax incentives and ensure that companies choose to be situated in a particular country based on other commercial benefits.

In its recent proposal, the U.S. sought to impose a global minimum tax on foreign income earned by U.S. corporations. The proposal is perhaps intended to disincentivise American companies from inverting their structures due to the increase in the U.S. corporate tax rate. The proposal is similar to Pillar Two, except for the rate of the effective minimum tax. While the OECD was considering a 10-12% rate, the U.S. proposed a 21% rate. This caused pushback from countries such as Ireland, which made a case for fiscal autonomy for smaller jurisdictions to compete with larger economies. The U.S. is now discussing a floor of 15% for the minimum tax rate despite the fact that it may have difficulty securing Congress support if the floor is too low. Even at 15%, it is unclear whether Ireland would agree, given its 12.5% marginal rate, thereby impacting a European Union-wide adoption of the 15% rate.

India has been part of the Pillar Two discussions and has not objected in principle to the proposal. The proposal, along with the increased tax bill for U.S. companies, may benefit the Indian revenue department. The tax department might benefit even at a 10% rate since the proposal would cover offshore structures set up by Indian companies.

Pillar Two acts as a set of controlled foreign corporation rules, where, for instance, if an Indian-headquartered multinational corporation (MNC) has an entity in Singapore or the Netherlands through which global operations are run, and its income from global operations is not taxed at an effective

notes that India loses over $10 billion in tax revenue due to the use of offshore structures, particularly through investments made by Indian residents through Mauritius, Singapore and the Netherlands. This is supported by the overseas direct investment (ODI) data from 2000 to 2021 published by the Reserve Bank of India, where the cumulative ODI for the period primarily went through Singapore, Mauritius, the U.S., the Netherlands, and the United Kingdom.

Start-ups and large Indian conglomerates commonly use offshore structures for conducting global operations. Revenue from such operations is often retained offshore and not repatriated to India. Tax advantages incentivise such structures, due to which taxes on such income are not paid in India. Once these proposals are implemented, Indian companies would have to pay additional taxes on their offshore structures to the extent that the effective rate of tax is lower than the global minimum tax rate.

Other major factors

With tax incentives neutralised, countries may have to compete on other factors like better regulatory regimes, ease of doing business, access to global talent, among others. The U.S. proposal indicates that the country is pushing the OECD to swiftly achieve consensus on the global minimum tax rate, in the absence of which the U.S. proposes to apply its domestic law version of Pillar Two at a rate of 21% (which may now be 15%).

Several countries have taken a different approach to the rate of global minimum tax. While France and Germany have expressed support, the EU has raised concerns regarding the high rate proposed by the United States. Countries have stated that the proposal infringes upon their tax sovereignty and that the fight against unfair tax competition should not become a fight against competitive tax systems. Given that the U.S. is now pushing for a 15% rate, the fate of Pillar Two will depend on whether this proposal is acceptable to other countries.

The U.S. appears keen on closing the negotiations around the 15% floor, which should also benefit India. Presumably, the remaining obstacles to gaining a consensus are the issues with Pillar One. As economies struggle amid the COVID-19 pandemic, the necessity of encouraging trade and economic activity should be prioritised over disagreements on tax allocations. A tax-related trade war or entrenchment of unilateral levies may further harm both global and national economies.

global operations is not taxed at an effective rate of 10% or 15%, then it can be taxed in India. The State of Tax Justice report of 2020

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