

Global Tax Reform and Tax Expenditures : A Prospective Analysis

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9th International Workshop on Domestic Revenue Mobilisation: “Tax Expenditures and DRM”

9-11 November 2021

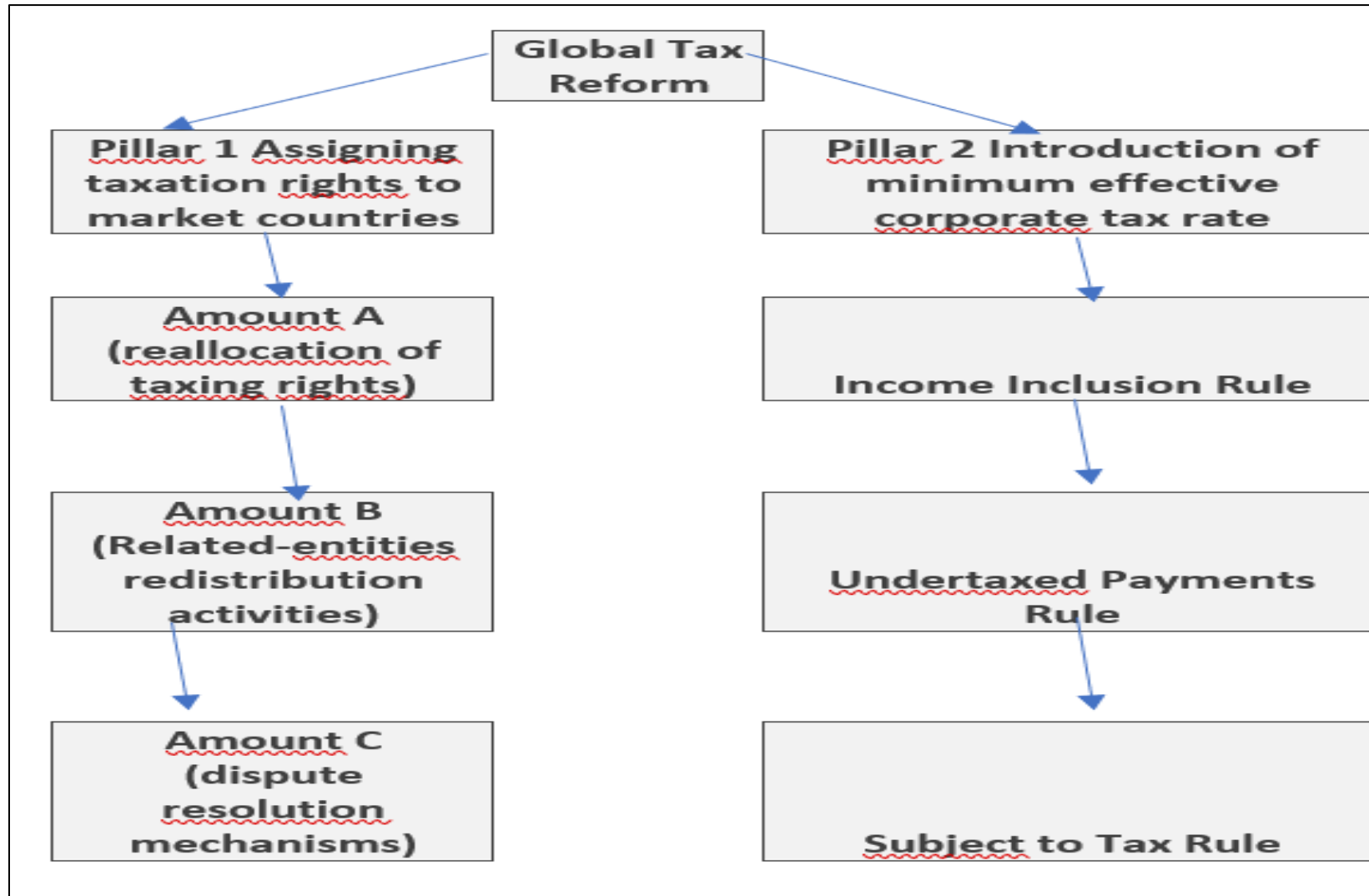
Agenda

1. Background
2. Overview of OECD/G20 two pillars global tax reform proposal
3. Criticisms of the international tax reform agreement
4. Empirical analysis of the impact of global tax reform on tax expenditures
5. Conclusion and policy implications

Background

- In October 2021, 136 out of the 140 jurisdictions of the OECD/G20 Inclusive Framework reached agreement on the two-pillar tax reform for addressing the tax challenges arising from the digitalisation of economies.

