ZEW policy brief

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Significant Costs, Limited Benefits: A Global Minimum Tax in Germany

In order to curb tax-motivated profit shifting and limit international tax competition, 137 signatory countries to the Inclusive Framework on Base Erosion and Profit Shifting (BEPS) agreed in 2021 to introduce a global minimum tax on multinational corporations. At first glance, the introduction of the minimum tax would effectively limit international tax competition to a rate of 15%. However, this would require the global implementation of the scheme, as well as the harmonization of tax-base calculation methods. Fulfilment of these conditions is unrealistic, however, due to non-cooperative countries as well as current political tensions. In addition, high administrative and compliance costs would result. Our estimates show that the additional tax declaration costs for affected German corporations would amount to around 319 million euros for implementation and to around 100 million euros annually for ongoing compliance. In September 2022, the German government announced that, if necessary, Germany will unilaterally introduce the global minimum tax scheme. This is not advisable, however, since a unilateral move would not reduce tax-motivated profit shifting or international tax competition. At the same time, it would lead to high one-sided costs and a reduction in Germany's attractiveness as a location for business and investment, while also generating little in the way of new revenues.

RECOMMENDATIONS FOR POLICYMAKERS

- The minimum tax will only work if it is introduced on a global scale and if tax base calculation methods are harmonized internationally. However, fulfilment of these conditions is not realistic due to non-cooperative countries and current political tensions. Implementation at the EU level would also be insufficient for achieving the desired objectives, and would lead to high costs for administration and compliance.
- Germany should not unilaterally introduce a global minimum tax, as this would not curb tax competition or generate meaningful additional tax revenues, but rather unilaterally damage Germany's attractiveness as a location for business and investment.
- As an alternative to the introduction of the complex and cost-intensive global minimum tax, the abolition of preferential tax regimes, such as IP boxes, would be more effective. Furthermore, the consistent introduction of CFC rules with exceptions for certain areas and the levying of internationally coordinated withholding taxes represent options for curbing profit shifting without causing additional costs of taxation.

THE GLOBAL MINIMUM TAX

The global minimum tax aims to curb tax-motivated profit shifting

In 2021, 137 countries agreed to introduce a global minimum tax on corporate profits. The aim is to establish a globally effective minimum tax level of 15% on corporations with consolidated revenues of at least 750 million euros. The core element of the minimum tax scheme is the top-up tax, which would be enforced if a corporation falls below the minimum tax level of 15% in a country. The top-up tax would then be levied through two complementary rules: the Income Inclusion Rule (IIR) and the Undertaxed Payments Rule (UTPR). The IIR, which is the primary mechanism, obliges the parent entity of the corporate group to pay the top-up tax for low-taxed group entities. Subordinately, the UTPR denies the deduction of expenses in the residence country of a subordinate group entity. In addition, countries would have the option of introducing a Qualified Domestic Minimum Top-up Tax (QDMTT), which would have priority application over the IRR and UTPR. The QDMTT would enable source countries to withhold the top-up tax from resident, low-taxed business entities.

Questionable effectiveness, but high compliance costs

At first glance, the global minimum tax would limit tax competition by establishing a minimum tax rate of 15%. However, this would require global implementation of the scheme, as well as the harmonization of tax base calculation methods. Due to non-cooperative countries as well as current political tensions, it is unlikely that these conditions could be fulfilled. As a result, (partial) implementation of the scheme would merely change the nature of tax competition, rather than reducing it. In addition, the creation of a special tax regime for only a few corporations would lead to the coexistence of varying regulations and considerably increase the complexity of the already complicated international tax system. Current estimates indicate additional tax revenues for Germany of less than 2 billion euros, which would potentially be even lower due to expected responsive measures by other countries (e.g. adoption of the QDMTT). At the same time, high compliance costs would arise for tax authorities and corporations.

ESTIMATING COMPLIANCE COSTS

Survey on compliance costs

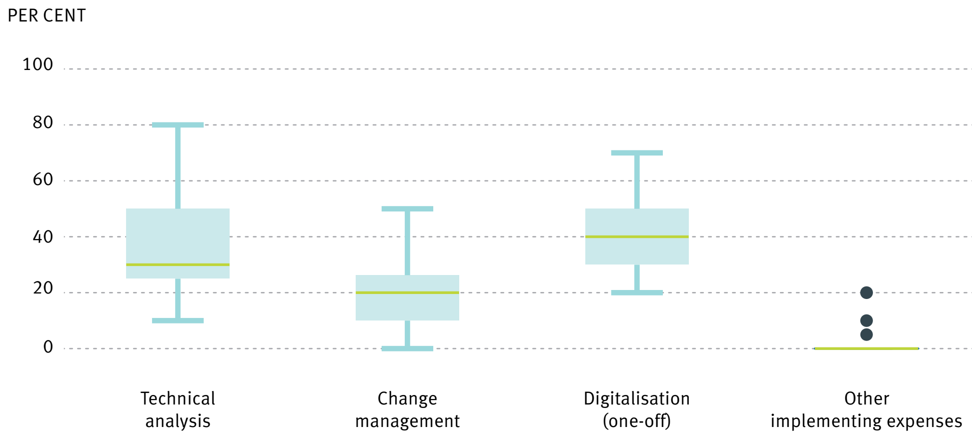
Empirical estimates of the compliance costs that would be borne by companies as part of the global minimum tax scheme have been lacking to date. To address this gap in the literature, in October 2022 we conducted a survey of companies in Germany that would be affected by the tax. Using the Orbis corporate database, we identified a total of 454 German corporations potentially affected by the global minimum tax.

