UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

UNCTAD

Short course for Permanent Mission in Geneva
P166 COURSE - GENEVE

Foreign Direct Investment Trends and Prospects and Investment Policies and their Impact on Sustainable Investment

Policy Brief: International Tax Reforms and FDI

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The introduction of the global minimum tax has major implications on international investment and investment policies

1. It is **transformational**

   It will fundamentally change the international tax architecture and the way MNEs invest internationally

2. It is **pervasive**

   It is hard for any country to escape

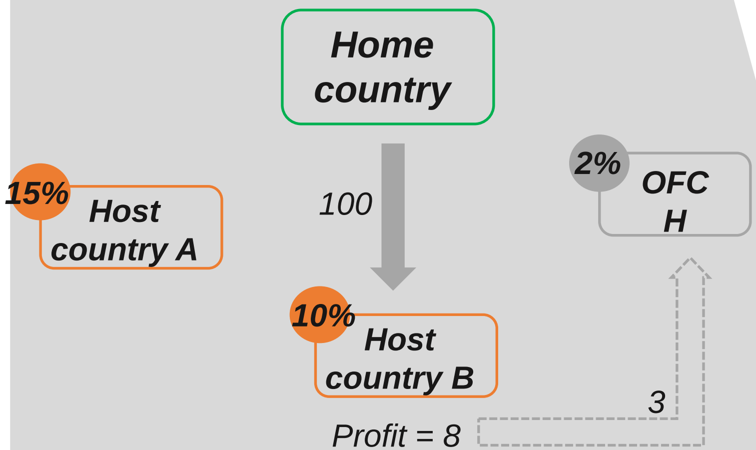
3. It is **urgent**

   Already signed, implementation planned for 2024; need for action is now

1. A global minimum tax will re-shape the way MNEs invest internationally

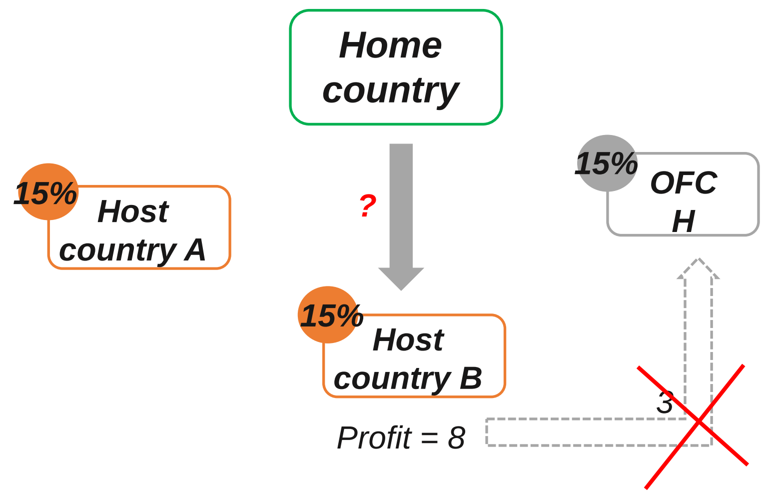
UNCTAD estimates, next slide

Before Pillar II (now)



- The classic case: **tax competition** + **profit shifting** in action
- Country A: no investment, no tax revenues
- Country B: 100 investment, 0.5 revenues
- OFC H: no investment, 0.06 revenues
- MNEs pay revenues for 0.56 corresponding to 7%

After Pillar II (tomorrow…2024)



- **Tax competition** + **profit shifting substantially reduced**

A. MNEs pay more (15% instead of 7%)

B. Overall investment may decrease

C. Location decisions of MNEs may change (tax will count less); some investment will divert from low to high tax countries

D. Host countries will gain more, with the exception of OFCs.

1. Economic impact is sizable, according to UNCTAD estimates in World Investment Report 22

A. **MNEs pay more** – average increase in CIT on FDI globally: **between 15 and 20 per cent**. Most of the increase due to reduction in profit shifting: 65 per cent globally.

