

International corporate taxation - A European view (ETUC draft position)

Adopted at the Executive Committee Meeting of 9 - 10 March 2020

The debate on Fair Taxation is becoming increasingly important as the need to increase public financing of common goods for people in both developed and developing world grows more urgent. This position paper notes the current debates in the OECD on fighting tax avoidance and aggressive tax planning from multinational companies and supports the efforts of the TUAC in this domain.

While the debate continues in the OECD, the ETUC underlines the need for the European Commission to address the unfinished discussions relating to draft legislation on Public Country-by-Country reporting and calls on the European Commission to complete the legislative process to ensure the much needed transparency in reporting so that member states could tax companies based on their real economic activity. Any decision on this issue should be taken on the basis of qualified majority voting in the Council.

The ETUC also calls on member organisations to lobby their governments to put pressure on the European Council, and urges the European Commission and European Union Member States to press for a clearer switch towards unitary taxation and a strong minimum tax rate. In consequence, the ETUC urges the Council to re-enter negotiations on a common consolidated corporate tax base on the bases of the reports of the European Parliament¹.

The issues at stake

The most striking development in tax policy throughout the world over the last few decades has been the decline in corporate income tax rates. Between 1985 and 2018, the global average statutory corporate tax rate fell by more than half, from 49% to 24%. Today's larger multinational companies do not seem to move tangible capital to low-tax places, they do not even have much tangible capital to start with. Instead, they avoid taxes by shifting accounting profits. In 2016, for instance, Google Alphabet made \$19,2 billion in revenue in Bermuda, where it barely employs any workers nor owns any tangible assets, and where the corporate tax rate is zero percent².

The current system is based on the premise of treating the various affiliates of multinationals as if they were independent of each other (the so-called "arm's length principle"). This has encouraged multinationals to create complex tax-avoidance structures by forming hundreds of affiliates in convenient jurisdictions. These arrangements are conceptually straightforward: low profits are declared in high-tax jurisdictions, both in developed and developing countries, through the use, for instance, of limited risk structures, excessive debt and deductions for the right to use intangibles. This system allows multinationals to allocate their profits in low-tax jurisdictions or tax havens, and, consequently, pay almost zero tax. Such schemes may be legal but can now be challenged by the European Union on legal grounds on the basis of state aid rules.

¹ European Parliament legislative resolution of 15 March 2018 on the proposal for a Council directive on a Common Corporate Tax Base (COM(2016)0685 – C8-0472/2016 – 2016/0337(CNS)) and European Parliament legislative resolution of 15 March 2018 on the proposal for a Council directive on a Common Consolidated Corporate Tax Base (CCCTB) (COM(2016)0683 – C8-0471/2016 – 2016/0336(CNS)).

² See T. R. Tørsløv, L. S. Wier & G. Zucman (2018a), "The missing profits of nations", Vox CEPR Policy Portal.

It is now well established that corporate tax cuts increase income inequality and is therefore detrimental to growth³ and democracy through the concentration of economic power and influence. It has indeed been shown⁴ that a corporate tax cut of 0,5 percentage points equates to about 7,8 percent of the average rise in the share of income accruing to the top earners between 1990 and 2010. Furthermore, the issue is not only the concentration of economic power and influence but letterbox practices have an impact on labour rights and if there is little money left in a company's balance sheet due to profit shifting, collective bargaining is seriously hampered and any attempt to address the income inequality is made impossible.

Tax avoidance diverts 40% of foreign profits to tax havens⁵. The International Monetary Fund's Fiscal Affairs Department estimates annual total corporate tax losses associated with profit shifting at more than \$600bn, with \$400bn for OECD member states (around 1% of GDP) and around \$200bn for developing countries per annum (1,3% of GDP)⁶. In 2018, 82% of global wealth generated went to the richest 1% of the world's population, while the poorest 50% - 3.7 billion people - did not benefit at all from this growth⁷. In 2019, the world's billionaires, only 2,153 people, had more wealth than the poorest 4.6 billion people combined⁸.

