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Chapter

# Taxing Multinationals: An International Perspective

by Esmé Berkhout

*Views are the author's personal position and do not represent those of Oxfam*

## Upsetting the Apple Cart

Tax-based industrial policy  
in Ireland and Europe

EDITED BY

David Jacobson

FOUNDATION FOR EUROPEAN  
PROGRESSIVE STUDIES  
FONDATION EUROPÉENNE  
D'ÉTUDES PROGRESSISTES



# Taxing Multinationals: An International Perspective

**Esmé Berkhout**

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**Draft Chapter for the forthcoming Book:**

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**Tax-Based Industrial Policy in Ireland and Europe**

**FEPS – TASC Project**

## **1) Introduction, competition as an out-dated ideology**

If we believe many of our governments' Finance Ministers, we should soon expect to see an end to corporate tax avoidance. While it is true that significant steps have been taken to stop corporations from shifting their profits to tax havens, the problem is not solved. Not only do many corporate tax loopholes remain open, but governments are also replacing policies that facilitate tax avoidance with overall lower corporate tax rates. Generally, the reason behind this lowering of corporate tax rates is to maintain a 'competitive tax system' and to attract FDI (Holder, 2017). An increasing concern of international bodies is that this might lead to a 'race to the bottom', so that even with anti-profit shifting measures, the result might be "corporations reporting the correct amount of profits in each country, but paying very little taxes over those profits anyway" (Weyzig, 2015). The possible decline in corporate taxes contributes to concerns about the impact of corporate tax competition on rising levels of extreme inequality worldwide and within countries.

While our governments have been willing to tackle tax avoidance through adjustments of technical tax policies (e.g. through the OECD-Base Erosion and Profit Switching/BEPS process, further discussed below), they have been much less keen on discussing the more global and more politically sensitive problem of tax rate competition between countries. This topic hits the core of what is wrong with dominant economic thinking. Tax competition between countries is a logical consequence of the neoliberal economic system that positively values competition. As clearly explained by Shaxson and O'Hagan (2013), while competition between companies in a market is broadly a good thing, competition between countries on tax is not. In effect, not only is competition valued positively under neoliberalism, but also inequality (Murphy, 2014). Driven by the perceived need for countries to compete on tax for FDI, corporate tax rates have fallen globally from an average of 26.95 in 2007 to 24.95 in 2017. In 1990, the average statutory corporate tax rate for

OECD countries was around 40 per cent; in 2000 it was 32 per cent; and in 2017, it was 24.7 per cent (KPMG, 2018). “Overall, the number of countries with a statutory rate above 30 per cent decreased from 21 in 2000, to 7 in 2008 and 5 in 2016” (OECD, 2017). A recent study by the *Financial Times* shows that big multinationals’ effective tax rates have fallen from around 35 per cent in the 1990s to 20 per cent or less in 2016 (Toplensky, 2018).

While there is increasing consensus that inequality is bad for economic growth, stability, poverty reduction and society overall, the insistence that tax ‘competition’ is (nearly always) a good thing does not seem to have changed in any significant way, especially at the national level. At the level of global institutions, concerns have been raised for decades about the likely negative impact of tax competition. The 1998 OECD report on Harmful Tax Practices concluded that governments must take measures against the proliferation of harmful tax practices resulting from tax competition. The OECD recommended intensifying international co-operation to protect tax bases and avoid a worldwide reduction in welfare. The report referred to tax havens and those who use them as “free riders”, who benefit from public goods while not contributing fairly to their financing (OECD, 1998). The negative effects of tax competition have also been a recurrent topic at the regional level. For example, France and Germany have pushed for many years to put harmonisation of the tax base in the EU on the agenda, as well as a possible minimum corporate tax rate. In the global South, the topic of tax incentives has received increasing attention, with growing acknowledgement of the contribution of many of these tax incentives to regional races to the bottom (instead of serving the purpose of increased investment and economic growth) (UN Office on Drugs and Crime, 2015).

Despite the increased international attention for the need to end harmful tax competition and to address tax incentives, national policy debates around tax incentives and the corporate tax rate often remain introverted and selfish in nature. These debates often focus on consideration of the competitiveness of the fiscal climate vis-à-vis other countries and how to outcompete them for foreign investments. These debates are heavily influenced by corporate interests and high levels of political capture and revolving-door practices.

Despite the denial of the harm of tax competition at the national level, increasingly governments are forced to acknowledge that measures are needed to prevent a corporate tax ‘race to the bottom’ (Rumney, 2018). It is not yet known exactly where the bottom is but this will be discussed further below.

Many countries argue that regional or global cooperation on corporate tax rates would violate national sovereignty. However, in a globalized world where powerful and large firms are key actors, it is questionable whether countries, especially poor countries, really can exert full sovereignty in this area. Tax Justice Network argues that the only way to reassert democratic national sovereignty on taxing MNEs is international cooperation towards systemic solutions at the global level (TJN, 2010). Without this international cooperation, countries will feel they have no choice but to give in to the demands of multinational enterprises and will continue to offer (often harmful) tax incentives or lower tax rates, out of fear of losing FDI.

