Aakar Today

1. Global Minimum Tax

Why in News?

Recently, EU members have agreed to implement a minimum tax rate of 15% on big businesses in accordance with Pillar 2 of the global tax agreement framed by the Organisation for Economic Cooperation and Development (OECD) in 2021.

In 2021, 136 countries including India had agreed on a plan to redistribute tax rights across jurisdictions and enforce a minimum tax rate of 15% on large multinational corporations.

Key Details

What is Global Minimum Tax?

- A Global Minimum Tax (GMT) applies a standard minimum tax rate to a defined corporate income base worldwide.
- The OECD developed a proposal featuring a corporate minimum tax of 15% on foreign profits of large multinationals, which would give countries new annual tax revenues of USD 150 billion.
- The framework of GMT aims to discourage nations from tax competition through lower tax rates that result in corporate profit shifting and tax base erosion.

What are the Key Points of the Plan?

- **Two Pillar Plan:**
- **Pillar 1:**
  - 25% of profits of the largest and most profitable Multinational Enterprise (MNEs) above a set profit margin would be reallocated to the market jurisdictions where the MNE's users and customers are located.
  - It also provides for a simplified and streamlined approach to the application of the arm's length principle to in-country baseline marketing and distribution activities.
  - It includes features to ensure dispute prevention and dispute resolution in order to address any risk of double taxation, but with an elective mechanism for some low-capacity countries.
  - It also entails the removal and standstill of Digital Services Taxes (DST) and similar relevant measures, to prevent harmful trade disputes.
- **Pillar 2:**
  - It provides a minimum 15% tax on corporate profit, putting a floor on tax competition.
  - This will apply to multinational groups with annual global revenues of over 750 million euros. Governments across the world will impose additional taxes on the foreign profits of MNEs headquartered in their jurisdiction at least to the agreed minimum rate.
  - This means that if a company's earnings go untaxed or lightly taxed in one of the tax havens, their home country would impose a top-up tax that would bring the effective rate to 15%.
- **Objectives:**
  - It aims to ensure that big businesses with global operations do not benefit by domiciling themselves in tax havens in order to save on taxes.
  - The minimum tax and other provisions aim to put an end to decades of tax competition between governments to attract foreign investment.

What is the Significance of the Move?

- **End of Race to the Bottom:**
  - It tries to put an end to the "race to the bottom" which has made it harder for governments to shore up the revenues required to fund their rising spending budgets.
  - A race to the bottom refers to heightened competition between nations, states, or companies, where product quality or rational economic decisions are sacrificed in order to gain a competitive advantage or reduction in product manufacturing costs.
- **Stopping Financial Diversion to Tax Havens:**
  - Increasingly, income from intangible sources such as drug patents, software and royalties on intellectual property has migrated to Tax Havens, allowing companies to avoid paying higher taxes in their traditional home countries.
- **Mobilising Financial Resources:**
  - With budgets strained after the Covid-19 crisis, many governments want more than ever to discourage multinationals from shifting profits – and tax revenues – to low-tax countries regardless of where their sales are made.
- **Global Tax Reforms:** Since the inception of the
  - Base Erosion and Profit Shifting (BEPS) programme, the proposal for GMT is another positive step towards global taxation reforms.
  - BEPS refers to tax avoidance strategies that exploit gaps and mismatches in tax rules to artificially shift profits to low or no-tax locations. OECD has issued 15 Action Items to address this.
- **Counters Global Inequality:**
  - The minimum tax proposal is particularly relevant at a time when the fiscal state of governments across the world has deteriorated as seen in the worsening of public debt metrics.

- It is believed that the plan will also help counter rising global inequality by making it tougher for large businesses to pay low taxes by availing the services of tax havens.

What are the Issues?

- **Threat of tax Competition:**
  - It is considered the threat of tax competition that keeps a check on governments which would otherwise tax their citizens heavily to fund profligate spending programs.
- **Impending Sovereignty:**
  - It impinges on the right of the sovereign to decide a nation's tax policy.
  - A global minimum rate would essentially take away a tool country use to push policies that suit them.
- **Question of Efficacy:**
- The deal has also been criticized for lacking teeth: Groups such as Oxfam said the deal would not put an end to tax havens.
- What is the Organization for Economic Cooperation and Development?
- The OECD is an intergovernmental economic organisation, founded to stimulate economic progress and world trade.
- Founded: 1961.
- Headquarters: Paris, France.
- Total Members: 36.
- India is not a member, but a key economic partner.

2. Carbon Markets

Why in News?

The Parliament has passed the Energy Conservation (Amendment) Bill, 2022 in order to establish Carbon Markets in India and specify a Carbon Trading Scheme.

The Bill amends the Energy Conservation Act, 2001.

Key Details

What is the Energy Conservation (Amendment) Bill, 2022?

- **About:**
  - The Bill empowers the Centre to specify a carbon credits trading scheme.
  - Under the Bill, the central government or an authorised agency will issue carbon credit certificates to companies or even individuals registered and compliant with the scheme.
  - These carbon credit certificates will be tradeable in nature. Other persons would be able to buy carbon credit certificates on a voluntary basis.
- **Concerns:**
  - Bill does not provide clarity on the mechanism to be used for the trading of carbon credit certificates— whether it will be like the cap-and-trade schemes or use another method— and who will regulate such trading.
  - It is not specified, which is the right ministry to bring in a scheme of this nature.
  - While carbon market schemes in other jurisdictions like the U.S., United Kingdom, and Switzerland are framed by their environment ministries, the Indian Bill was tabled by the power ministry instead of the Ministry of Environment, Forest, and Climate Change (MoEFCC).
  - The Bill does not specify whether certificates under already existing schemes would also be interchangeable with carbon credit certificates and tradeable for reducing carbon emissions.
  - Two types of tradeable certificates are already issued in India— Renewable Energy Certificates (RECs) and Energy Savings Certificates (ESCs).
  - These are issued when companies use renewable energy or save energy, which are also activities which reduce carbon emissions.