The estimation that 40% of multinational profits are shifted to tax havens is based on statistics recording the amount of wages paid by affiliates of foreign multinational companies and the profits these affiliates make. In other words, they allow to decompose national accounts aggregates (wages paid by corporations, operating surplus of corporations, etc.) into 'local firms' and 'foreign firms'. In the current international tax system, tax authorities of high-tax countries do not produce the right incentives to combat profit shifting to tax havens and tend to focus their enforcement effort on relocating profits booked in other high-tax places⁹. This type of approach crowds out enforcement on tax havens, which is hard (little data exist), costly (as multinationals spend large resources to defend their shifting to low-tax locales), and lengthy (due to a lack of cooperation by tax havens).

Non-haven European Union Member States appear to be the greater losers from this phenomenon, while very-low tax countries (and the shareholders of multinational firms) appear to be the main beneficiaries¹⁰. Recent estimates on profit shifting by multinationals show a corporate tax loss in the European Union at around 20% of corporate tax revenue collected⁶. These findings have implications for economic statistics. They show that headline economic indicators - including GDP, corporate profits, trade balances, and corporate labour and capital shares - are significantly distorted. Adding back the profits shifted out of high-tax countries increases the corporate capital share significantly. The rise in the European corporate capital share since the early 1990s would be twice as large

³ See J. Ostry, A. Berg & G. Tsangarides (2014), "Redistribution, inequality, and growth", Staff discussion note SDN/14/02, Washington DC, International Monetary Fund.

⁴ S. Nallareddy, E. Rouen & J. C. Suárez Serratoa (2018), "Corporate Tax Cuts Increase Income Inequality", Working Paper 18-101, Harvard Business School.

⁵ See T. R. Tørsløv, L. S. Wier & G. Zucman (2018b), "The missing profits of nations", Working Paper 24701, National Bureau of Economic Research.

⁶ Ernesto Crivelli, Ruud De Mooij and Michael Keen, "Base Erosion, Profit Shifting and Developing Countries", Working Paper WP15/118, International Monetary Fund.

⁷ See Oxfam (2018), *Reward work, not wealth*.

⁸ See Oxfam (2019), *Time to care, Briefing Paper*, Oxfam.

⁹ See T. R. Tørsløv, L. S. Wier and G. Zucman (2018b).

¹⁰ "Tax havens", although having "low statutory tax rates (and even lower effective rates) generate much more revenue than non-haven countries. Malta collects about 8% of its national income, Luxembourg 7%, and Ireland more than 5%. By contrast, in the United States, Germany, and Italy (three of the countries with the highest statutory tax rates), corporate tax revenue amount to less than 3% of national income" (see. See T. R. Tørsløv, L. S. Wier & G. Zucman (2018b)).

as recorded in official national account data¹¹. This finding has important implications for current debate about the changing nature of inequality.

When global corporations and the super-rich dodge their tax paying responsibilities, it is the poorest countries and people who lose most. Governments are left with the option of either cutting back on the essential spending needed to fight inequality and poverty and climate change; or make up the shortfall by increasing taxes such as VAT, a proportional tax to which the ETUC is opposed as a general principle, thus adversely effecting mostly ordinary citizens¹², since increases in top marginal tax rates on income and wealth taxes seem not to be considered.

The European Common Consolidated Corporate Tax Base and the European Parliament reports

In December 2016¹³, ETUC welcomed the European Commission's initiative to relaunch the Common Consolidated Corporate Tax Base (CCCTB) proposal. Enhanced convergence of tax bases within the European Union is needed in order to build more coordinated economic policies and fight tax avoidance and aggressive tax planning. However, given that tax avoidance uses both tax base and tax rate differentials, ETUC reiterated its call for the setting of a minimum corporate tax rate of 25% in Europe, this would ensure that companies pay their fair share of tax where profits are generated and/or realised.

