

World Investment Report 2022

The impact of the BEPS global minimum tax rate on FDI

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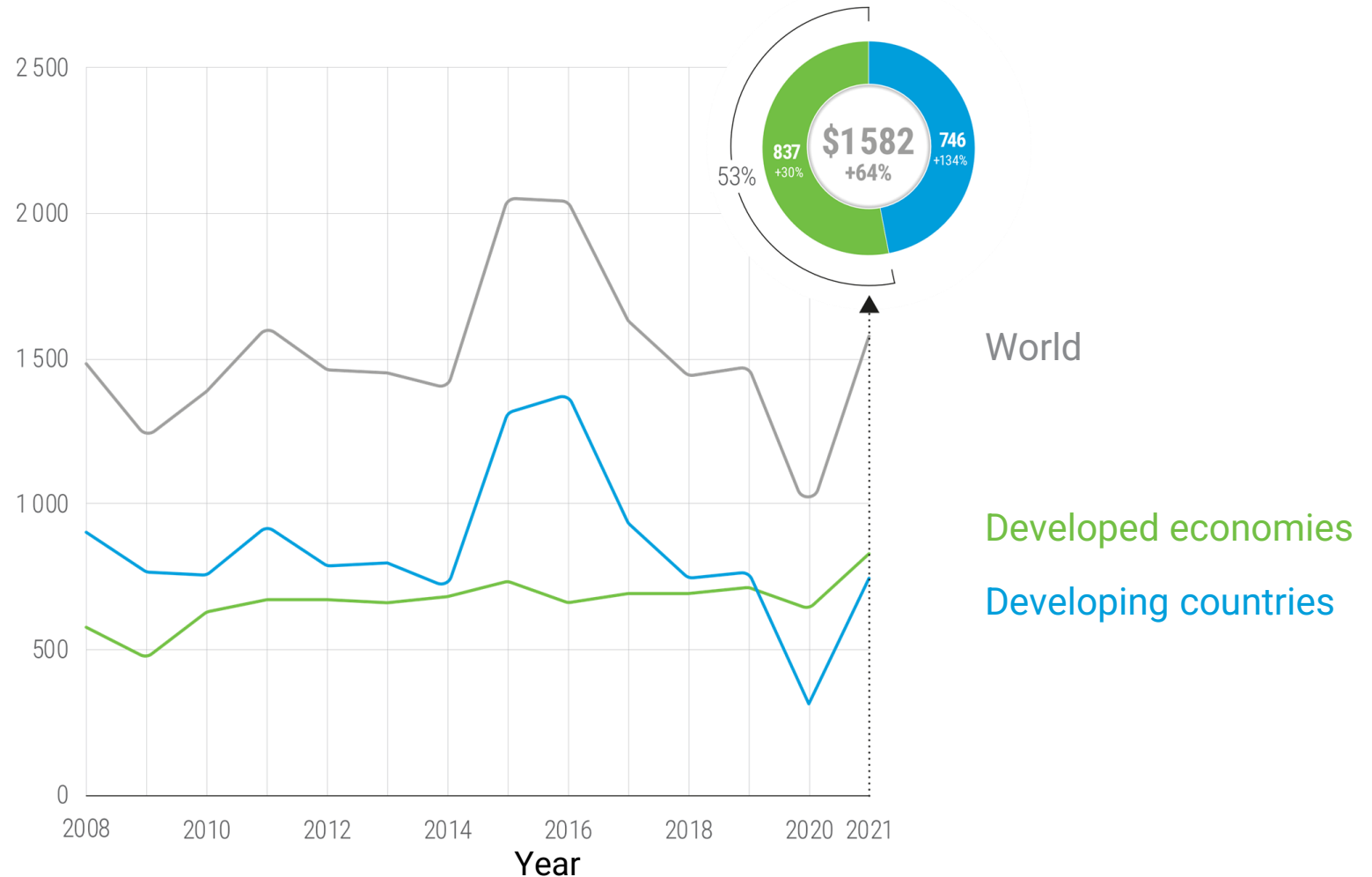
Bogotá, 07 October 2022

KEY INVESTMENT TRENDS



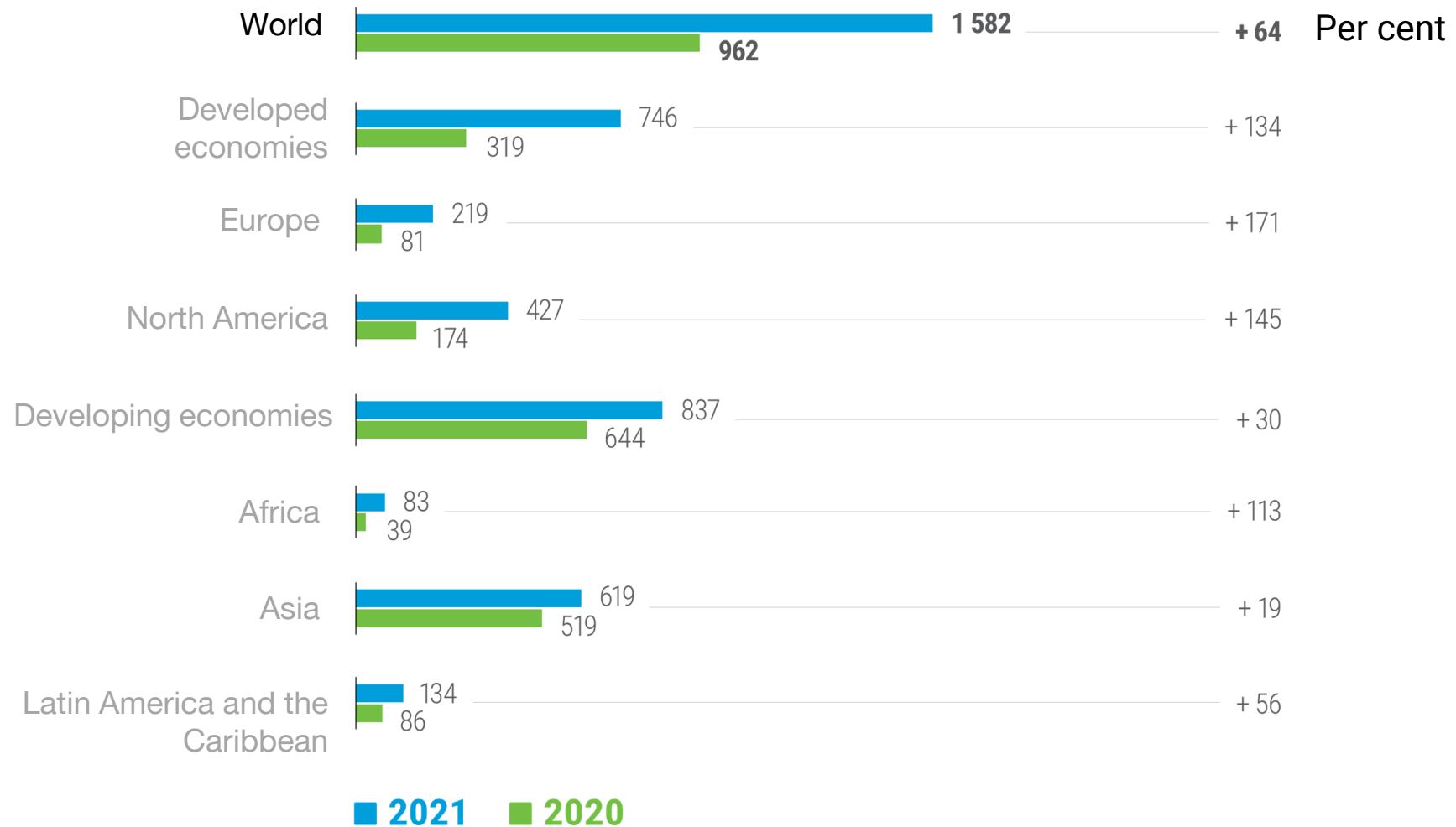
Global FDI flows in 2021 were \$1.6 trillion, up 64 per cent from the exceptionally low level in 2020