## **2) Why time has come for a minimum effective corporate tax rate**

### **a. Sustainable and fair finance to achieve the global development goals**

In September 2015, countries across the globe adopted the Global Development Goals, a set of goals ‘to end poverty, protect the planet and ensure prosperity for all’. Governments have until 2030 to

achieve the targets set out under these goals (UN, 2015), which include commitments towards ensuring access to quality healthcare and education and to reduce inequality within and between countries. The finance needed for these aims is huge. It is estimated that it will take from US\$5 to US\$7 trillion to achieve them (Niculescu, 2017). Considering the decreasing role of already insufficient international aid to poor countries, efforts have intensified to support countries with domestic resource mobilization, including improvements to tax systems.

These improvements are necessary because fair tax systems are crucial for establishing a healthy and strong relationship between the government and its citizens. “Well-functioning tax systems allow countries to chart their own futures, pay for essential services such as education and healthcare, and build trust with their citizens. Indeed, tax capacity is a fundamental development issue” (Brumby, 2016). Especially in many developing countries, tax systems are weak and there is significant potential for increasing tax revenues by improving tax administrations.

It is therefore significant that world leaders agreed, through the Addis action agenda, to ‘work to improve the fairness, transparency, efficiency and effectiveness of our tax systems’, ‘to reduce opportunities for tax avoidance’, ‘to address excessive tax incentives’, ‘to scale up international tax cooperation’ and to ‘make sure that companies pay taxes to the governments of countries where economic activity occurs and value is created, in accordance with national and international laws and policies’ (UN, 2015). Through the Addis Tax Initiative, more than 40 countries signed the commitment to double technical cooperation in the area of domestic revenue mobilization and for partner countries to step up domestic revenue mobilization. All countries restated their commitment to ensure policy coherence for development (Addis Tax Initiative, n.d.).

Our governments have turned some of the commitments into action, including by adopting the OECD actions against BEPS (Base Erosion and Profit Shifting) (see below). Some countries have acknowledged the impact of their tax systems on developing countries. In 2017, Ireland published a review of Ireland’s tax code including consideration of the benefits for developing countries from higher levels of global tax transparency (Coffey, 2017). Ireland and the Netherlands are also reviewing their tax treaties with developing countries in response to the critique that these treaties reduce the taxing rights of developing countries and facilitate tax avoidance. In June 2017, as part of the OECD-BEPS measures, 78 countries signed a convention to incorporate anti-tax avoidance measures into tax treaties in a coordinated and consistent way (OECD, 2018). This is progress, even though many countries unfortunately opted out of critical elements of the convention or do not plan to apply it to all tax treaties with developing countries.

The ability to raise corporate tax revenues and to address tax avoidance is crucial for developing countries. “Many developing countries have relatively high nominal corporate tax rates and they rely on corporate taxes for a high share of all tax revenues. In 2017, the median nominal corporate tax rate for a sample of 36 poor countries in sub-Saharan Africa was 30%” (Henry, 2017). The corporate tax income share of overall government revenues is also relatively high in developing countries. The IMF reported that “corporate income taxes account for about 16 per cent of government revenues in low and middle-income countries, compared to just over eight per cent in high-income countries” (ActionAid, 2015: 7).

The relative importance of corporate tax revenues for developing countries makes it all the more urgent to address the current shortcomings, or major errors, in the global (and national) tax systems. UNCTAD has estimated that developing countries miss out on at least US\$100 billion as a result of corporate tax avoidance (UNCTAD, 2015). With regard to tax losses due to competition on tax incentives, ActionAid estimated that just four East African countries could lose around US\$1.5 billion and possibly up to US\$2 billion a year by providing tax incentives (TJNA and ActionAid, 2016). Based on work by the IMF, Johannesen *et al* (2016) state that poor countries are up to three times

more vulnerable to the negative effects of other countries' tax rules than rich countries, and the poorer a country, the more vulnerable.

It could be argued that there is no 'race to the bottom' because income from corporate tax relative to GDP has remained relatively stable despite the lowering of the corporate tax rate. This is called the 'corporate tax paradox'. However, as several studies have pointed out, the corporate tax income relative to GDP has remained relatively stable in many OECD countries because a base broadening compensated for the rate-reduction. It can also be a result of increases in corporate profits as a share of national income, but this topic needs further research (OECD, 2017). It has also not been true for all countries. The base broadening (e.g. increase in number of taxable corporations) could arguably have led to higher (relative) corporate tax income if the rates had not been reduced.

The OECD concludes that corporate income tax (CIT) "rate reductions are all associated with significant negative revenue effects" (OECD, 2017: 59). In addition, it is clear that the income from corporate tax as a share of overall tax income has decreased significantly in many countries. Governments have partially offset the cuts in corporate tax by raising other taxes, including VAT and personal income taxes (PIT).

In recent years, tax revenues in OECD countries have shifted towards greater shares of labour taxes and VAT. The share of CIT revenues in total taxation remained below 9% of total tax revenues in 2014, compared to 11.2% in 2007, shifting more of the income tax burden towards households... [T]he share of revenues from VAT has been increasing since 2007 and reached just over 20% in 2014. Revenues from income taxes reached 33.7% of total tax revenues in 2014. Within this category, the share of PIT in total tax revenues continued to increase following the crisis, reaching 24% of total tax revenues in 2014 (OECD, 2017: 31).

Similar declines in CIT revenues have occurred in developing countries. In Senegal, for example, corporate tax revenues accounted for about 10% of tax revenues in 2005 but declined to between 7.2 and 8.9 over the period 2006-2012, after a CIT rate decrease from 33% to 25% in 2006. When a new government in 2012 increased the CIT rate to 30%, the CIT contribution increased to 9.3% (Oxfam and Le Forum Civil, 2015).

