WealthBriefing

G7 Countries Ink Minimum Corporate Tax Pact

Tom Burroughes

June 8, 2021

The question remains as to what extent any such multilateral deal on tax rates can be agreed when the level of taxation is often a hot domestic issue, both when increases and cuts are on the table.

The Group of Seven (G7) nations agreed to set a floor on corporate taxes at 15 per cent and give countries more powers to tax digital businesses such as Apple and Facebook. Whether a wider group of nations is willing to go along with such a pact, given the thorny issue of tax sovereignty, remains to be seen.

The G7 countries (Canada, France, Germany, Italy, Japan, the UK and the US), agreed at a weekend meeting in the UK that businesses should pay a minimum tax rate in each of the countries in which they operate.

In the US, the rate is 21 per cent, and this was slashed from 35 per cent under the Trump administration. Prior to this, the US had one of the highest rates in the OECD collection of major industrialised nations. The Biden administration has proposed raising the corporate tax rate to 28 per cent and hike the existing minimum tax on foreign profits of US-based companies to 21 per cent from 10.5 per cent. A concern is that without some kind of global accord, countries with lower rates will lure away US business and encourage corporate tax arbitrage via offshore centres.

The pact – which has not yet been signed into domestic law – begs the question of what happens with countries such as Ireland, a European Union member state, which has a 12.5 per cent rate on trading income. In Luxembourg, another EU member state with a relatively light corporate tax regime, a 15 per cent rate applies to companies with annual taxable income up to €175,000 ($213,053) and a 17 per cent rate applies on firms with taxable income over €200,000. In the UK – no longer in the EU – there is a 19 per cent rate, and a 25 per cent "diverted profits tax" is levied on multinational firms using artificial arrangements to divert profits abroad to avoid UK tax. Such a move to a minimum tax regime also raises questions for offshore centres such as the cluster of overseas territories and Crown Dependencies linked to the UK, such as the British Virgin Islands, Cayman Islands, Gibraltar, Isle of Man, Guernsey and Jersey.

Over the past few decades, corporate tax rates have eroded as countries have sought to attract inward investment.

Norman Villamin, chief investment officer, wealth management, at Geneva-based Union Bancaire Privée, said that investors will have to adjust and be choosy about the companies they hold.
"With falling effective corporate tax rates (from 31 per cent to 13 per cent currently) accounting for over 30 per cent of US corporate profit growth since the turn of the century, companies will have to increasingly rely on margin expansion and revenue growth just to maintain the recent pace of profit growth," he said in a note. "With a fiscal and monetary tailwind, a cyclical recovery in corporate revenue growth and margins appear likely looking ahead."

"However, with the innovation revolution rapidly shifting from being narrowly focused to the digital space to the accelerating investments in the green industrial space and with supply chains shortening and domestic political opposition to outsourcing growing, drivers to a new round of margin expansion do not appear on the horizon, suggesting that stock picking should grow increasingly valuable looking ahead," Villamin said.

The changes proposed by Biden, along with the G7 pact, represents the first reversal in the corporate tax burden since the Reagan tax reforms of the 1980s, he added.

US Treasury Secretary Janet Yellen said that the global minimum rate will end the "race-to-the-bottom in corporate taxation and ensure fairness for the middle class and working people in the US and around the world."

"By collaborating with one another on the global minimum tax, governments protect their national sovereignty to set tax policy, because the pressures that have forced the race to the bottom on corporate tax rates are alleviated," she said. "This effort is far from over, and we look forward to engaging closely with the G20 and members of the OECD Inclusive Framework process in the coming weeks to finalise an agreement on the global minimum corporate tax as soon as possible."

In the past, some commentators, such as CATO Institute author Daniel Mitchell have claimed that attempts to set lower limits on corporate tax amount to a kind of "tax cartel" and that it is healthy for countries to compete with one another on tax, otherwise there will be inevitable upward pressures on public spending and tax burdens.

To some extent the move towards such a minimum rate continues pressures exerted by large industrialised nations to squeeze profit-shifting and the siting of tax registration hubs in low-tax, no-tax financial centres, not all of which are necessarily "offshore" as traditionally understood.