B. Overall **investment may decrease**. Overall decrease in global investment expected to be between **2 and 3 per cent.**

C. Location decisions of MNEs may change (**tax will count less)**; some **investment will divert from low to high tax countries**. Tax rate differential will decrease between 15 and 30 per cent globally. Developing countries expected to **gain between 1.5 per cent and 3 per cent of FDI.**

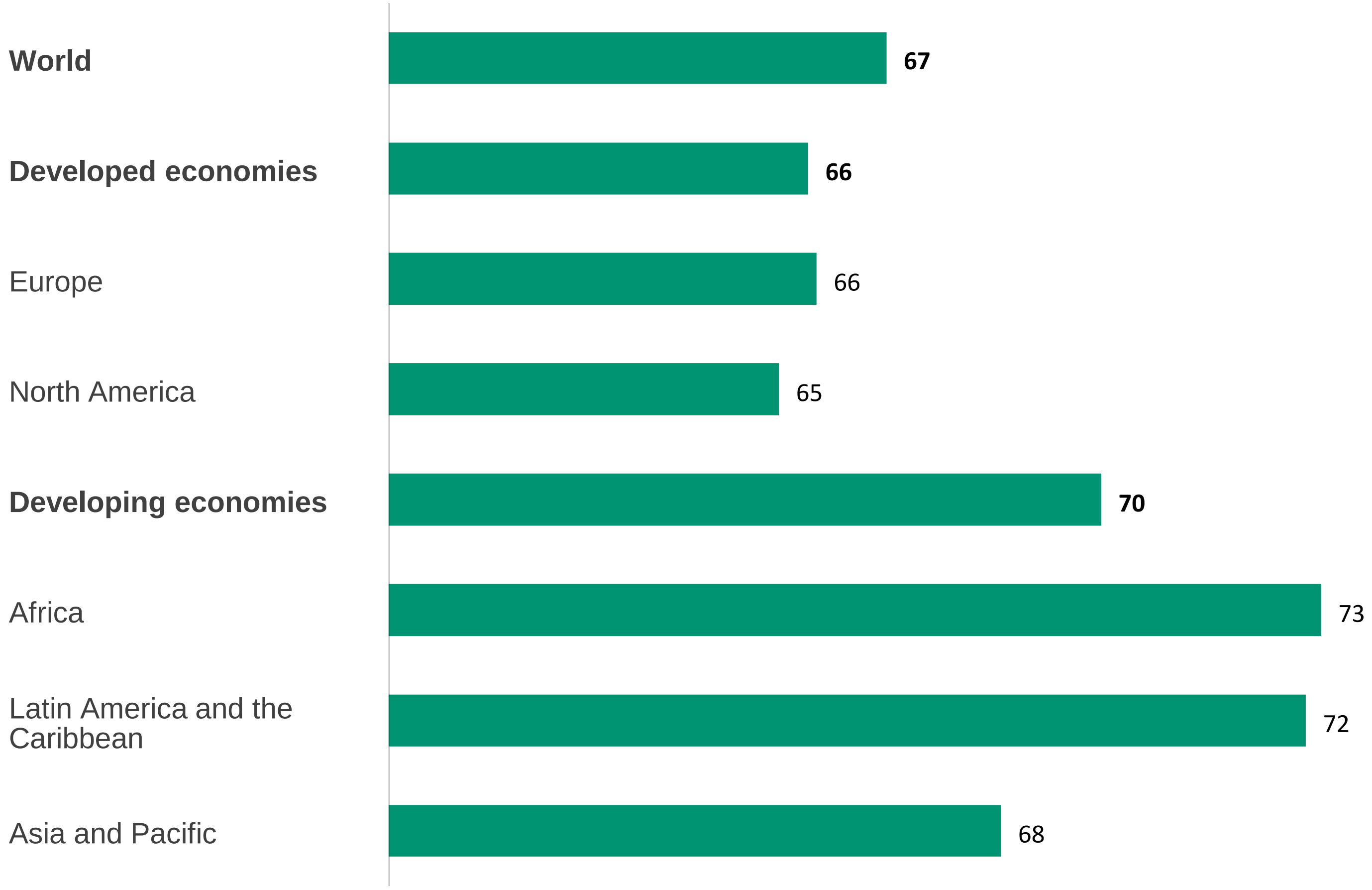
D. Revenue **gains for government are sizable**. Globally governments will receive around **20 per cent more** corporate income taxes; OFCs will lose substantial revenues.