While corporate tax competition is leading to a corporate tax race to the bottom, it is important to understand it in the wider context of competition between countries. For example, competition for private wealth between countries seems to be intensifying. As described in the latest OECD report on tax policy reforms:

Some countries focus on high-wealth individuals as an attempt to broaden their tax base and to stimulate entrepreneurship. Italy, for instance, allows individuals who become Italian residents after having resided for at least nine of the last 10 years outside of Italy to pay a yearly lump-sum substitute of tax of EUR 100,000 (for a maximum of 15 years) on all foreign-sourced income instead of having to pay the regular PIT on this foreign-source income, in addition to the incentives for highly skilled workers; Portugal introduced a non-habitual residents (NHR) regime, which grants a special tax residency status if certain conditions are fulfilled (OECD, 2017: 47).

In his analysis of this NHR scheme, Weyzig (2017a) pointed out that the tax breaks are only for people who were not Portuguese residents during the previous five years, and the scheme requires foreigners to physically move to Portugal for at least 183 days in a year. Thereafter, however, they become entitled to pay tax in Portugal for ten years without having to live there. Lest it be thought that this discriminates against Portuguese millionaires, he points out that they in turn can opt to become residents of other tax havens like a Caribbean island, Jersey or Malta. This shows that each

such scheme to compete for high net-wealth individuals generates further means to reduce their tax burden.

The tax competition between countries on income and wealth is relevant to the discussion on the corporate tax race to the bottom. *The Economist* concluded: “Many rich individuals can choose to shift the way they report their income to take advantage of lower corporate-tax rates. So it is difficult to push up the tax rate on individual incomes while simultaneously lowering the corporate rate” (*The Economist*, 2017). There is little evidence that reductions in corporate taxation are good for investments and economic growth (see more below); there is similarly no good economic rationale behind this type of competition between countries for private wealth. The IMF’s *Fiscal Monitor* in October 2017 found little support for the argument that fiscal policies aimed at progressive redistribution could harm economic growth (IMF, 2017). As summarised by a headline in *The Economist*, “Higher taxes can lower inequality without denting economic growth” (*The Economist*, 2017).

Many articles and contributions (including those of the IMF), raise the issue of lack of political support for more intensive international cooperation. While this is currently the political reality, unless governments are able to accept higher levels of coordination on corporate and private tax, tax havens will not end and the efforts against BEPS will be futile. As concluded in the 2016 report of the UN Independent Expert on the promotion of a democratic and equitable international order, “an international tax convention is necessary to stop competition among tax jurisdictions and abolish secrecy.” He also recommended that governments “agree on a minimum corporate tax rate and curb tax competition among countries, acknowledging that this policy facilitates corruption, bribery and money laundering” (UN, 2016: 25).

#### **b. The failure of BEPS**

In 2014, the IMF published a report on the international effects of domestic tax rules. The report concluded that these effects are significant and that the ‘institutional framework’ for addressing these ‘tax spillovers’ is weak. The authors argued that this weakness increases the need for “an inclusive and less piecemeal approach to international tax cooperation” And: “Current initiatives, which operate within the present international tax architecture, will not eliminate spillovers” (IMF, 2014: 35). This seems explicit critique of the BEPS action plan that the OECD agreed in 2013.

While many countries have committed to valuable actions against corporate tax avoidance through the BEPS action plan, there are many noteworthy shortcomings especially for developing countries. It was clear from the beginning that the OECD-BEPS project took a developed-country perspective and was less suited to the needs of developing countries. The proposal from developing countries to place global decision making on tax clearly under a UN structure has been rejected by OECD members for many years now. Instead, the OECD has made the OECD-BEPS project more inclusive. However, the project’s focus is mainly on implementation of those actions that OECD-countries had already agreed on, with little attention given to the fundamental changes that are needed to ensure that developing countries can raise a fair level of corporate tax.

Many of the BEPS actions require considerable tax administrative capacity, which presents significant challenges to developing countries that lack the necessary institutions. The OECD-BEPS action plan also does little to address the rising concern of developing countries that the reduction in source-based taxation; the provisions of the BEPS plan does not take their needs into account. For instance, BEPS ‘Action 7’ focuses on changes to the definition of Permanent Establishment (PE) to

“prevent the artificial avoidance of PE status.” Developing countries, however, are also concerned “with the appropriateness of the PE definition generally and the extent to which it unduly restricts source-based taxation of activities that involve substantial economic activity in the domestic jurisdiction” (Ault and Arnold, 2017: 17).

The Permanent Establishment (PE) concept concerns the level of business presence required in a source country for that country to be permitted to tax profits that are attributable to this establishment within its territory (Article 7 UN and OECD Model Tax Conventions). According to Martín Jiménez (2017: 408), the PE concept was not designed for the benefit of source countries: “Full alignment of the source-country economic presence and taxation rights can be achieved only through relevant and substantial changes in the concept of PE or by using other tools, not by reinterpreting it or by forcing the acceptance of anti-avoidance rules in a context where they do not fit very easily”. This issue is also particularly important in the context of digitalization of the economy (see below).

Another problem is that the OECD has deliberately avoided more fundamental discussions on how to address tax competition between countries in the long run. As already predicted by civil society organizations, measures against base erosion actually intensify competition between countries on corporate tax rates (Weyzig, 2015). The same risk of increasing tax rate competition applies to the EU plans for a Common Consolidated Corporate Tax Base. If the EU countries can no longer compete through differences in domestic tax rules, it is likely that competition among European countries via tax rates will intensify.