A company would have to comply with just one EU-wide system for computing its taxable income, rather than different rules in each Member State in which it operates. Those profits would then be apportioned among countries, split on the estimated level of real economic activity taking place in that country using a **formulary apportionment**. This would be measured on the basis of the weighted ratio of sales, payroll and number of employees and assets in each country. Member States would then be free to choose what tax rate to apply to those apportioned profits. ETUC considered that the proposed threshold for mandatorily entering the CCCTB scheme was too high and should be set in accordance with the accounting directives, and to be reduced to zero after seven years maximum, as suggested and supported by the ETUC¹⁴ in the reports of the European Parliament¹⁵, meaning that eventually all European companies would fall under the CCCTB.

On 15 March 2018, Members of the European Parliament voted overwhelmingly in favour of two reports on the Common Corporate Tax Base (CCTB) and the Common Consolidated Corporate Tax Base (CCCTB), integrating important remarks of the ETUC¹⁵. On 21 March 2018, the European Commission set out two proposals for taxing digital companies where value is created. The definition of the digital permanent establishment is presented in the proposal for a Council Directive laying down rules relating to the corporate taxation of a significant digital presence¹⁶. It defines a digital platform deemed to have a taxable digital presence or a virtual permanent establishment in a Member State if it fulfils one of the following criteria: it exceeds a threshold of EUR 7 million in annual revenues in a Member State; it has more than 100,000 users in a Member State in a

¹¹ T. R. Tørsløv, L. S. Wier and G. Zucman (2018a).

¹² See M. Méaulle (2019), "Profit, investment and inequality: a preliminary view", in P. Scherrer, J. Bir, W. Kowalsky, R. Kuhlmann & M. Méaulle (2019), *The future of Europe*, ETUI.

¹³ ETUC position on the Common Consolidated Corporate Tax Base (CCCTB), adopted at the Executive Committee Meeting of 14-15 December 2016.

¹⁴ Communication from the General Secretary, Extraordinary Executive Committee, 12 April 2018.

¹⁵ Update on the ETUC positions on the completion of EMU considering the most recent Commission proposals, adopted at the Executive Committee of 18 – 19 December 2018.

¹⁶ Council Directive laying down rules relating to the corporate taxation of a significant digital presence COM/2018/0147 final - 2018/072 (CNS).

taxable year or over 3000 business contracts for digital services created between the company and business users in a taxable year.

With such a framework the European perspective on curbing tax avoidance and aggressive tax planning for multinational businesses, being highly digitalised or not, was going in the right direction, but the file is still unfortunately pending at the European Council.

The OECD Inclusive framework

In 2015, as part of the OECD/G20 Base erosion and profit shifting (BEPS) Project, over 60 countries delivered 15 Actions to tackle tax avoidance, improve the coherence of international tax rules and ensure a more transparent tax environment (BEPS package). In 2016, the OECD/G20 Inclusive Framework on BEPS (IF) was established to ensure interested countries and jurisdictions, including developing economies, can participate on an equal footing in the development of standards on BEPS related issues, while reviewing and monitoring the implementation of the OECD/G20 BEPS Project. In 2017, the first high-level signing ceremony of the Multilateral Instrument (MLI) took place. To date, more than 94 jurisdictions have signed the MLI, which enables the efficient implementation of tax treaty related BEPS measures without the need to bilaterally renegotiate individual tax treaties which was the dominant way of facilitating tax avoidance. For the period 2018-2020, the IF members (more than 135 countries) developed a *Programme of Work* that aims to provide consensus-based, long-term solutions to the tax challenges arising from the digitalisation of the economy by 2020. In May 2019, the Inclusive Framework on BEPS launched the Programme of Work to explore three proposals and expected an agreed outcome by January 2020, under the “Unified Approach” branding. The general framework was provided on 9 October 2019¹⁷ and the latest update on 31 January 2020¹⁸. It is divided into two pillars discussed hereunder.

Pillar 1:

Under the current system many countries have little or no right to tax profits generated from sales and other digital activities on their territory, because a company needs to be physically present in order to be taxed¹⁹. The new approach now aims to allocate a portion of multinationals profits to market jurisdictions starting from their total global profits.