2. It involves much more FDI and countries than it seems

What it seems…	***What is:***
A. It involves "only" large firms – annual revenues threshold of EU750 million	A. It does not involve only large firms but FDI by large MNEs: the majority!
B. It will affect only countries that have signed the agreement – 141 jurisdictions, excluding many developing countries	B. By its design Pillar II does not require global agreement and, moreover, is hard for host countries to escape
C. A minimum at 15% will affect only low-tax countries	C. All countries will be affected; higher-tax countries will just be *less* affected than lower-tax countries

A. FDI by large MNEs are the majority

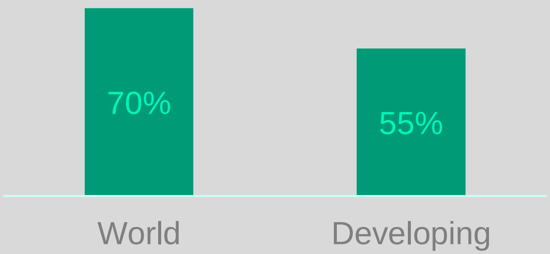
Share of greenfield investment projects by MNEs with revenues of more than EU750 million, 2015-2021



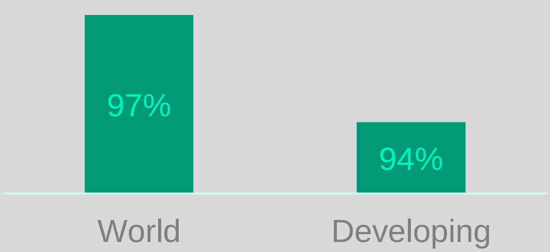
B. Hard for any country to escape

Inclusive Framework: 141 jurisdictions

Share of countries:



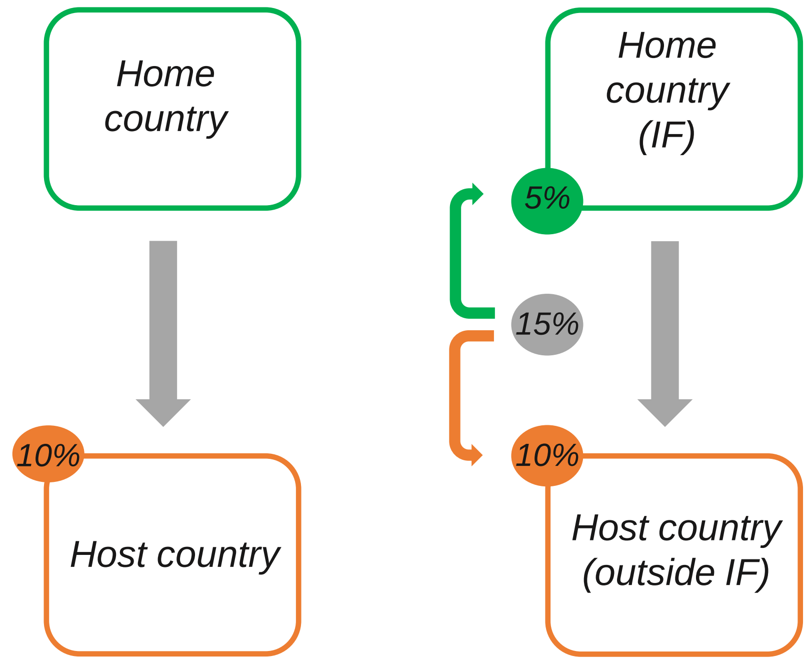
Share of inward FDI stock:



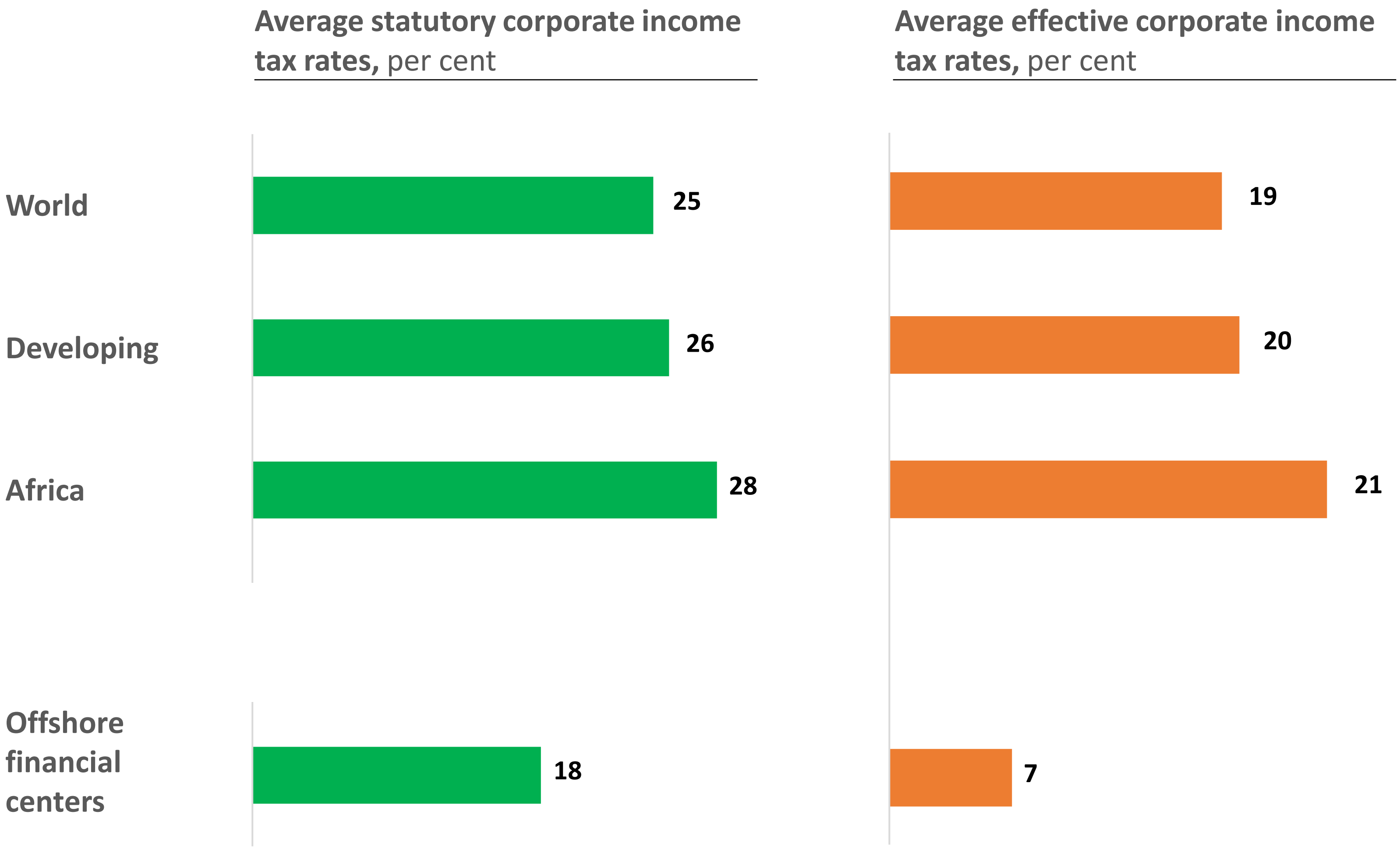
Outside the Inclusive Framework? *Not really, if the investor country is inside the IF*

Pre-Pillar II:

Post-Pillar II:

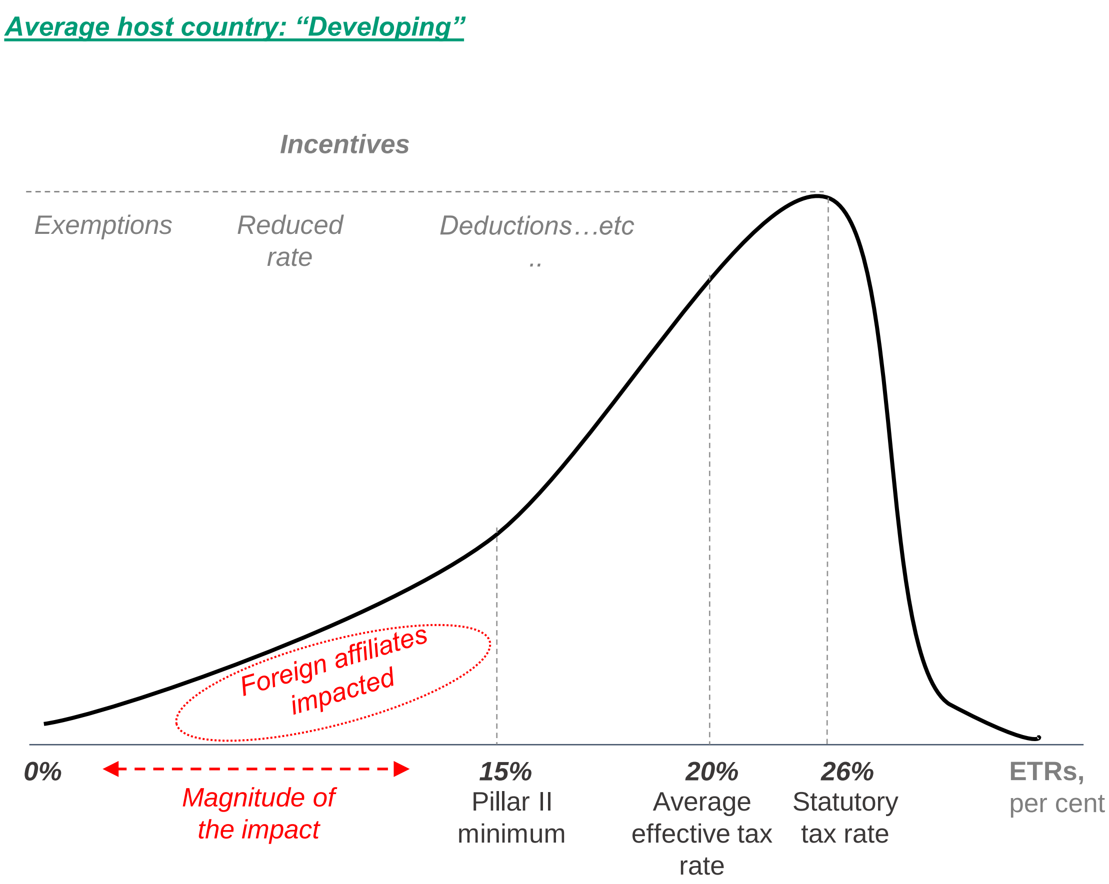


C. But most countries have tax rates well above 15%!



C. On average…that does not mean that individual firms do not pay less than 15%

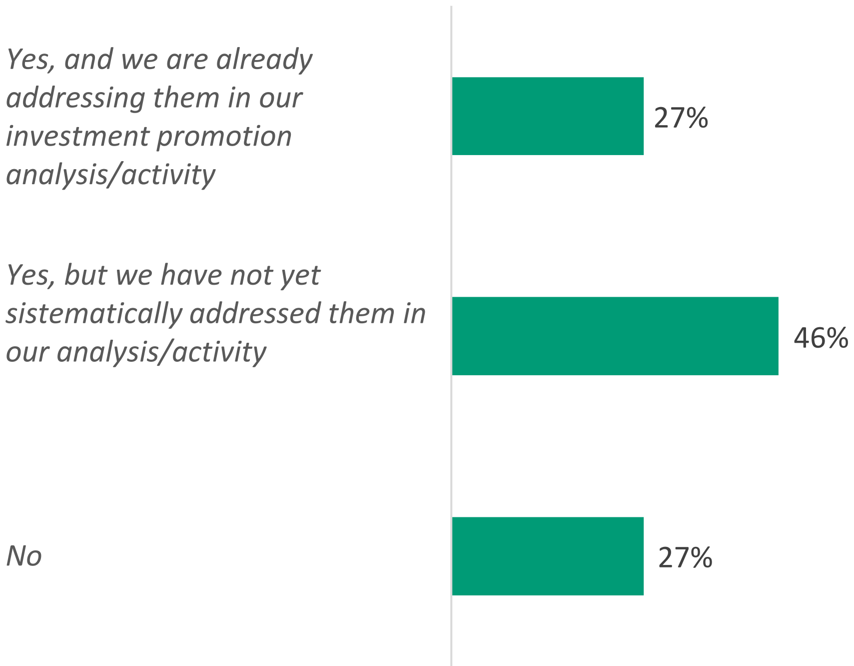
- National governments use a range of tax incentives to attract FDI.
- However, tax incentives are not granted uniformly to all foreign affiliates
- The average effective tax rate observed at the country-level is the result of very different tax rates faced by single firms.
- **Even when the average ETR is high, some companies/incentives will be affected**