BEPS-actions have not only intensified rate-competition, but also competition through tax incentives that do not violate the OECD-BEPS agreements. “In 2016, many countries introduced enhanced or new tax incentives for businesses, driven by growth stimulus and tax competition objectives” (OECD, 2017: 59). Patent boxes and other R&D tax incentives are a clear example of such business oriented measures. While in principle there is nothing wrong with stimulating R&D, rather than increasing investment or employment in R&D and innovation, these tax incentives significantly reduce tax revenues and encourage profit shifting. For example, the tax loss for the Netherlands as a result of the Dutch Innovation Box was more than €1 billion in 2016, or 7.6 per cent of total corporate income tax revenues (Berkhout, 2016a). In the OECD-BEPS action plan, patent boxes are not considered harmful, but countries would need to ensure sufficient economic substance (or ‘nexus’). The BEPS monitoring group warned that through this approach the OECD would legitimize ‘innovation box’ regimes and hence supply legal mechanisms for profit shifting (BEPS Monitoring Group, 2015).

Some of the OECD-BEPS actions, including Controlled Foreign Company (CFC) rules (if countries adopt the strong version) and the reporting requirement that large corporations disclose where they make their profits and where they pay their taxes, help discourage profit shifting. However, unless the OECD and other international and regional institutions address the issue of ever-increasing tax-rate competition, there is a risk of corporations “reporting the correct amount of profits in each country, but paying very little taxes over those profits anyway” (Weyzig, 2015: 10).

### **c. Blacklists are not the solution**

While the low corporate tax rate may have helped Ireland attract FDI in the past, it has earned the reputation of creating a corporate tax haven. However, Ireland has been far from alone in capitalizing on low corporate tax. It is important to acknowledge that among the biggest global corporate tax havens are countries with far higher corporate tax rates than Ireland, that have enabled multinationals to avoid paying their fair share of tax through other policies, including patent

boxes, tax rulings, notional interest deduction and the absence of effective Controlled Foreign Company (CFC) rules. Countries belonging to this category are the Netherlands, Switzerland and Hong Kong (Berkhout, 2016b). In its push for a more systematic identification of corporate tax havens, Oxfam developed a test that assessed a country's nominal corporate tax rate, its harmful tax practices and the extent to which it participates in intergovernmental efforts against tax avoidance (Berkhout, 2016b; Chardonnet and Langerock, 2017). The national responses to this list from countries rejecting their identification as 'corporate tax havens' shows they do care about their tax reputation:

- According to the Irish Ministry of Finance spokesman, the 12.5 per cent is fully in line with the OECD and international best practice in having a low rate and applying it to a very wide tax base. It "violates no international rules" he said (Kirwin, 2016).
- "The Netherlands have a corporate tax rate of 25 per cent", the Dutch finance ministry official said. "The Netherlands also actively cooperates with international initiatives to tackle base erosion and profit shifting within the OECD, as well as within the EU" (Kirwin, 2016).
- "The Cayman Islands is not a 'tax haven.' The Cayman Islands is an efficient and effective tax neutral jurisdiction that does not add additional taxes and has been recognised for decades as a strong partner in combatting global financial crime including money-laundering, terrorism financing, corruption and tax evasion" (Scott, 2016).
- "The great progress made by Switzerland over the past years is absolutely not reflected in this rating. Its value is therefore not very meaningful" (Allen, 2016).

While lists such as Oxfam's have been successful in putting pressure on governments and raising attention among the wider public about the problem of tax havens, only regional and global institutions can ensure coordinated action and policy change. For example, the OECD's attempts to use blacklists have pushed countries towards higher levels of transparency. Likewise, the EU exhibited real courage in 2017 by publishing a grey and blacklist that was not only based on countries' lack of transparency, but also on an assessment of 'preferential regimes' and zero tax rates. As of March 2018, there is an EU list of nine non-cooperative jurisdictions: American Samoa, the Bahamas, Guam, Namibia, Palau, Samoa, Saint Kitts and Nevis, Trinidad and Tobago, and US Virgin Islands. Another 62 countries have committed to address deficiencies found, and have been put on a grey list. Out of those 62, six jurisdictions have committed to 'introduce substance requirements' (Bermuda; Cayman Islands; Guernsey; Isle of Man; Jersey; Vanuatu) and 27 have committed to improve in the area of 'fair taxation' (including Switzerland, Hong Kong, Mauritius and Curaçao) (European Commission, 2017a).

In 2018, countries on the grey and blacklist will need to change some of their policies to avoid EU sanctions, including restrictions to channel EU funds through non-cooperative tax jurisdictions.. Since the publication of the lists, several countries have agreed to implement the OECD minimum BEPS standards. While the EU list is a step in the right direction, the lack of public transparency on what preferential regimes and zero-tax countries must do to be de-listed is problematic because it suggests the EU is taking a political, rather than an objective, approach to the de-listing of tax havens. As one article on Guernsey, Jersey and Isle of Man put it: "What the islands will have to do is clear as mud to the public" (Mann, 2017). According to the EU, these islands have committed to 'introduce substance requirements', although it is yet unclear as to what those requirements are. It may also be the case that these jurisdictions will need to increase their corporate tax rates to avoid being blacklisted in the future, but as the EU regards the setting of tax rates a sovereign right, this demand has not been made explicit (Mann, 2017).

