



Case Study 4: Global Tax Deal

What is the Global Tax Deal and what impact will it have on U.S. and foreign multinationals?

Global Taxation

Global taxes in this case study refer to taxes levied on U.S. and foreign multinational companies. These companies may be headquartered in one country (and tax jurisdiction) but have operations such as manufacturing or sales in other countries and tax jurisdictions.

Some multinationals strategically place their operations in a way that minimizes their tax burden, or how much they owe in corporate income taxes (CIT) to the countries they operate in. Oftentimes, low-tax jurisdictions are part of these strategies to minimize CIT liability. This is what the term *tax haven* refers to.

The Base Erosion and Profit Shifting (BEPS) project in 2015 and later Digital Services Tax (DST) proposals which came on the scene in 2018 were attempts to change tax rules for multinational corporations and address cross-border tax avoidance.

Cross-border tax avoidance occurs when multinational companies seek low-tax jurisdictions or exploit mismatches between tax systems to reduce their overall tax burden. Countries that are reliant on the CIT suffer more from this type of avoidance, and the issue can only be fully addressed by countries working together to close gaps in their tax codes and limit the use of tax havens.

The OECD and G20 countries worked together to adopt an action plan to combat BEPS, with a focus on limiting the ability to avoid taxation. The 15-point plan also sought to avoid introducing double taxation as a remedy to the tax avoidance.

DSTs were meant as temporary policies targeted at large, digitalized business models. By targeting the digital presence of a multinational tech company instead of the location of its physical offices (think streaming services, social media, or online retailers), governments saw an opportunity to catch lost global corporate income tax revenue generated by companies that operate worldwide but only technically owe taxes in a home country.

These tactics proved to fall short in targeting global taxation and instead created new trade conflicts.

In the last few years, the Organisation for Economic Co-operation and Development (OECD) has discussed a more permanent and effective plan to change tax rules for large companies and continue to limit targeted tax planning by multinationals. This plan was broken into two pillars: Pillar 1 is focused on changing where companies pay taxes, and Pillar 2 would establish a **global minimum tax**.

The OECD Global Tax Deal

In October 2021, more than 130 countries (over 90 percent of the global economy) agreed to set a minimum global corporate tax rate of 15 percent starting in 2023.

The Global Tax Deal is a significant shift in international tax rules. The OECD's plan aims to reduce incentives for tax planning and avoidance by U.S. and foreign multinational companies by limiting tax competition and changing where companies pay taxes.

To achieve this, the proposal is divided into two independent plans: Pillar 1 and Pillar 2.

Pillar 1

Pillar 1 would expand a country's taxing power to include a share of profits from companies that make sales in the country regardless of a company's physical location. This would result in some companies paying more taxes in the countries where their customers or digital users are, even if the company has no *permanent* local establishment in that country.

For companies with global revenues of more than €20 billion (US \$26.4 billion) and profitability above 10 percent, 25 percent of profits above 10 percent would be taxed according to a new formula based on where a company's customers are located.

Pillar 1 would also include dispute resolution processes meant to improve tax certainty for companies.

Pillar 1 Example

The company has \$40 billion in annual revenues and profits of \$10 billion (a profit margin of 25%). \$1.5 billion of its profits will be impacted by Pillar 1.

Total Profits	\$10.00
Profits above 10% Profit Margin (in excess of \$4 billion)	\$6.00
Pillar 1 Profits (25% of profits above a 10% Profit Margin)	\$1.50

Pillar 2 – Global Minimum Tax

Pillar 2 of the Global Tax Deal would limit tax competition and the so-called “race to the bottom” on corporate tax rates. It would establish a minimum percentage for effective tax rates applied to cross-border investment by large multinational corporations that have a “significant economic footprint” across the world, or a **global minimum tax**. The proposed global minimum tax is 15 percent.

Pillar 2 includes three rules that apply to companies with more than €750 million (\$991.9 million) in revenues.

- **Income inclusion rule:** determines when a company's **foreign income** should be included in the parent (main) company's taxable income.
- **Under-taxed payments rule:** allows a country to reject a deduction on cross-border payments to the parent company.
- **Subject to tax rule:** makes it possible for countries to tax inter-company payments that would be under-taxed.

According to initial analysis of the original proposals, Pillar 1 and Pillar 2 would increase the effective average tax rate by around 0.7 percent across all jurisdictions. Pillar 2, the global minimum tax, is responsible for the majority of this increase, accounting for 0.6 percent.

Pillar 2 Example

The company has \$40 billion in annual revenues and profits of \$10 billion but faces a 10% effective tax rate. The top-up from the global minimum tax amounts to 5%.

Pre-tax Profits	\$10.00
Normal Tax Liability (10% tax rate)	\$1.00
Top-up tax of 5% (based on minimum tax rate of 15%)	\$0.50
After-tax Profits (Profits minus Taxes)	\$8.50

Pillar 2 also includes some carveouts. Companies would be able to exclude 5 percent of the value of their tangible assets (like buildings and machinery) and 5 percent of their salaries and wages from the minimum tax calculations.

Impact on U.S. & Foreign Multinationals

The plan would impact U.S. and foreign multinationals by:

- Limiting tax planning
- Increasing effective tax rates on cross-border investment
- Increasing taxes on earnings in low-tax jurisdictions
- Reshaping foreign direct investment (FDI)
- Impacting where companies hire and invest globally and domestically
- Slowing global economic growth
- Introducing additional tax complexity

Further Reading

Below are some resources regarding the global tax deal from Tax Foundation and other sources. Please conduct additional research on the case prior to discussion.

[International community strikes a groundbreaking tax deal for the digital age](#)

[Over 130 countries clinch a deal that could radically reshape how companies are taxed](#)

[What's in the New Global Tax Agreement?](#)

[What Do Global Minimum Tax Rules Mean for Corporate Tax Policies?](#)

[BEPS Project Explanatory Statement](#)

Reflect on the following questions:

- What is the problem(s)?
- How do these policies meet (or not meet) the [Principles of Sound Tax Policy](#)?
- What general options are available to develop more sound policy that targets the issue at hand?
- Who are the stakeholders and what are their interests?
- How and why did previous attempts to address profit shifting fall short?