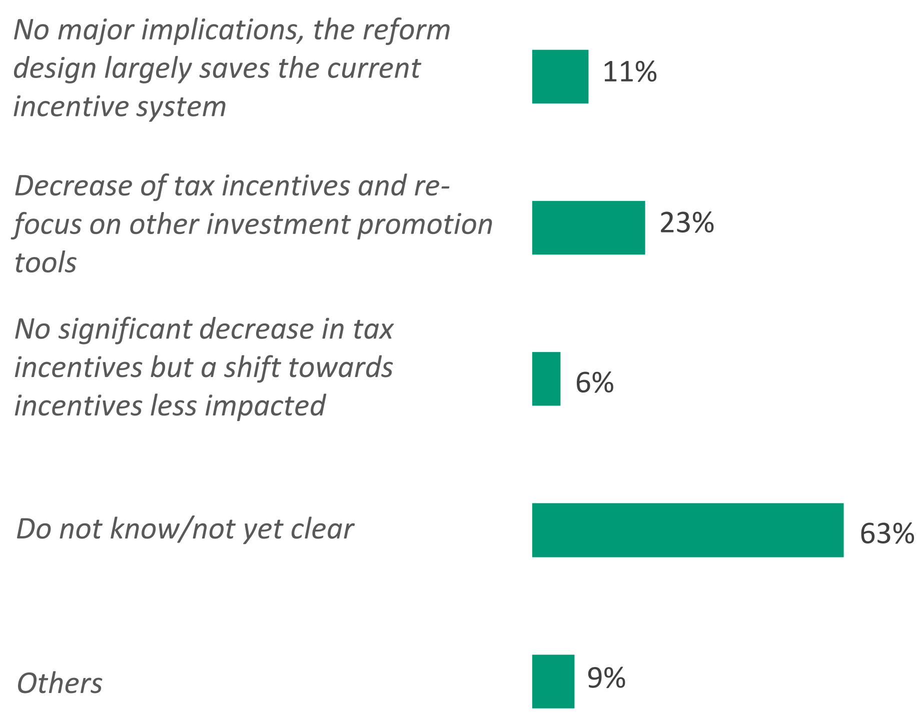
3. Implementation starts “tomorrow”: are we ready?

From UNCTAD IPA Survey

Are you aware of the potential implications on tax incentives of the introduction of a global minimum tax on FDI profits?

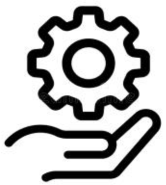


What do you expect to be the main implications from the introduction of a global minimum tax on tax incentives in your country?



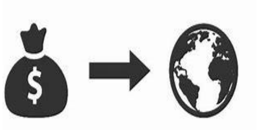
3. UNCTAD three policy recommendations to support developing countries

1. Vastly **scale up technical assistance** to developing countries to best respond to the investment challenges posed by the reform, with a particular focus on facilitating exchange and coordination between the tax and investment policymakers



2. As part of the IIA reform process, consider adopting a **multilateral solution to address potential conflicts arising from Pillar II** and mitigate related ISDS risks

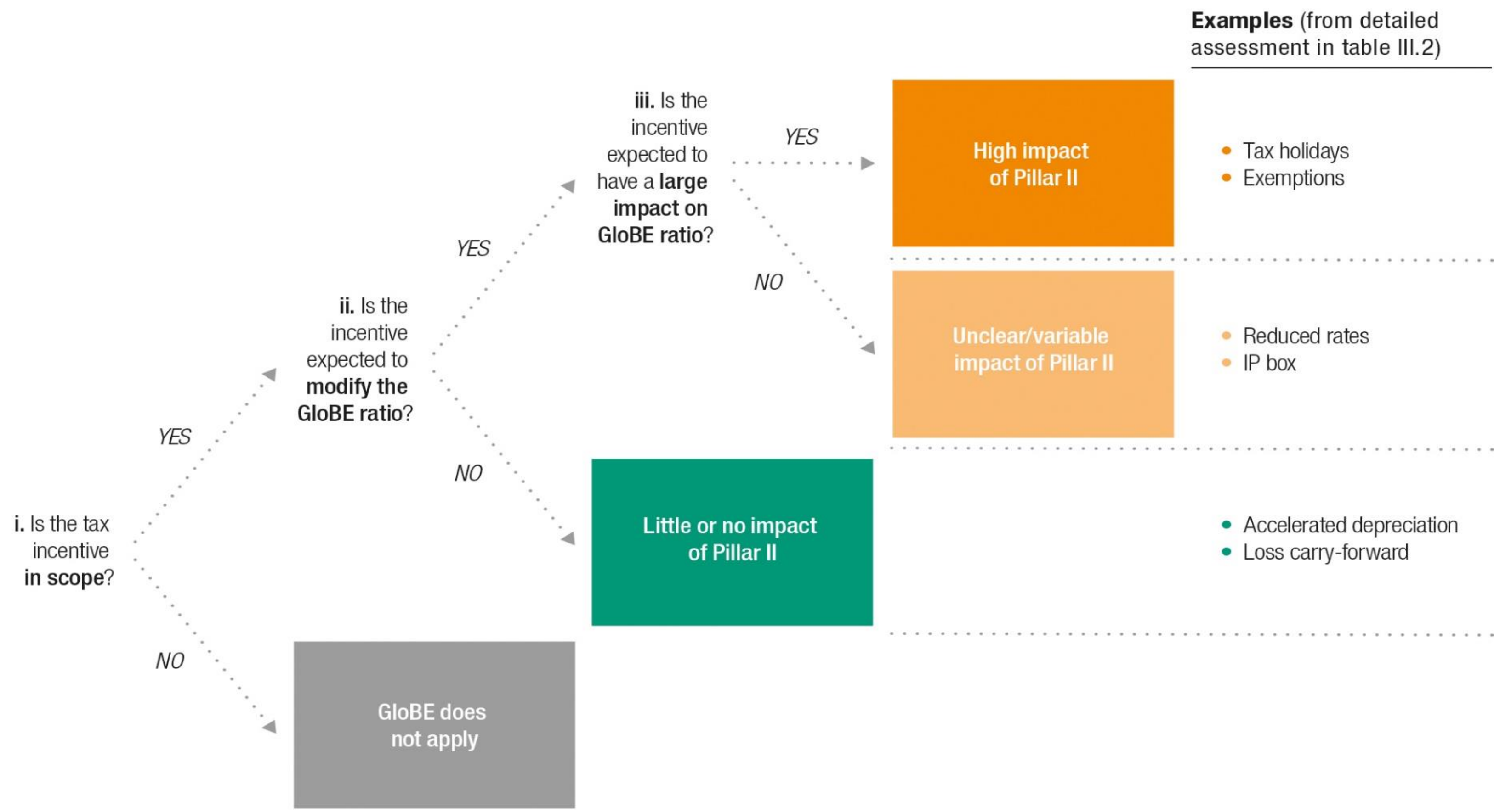
3. **As a stopgap measure,** envision **mechanisms to compensate developing countries for any top-up revenues** raised by developed home countries that should have accrued to developing host countries, but that they were unable to raise because of capacity or treaty constraints.