FDI inflows, global and by economic grouping, 2008–2021
(Billions of dollars and per cent)



Most of the growth was in developed countries

FDI inflows by region, 2020–2021 (Billions of dollars and per cent)



Investment in the SDGs was up due to growth in renewables, but most SDG sectors remain below pre-pandemic levels

International private investment in the SDGs: 2021 project numbers compared to pre-pandemic levels (Per cent)

Infrastructure

Transport infrastructure, power generation and distribution (except renewables), telecommunication



-11

Renewable energy

Installations for renewable energy generation, all sources



+2

WASH

Provision of water and sanitation to industry and households



-9

Food and agriculture

Investment in agriculture, research, rural development



-35

Health

Investment in health infrastructure, e.g. new hospitals



-25

Education

Infrastructural investment, e.g. new schools



+17

The impact of the BEPS global minimum tax rate on FDI



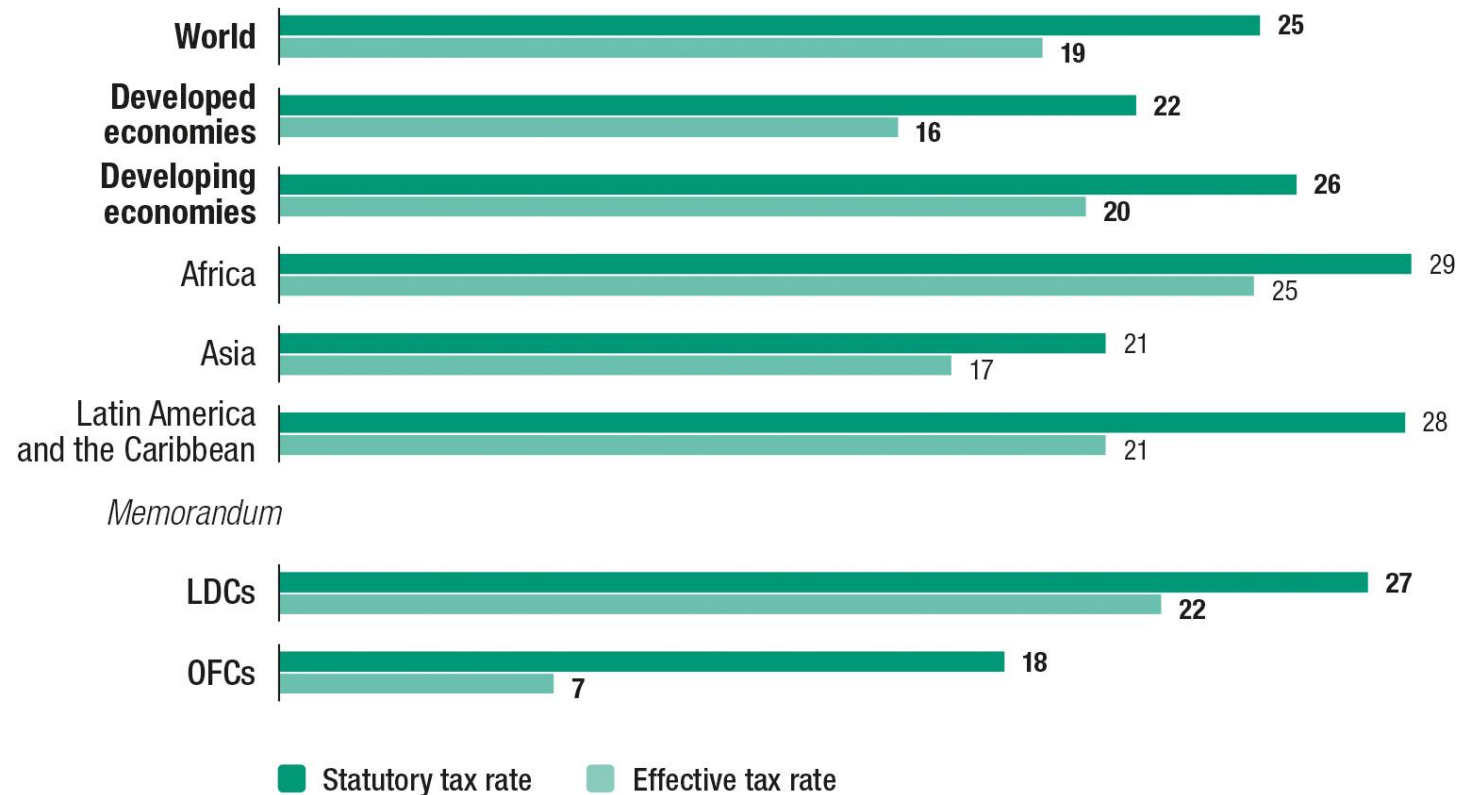
A 15% MINIMUM TAX ON PROFITS OF MULTINATIONALS WILL HAVE MAJOR IMPLICATIONS FOR INVESTMENT POLICY

Scope of Pillar II: MNEs with €750 million annual revenues

- Increased tax revenues from multinationals (15%) for most countries.
- Higher taxes on foreign profits of multinationals.
- Potential downward pressure on new investment by multinationals.
- Reduced effectiveness of low tax rates and fiscal incentives to attract investment.
- Urgent need for investment promotion agencies (IPAs) and special economic zones (SEZs) to review investment attraction strategies.