The purpose of the EU blacklist has been described as an effort "to deal more robustly with external threats to Member States' tax bases and to tackle third countries that consistently refuse to play fair



on tax matters, (European Commission, 2017a)” and also as a way to “improve tax good governance globally, and to ensure that the EU’s international partners respect the same standards as EU Member States do” (European Commission, 2017b). Considering that among the world’s most significant corporate tax havens are EU member states such as the Netherlands, Luxembourg and Ireland, trying to force non-members to abide by the same standards might be considered consistent. However, it is of course inadequate. Although it has not been made public exactly what the ‘fair taxation’ criteria are, it can be assumed that the criteria will not go (much) beyond the general OECD and EU agreements, with regard to identifying harmful tax practices, anti-profit shifting rules (e.g. CFC) and transparency requirements. Extremely low corporate tax rates alone are not enough to cause a country to be blacklisted and it is unclear which preferential fiscal measures have been identified as unacceptable.

Any blacklist based on a narrow tax haven definition of a country that fails to meet the current flawed international tax standards is destined for eventual failure. While the short-term improvements in tax transparency and abolition of harmful tax regimes is welcome, these initial changes will most likely be replaced by an overall lowering of the corporate income tax rate, or lead to a legitimization of other harmful tax practices. In this case, the end result will be the same, with a loss of corporate tax revenues and a shift of tax burden on to citizens. Oxfam (2017) argued that a corporate tax haven should be defined as a country or territory that plays a significant role in the corporate tax race to the bottom, in part through an absence of transparency. The international community needs to initiate a transparent and public dialogue on the definition of ‘harmful tax practice’, on the risks of the downward trend of the corporate income tax rate and on how countries can work together to prevent a race to the bottom.

Assessing tax havens in light of their contributions to the global corporate tax race to the bottom would also force EU and other countries to consider their own tax policies more critically. This reflection should provide more opportunity to consider how to support countries that currently seem dependent on their zero-corporate tax rate (instead of mainly focusing on sanctions, or other countermeasures). The reality is that for many countries, being a tax haven has not brought the level of prosperity expected (Harrington, 2016).

#### **d. US tax reform**

In December 2017, the US adopted its most far-reaching tax reforms in decades, changes that will affect poverty and inequality in the US and around the globe. The US tax reforms could provide a window of opportunity for more fundamental reforms to corporate taxation. However, the cut in the corporate tax rate from 35 per cent to 21 per cent is a major negative contribution to the global race to the bottom on corporate taxation. Also, the move towards a territorial system could intensify tax competition. As noted by the IMF for the UK and Japan, but just as relevant for the recent US changes: “Shifting profits to, or investing in, low tax countries becomes more attractive if the income generated there becomes less heavily taxed in the parent’s residence country” (IMF, 2014: 38). With foreign business profits exempted the effective tax rate in source countries becomes more relevant and this in turn can lead to more intense competition in source countries. “Tax holidays and other tax breaks become more attractive to investors if the tax saved in source countries is no longer offset by increased taxation in their residence country. The point is especially important for developing countries, with CIT bases often substantially weakened already by incentives” (IMF, 2014: 38).

The move to a territorial system has increased the risk of profit shifting from the US to tax havens, since profits generated outside of the US will no longer be taxed in the US.

Particularly relevant to the global discussions on taxing rights is the new US introduction of a 'Base Erosion and Anti-Abuse tax' (BEAT). The BEAT is designed to impose a minimum tax on profits of companies with more than US\$500m in annual revenue in the US and with significant payments for services, interest and royalties to foreign parties. The minimum rate will be 10 per cent in 2019 and 12.5 per cent in 2026. This tax is meant to discourage profit shifting, especially in today's digital economy where profit shifting has become easier. Several EU countries have raised strong concerns about this tax, as it is likely to lead to double taxation for European companies, especially in the technology, banking and pharmaceutical sectors

BEAT can be considered a vote of 'no confidence' against the current global transfer pricing guidelines. The US is not alone in deviating from international principles out of reaction to increasing concern over the inadequacy of the outdated global tax rules. The European Union is now considering a tax on turnover rather than profit so as to be able to tax the digital economy (see below). The UK's 'diverted profits tax' of 25 per cent on profits, which is considered artificially shifted to tax havens, is another example.

Countries and regions now have the choice between looking the other way as an increasing number of countries take unilateral approaches against profit shifting and base erosion, which will likely have more negative consequences such as those that accompany BEAT, or joining regional and global efforts towards a more fair and coordinated global tax system. BEAT and the discussions around taxing the digitalized economy provide an opening towards discussing the allocation of taxing rights more fundamentally. The question now is whether we can get our political leaders convinced of the need to quickly go back to the drawing board on international taxation.

The UK leaving the EU might increase the chance of finding political agreement at the EU level on harmonized corporate tax rules (the common, consolidated corporate tax base - CCCTB). "The idea of imposing a common consolidated corporate tax has been circulating in European capitals over the years, with the most fervent opponents being Ireland and the UK. Now that the latter has opted for Brexit, the opportunity now exists to push on with these necessary changes and finally take full advantage of the common market" (Kratunkova, 2017). With Brexit, Ireland will lose a strong and vocal opponent to the CCCTB within the EU (Doyle *et al*, 2017). There are valid reasons for Ireland to support the EU's efforts to collectively tackle corporate tax competition at the EU and global level. Ireland has been able to attract disproportionate amounts of MNE investments in the past, but it is losing its competitive advantage as other countries lower their own corporate tax rates. Ireland has little or no scope to further reduce its already very low corporate tax rate, as any reduction would have serious budgetary implications and reduce the Irish government's ability to invest in education, housing, and infrastructure. These public funding areas are all important for maintaining an attractive investment climate, which is why tackling a race to the bottom through further international cooperation is in the interest of all countries, even countries like Ireland.