BACKUP

C. A bit more on incentives: for Pillar II, not all are the same

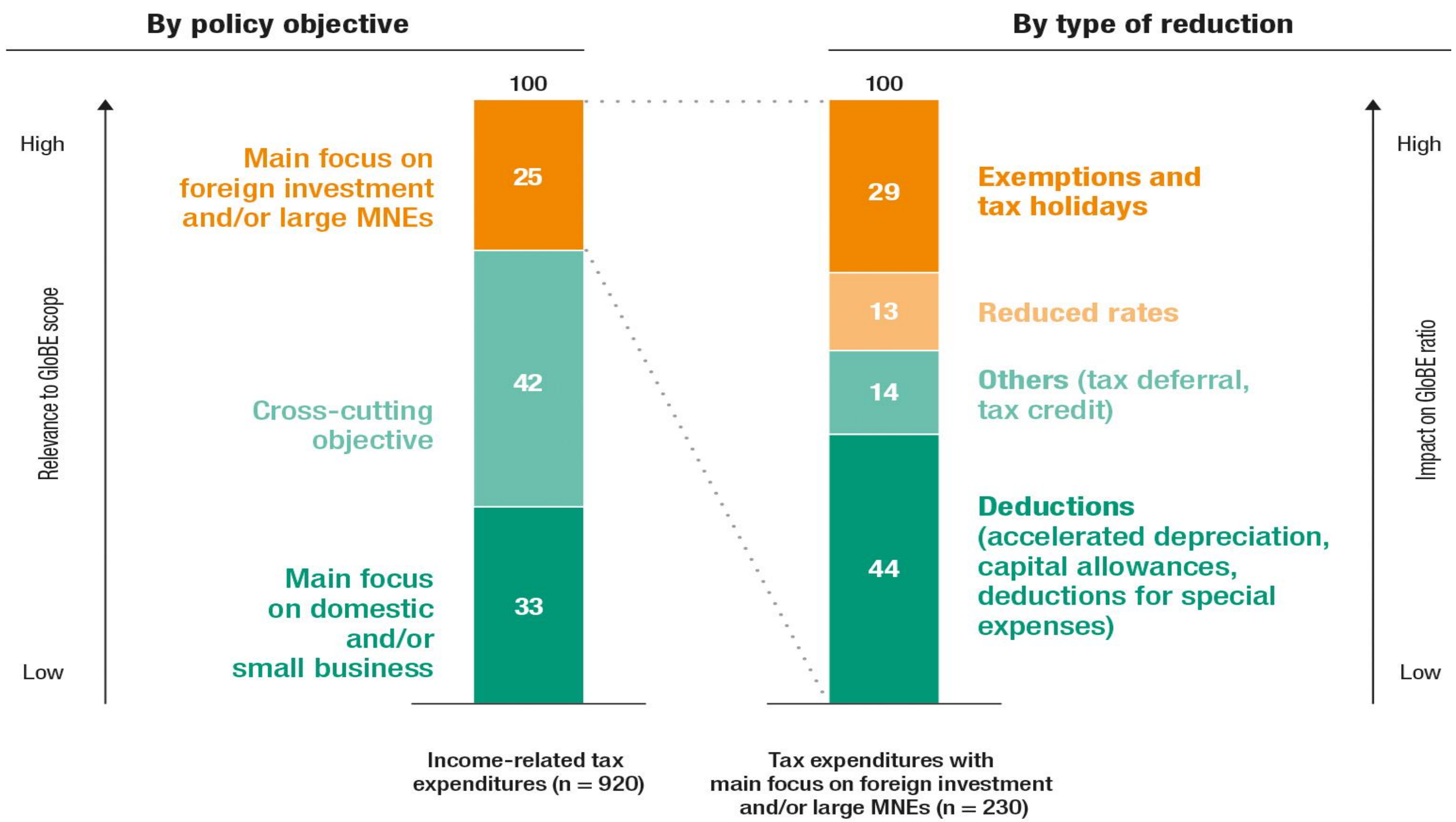
Figure III.17. | Framework to assess the impact of Pillar II on (income-related) tax incentives