The average ETR paid by foreign affiliates of large MNEs is 19 % globally, 6 points below the average STR

Average statutory and effective tax rates of foreign affiliates of large MNEs, by economic grouping and region, 2017 (Per cent)

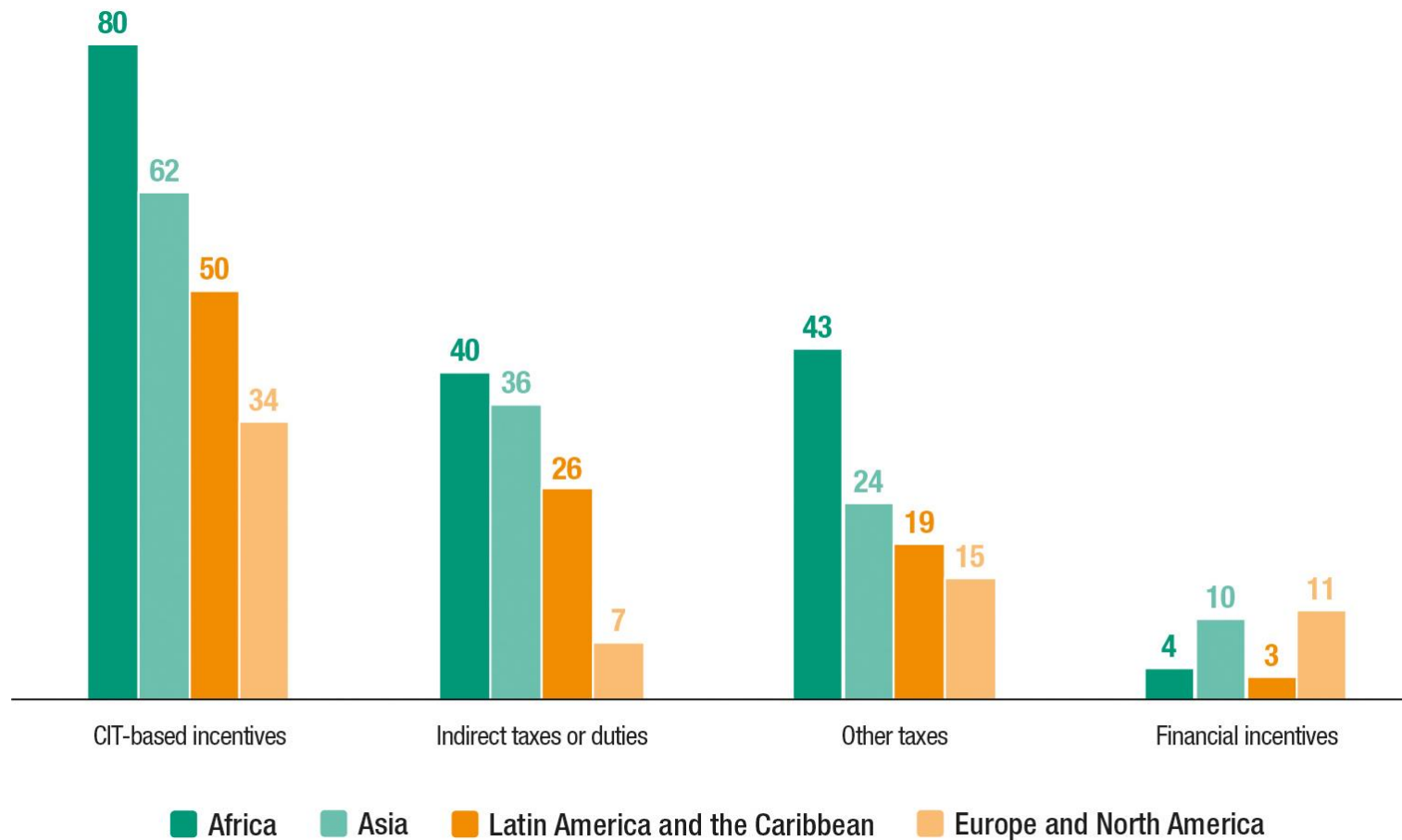


Source: UNCTAD; Tax Foundation for statutory tax rates and Garcia-Bernardo and Janský (2022) for CbCR-based effective tax rates.

Note: Simple averages across countries. CbCR = country-by-country reporting, LDCs = least developed countries, OFCs = offshore financial centres.

Strong reliance on profit-based tax incentives

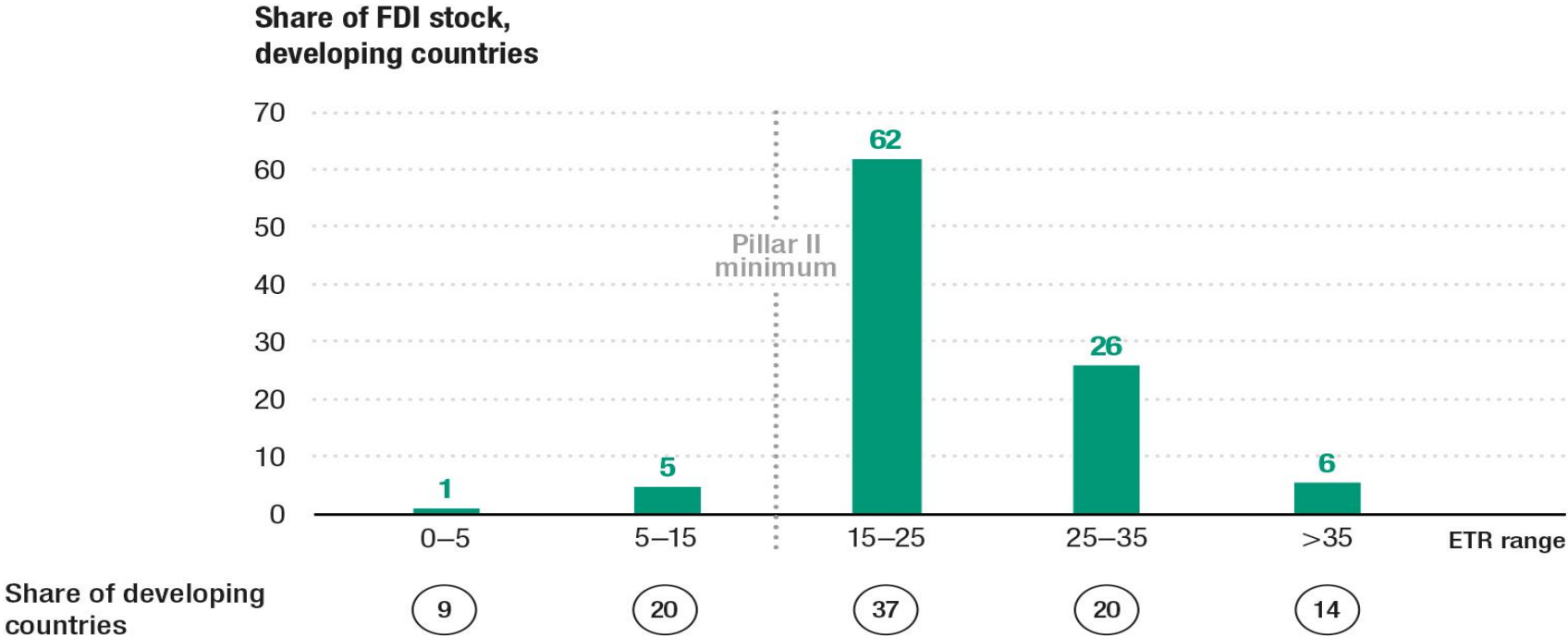
New investment incentives by type and region, 2011-2021



Source: UNCTAD, Investment Policy Monitor.