Structure of the agreement



Criticisms/reservations about the international tax reform agreement

- Priority given to headquarters countries to charge a top up tax under the income inclusion rule of pillar 2
- The global minimum corporate tax rate of 15% is low and the tax base under pillar 1 is narrow.
- Discomfort with the removal of domestic digital taxes.
- Legitimacy of OECD and call for setting an UN tax body to lead discussions on global tax reform (Mukamba, 2021).

Global tax reform and tax incentives

- Beyond these critical observations, the implementation of the global minimum corporate tax rate may lead countries to review tax incentives (Readhead, Lassourd and Mann, 2021).
- However, it may be difficult to amend tax incentives that are subject to fiscal stabilisation clauses (Readhead et al, 2021).
- Accordingly, the impact of global tax reform on tax expenditures for developing countries is unknown a priori.

Objective of the paper

- This paper explores the impact of the global minimum corporate tax rate on the use of tax incentives in african countries.
- This ex-ante evaluation will inform policy decisions for the revision, the adoption and the implementation of global tax reform rules

Empirical methodology

Objective: Evaluate the effect of having an effective corporate tax rate of at least 15% on tax expenditures.

- **Methodology:** Randomized discontinuity design (Imbens and Lemieux, 2008; Hahn, Todd, and Van der Klaauw, 2001; Meyersson, 2014)
- **Assignment/forcing variable:** Effective corporate income tax rate
- **Cutoff (threshold):** 15%
- **Outcome variable:** tax expenditures (revenue forgone in %GDP)
- **Specification:**

$$y_i = \alpha + \beta T_i + f(a_i) + \varepsilon_i$$

$$\forall a_i \in (c - h, c + h)$$

Data

- **Data on tax expenditures** : Global Tax Expenditures Database (GTED) built by the Council on Economic Policies and the German Development Institute.
- **Corporate income tax revenue** : ICTD/UNU-WIDER-GRD database.
- **Statutory corporate income rate** : Tax Foundation's Corporate Tax Rates and the Fiscal Affairs Department of IMF.
- Controls variables including GDP per capita growth, FDI net inflows and trade openness are extracted from the WDI.

Data

We compute effective corporate tax rate (ETR) using data on tax expenditures, tax revenue and statutory corporate tax rate (STR) as inputs in the following approach:

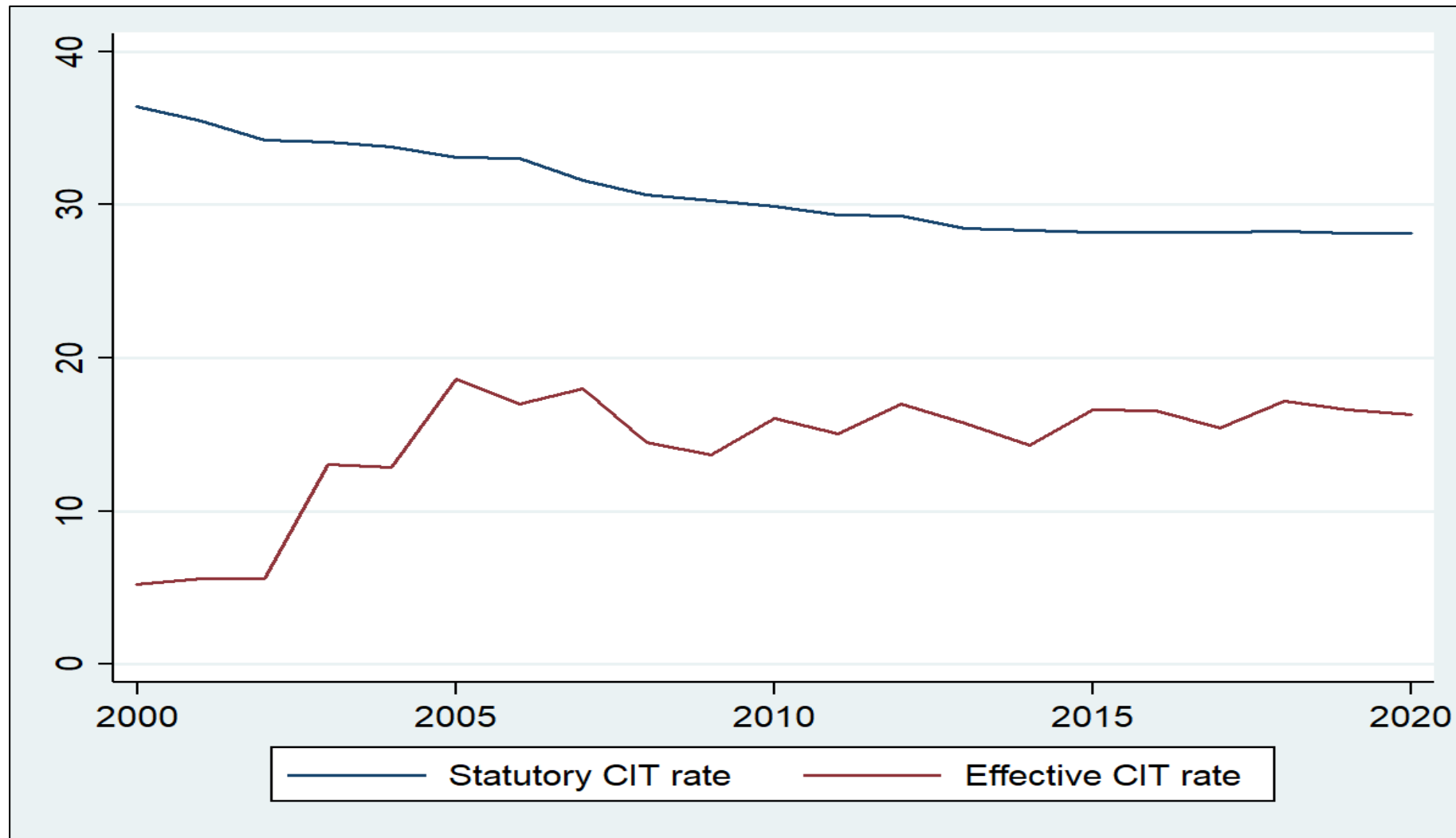
- **$(\text{Accounting Profit}) \times \text{STR} - (\text{tax expenditures}) = \text{actual taxes}$** (1)

- **$\text{Accounting profit} = (\text{actual taxes} + \text{tax expenditures}) / \text{STR}$** (2)

- **$\text{ETR} = \text{actual taxes} / \text{Accounting profit}$** (3)

- **$\text{ETR} = \text{actual taxes} / ((\text{actual taxes} + \text{tax expenditures}) / \text{STR})$** (4)