What are Carbon Markets?

- **About:**
  - Carbon markets are a tool for putting a price on carbon emissions. It allows the trade of carbon credits with the overall objective of bringing down emissions.
  - These markets create incentives to reduce emissions or improve energy efficiency.
  - For example, an industrial unit which outperforms the emission standards stands to gain credits.
  - Another unit which is struggling to attain the prescribed standards can buy these credits and show compliance to these standards. The unit that did better on the standards earns money by selling credits, while the buying unit is able to fulfill its operating obligations.
  - It establishes trading systems where carbon credits or allowances can be bought and sold.
  - A carbon credit is a kind of tradable permit that, per United Nations standards, equals one tonne of carbon dioxide removed, reduced, or sequestered from the atmosphere.
  - Carbon allowances or caps, meanwhile, are determined by countries or governments according to their emission reduction targets.
  - Article 6 of the Paris Agreement provides for the use of international carbon markets by countries to fulfill their NDCs (Nationally Determined Contributions).
  - NDCs are climate commitments by countries setting targets to achieve net-zero emissions.
- **Types of Carbon Markets:**
- **Compliance Markets:**
  - Compliance markets are set up by policies at the national, regional, and/or international level and are officially regulated.

SHAKAR IAS SHAPE YOUR DREAMS

- Today, compliance markets mostly operate under a principle called 'cap-and-trade", most popular in the European Union (EU).
- Under the EU's emissions trading system (ETS) launched in 2005, member countries set a cap or limit for emissions in different sectors, such as power, oil, manufacturing, agriculture, and waste management. This cap is determined as per the climate targets of countries and is lowered successively to reduce emissions.
- Entities in this sector are issued annual allowances or permits by governments equal to the emissions they can generate.
- If companies produce emissions beyond the capped amount, they have to purchase additional permits. This makes up the 'trade' part of cap-and-trade.
- The market price of carbon gets determined by market forces when purchasers and sellers trade in emissions allowances.

- **Voluntary Markets:**
  - Voluntary markets are those in which emitters— corporations, private individuals, and others— buy carbon credits to offset the emission of one tonne of CO_2 or equivalent greenhouse gases.
  - Such carbon credits are created by activities which reduce CO_2 from the air, such as afforestation.
  - In this market, a corporation looking to compensate for its unavoidable GHG emissions purchases carbon credits from an entity engaged in projects that reduce, remove, capture, or avoid emissions.
  - For Instance, in the aviation sector, airlines may purchase carbon credits to offset the carbon footprints of the flights they operate. In voluntary markets, credits are verified by private firms as per popular standards. There are also traders and online registries where climate projects are listed and certified credits can be bought.
- **Status of Global Carbon Markets:**
  - In 2021, the value of global markets for tradeable carbon allowances or permits grew by 164% to a record 760 billion euros (USD 851 billion), according to an analysis by Refinitiv.
  - The EU's ETS contributed the most to this increase, accounting for 90% of the global value at 683 billion euros.
  - As for voluntary carbon markets, their current global value is comparatively smaller at USD 2 billion.
  - The World Bank estimates that trading in carbon credits could reduce the cost of implementing NDCs by more than half — by as much as USD 250 billion by 2030.

What are the Challenges to Carbon Markets?

- **Poor Market Transparency:**
  - The UNDP (United Nations Development Programme) points out serious concerns pertaining to carbon markets- ranging from double counting of greenhouse gas reductions and quality and authenticity of climate projects that generate credits to poor market transparency.
- **Greenwashing:**
  - Companies may buy credits, simply offsetting carbon footprints instead of reducing their overall emissions or investing in clean technologies.
- **May Increase Net Emission through ETS:**
  - As for regulated or compliance markets, ETSs (Emissions Trading System) may not automatically reinforce climate mitigation instruments.
  - The International Monetary Fund (IMF) points out that including high emission-generating sectors under trading schemes to offset their emissions by buying allowances may increase emissions on net and provide no automatic mechanism for prioritizing cost-effective projects in the offsetting sector.

What is the Related Indian Initiative?

- **Clean Development Mechanism:**
  - In India, the clean development mechanism under the Kyoto Protocol provided a primary carbon market for the players.
  - The secondary carbon market is covered by the perform-achieve-trade scheme (which falls under the energy efficiency category) and the renewable energy certificate.

PRACTICE QUESTION

Prelims

Q. Regarding "carbon credits", which one of the following statements is not correct?

(a) The carbon credit system was ratified in conjunction with the Kyoto Protocol

(b) Carbon credits are awarded to countries or groups that have reduced greenhouse gases below their emission quota

(c) The goal of the carbon credit system is to limit the increase of carbon dioxide emission

(d) Carbon credits are traded at a price fixed from time to time by the United Nations Environment Programme.

Mains

Q. Discuss global warming and mention its effects on the global climate. Explain the control measures to bring down the level of greenhouse gases which cause global warming, in the light of the Kyoto Protocol, 1997.

(200 words)