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Tailoring Developing Country Advice: A Response to Noam Noked

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Noam Noked has recently written an excellent piece in *Tax Notes International* entitled "The Case for Domestic Minimum Tax on Multinationals",[1] which also follows up most of his previous work on these matters.[2] Noked argues in this TNI piece that most countries would benefit from adopting domestic minimum taxes, particularly developing countries, financial centres with substantial economic activities, as well as developed countries with low corporate tax rates. Indeed, in Noked's view, the design of the OECD minimum tax rules (hereinafter also, Global Anti-Base Erosion Rules or GloBE rules), as made public in the OECD Model Rules, provide an opportunity for these countries since it grants them a priority to apply domestic minimum taxes which would operate with priority over the global minimum tax rules (GloBE rules). In the overall, therefore, all these countries would be better off implementing a domestic minimum tax than just adopting GloBE alone.

The argument is sound, especially for financial centres with substantial economic activities and developed countries with low corporate tax rates. However, I am not entirely convinced that this equally true for all developing countries or emergent economies, particularly if we think in those with less competitive advantages and high investment elasticities. This is precisely what this response is about.

Domestic GloBE and developing countries

Noked's core argument relies upon the random priority given by the GloBE rules to certain jurisdictions to tax the difference in rates up to the minimum (top-up tax), which corresponds to the country where the ultimate parent company (UPE) is located. This is right, as it is also right that, coincidentally or not, most of these jurisdictions are ultimately developed countries with high corporate effective tax rates. In this regard, Noked argues that a domestic minimum tax with the same design parameters and scope as the GloBE rules could be used by developing countries to revert this outcome, giving them now the priority to tax. This option is indeed explicitly allowed by the OECD Model Rules.

He is right. Adopting a domestic minimum tax will revert the priority towards countries other than those where the UPE is located, offering them potentially more revenues that could be used for several purposes. However, the automatic revenue benefit foreseen by Noked

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[1] Noam Noked, *The Case for Domestic Minimum Tax on Multinationals,* TAX NOTES INT'L (2022).

[2] Noam Noked, *Defense of Primary Taxing Rights*, 40 VA. TAX REV. 341 (2021); Noam Noked, Comments to the OECD's Public Consultation on the Reports on the Pillar One and Pillar Two Blueprints, and Noam Noked, *Potential Response to GloBE: Domestic Minimum Taxes in Countries Affected by the Global Minimum Tax*, 102 TAX NOTES INT'L 943 (2021).

depends also on the elasticity of investment in the country that we are talking about. In other words, it is true that developing countries may benefit from additional revenues in the short-term, and perhaps also in the medium-term. However, such benefit can be expected in the long-term only if the domestic minimum taxes do not push investors out to other developing countries with a better infrastructure, political stability, or any other better competitive advantages. I do not argue that investors could be disincentivised and leave under the application OECD GloBE rules alone (i.e., without a domestic minimum tax). They will. However, the idea of a revenue benefit associated to the implementation of a domestic minimum tax should be consider neither automatic nor permanent, at least not in the long term.

Let me provide a simple example. A multinational located with an UPE in country X is deciding to invest either in country Y or Z, both developing countries. Whilst country Y offers an effective 0% CIT, country Z offers a CIT of 5%. Country Y is chosen despite of the fact that country Z still provides a more stable political environment as well as a more serious legal and judicial system. All the countries in this example implement the GloBE rules. Also, country Y implements a domestic minimum tax following the OECD Model Rules. Due to the implementation of GloBE, countries Y and Z must increase their ETR, unless they want country X to tax the residual up to the minimum (top-up). The difference between the two countries (Y and Z) therefore relies upon the fact that country Y could keep the revenues for the difference in rates, whilst country Z would give up those revenues to country X. As one can notice, Noked's premise proves to be true thus far because country Y would be "better off" if it adopts a domestic minimum tax too. Indeed, it will keep the revenues. However, that premise disregards the fact that country Y, apart from the interesting CIT rate that used to offer, does not have the most reliable political environment and its legal and judicial systems seem to get every day more corrupted. In this scenario, what would be the incentive for the investor to stay in country Y and not to move to country Z, considering both countries as equally interesting for their business? If we consider taxation in isolation, the answer is none. However, taxation is neither the main nor the only reason for investment, and it is likely that in the long-term (or perhaps even before) investors decide to leave country Y, diluting the apparent gain from revenues assumed by Noked.

The above does not mean that some developing countries, as foreseen by Noked, will still benefit from introducing a domestic minimum tax. Those with a less elastic investment and more competitive advantages will do. However, one should be careful to conclude that "all" developing countries will equally do it because some will simply not, and it is unfair to assume that this group (those that will not) simply represents the pejorative qualification of tax heavens.

Administration, compliance, and other costs

Another aspect mentioned by Noked refers to the apparent complexity associated to a domestic GloBE (domestic minimum tax). Noked is convinced that administrative costs related to the collection of the tax will not be high because countries will have already implemented the OECD GloBE rules. Therefore, developing countries can adopt the domestic GloBE without investing many resources in administration and enforcement.

I tend to agree with Noked's premise but only to the extent that we limit the analysis to administration and compliance costs. Indeed, if we think about transaction costs more generally, there will be complexity added. For example, taxpayers (and tax administrations too) will have to deal with more than one GloBE now, which includes timing differences and substance carve-outs. Moreover, one should not underestimate the fact that US GILTI and Subpart F (CFC), in general, will still be in place. If this will not increase transaction costs, then what could.

A different advice for some (not all) developing countries

It is difficult not to sympathise with Noked's claim, after all, his intention is to preserve revenues in the countries that, up to now, were the losers in this international tax deal, i.e., developing countries. However, I am still hesitant that calling all developing countries to implement a domestic GloBE can be the holy grail for the challenge that the global GloBE rules have created. Instead, some developing countries, especially those with less competitive advantages and high investment elasticities, could start thinking about more sensitive domestic reforms to their tax incentives regimes, including also alternative forms of competition. Perhaps in this way they can still ride the wave of global corporate income taxation in which the world seems to be in.

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