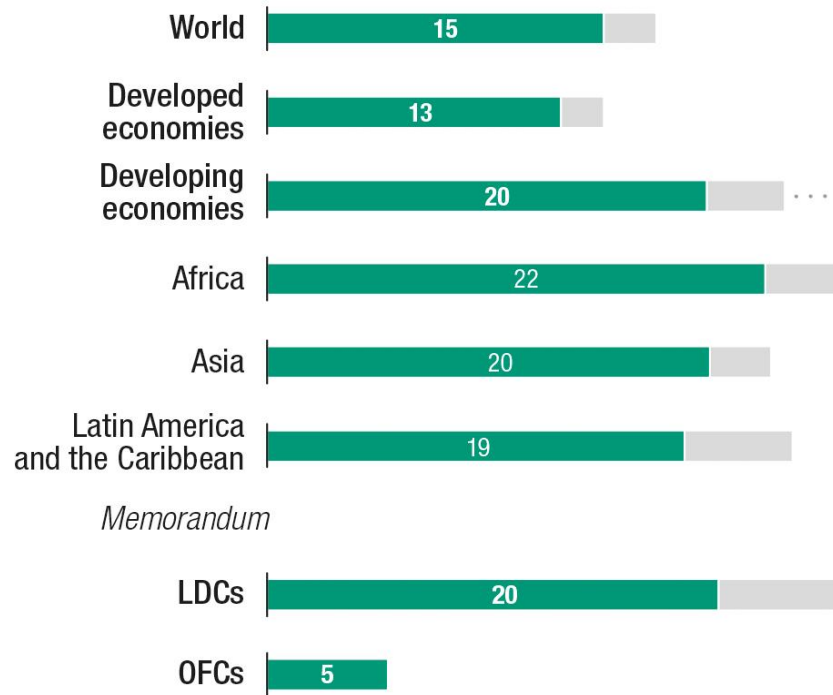
In developing countries, the bulk of FDI pay an average ETR above 15%

Distribution of FDI stock by average ETRs paid in the host countries; developing countries



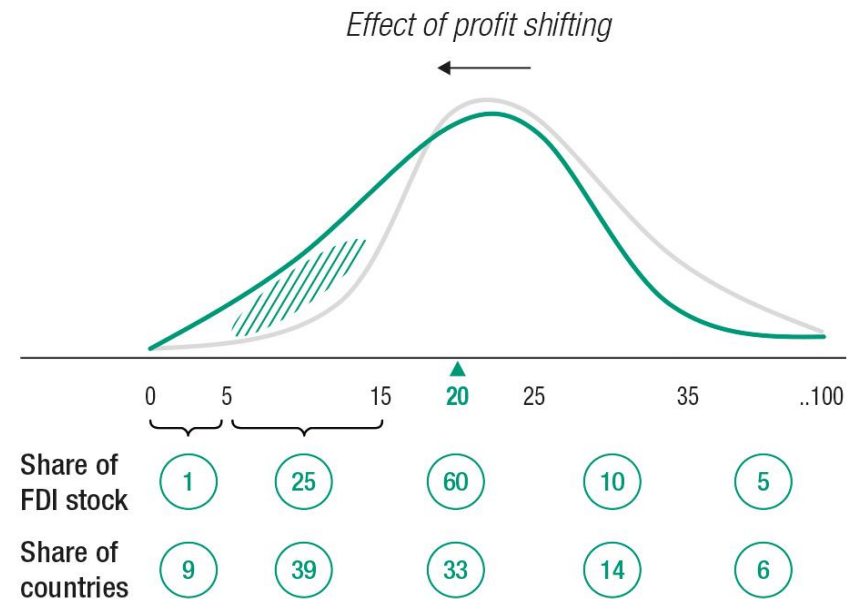
However, in presence of profit shifting, host countries' ETRs overstate the effective taxation of FDI

Average “FDI-level effective tax rates” paid by large MNEs (with consolidated revenues > \$750 million annually); by economic grouping region and region



■ FDI-level ETR
■ Delta to ETR

Stylized distribution of inward FDI stock by average (FDI-level) ETR in the host countries, developing countries



▲ Average FDI-level ETR
— FDI-level ETR — ETR

Why do we need to “worry” about the global minimum tax?

1. It is transformational: it re-shapes the international investment landscape
2. It is pervasive: it involves more FDI and countries than it seems
3. It is concrete: already signed, implementation in 2023 but awareness still very low

What are the development implications?

It is transformational

- MNEs pay more – average increase in CIT on FDI globally: between 15 and 20%; in LAC between 12 and 22 %. Most of the increase due to reduction in profit shifting: 65 % globally, more than 90 % in LAC.
- Overall investment may decrease: between 2 and 3 % .
- 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 % globally. Developing countries expected to gain between 1.5 and 3 % of FDI; LAC between 1 and 2 %.
- Revenue gains for government are sizable. Globally governments will receive 20 per cent more corporate income taxes, but gains are higher for developed economies (+30 per cent) than for developing economies (+15%); OFCs will lose substantial revenues .

2. Pervasive

It involves much more FDI and countries than it seems

What it seems...

