So, Shall We Do Tax Our Way?

Suranjali Tandon

Donald Trump's recent decision to withdraw the US from global tax agreements and negotiations, along with tariff policies, has raised concerns that trade and policy cooperation could face several hurdles. Trump 1.0 saw retaliatory tariffs, which remain an enticing source of income despite accounting for only about 2% of total tax revenues. As a result, many tariffs were retained by the Joe Biden administration, despite their negative impact on GDP and the pass-through of price increases — especially in steel and aluminium sectors — to US consumers.

Trump 2.0 is undeterred and hopes to raise revenues to compensate for proposed corporate tax cuts. Tax Cuts and Jobs Act (TCJA) of 2017 was intended to kickstart the US economy. But the outcome is debatable. In another attempt to bolster the economy, Trump has indicated a tax cut. This is a departure from the previous government's approach, which was to ensure equity in taxes and that MNCs pay their fair share of taxes.

In 2021, fate of the global tax deal remained uncertain due to US reluctance to commit. Then, secretary of treasury Janet Yellen came out in support of a global minimum corporate tax of 15%, putting the deal back on track. Countries, including India, began to labour on fine details, and 50 of the 140 countries have accepted a multilateral convention to end tax competition.

This tax ensures that in each jurisdiction, a company with revenue of more than €750 mn pays at least 15% tax. The top-up tax is collected through a rule that allows the country of the ultimate parent entity to collect taxes if the source country refuses to raise domestic taxes to the minimum rate.

With the US being a prominent country of residence, will Trump's executive order break the deal? Given that many countries have an alternative minimum tax, and many have raised their corporate tax rates, the US' lack of interest does not stall progress made so far.

It does leave open the question of what happens to under-taxed profits of American MNCs. There's a possibility that top-up taxes could be collected by third jurisdictions, which is possible under law, and these profits could end up being taxed again in the US. While the US suggests that the deal has 'no force or effect', it may introduce a law less aligned with OECD to prevent any such double taxation.

Do your own reeling in

The US has also announced that it will take measures to address discriminatory taxes — such as digital services tax that many countries, such as India, have introduced — and their discontinuation depends on the acceptance of the other pillar of the tax pact that deals with the redistribution of taxing rights for large companies. In the past, the US has used US Trade Representative (USTR) investigations to thwart efforts of countries like India to unilaterally implement taxes by applying retaliatory tariffs on specified products.

As Trump puts 'America first', countries, including India, must assess the consequences of this approach. Imposition of tariffs on some of India's key sectors means that the country will have to diversify into other export markets or lose some of its market share, only to the extent that it competes in the same market. If the trade war escalates, consumers in both countries will experience a price rise. It is unlikely that tariff increases will compensate for tax cuts, as is hoped, let alone lead to increases in output and employment.

Washington's disinterest in global tax deals means that it is keen to introduce a domestic strategy tailored to its domestic tax policy, leaving other countries to figure out their own domestic stance, rather than relying on the popular OECD approach. The vote in favour of a UN tax forum already indicates that there are fissures between OECD and developing countries.

With the US stepping away from the international approach, it paves the way for a more bilateral approach. In that context, India's budget announcements reflect its independent and de-escalating approach.

The writer is associate professor, National Institute of Public Finance and Policy (NIPFP)