International Politics and Society

Taxes, taxes, taxes

Developing countries need to unite their efforts now to prevent an unfair and inadequate international tax reform

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In 2018, 60 of the top 500 companies in the United States, including Amazon, Netflix, and General Motors, paid no taxes – despite profits totalling USD 79bn. The current system allows this: it's entirely legal.

To accomplish it, the companies use complex structures that have been developed by legions of lawyers, but the basic principle is quite simple: their network of affiliates and subsidiaries allows them to declare their profits in those territories with the lowest tax rates, even if the company has no customers there. Meanwhile they report losses in countries with relatively high taxation.

As a result, each year developing countries lose at leastUSD 100bn, which corporations then hide in tax havens. According to calculations by the economist Gabriel Zucman, only 40 per cent of the global profits of multinational companies are being taxed. Because of the accelerated digitisation of economies, the amounts shifted continue to increase, according to the International Monetary Fund, the OECD, and the United Nations Conference on Trade and Development (UNCTAD).

Developing countries need to step up

Faced with global indignation over low or non-existent tax payments, and after decades of inaction, a few years ago the G20 commissioned the OECD to come up with alternatives to put an end to this abuse. Recently, the OECD has put forward proposals for a new international taxation system that could be introduced worldwide in the coming decades.

Change could now come swiftly: after the publication ofits first draft on this topic in October 2019, the OECD will present a final proposal in 2020. After that, for all intents and purposes any additional influence on the reform process will be impossible.

However, as stated in our last report, the OECD proposals are neither far-reaching enough nor are they balanced.

For this reason, now is the time to sound the alarm in developing countries. The claim that they have no say is no longer valid. By setting up the 'Inclusive Framework' group, the OECD has offered them a place at the negotiating table. With its 134 members, it's the arena where the international tax system of tomorrow will be decided.

Unfortunately, despite its name, the 'Inclusive Framework' doesn't grant developing countries a level playing field. Wealthy countries have an easier time asserting their positions thanks to their greater human, political and financial resources. As the headquarters of large multinational companies, they are also subject to more pressure by said companies. And that's precisely why the proposals put forward by all the developing countries participating in the negotiations are even more important.

The OECD's shortcomings

The OECD's reform proposal rests on two pillars. On the one hand, it wants to create transparency with regards to where the tax-relevant corporate profits are generated. According to the Independent Commission for the Reform of International Corporate Taxation (ICRICT), which I chair, the best option is to consider a multinational company as a single entity: its total profit would be taxable based on objective, non-manipulable criteria such as employment, sales, natural resources exploited and user-based digital data.

However, as stated in our last report, the OECD proposals are neither far-reaching enough nor are they balanced. The profit, which would be divided up internationally, would be limited to so-called residual profit, i.e. only a part of the total profits of the company. Even more importantly, this principle would apply only to very large multinationals — and the accounting of these profits would depend exclusively on turnover, thereby excluding employment and other factors that favour developing countries.

It's time for the developing countries to take action. Increasing tax revenues is their only chance to improve access to health care, education, gender equality and to confront climate change.

The second pillar is the introduction of an effective, worldwide minimum corporate tax rate. Some developing countries apparently see a risk in this: they fear that they would be unable to attract foreign investment if they had no tax incentives to offer. However, according to findings by the IMF, we can doubt whether such incentives attract any investment at all.

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It would be more important for the international community to agree on a sufficiently high tax rate. According to the ICRICT, this should be at least 25 per cent – which is the currently prevailing rate in developed countries – to put an end to the downward spiral that we're seeing at moment, and which only multinationals profit from. On the one hand, this would deprive the tax havens of their right to exist; on the other hand, it would ensure that all states have access to the resources essential for their development.

Considering the lack of international consensus, some countries are opting for partial solutions. For example, France will charge a sales tax of 3 per cent on certain digital services. Other countries, such as Mexico, are considering requiring platforms such as Uber and Netflix to pay VAT on services provided within their territory. The initiative to tax hitherto exempt revenues is certainly to be welcomed. However, given the increasing number of companies that use digital technologies in their activities, it's impossible to look at the digital economy separately and make it the sole subject of reform.

It's time for the developing countries to take action. Increasing tax revenues is their only chance to improve access to health care, education, gender equality and to confront climate change. If heads of state and finance ministers continue to underestimate the importance of this debate, they will soon be forced to accept a new international tax system that runs counter to their interests. The winners will be the same, but there will be no time left to protest.