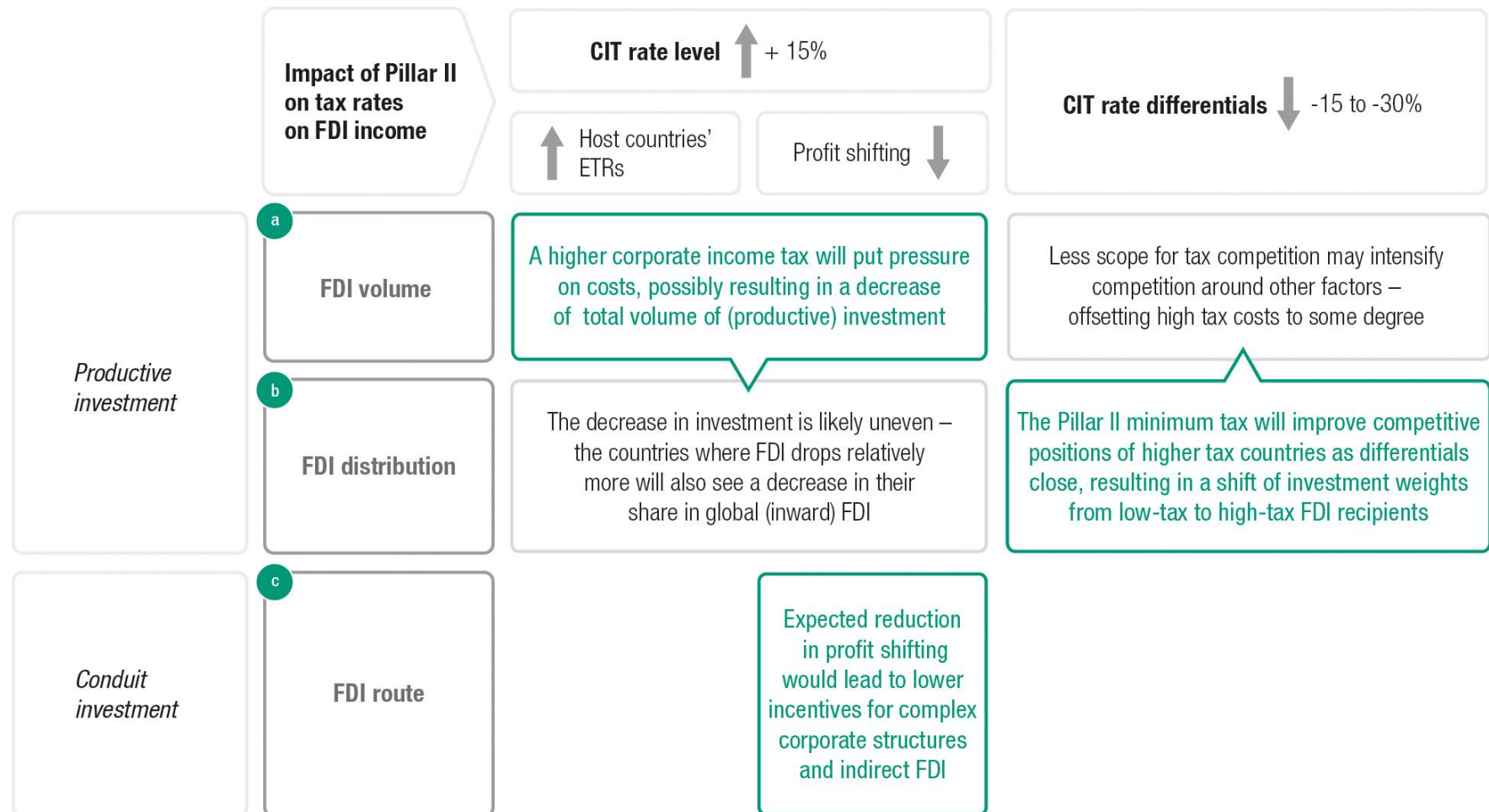
- A. It involves “only” large firms – annual revenues threshold of EU750 million
- B. It will affect only countries that have signed the agreement – 141 jurisdictions, excluding many developing countries
- C. A minimum at 15% will affect only low-tax countries

What is:

- A. It does not involve only large firms but FDI by large MNEs: the majority!
- B. By its design Pillar II does not require global agreement and, moreover, is hard for host countries to avoid it
- C. All countries will be affected; higher-tax countries will just be *less* affected than lower-tax countries

Implications of the minimum tax rate

Pillar II is expected to affect all three dimensions of the global FDI network: volume, distribution and route



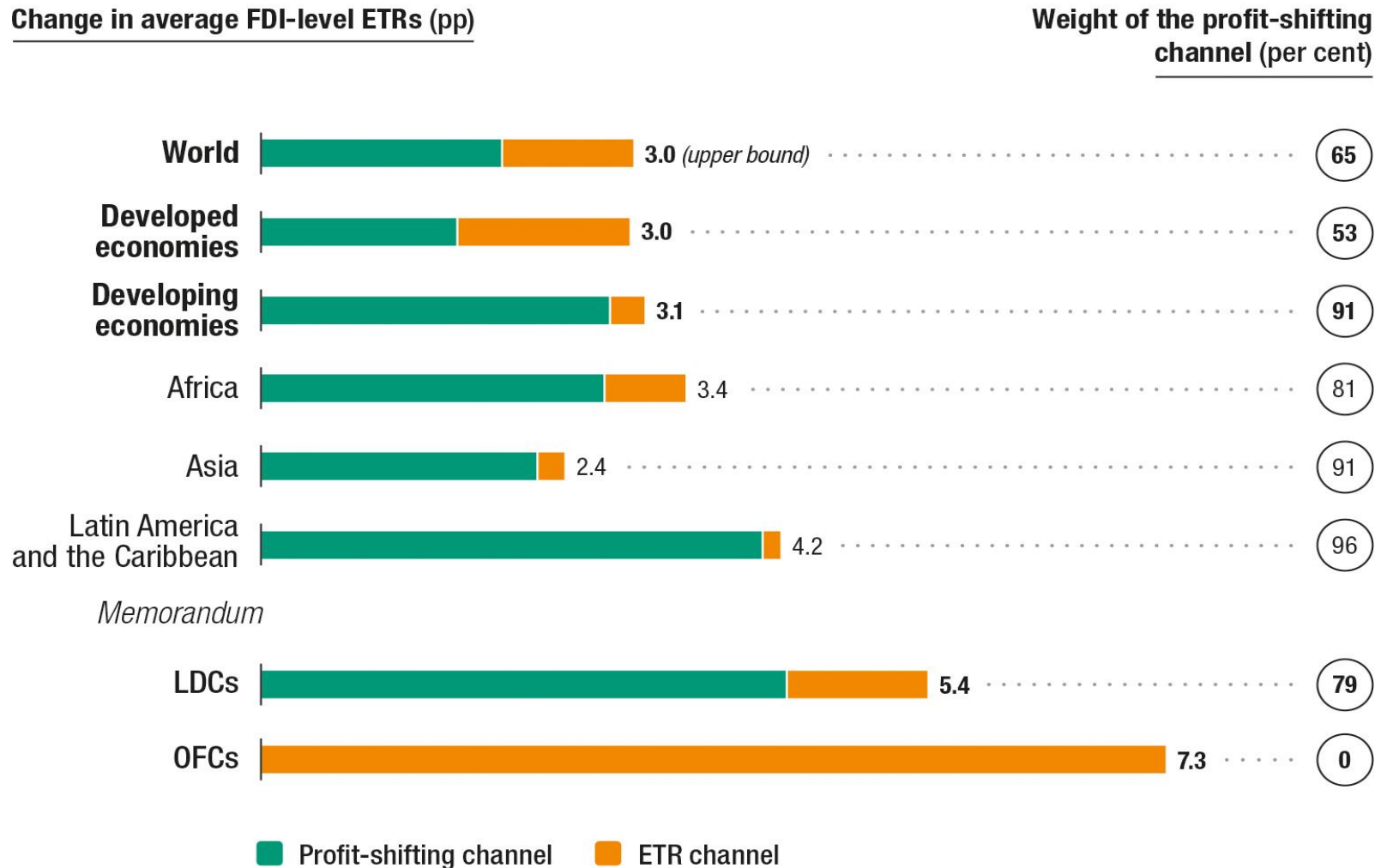
□ Direct effect, focus

Source: UNCTAD.

