Impact of Global Minimum Tax on the ESG Incentives

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27th-28th of April 2025, Ferrara

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Content

1.1 Global Minimum Tax

OECD/G20 Inclusive Framework and EU Implementation

- OECD/G20 Inclusive Framework agreement (October 2021) – "Pillar Two" of this global deal on international tax reform
- The European Union formalized this through a Directive (approved December 2022)
  - This rapid adoption demonstrates the EU's commitment to addressing tax avoidance and ensuring large corporations pay a fair share regardless of where they operate.

Key Mechanisms and Scope

- **minimum effective tax rate of 15%** for multinational enterprise groups with combined annual revenues exceeding **€750 million**
  - This should ensure that large corporations cannot use tax planning strategies to reduce their effective tax rates below the 15% threshold

The Income Inclusion Rule (IIR): allows a parent company's jurisdiction to impose top-up taxes when a subsidiary pays less than the minimum rate

The Undertaxed Payments Rule (UTPR): serves as a backstop when the IIR cannot be applied

1.2.1 Framework of ESG Incentives

EU Sustainable Finance Framework: The Taxonomy Regulation; The Sustainable Finance Disclosure Regulation (SFDR), The Corporate Sustainability Reporting Directive (CSRD) and European Sustainability Reporting Standards (ESRS)

Tax Incentives for Sustainability

- Tax policy has become a powerful tool to drive investment in environmentally sustainable outcomes
  - Governments use tax measures to change the relative prices of sustainable versus unsustainable activities, thereby incentivizing market responses to achieve ESG objectives.
- These incentives generally fall into three categories:

1. Incentives to **reduce natural resource consumption**
2. Incentives to **switch to renewable energy sources**
3. Incentives to **innovate low-carbon products and processes**

1.2.2 Types of ESG Incentives

Incentive	Description	Examples
Accelerated Depreciation	• Allows companies to deduct a higher percentage of asset costs in early years for qualifying green technologies (e.g., renewable energy infrastructure).	• A solar farm operator might write off 40% of equipment costs in Year 1 instead of standard 20% depreciation, reducing taxable income
R&D Tax Credits	• Super-deductions (e.g., 150% of R&D expenses) for sustainable innovation, such as carbon capture or circular economy technologies.	• A company might apply super-deduction of 150% of R&D expenses
Concessionary Tax Rates	• Reduced corporate tax rates for activities aligned with the EU Taxonomy (e.g., 10% rate for green hydrogen production vs. standard 25%). • Directly impacts ETR calculations under GMT.	• 10 % rate for green hydrogen production vs. standard 25 %
Tax Exemptions for Green Bonds	• Interest income from EU Green Bonds is exempt from corporate tax, incentivizing sustainable capital markets	
Regulatory Drivers	• **Corporate Sustainability Reporting Directive (CSRD):** Mandates disclosure of tax incentives linked to ESG activities, increasing transparency	**Revised Energy Taxation Directive:** Aligns energy tax rates with carbon content, penalizing fossil fuels while subsidizing renewables

2.0 The Clash

- The GMT has been specifically designed to eliminate rate-based tax competition between jurisdictions, regardless of the objective behind the tax incentives.
- Under the Global Anti-Base Erosion (GLoBE) rules, if a tax incentive reduces a multinational's effective tax rate below 15% in a particular jurisdiction, a top-up tax will be applied

  → This effectively dilutes or neutralizes the financial benefit of many sustainability-focused tax incentives
- According to the EY Green Tax Tracker, there are more than **1,850 sustainability tax** incentives globally that could be affected by the GMT

This creates significant challenges for:

- EU policymakers who have relied on tax incentives as a key tool to catalyze private sector investment in sustainability
- Companies that have built their ESG and tax strategies around these incentives
- The overall achievement of climate neutrality goals by 2050

3.0 What can be done?

Redesigning ESG Incentives to be GMT-Compatible

- The OECD framework does provide for certain exceptions – the main one = **Qualified Refundable Tax Credits**
  - EU member states could reformulate their existing tax incentives to fit within these exceptions, maintaining their effectiveness while complying with GMT requirements.

Alternative Non-Tax Incentive Mechanisms

To address the clash, the EU could shift focus from tax-based incentives to:

- Direct grants and subsidies
- Preferential access to financing through sustainable finance instruments
- Regulatory incentives such as fast-track permitting for sustainable projects
- Preferential treatment in public procurement processes

Discussion

1. How might the EU best redesign existing ESG tax incentives to maintain their effectiveness while complying with GMT requirements?

2. What alternative non-tax incentive mechanisms could prove most effective in driving sustainable investment in the post-GMT landscape?

3. Should certain types of sustainability investments receive special treatment or exemptions under the GMT framework, and if so, how would this be justified?

4. How might the tension between GMT and ESG incentives affect the competitiveness of EU businesses compared to those in regions with different approaches?