The EU's recent decision to investigate whether the UK Group Financing Exemption complies with EU state aid rules is an indication that the EU is concerned about the consequences of the UK leaving the EU. The UK will no longer be subject to EU state aid regulations and the EU Code of Conduct for business taxation and could intensify tax competition with EU countries. Consolidating the tax base in Europe, in combination with a minimum (effective) tax rate, could stop this competition.

#### **e. Discussion around taxing of digital economy**

The challenge of taxing 'the digital economy' has intensified the discussions on harmonization of tax rules and rates. As concluded by O'Donovan (2018), "Ireland's right to set its own tax rate, and more importantly perhaps the terms of its tax rules, can no longer be taken as a given. (...) Digital

companies, whose profits are huge and hard to pin down, are being targeted in particular by EU tax reformers. But there is little reason to think the push for harmonisation will take in profits made by Facebook and not extend to Pfizer.”

It is increasingly recognized that new rules should apply to all businesses, irrespective of their degree of digitalization, as there is really a ‘digitalization of the economy’ as a whole rather than a separate ‘digital economy’. Action 1 of the OECD-BEPS action plan was to ‘address the tax challenges of the digital economy’. The growing importance of profits generated through digital sales, services and data have made the need to address the out-dated global corporate tax system more acute. The current international tax rules “can no longer distribute taxing rights fairly among countries and adequately define a country’s tax base” (Li, 2017: 479) As further noted by Li (2017: 480), “The digital economy threatens the tax base of the corporate income tax and the value added tax by facilitating BEPS and potentially causing the tax base to disappear (base cyberization)”. The digitalization of the economy has particularly big consequences for developing countries, which already struggle with limited taxing rights. The tax base of these countries is more at risk as these nations are net importers of digital goods and services. By June 2016, “the internet population in Africa, Asia, Latin America and the Caribbean, and the Middle East accounted for 73 per cent of the world’s internet users. Whereas 65 per cent of Chinese shoppers make purchases online via their mobile devices, the same is true of only 22 per cent of American shoppers” (Li, 2017: 481)

The importance of the digitalized economy is expected to increase. It is also combined with an increasing ‘dematerialization’, referring “to the transformation of any material object into something of virtual or digital quality” (Li, 2017: 495). The increase in digitalization of the economy makes it more difficult to define where a company is located. For example, many business functions and sales or services are in various locations, with varying degrees of digitalization and dematerialization across the globe. In addition, people are no longer merely ‘consumers’ but are increasingly contributing to value-creation as a source of big data (Li, 2017). This makes the current profit attribution rules, which are largely based on physical presence, outdated.

Several proposals are being discussed at EU and OECD level now to address the challenges of digitalization. The OECD published its interim report in March 2018, mainly highlighting a lack of international consensus on the way forward (Martin, 2018). The EC, clearly not satisfied with the lack of progress at the OECD level, put forward a short-term and long-term proposal to be discussed at the EU level (European Commission, 2018).

The short-term options considered by countries includes the proposal by the European Commission for a 3 per cent tax on gross revenues from certain digital activities (a turnover tax) based on where users are located rather than where the physical presence of the corporations is (European Commission, 2018). Yet another short-term fix for tax in the digitalized economy is to introduce a withholding tax on digital transactions. “This could apply to payments by residents of a country for online purchases of goods and services from non-resident enterprises” (Li, 2017: 518). The advantage of a withholding tax is that it will be relatively easy to implement, but it is likely that such a tax will be passed on to consumers, resulting in double taxation (BEPS Monitoring Group, 2017).

With regard to more long-term proposals, one proposal that the EU and OECD will further discuss is to adjust the permanent establishment (PE) rules to take into account significant digital presence. According to Li (2017), having a PE is either not needed or more easily circumvented in a digital economy. “Under the existing rules, attribution of profit is based on assets, ownership or intangibles and risks. Little or no profit is attributed to the role of the market, connectivity infrastructure provided by the market country, or the role of customers in generating data which is critical to the

success of the digital business” (Li, 2017: 504). As 2014 IMF study notes, “To the extent this results in sales themselves creating a presence that could trigger a CIT liability, the change in the current international tax architecture would be profound” (IMF, 2014: 50). A new PE definition should also enable allocation of profits to a ‘virtual PE’, one that does not necessarily have a physical presence but a clear digital presence in a jurisdiction (Li, 2017).

The European Commission sees scope within the proposal for the CCCTB to revise the PE rules and to ensure an apportionment approach based on a formula that effectively captures digital activities and attributes profits in a way that better captures how and where value is created (European Commission, 2017d).

The BEPS monitoring group has also suggested adopting a residence-based, worldwide taxation system through which MNEs would be taxed on worldwide profits in the country of residence of the ultimate parent, but then eligible for a credit for foreign taxes. This option was not considered during the OECD discussions on base erosion and profit shifting, and with the move of an increasing number of countries (like the US) towards territorial systems, this approach does not seem to have much traction. Also according to the BEPS monitoring group, another possibility could be a combination of the long-term options, for example “regional formulary apportionment with full-inclusion for CFCs outside the region” (BEPS Monitoring Group, 2017: 22).