Note: Impact figures rounded. CIT = corporate income tax.

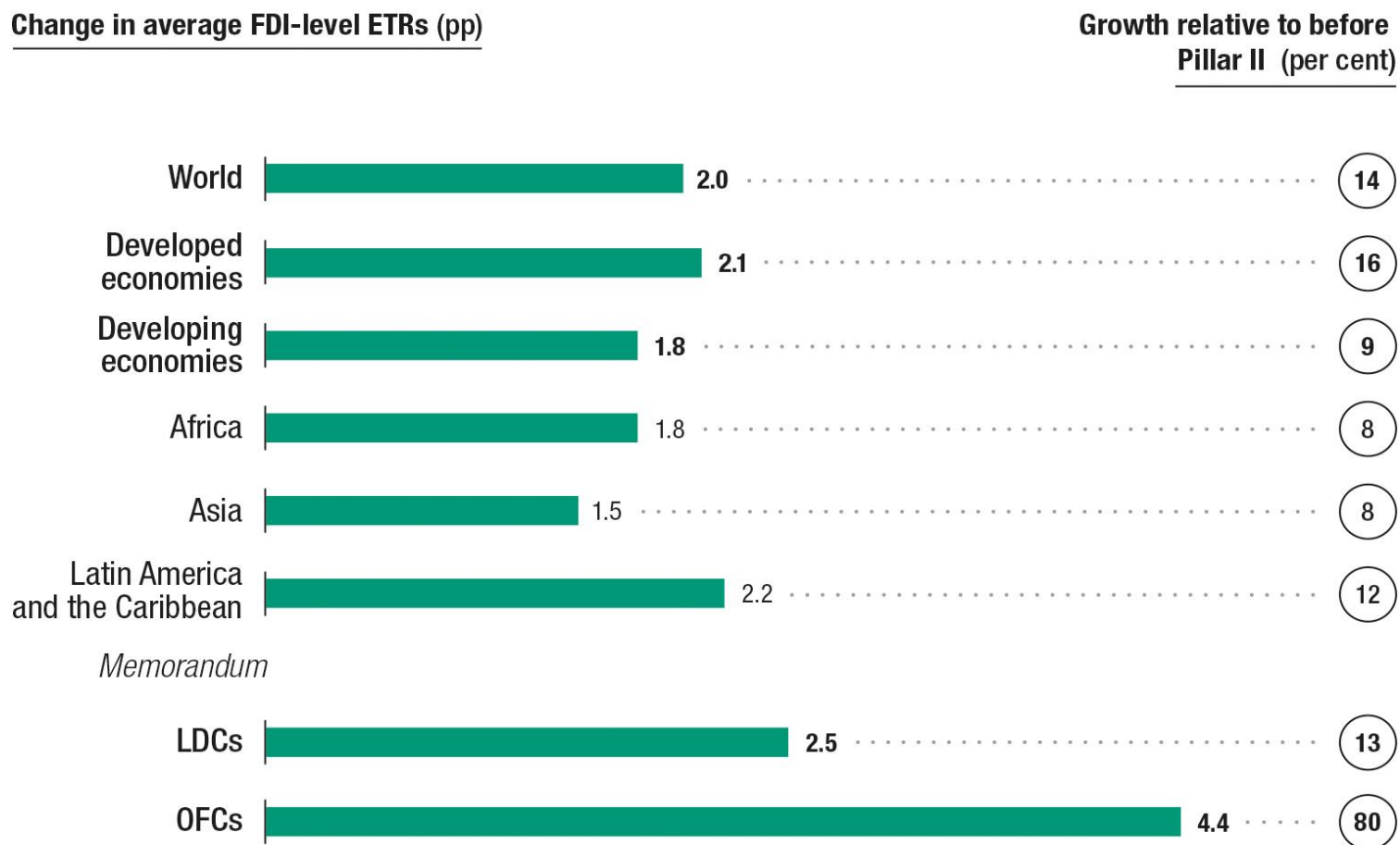
Profit shifting is a critical driver of the reform, accounting for 2/3 of the impact in the upper-bound scenario

Decomposition of the impact of Pillar II on FDI-level effective tax rates, by economic grouping and region (percentage points and per cent)



The global minimum tax will increase effective tax rates on FDI income by 2 percentage points on average

Impact of Pillar II on average FDI-level effective tax rates, by economic grouping and region (Percentage points and per cent)

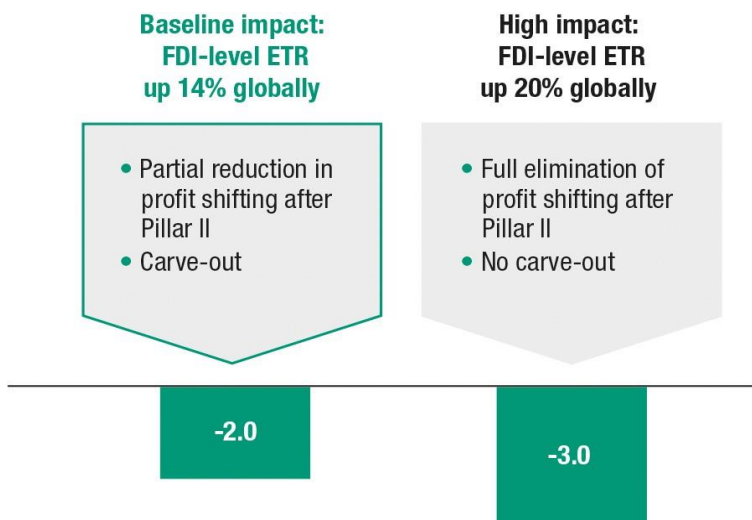


Increased taxes, coupled with reduction in tax rate differentials, could have a volume and distribution effect on FDI

*Flipside of increased tax revenue is the potential **downward pressure on overall volume** of investment....*

