MILESTONE: THE INTRODUCTION OF A GLOBAL MINIMUM TAX AS A POSSIBLE SOLUTION FOR TAX AVOIDANCE*

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It seemed, that Hungary, too, has accepted the proposal made by the OECD regarding the global minimum tax, which is planned to apply to the taxation of profits of larger multinational companies from 2023 onwards. In June 2022, however, Hungary blocked the European Union's agreement on the global minimum tax. Cyprus, Estonia and Ireland also oppose the EU directive.

The goal of the framework signed by 136 countries in Paris is to introduce a universal (minimum) 15% tax – with regards to Hungary, applied to business profits generated in the corporate, industrial, and other sectors – for companies (e.g., Facebook, Google, Microsoft, Apple) with group-wide revenues exceeding 750 million USD. From the beginning, the supporters focused on the fiscal aspects – the revenue-generating capability of taxes –, meanwhile the opposers (e.g., Hungary) considered the long-time investment more important (e.g., the role of low tax rates in the encouragement of investments). A consensus regarding the framework has been achieved, and while the detailed rules are still being developed, the advantages and disadvantages of the proposal are already clearly visible.

Introduction

Previously we have written about how the introduction of a global tax minimum can cause a significant difference in the economy of not only Hungary, but the whole world (Bak 2022). Many may question why this step is so imperative, why it is justified, and what the history behind it is. How big of an impact the still ongoing coronavirus pandemic had on the introduction of the minimum tax further deepens the question, since, as a result of the crisis starting in 2019/20, multiple countries decided to limit the tax income of multinational companies, and the displacement of their profits to tax havens. 136 countries, including Hungary, signed the proposal in October 2021.

1. Proposal

The development of the global minimum tax's draft by the OECD (Organisation for Economic Co-operation and Development) has already begun in 2019. The draft can be divided into two large segments: 'Pillar 1' and 'Pillar 2'. The first part relates to the taxation of digital enterprises (in cases where their activity is not localised), while the second part is linked to the global minimum tax and the enterprises engaging in „real economic activity". The goal of the first pillar is to make multinational companies pay taxes in not only the countries they originate from, but in the locations of their subsidiaries as well. This way, if the subsidiary's tax liability does not reach the minimum tax amount, the parent company's country can collect the tax difference. If

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they don't exercise their right, the other countries where they have subsidiaries could collect the difference.

The second pillar of the draft aims to set a minimum tax rate (as of right now 15%), which opens up the possibility to reduce the tax avoidance of multinational companies. The importance of this measure lies in the fact that a multinational corporation pays significantly less tax if they base their corporation in a country where the corporate tax rate is lower than in their country of origin. The corporate tax rate heavily differs in the European Union as well: e.g., in Malta the tax rate reaches 35%, while in Montenegro or Hungary it is 9%, among the lowest in Europe. See Figure 1, based on data from December 2021 (Bray 2021). The acceptance of the proposal could result in the compensation of these deviations, since if the tax liability of a multinational corporation's subsidiary does not reach the minimum rate, the difference will have to be paid in the corporation's home country (Adó Online 2021).

Figure 1

Statutory Corporate Income Tax Rates in certain European Countries, 2021

Country	Tax Rate
Malta	35%
Cyprus	12.5%
Gibraltar	12.5%
Ireland	12.5%
Republic of Moldova	12%
Andorra	10%
Bosnia and Herzegovina	10%
Bulgaria	10%
Republic of Kosovo	10%
The former Yugoslav Republic of Macedonia	10%
Hungary	9%
Montenegro	9%

Source: Bray 2021

2. The advantages of the global minimum tax

The main benefit of the introduction of the global minimum tax matches the main goal of the project, reducing tax avoidance, although it could prove beneficial in many other aspects as well. The OECD describes these advantages in its impact analysis, the most important of which is that the solution based on consensus provides a favourable investment opportunity, since it can encourage investment by increasing predictability, transparency, and tax security.