The OECD proposes to start taxing multinationals as global firms and distribute part of the global profits where the value is created (known as Pillar 1 of the proposal). In this respect, it intends to create new taxing rights for jurisdictions where permanent establishments were absent. However, new conceptual classifications, such as “routine” and “residual” profits, were brought in, therefore creating the risk of downgrading a proposal that could have taken the orientation described in the CCCTB proposal. As stated by the Independent Commission for the Reform of International Corporate Taxation, “Any reform actions by OECD Inclusive Framework taken now should (...) be the first step towards taxing multinationals as single and unified firms, **using formulary apportionment based upon objective factors**, and result in a system that is simpler, easier to administer, more efficient and more equitable”, as is the case for the CCCTB scheme, and which is only partially present in the OECD proposal, as the “approach largely retains the current transfer pricing rules”²⁰ for pricing routine transactions.

¹⁷ OECD (2019), “Public consultation document, Secretariat Proposal for a “Unified Approach” under Pillar One”, OECD

¹⁸ OECD/G20 Base Erosion and Profit Shifting Project (2020), “Statement by the OECD/G20 Inclusive Framework on BEPS on the Two-Pillar Approach to Address the Tax Challenges Arising from the Digitalisation of the Economy as approved by the OECD/G20 Inclusive Framework on BEPS on 29-30 January 2020”, OECD.

¹⁹ Here lies the legitimacy of the Council Directive laying down rules relating to the corporate taxation of a significant digital presence COM/2018/0147 final - 2018/072 (CNS).

²⁰ OECD (2019), “Public consultation document, Secretariat Proposal for a “Unified Approach” under Pillar One”, OECD.

The new taxing right would be granted only on a portion of the group deemed residual profits on consumer end-users sales only²¹, the amount of which will crucially depend on the calculation of routine profits, using transfer pricing. The amount of the residual profits that could be taxed would be proportional to the volume of domestic end-users' sales only, not integrating payroll, number of employees and assets in each country in the formulary apportionment. Therefore, only a fraction of a fraction of the total profits would be reallocated using formulary apportionment, based solely on the volumes of end-user's sales with no reference to the number of workers and assets. This proposal will therefore in all likelihood benefit OECD countries first and foremost.

Lot of debates are indeed taking place on the expected impacts of the new proposal on the collection of taxing income. The OECD (2020)²², in its most recent impact assessment, is claiming that most jurisdictions would gain tax revenues except investment hubs, although high income countries would benefit more in terms of average revenue gains as percentage of current corporate income tax revenues. Indeed, research relating to the chosen apportionment formula²³, related to end-users' sales alone, as suggested by the OECD in its 2019 and 2020 proposals, would be "of little benefit" to non-OECD countries, compared to formula integrating employment levels. Finally, the analysis from the French Council of Economic Analysis²⁴ is bleaker, although the assessment is based on the November 2019 proposal from the OECD, stating that "the reforms that aim at designing a profit splitting rule to partially reallocate profits to destination markets (so called pillar 1 at the OECD) have a negligible impact on tax revenues and a modest positive impact on the attractiveness as a business location of most non-tax haven countries."

Therefore, as rightly emphasised by the Trade Union Advisory Committee to the OECD²⁵, "the proposed scope is based on unclear and untested concepts. This is all the more true for the concept of residual profits. The proposed rules should also distinguish between within-scope "consumer-facing activities" from out-of-scope Business to business operations", and the "proposed design for pillar one is excessively cautious, ensuring that most corporate profits would continue to be taxed according to the existing transfer pricing rules. Indeed, the new taxing right ("Amount A" in IF terminology) would be effective after applying no less than five successive thresholds. These hurdles range from gross revenues thresholds, most likely EUR 750 million, to assessing what business profitability may justify the imposition of a new tax. Each of these thresholds would not only exclude the vast majority of MNEs from the tax reform, it would also be the source of considerable complexity and arbitrary decisions."