*...at the same time, reduction in tax rate differentials will result in **diversion of investment from low- to high-tax jurisdiction**, with benefit for developing countries.*

Pillar II volume effect: decrease in global FDI flows (per cent)

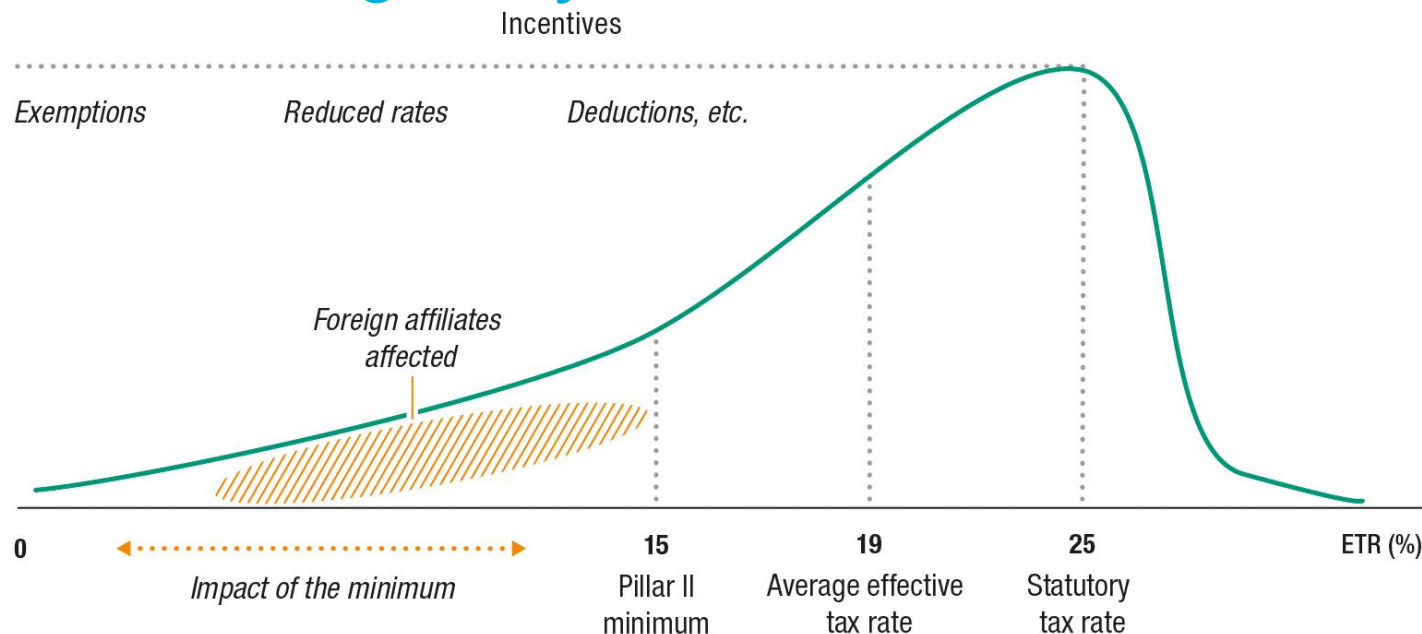


Pillar II diversion effect: change in FDI inflows by region (per cent)



These estimates may underestimate the impact if considering within-countries heterogeneity of tax incentives

- 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**

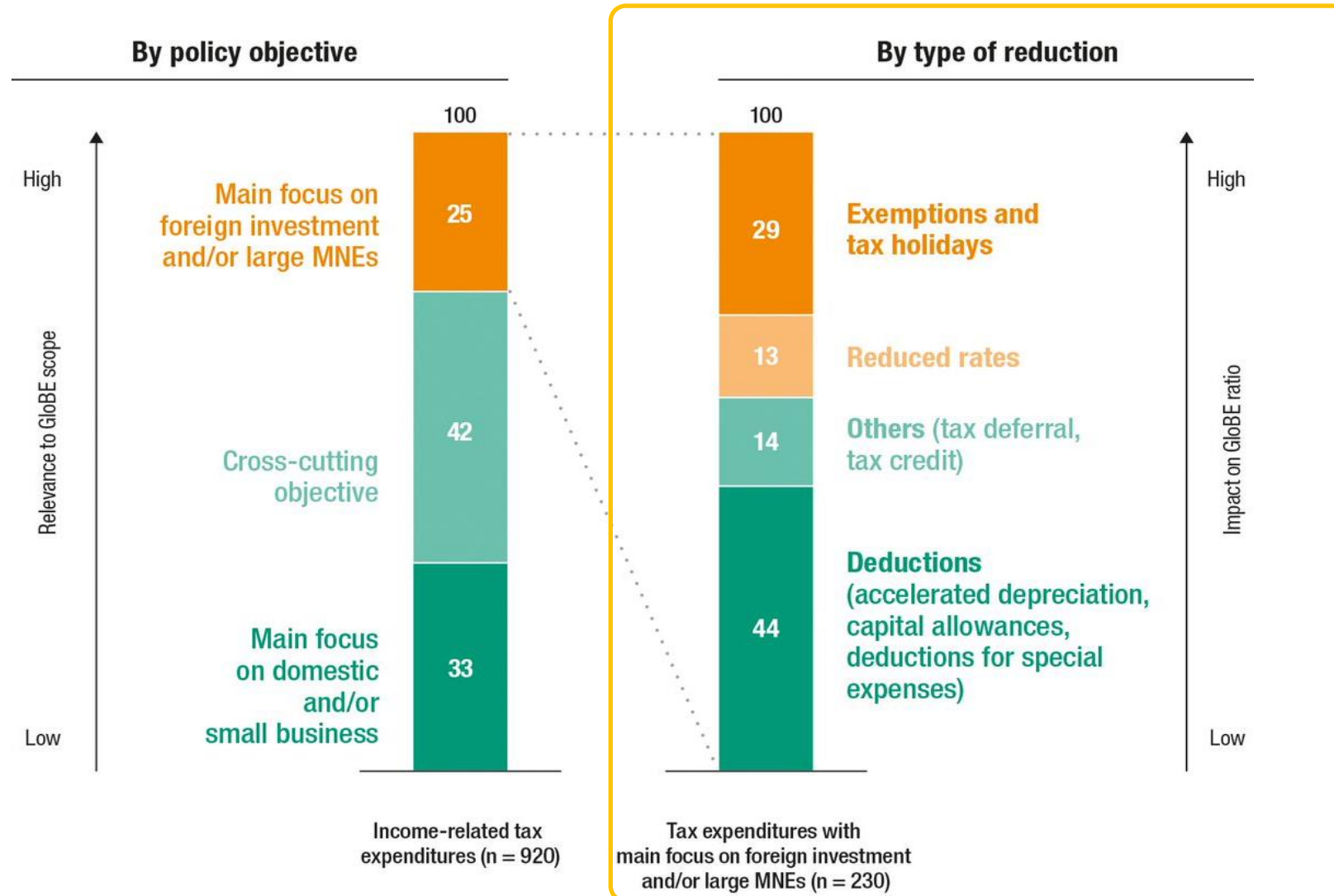


Source: UNCTAD.