Statutory corporate tax rate and Effective corporate tax rate



Results

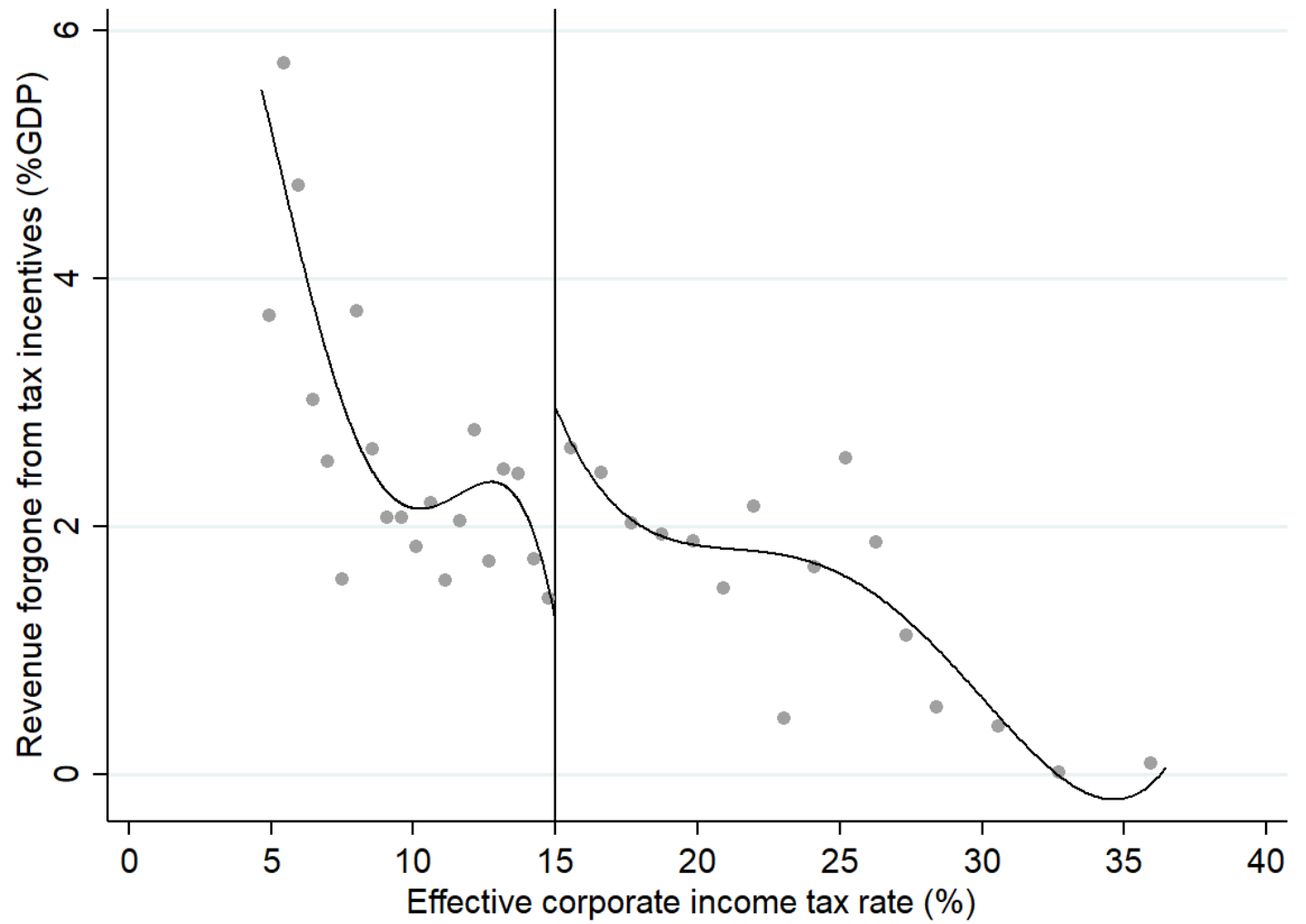
- RDD specification tests (Cattaneo et al, 2020) :

- (i) the null treatment effect on predetermined covariates
- (ii) (ii) the continuity of the score density around the cutoff. H0: No difference in the density of treated and control observations at the cutoff
- (iii) (iii) the treatment effect at artificial cutoff values (placebo cutoff)

	(1)	(2)	(3)	(4)	(5)
	FDI	AIDI	Trade openness	Inflation	GDP per capita growth
RD Estimate	-1.364	26.058**	-12.443	-10.05**	1.397
	(2.310)	(10.232)	(11.953)	(5.060)	(1.164)
Observations	146	146	147	145	149
N right	84	85	83	83	85
N left	62	61	64	62	64
Pvalue	0.581	0.0309	0.322	0.0422	0.210
Density test of the assignment variable					
RD Estimate =0.8424 ; Robust P-value =0.3996					
Placebo test					
RD Estimate= -0.17809 ; Robust P-value =0.127					

Results

- Graphical representation



Estimation Results

	(1)	(2)	(3)	(4)
Revenue forgone from tax incentives (%GDP)				
RD Estimate	-0.569*** (0.205)	-1.029** (0.407)	-0.672*** (0.211)	-1.045*** (0.363)
Observations	139	139	139	139
Threshold of forcing variable (c) (%)	15	20	15	20
Clustered standard errors	No	No	Yes	Yes

Conclusion and Policy implications

- ✓ This study contributes to the debate on the implications of the global minimum corporate tax rate for african economies. We implement a randomized discontinuity design to evaluate the effect of having an effective corporate tax rate at least 15% on tax expenditures.
- ✓ The results indicate that the implementation of the global minimum effective corporate tax rate of 15% is likely to reduce tax expenditures and thereby increase revenue for african economies.
- ✓ Moreover, we find that the potential gains from the global tax reform in terms of cuts in tax expenditures would have been much larger for african economies if the minimum global effective corporate income tax rate was at least 20%.
- ✓ These findings exhort the Inclusive Framework and all the stakeholders of the global tax reform negotiations to consider revising the agreement towards increasing the threshold for the global minimum effective tax rate for improving the benefits of the agreement for african economies.
- ✓ Such a revision will facilitate the political acceptability and the implementation of the reform in african countries

THANK YOU FOR YOUR ATTENTION