Pillar 2:

Pillar two is intended to introduce a global effective minimum corporate tax rate. Indeed, the issue is at the core of the ongoing debates. The ETUC is one of the few organisations which managed to agree on a minimum corporate tax rate of 25%. If competition were not integrating tax optimisation from Multinational companies, most profit shifting would be disincentivised. The implementation of a minimum effective tax rate would allow a substantial increase in tax collection. As stated by the most recent OECD appraisal, much of the gains in tax collection would come from this new pillar. As stated by the French Council of Economic Analysis, "The introduction of a worldwide minimum effective corporate tax rate should be the main priority of international negotiations.". However, as

²¹ *The B2C, Business to Consumer, approach, excluding most Business to Business (B2B) transactions from profits being possibly newly taxed.*

²² *Update on Economic Analysis and Impact Assessment, OECD.*

²³ A. Cobham, T. Faccio and V. Fitzgerald (2019), "Global inequalities in taxing rights: An early evaluation of the OECD tax reform proposals", <https://doi.org/10.31235/osf.io/j3p48>

²⁴ C. Fuesta, M. Parentib & F. Toubalc (2019), "International Corporate Taxation: What Reforms? What Impact?", *Les notes du conseil d'analyse économique*, n° 54, November 2019

²⁵ TUAC (2019), "OECD-hosted G20 Forum delivers a watered down proposal on the taxation of digitalised businesses", TUAC.

stated by the TUAC, “The inability to agree on pillar two is of major concern. Pillar two would indeed offer better guarantees in terms of addressing under-taxation of digital businesses and tax competition.”.

ETUC assessment: a synthesis

The ETUC is disappointed with the current debates and proposals at stake within the OECD/G20 Inclusive Framework on BEPS. Indeed, this is of vital importance for ensuring a fair contribution of corporations to financing public budget.

While the European proposal could bring solutions for preventing tax avoidance and aggressive tax planning by supporting the possibility to tax the whole amount of profits of a multinational and using a formulary apportionment based on objective factors such as sales, payroll, number of employees and assets in each country; the OECD proposals suggest five successive threshold to attain the possibility for some jurisdictions to receive their fair share of taxes with regards to their role in the production process of the multinationals at stake.

In addition, the successive thresholds could be extremely limiting, using new unclear and untested concepts. This is all the more true for the concept of residual profits, which will in fact be the residual of the total normal profits, still defined using transfer-pricing techniques. It is also the case for the proposed rules to distinguish between within-scope “consumer-facing activities” from out-of-scope Business to Business operations.

Moreover, the ETUC, in coherence with its former position on the CCCTB, contests the proposal to include definite and specific references on carving out extractive industries and (most) financial services (including insurance), as well as airline and shipping businesses and calls for the implementation of pillars one and two simultaneously. All industries and multinational companies should enter the new process.

With the same line of reasoning, the ETUC also opposes the reference to an “alternative safe harbour” system. Indeed, on December 3, 2019, the United States Treasury Secretary wrote to the OECD stating that while the United States was supportive of a long-term solution to prevent the proliferation of unilateral measures, it had serious concerns regarding potential mandatory departures from arm’s length transfer pricing and taxable nexus standards. In this letter, the Treasury Secretary indicated that it believed the goals of the pillar one regime could be substantially achieved by making pillar one an elective safe-harbour regime, this allowing companies to elect for pillar one to be applied, or to otherwise stay in the old system of transfer pricing. In response, the OECD noted in its January Statement that a form of safe harbour as suggested by the United States will be considered by the Inclusive Framework as the architecture of pillar one is further considered.

The ETUC regrets the lack of ambition displayed by the OECD/G20 Inclusive Framework on BEPS on the issue of tax avoidance and tax planning and urges the European Commission and European Union Member States to press for a clearer switch to unitary taxation and a strong minimum tax rate. Furthermore, and in consequence, the ETUC urges the Council to re-enter negotiations on the CCTB and CCCTB²⁶, and pursue the debate on the implementation of Public Country-by-Country reporting from multinationals, intimately linked to the issue at stake.

²⁶ *European Parliament legislative resolution of 15 March 2018 on the proposal for a Council directive on a Common Corporate Tax Base (COM(2016)0685 – C8-0472/2016 – 2016/0337(CNS)) and European Parliament legislative resolution of 15 March 2018 on the proposal for a Council directive on a Common Consolidated Corporate Tax Base (CCCTB) (COM(2016)0683 – C8-0471/2016 – 2016/0336(CNS)).*