Source: UNCTAD.

C. Highly affected incentives are a minority

Figure III.16. **Income-related tax expenditures, by policy objective and type of reduction, 1990–2020** (Per cent)

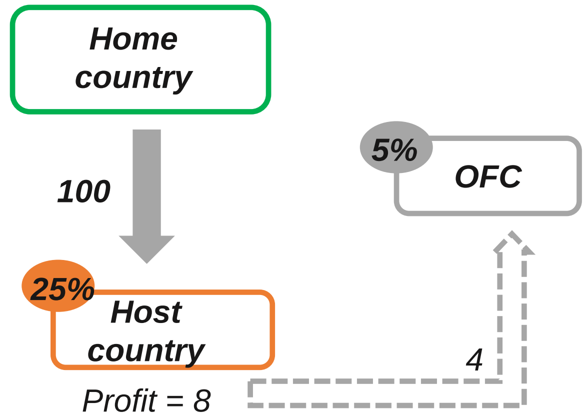


Source: UNCTAD, based on the Government Tax Expenditure Database.

C. Additionally the “profit-shifting channel” affects also high-tax countries

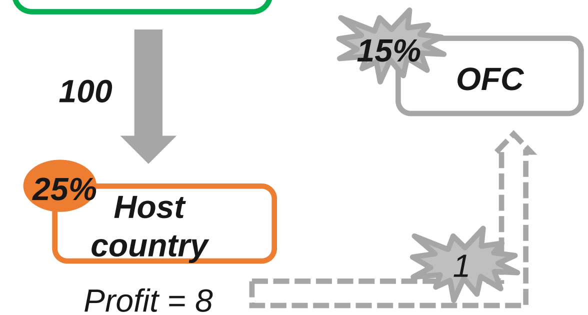
- As result of profit shifting, the ETRs observed in host countries do not reflect actual tax rates faced by MNEs on (income generated by) FDI in the country
- Even **countries with high ETR will be affected by the reform through its impact on outward profit shifting**

Pre-pillar II



- *MNE pays 1.2 of CIT (15% effective tax rate)*
- *Host country makes 1 of revenues*

Post-pillar II



- *MNE pays 1.9 of CIT (+60% CIT)*
- *Host country makes 1.75 of revenues*
- *Investment becomes more expensive – MNE may invest less (**volume effect**)*
- *Host country B becomes relatively cheaper – **diversion effect** may compensate volume effect*

How should IPA and SEZ managers respond?

(Timely) build awareness and knowledge...

The global minimum tax is due to take effect from 2023, so **the need for action is now**: seek advisory, build background knowledge and liaise with the relevant stakeholder (MNEs and investment institutions)

…make a diagnostic of the situation as is…

Based on such knowledge, assess **likely impact of the global minimum tax:** mapping and assessment of tax incentives; screening of effective tax rates paid by foreign affiliates.

…think forward, re-shape investment promotion strategies.

Based on assessment, think at what is going to be the impact of the minimum tax on **investment promotion strategies going forward:** how it is going to change the tax framework for investment promotion and how will other non-tax investment promotion tools can be leverage

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