Notes: Illustrative shape of an ETRs' distribution for a generic host country (with STR and ETR equal to the global averages). In this example, a large group of foreign affiliates pays the full statutory rate (resulting in a "peak" at the STR). Host countries provide a variety of incentives to specific subsets of foreign affiliates; these firms face ETRs lower than the STR. Incentives can range from deductions to reduced rates to exemptions, for which the tax reduction is maximized. The example shows that the country's average effective tax rate (19 per cent) is not a fully representative indicator for the impact of Pillar II. Simply based on the average ETR, the host country would not be affected by a minimum at 15 per cent; however, a subset of foreign affiliates is. As they align their ETR to the minimum, the country's overall average increases above 19 per cent.

Pillar II will have major implications for fiscal incentives, depending on their design

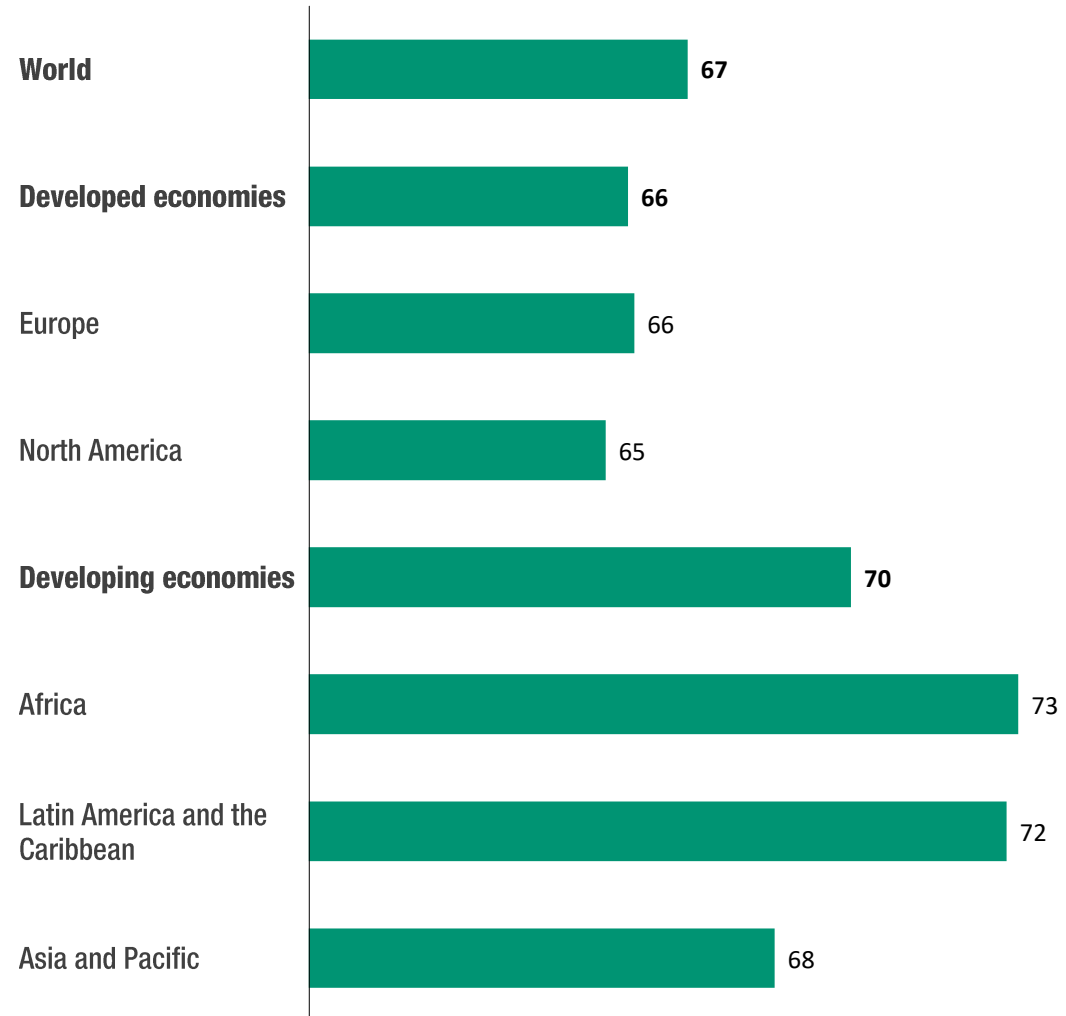
Income-related tax expenditures, by policy objective and type of reduction, 1990–2020
(Per cent)



FDI by large MNEs are the majority

- The global minimum tax will initially apply only to **foreign profits (FDI income) of MNEs with consolidated revenues over €750 million.**
- **More than two thirds of new investment projects** carried out over the past five years is done by large MNEs, with even higher shares in developing regions.
- Moreover, even if initially many firms will remain out of scope, the fact that more and more FDI is carried out by the largest MNEs (overseas investment by SMEs is in decline), combined with the expected gradual reduction of the threshold, will mean that **over time almost all FDI will be subject to the minimum.**

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



Adjusting the fiscal investment policy toolkit: key insights

a. Outside the Inclusive Framework

- Investment strategies need rethinking even in countries not endorsing Pillar II

b. Direct effects of Pillar II (lower-tax regimes, preferential rates for investors)

- Applying the Qualified Domestic Minimum Top-Up Tax protects revenue without affecting investment
- The effectiveness of traditional tax incentives will be diminished
- Some scope remains for domestic tax measures to reduce ETRs on investment

c. Indirect effects of Pillar II (higher-tax regimes)

- Higher-tax countries will also need to respond strategically to the changing tax-investment landscape

d. Implications for regional cooperation

- Regional tax cooperation still has a role in facilitating investment and economic integration

e. Implementation issues

- Complexities related to implementation should be timely addressed to ensure investor certainty

f. Effects on tax competition

- Tax competition is blunted, but not ended – and will likely take new forms

Source: UNCTAD.

Note: ETRs = effective tax rates.

Key recommendations for the international community

The international community, in parallel with or as part of the Inclusive Framework discussions, should alleviate the constraints that are placing developing countries, and especially LDCs, at a disadvantage:

- Scale up technical assistance to developing countries to support BEPS implementation and investment policy adjustment.
- Adopt a multilateral solution to remove implementation constraints posed by IIAs and mitigate ISDS risks.
- As a stop-gap measure, establish a mechanism to return 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.