The fact that different short-term proposals are on the table reflects a political lack of confidence that a regional or global-level consensus can be achieved on fundamental changes. Moreover, the options also reflect a lack of clarity, or perhaps lack of agreement, on the exact problems that need addressing. Central questions that need to be answered include how to address the digital economy problem of corporations shifting their profits to tax havens in which they have little real economic activity; how to determine what level of tax constitutes a country’s ‘fair share’; how to address the fact that profit shifting activities of large multinationals contribute to unfair competition between small and medium enterprises and large multinationals; what to do about the likelihood that this unfair competition will put further pressure on governments to lower the CIT rate for all corporations, exacerbating the race to the bottom and the immediate revenue-raising challenges for governments around the globe. To solve this last problem, governments will not be able to rely on temporary solutions, but will need to support more fundamental, lasting reforms.

#### **f. Need to end business pressure to eliminate CIT**

Business representatives often insist that lowering the CIT attracts FDI and increases economic growth. These arguments were used in The Netherlands when large corporations successfully lobbied for abolition of tax on dividends (Thompson, 2017). Large companies in the US and other countries that successfully lobbied for decreases in CIT also used these same arguments. There is research that can be used to support business’s arguments. OECD research, for example, (used by Ireland to support its low CIT), suggests that a 1 per cent rise in corporation tax results in a fall in FDI of 3.7 per cent (Department of Finance, 2014; Hodge, 2016). However, even OECD tax experts are starting to explain that while lower corporate tax rates may boost GDP, they are likely to lead to undesirable tax competition and to contribute to higher levels of income and wealth inequality (Bowers, 2016). With regard to the US corporate tax rate reduction, IMF’s chief economist has said that the lower rate might just give a “one-off boost”, but that the US economy will “ultimately face an economic bill” of lower growth later, reduced revenue and increased federal debt (see Ryan, 2018).

Other studies strongly challenge the business (and OECD) claims that lower corporate tax rates are positive for economic growth (Shaxson and O'Hagan, 2013). A study for the Australia Institute on Australia and OECD countries found no correlation between corporate tax rates and economic growth (Richardson, 2016). In Australia, increased levels of investment can be most accurately explained by the impact of a mining boom and of privatisations. The study concludes: "If the aim really is increased economic growth, then Australians would be better advised to ignore the business lobby's call for lower company tax rates and look seriously at other policies" (Richardson, 2016: 16). A study by the Canadian Centre for Policy Alternatives on the interplay between the Canadian CIT regime and growth found no significant relationship between CIT and growth. This paper even suggested that CIT rate reductions might contribute to slower growth. The conclusion was that "If the findings contained in this paper are true, then corporate income tax cuts will go down as one of the great Canadian public policy blunders of recent times" (Brennan, 2015: 6). In a 60-nation panel study that tested the assumptions that lower corporate tax rates increase FDI and lead to GDP growth, it was found that while reduced corporate tax rates may attract FDI inflows, "that influx does not lead to the expected economic growth". The study found, rather, that countries that lowered their marginal CIT rates most, "significantly decreased their economic growth rates". The apparent inflow of FDI "may be in financial instruments for debt-reducing, tax-deductible write offs, as opposed to operational FDI that generates economic activity" (Anguelov, 2015: 28-29).

For business investment decisions, tax rates and policies matter but may not be the main determinants (OECD, 2008). To analyse the relationship between tax rates and competitiveness, Weyzig analysed the top 50 countries in the Global Competitiveness Index and found that tax rates on profits are irrelevant for a country's competitiveness (with a few exceptions). He found that "highly competitive discounters," including Switzerland, Singapore, Hong Kong and Ireland are just as competitive as "notorious high-tax countries," a group that includes the US, Germany, Japan, Belgium and France (Weyzig, 2017b).

Despite the aforementioned research, it seems that business representatives are not just asking for lower corporate tax rates, but for completely replacing corporate tax with other forms of taxation (such as VAT or sales tax). While the evidence is thin on the need to lower corporate tax rates, the justification for replacing corporate tax seems to be missing altogether. This topic needs more attention from policymakers, researchers and civil society, as with the lack of international consensus on how to tax corporations fairly, and with the move from some governments and regions towards turnover tax (e.g. EC proposal for taxing large digital corporations), the corporate income tax may be heading towards an existential crisis.

According to Richard Murphy, Professor of International Political Economy at City University London, replacing the corporate income tax with a sales tax, "would create massive complications in the tax system; would shift the burden of tax onto lowest paid and small business, would increase income and wealth inequality. It would also give big business a real boost in their competitive advantage as a result of that tax boost... I can see every reason why a lot of lobbying will be thrown in the direction of such a tax now" (Murphy, 2016). Grahame Steven, of Edinburgh Napier University, explains in a brief summary on the topic that this would be bad for companies as they would be taxed on their sales even when making small profits or even losses; it could, as a result, be a disincentive to investment. A sales tax would have to be introduced on a global scale, as companies cannot pay taxes on profits in some jurisdictions but on sales in others. Alternatively, sales could become focused on countries with lower tax rates, which would intensify a race to the bottom. It would also be complicated to define which tax rate to apply to different business sectors and different business models (Steven, 2016). Justin Ross, who teaches public finance and economics at

Indiana University, examined theory and case studies on turnover taxes and concluded that developed countries have had good reasons to abandon them. In countries with very weak tax administrations, such as in some developing countries, this type of tax could enable them to raise more corporate tax (Ross, 2016). However, as a study on Pakistan concluded, in a situation with relatively strong tax administrative and enforcement capacity this should not be the preferred option. In such circumstances taxing profits is preferable (Best *et al*, 2014).