Additionally, the OECD mentions the indirect impacts of the global minimum tax, from which I would like to highlight a few:

1. Budgetary margin: as a result of the revenue growth, the support for the public finances will be guaranteed, which is particularly relevant for developing countries.

2. Moderate tax competition: the less intense tax competition may have the effect of supporting public finances in the longer term.
3. Impact on corporate competition: the competition between corporations, as well as the outcome, could be influenced by the fact that larger multinational corporations must pay greater taxes than previously (OECD 2020).

3. The disadvantages of the global minimum tax

In addition to the benefits listed above, there may of course also be negative consequences. The corporate tax competition affects where the individual companies invest – not only international, but national investments as well –, since the rate of the corporate tax is relevant, as well as where they must pay it (Bauer 2020). Eliminating the differences could result in smaller countries being seen as less of a favourable investment option compared to larger ones. The reason for this is that larger companies might prefer larger countries to smaller ones, because of their more significant market attractiveness.

The different tax rates between the different countries form one of the bases of tax competition between countries. The OECD aims to reduce this competition – in addition to combating tax avoidance and promoting fair taxation –, although impact analyses need to be performed in order to determine how this will affect the economy as a whole. According to an impact analysis concluded by the OECD, annually a 50-80 billion USD global tax revenue is to be expected, thanks to the innovations of the first and second pillar. Despite everything, impact analyses concluded in some individual countries are not available for the public, or they were not even completed at all. The framework is seen by many as not as flexible in terms of tax bases, thus it can be detrimental in countries that operate with higher tax rates but determine their tax bases otherwise. Because of these differences, numerous companies operating in countries where the tax rate is higher than the OECD rate may also be subject to the regulation.

Hungary is among the countries that have accepted the proposal. Although it is important to highlight that this was not always the case. In 2021, the government still rejected the OECD's proposal. Several arguments have been put forward in favour of rejection. The country's corporate tax rate is minimal compared to the tax rates of other countries, so they can only incorporate the 15% minimum tax in the form of a tax increase. The other argument is jurisdictional rather than economical since it's connected to the fact that the determination of the tax rate and the tax policy is national competence (HVG 2021). Compromises had to be made in favour of the Hungarian side: thus, the corporate tax rate will not change; a 10 year transitional period will be established, during which the tax return will decrease, and a reduced tax calculation will apply, moreover the taxation will not affect the corporations performing real, actual economic activity (Kovács 2021).

So, when our country accepted the proposal, it considered the complex effects of the framework. It is important to consider that if a corporation chooses a country to invest in, their decision is not only influenced by the tax rate, but for example the skilled workforce, the development of digitalisation, and the infrastructure as well. Furthermore, the minimum tax rate applies to the taxes on company profits taken together (e.g., TAO, IPA), while it provides a discount to companies performing real economic activities; this way there will be no increase in burden for the majority of the affected. In addition, the framework will contain numerous customisable points, which could further improve the competitiveness of our country.

Summary

Overall, the OECD's two-pillar proposal, which includes the global minimum tax, may have negative effects, as well as multiple positive ones; although looking at both sides, I still believe the positive effects remain dominant if the implementation of the regulations into practice happens according to plan. Based on the impact analysis done by the OECD, this draft could contribute to increasing tax revenue, improving investment factors, and can also have a favourable impact on developing countries. On top of all this, the most important goal is to minimize tax avoidance, and this solution is certainly a milestone in this regard.

The final detailed rules would have been adopted in 2022 and would have entered into force by 2023. Since the determination of tax rules within the European Union is a national competence, the process would also require the adoption of a common directive in this area within the community and its implementation at the national level. The target date of 2023 is considered by many to be too ambitious and unsustainable. In June 2022 Hungary blocked the European Union's agreement on the global minimum tax. Cyprus, Estonia and Ireland also oppose the EU directive.

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