High implementation and ongoing expenses for German corporations

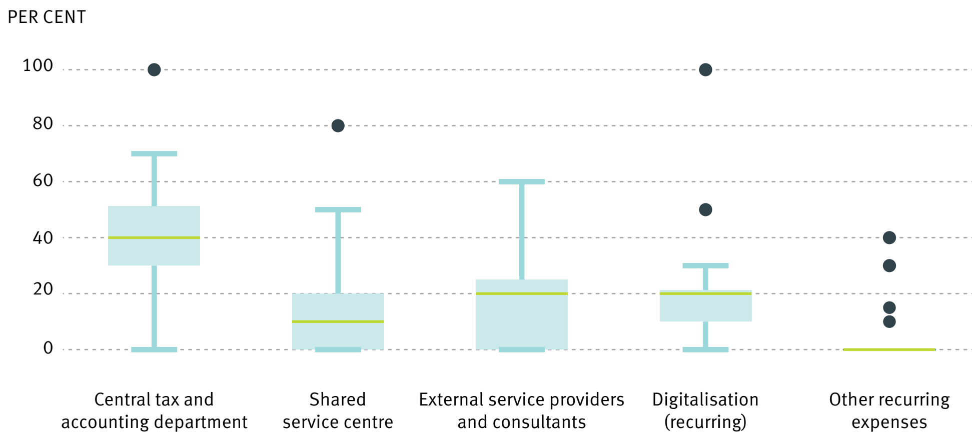
The company survey was conducted in cooperation with the Federation of German Industries (BDI), which notified corporate tax departments of the online survey by e-mail. After two weeks, a total of 27 corporations had fully completed the survey. The participating corporations included those with annual revenues of less than 2 billion euros as well as some of the largest German corporations, with annual revenues of more than 20 billion euros. The average implementation expenses per corporation were estimated at 1.6 million euros and the average annual expenses on an ongoing basis were estimated at 0.4 million euros. Based on the ratio of revenues to declaration costs that was determined for participating corporations, we then estimated the cumulative expenses that would results for all affected German corporations. The estimated costs for all 454 affected German corporations were estimated at 319.3 million euros for implementation and 97.3 million euros for ongoing compliance.

FIGURE:

BREAKDOWN OF IMPLEMENTATION EXPENSES IN DETAIL, N=28



BREAKDOWN OF RECURRING EXPENSES IN DETAIL, N=28



The figure breaks down reported costs. The implementation expenses are strongly driven by required IT outlays (average: 41%, median: 40%) as well as costs for functional tax audits (average: 38%, median: 30%), while the recurring expenses are primarily attributable to increased central tax and accounting department expenses (average: 42%, median: 40%). Several corporations reported that the introduction of the minimum tax poses a challenge, because new data would need to be generated and aggregated at different levels, thus requiring the expansion of IT systems. The high costs for tax audits as well as the recurring expenses for central tax and accounting departments reflect the complex nature of implementing the minimum tax across a corporate group.

High costs for tax authorities

The compliance costs that would fall to corporations are likely to be incurred in a similar way by tax authorities. This is because tax authorities would need to establish new IT systems and staff resources, to enable the top-up tax to be efficiently determined, assessed, and levied. Furthermore, costs would accrue as part of information exchange with corporations and other jurisdictions.

CONSEQUENCES OF A UNILATERAL INTRODUCTION IN GERMANY

Germany is considering a unilateral move

The German government's coalition agreement states that Germany will continue to actively promote the introduction of a global minimum tax. Given a continued lack of international consensus on this issue, the Federal Ministry of Finance announced in September 2022 that Germany will introduce the global minimum tax, unilaterally if necessary, irrespective of EU-level agreement.

Unilateral action would harm Germany as an investment location

However, the extent to which German tax authorities could enforce a unilateral minimum tax is subject to question. The only possible option appears to be enforcement through the IIR at German parent firms. In this way, low-taxed entities would be additionally taxed in Germany. However, this would significantly reduce Germany's attractiveness as a location for headquartering a company. By contrast, the enforcement of a minimum tax through the Undertaxed Payments Rule (UTPR) appears unfeasible, since the UTPR could easily be circumvented through modified ownership structures. Specifically, companies could be expected to strategically move low-taxed subsidiaries out of the hands of German entities, relocating them in conglomerates based in countries without a minimum tax. As a result, the additional tax revenues generated by a unilaterally imposed minimum tax in Germany would be minimal. At the same time, a unilateral introduction would provide incentives to relocate real investment abroad, significantly reducing Germany's attractiveness as a business location, both for German and international corporations.

ALTERNATIVES

Eliminating preferential tax regimes would be easier and more appropriate

In the absence of international consensus, the global minimum tax is an ineffective means for curbing profit shifting or tax competition. However, good alternatives for pursuing these objectives exist. Abolishing preferential tax regimes (such as IP boxes and notional interest deductions on equity) while also eliminating special agreements with tax authorities (so-called tax rulings) could not only curb tax-motivated profit shifting but also generate additional tax revenue at a lower cost than the global minimum tax scheme.

Expanded CFC rules and withholding taxes are a good alternative

In addition, existing regulations should be consistently extended. With regards to outbound investments in low-tax countries, existing CFC regulations could be expanded in a targeted and reasonable manner in order to make a top-up tax redundant. In the case of inbound investments, withholding taxes should be extended in an internationally coordinated effort, as called for in the German government's coalition agreement. Consequently, withholding taxes could be levied on all outbound payments. In this way, tax sovereignty would be strengthened, and tax havens would suffer a decline in economic relevance.

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