In the Netherlands, civil society organizations investigated the influence of big corporations and their tax advisors on the Dutch government policies. They looked first at the relationships between tax advisors and universities, as universities are important contributors to Dutch policy making. Out of 289 tax partners, 40 were connected to one or more universities, many of them as professors. In 2011, 26 per cent of professors at the accountancy departments of Dutch universities were also tax partners at one of the big four accountancy firms. Tax advisors were also found to take central positions in advisory bodies, committees and working groups that inform the policy and positions of Dutch political parties and of the government (Berkhout, 2016a). Through an access to information request, documents were made public that showed that the Dutch government consulted intensively with business representatives before taking new tax policies to parliament and found their approval very important (Oxfam Novib, 2016). The lobbying of business representatives has been focused on protecting the 'fiscal crown jewels', including the Dutch tax rulings system, the innovation box, and the lowering of corporation income tax to compete with other countries. While consultation with corporations and their tax advisors is important, what remains to be seen is whether governments remain able to keep the public interest in mind when they make their policies.

Instead of governments serving business interest by reducing the corporate income tax, what the general public needs is a government that is able to defend (a fair level of) corporate income tax and to reject risky alternatives.

### **3) What a global minimum tax rate might look like**

If the objective of governments truly is in line with the sustainable development goals, the objective of any industrial policy should not be focused on competition with other countries, as competition naturally includes 'winners' and 'losers'. Creating losers is not in the spirit of the sustainable development goals, including ensuring quality access to health and education and reducing inequality within and between nations. While the current competition-focused strategies of many countries may be compatible with the political reality of global competition, in the medium to long-term, these strategies are extremely harmful to all countries.

The ability of governments to collect tax is harmed by regional and global corporate tax competition. This competition undermines the efforts by governments to achieve the sustainable development goals and to fight poverty and inequality. Corporate tax incentives, including lowering of overall corporate income tax rates, have led to a shift in tax burden from large corporations to citizens while decreasing much-needed funding available to governments. In response to the developments described in this chapter, governments should seriously consider working towards setting a minimum effective tax rate for corporate profits at the national, regional and global level. Such an initiative would help to prevent a further race to the corporate taxation bottom.

A few proposals have been put forward so far for a minimum (effective) tax rate, including by the rapporteur of the European Parliament Committee on Economic and Monetary affairs, Paul Tang, to introduce a minimum corporate tax rate of 15% in each EU member state. Oxfam is currently

preparing a position paper on a global minimum effective tax rate, including how it could be implemented and the rate it should be set at. This will hopefully advance thinking on this area.

Importantly, one minimum effective tax approach published so far would even enable countries or regions to take the initiative without having to wait until a worldwide agreement. Azam (2017) suggested for the US to adopt a minimum global effective corporate tax rate, to serve as a general anti-avoidance rule against international corporate tax avoidance. Building on his work, governments could consider the following to end the corporate tax race to the bottom: they can decide that when the *global effective corporate tax rate* of any multinational and its Controlled Foreign Companies (CFCs) falls below 20 per cent, the corporation should be required to close the gap and pay up to the minimum of 20 per cent or the CIT rate in the home country (if above 20 per cent). Countries with a statutory rate of less than 20 per cent could commit to ensuring that within two years they would impose a minimum effective corporate tax rate of at least 10 per cent. Countries and regions can advance alone on this. As Azam (2017) remarked on his proposal for a minimum global effective corporate tax rate: “This might produce a race to the top, since residence countries will be increasingly interested in adopting the regime and setting a minimum rate in order to get the right of taxation as the resident country”.

A minimum effective tax rate of 20 per cent should be acceptable, considering the current effective tax rate that corporations report is often higher. In the EU, it is not just the statutory rates that have declined, but also the effective tax rates, which have decreased significantly over the past decade but are still above 20 per cent on average (European Commission, 2017e).

While a rate of 20 per cent could be set as a minimum to discourage further profit shifting to tax havens, countries should adopt regional and global objectives to ensure that revenue from the corporate income tax is sufficient to meet the sustainable development goals. At regional and global level it should be considered to adopt targets on increasing the regional and global average CIT (e.g. 30% in 2030). In agreeing such a proposal consideration may have to be given to adopting a bandwidth of (effective) tax rates to be adopted differentiating between smaller/bigger economies based on GDP.

In addition, jurisdictions that claim to be dependent on extremely low corporate tax rates need to be supported to move towards a more sustainable economy.

This proposal would not necessarily rule out all tax incentives. Some exceptions could be made for sectors with clear and explicit social benefits (e.g. for the purpose of greening the economy), but in these cases governments should place caps on private shareholder and executive pay.

Beyond working towards a minimum effective tax rate, countries should consider moving towards a complete overhaul of the current global tax system, or a system of unitary taxation. The discussions on the CCCTB, BEAT and the taxing of the digitalized economy open windows of possibility for such a scheme. A complete tax overhaul of this magnitude, however, will present a whole new set of challenges, especially for developing countries. The success of a unitary taxation model will depend on the influence that poor countries have in the negotiation process at the regional and global level on how to apportion profits across jurisdictions. This will determine whether the taxing rights of developing countries will improve.

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