EXPLAINER: How global deal stems corporate use of tax havens

October 9 2021, by David McHugh

In this Monday, Nov. 18, 2019 file photo, the logo of Google is displayed on a carpet at the entrance hall of Google France in Paris. On Thursday, Oct. 7, 2021 Ireland agreed to join an international agreement establishing a minimum corporate tax of 15% around the world, ditching the low-tax policy that has led companies like Google and Facebook to base their European operations in the country. Credit: AP Photo/Michel Euler, File

More than 130 countries have forged a deal on sweeping changes in how big global companies are taxed.

The goal: deterring multinational companies from stashing profits in countries where they pay little or no taxes—better known as tax havens.

The sweeping agreement was struck Friday among 136 countries after talks overseen by the Organization for Economic Cooperation and Development. It would update a century's worth of international taxation rules to cope with changes brought by digitalization and globalization.

The most important feature: a global minimum tax of at least 15%, a key initiative pushed by U.S. President Joe Biden and Treasury Secretary Janet Yellen. Yellen said the minimum tax will end a decadeslong "race to the bottom" that has seen corporate tax rates fall as tax havens sought to attract corporations that take advantage of low rates—but do little actual business in those locations.

Here's a look at key aspects of the deal:

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WHAT PROBLEM DOES IT ADDRESS?

In today's economy, multinationals are increasingly likely to earn profits from intangibles such as trademarks and intellectual property. Those can be easy to move, and global companies can assign the earnings they generate to a subsidiary in a country where tax rates are very low.

Some countries compete for revenue by using rock-bottom rates to lure companies, attracting huge tax bases that generate large revenue even when tax rates only marginally above zero are applied. Between 1985 and 2018, the global average corporate headline rate fell from 49% to

24%. By 2016, over half of all U.S. corporate profits were booked in seven tax havens: Bermuda, the Cayman Islands, Ireland, Luxembourg, the Netherlands, Singapore, and Switzerland. That costs the U.S. Treasury $100 billion a year according to one estimate.

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HOW WOULD A GLOBAL MINIMUM TAX WORK?

The basic idea is simple: Countries would legislate a global minimum corporate tax rate of at least 15% for very big companies, those with annual revenues over 750 billion euros ($864 billion.)

Then, if companies have earnings that go untaxed or lightly taxed in one of the world's tax havens, their home country would impose a top-up tax that would bring the rate to 15%.

That would make it pointless for a company to use tax havens, since taxes avoided in the haven would be collected at home. For the same reason, it means the minimum rate would still take effect even if individual tax havens don't participate.

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HOW WOULD THE TAX PLAN ADDRESS THE DIGITALIZED ECONOMY?

The plan would also let countries tax part of the earnings of the 100 or so biggest multinationals when they do business in places where they have no physical presence. That could be through internet retailing or advertising. The tax would only apply to a portion of profits above a profit margin of 10%.

In return, other countries would abolish their unilateral digital services taxes on U.S. tech giants such as Google, Facebook and Amazon. That would head off trade conflicts with Washington, which argues such taxes unfairly target U.S. companies and has threatened to retaliate with new tariffs.

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DOES EVERYONE LIKE THE DEAL?

Some developing countries and advocacy groups such as Oxfam and the UK-based Tax Justice Network say the 15% rate is too low and leaves far too much potential tax revenue on the table. And although the global minimum would capture some $150 billion in new revenue for governments, most of it would go to rich countries because they are where many of the biggest multinationals are headquartered.

A 20% to 30% minimum was recommended by the UN's high-level panel on International Financial Accountability, Transparency and Integrity. In a report earlier this year, the panel said that a rate that is too low can incentivize countries to lower their rate to remain competitive.

Countries that participated in the talks but did not sign the agreement were Kenya, Nigeria, Pakistan and Sri Lanka.

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WHAT IS THE U.S. ROLE IN THE AGREEMENT?

Biden's tax agenda is stuck in negotiations among Democratic lawmakers, as the scope of his spending and proposed rate hikes are still under debate. But the administration has staked a claim in saying that it must expand the U.S. global minimum tax in order to convince other

nations to do so.

Biden has retreated somewhat from his initial proposals as Congress has provided its input. The latest plan from the House Ways and Means Committee would increase the global minimum tax to roughly 16.5% from 10.5%. The president initially wanted 21% as the U.S. global minimum rate. Domestic corporate income would be taxed at 26.5%, up from 21% currently.

U.S. participation in the minimum tax deal is crucial, simply because so many multinationals are headquartered there. Complete rejection of Biden's global minimum proposal would seriously undermine the international deal.

Manal Corwin, a tax principal at professional services firm KPMG and a former Treasury Department official in the Obama administration, said that the removal of the unilateral digital taxes, or DST's, would provide "a very strong motivation" for the U.S. to participate. That is because the agreement would head off destructive trade dispute that could spread to unrelated companies in other sectors of the economy.

"When you get into back-and-forth threats of tariffs, the tariffs are not necessarily imposed on the companies that are in the crosshairs of the issue being debated," she said. "It may be DSTs today and then tomorrow it's some other unilateral measure." She said international taxation needs stability and consensus "to encourage investment and growth .... (T)he unravelling of global consensus, if it starts with DSTs, can expand to other things."

HOW WOULD THE AGREEMENT TAKE EFFECT?

The accord will go to the Group of 20 leaders. Agreement there is likely since all 20 members signed Friday's deal. Implementation then moves to the individual countries.

The tax on earnings where companies have no physical presence would require countries to sign up to an intergovernmental agreement during the course of 2022, with implementation in 2023. The global minimum could be applied by individual countries using model rules developed by the OECD. If the U.S. and European countries where most multinationals are headquartered legislate such minimums, that would have much of the intended effect.

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