EUROPE 03.10.2018 | Tove Maria Ryding

Tax paradise lost

It's time for Europe to show leadership when it comes to taxing multinational corporations in today's digital world

'Let's continue this discussion!' That's been the main conclusion of years of negotiations between governments about how to tax multinational corporations in today's digital world. In the EU governments have agreed to meet, to disagree and to meet again. But what might look like a traveling university debate club is actually a group of finance ministers discussing a problem that is costing citizens many billions of euros per year. And time lost is money lost.

The examples of large-scale corporate tax avoidance are piling up. 'Amazon was allowed to pay four times less tax than other local companies,' EU Commissioner for Competition Margrethe Vestager concluded in her state aid case on Amazon and Luxembourg last year. She also found that Amazon had avoided taxes worth around €250 million on its European income, thanks to a tax agreement with Luxembourg.

In another state aid case, the Commission revealed that Apple, due to a tax agreement with Ireland, had avoided taxes worth around €13 billion on its income from Europe, Africa, the Middle East and India. And even more strikingly, Apple's effective corporate tax rate in Ireland had been as low as 0.005 per cent in 2014.

However, both these cases have been appealed to the European Court of Justice, and just recently, the Commission had to give up another state aid case concerning Luxembourg and McDonald's. So it's clear that collecting taxes with state aid rules is no easy matter. So why can't we use European tax rules to ensure that multinationals pay their share?

A tax system well past retirement age

The international tax system is fast approaching its 100th birthday. Hence, it's still based on the outdated idea that multinational corporations should be taxed as groups of smaller, independent

companies, rather than as the large, integrated, multinational entities they really are. According to this system, a government's right to tax corporations should depend mainly on a physical presence, such as offices and employees, in the respective country. Of course, that's not how the world works today, and it's becoming painfully clear that trying to tax multinational corporations in the digital economy with 20th century rules is like trying to write an email with a 100-year-old typewriter.

Through measures known as 'harmful tax practices', which are often sold as 'attracting investments', some governments are helping multinational corporations to avoid taxes on profits made in other countries.

Importantly, digital giants are not the only ones engaged in large-scale international tax avoidance. Digitalisation has happened across the entire economy, and has made international tax dodging much easier for multinational corporations in all industries, including extractives, food, clothes, furniture etc.

But alternative approaches to corporate taxation do exist. Some of them are patchy in nature, such as the Commission's proposed short-term solution: a 'digital services tax' aimed at taxing digital giants based on their turnover. Others however, such as the Commission's proposal for a Common Consolidated Corporate Tax Base, would fundamentally change the system. By taxing multinational corporations as coherent entities, and introducing a direct link between taxation and the economic activity of a corporation, the European tax system would leapfrog into the reality of the 21st century. But if this would be such a big step forward, why is it so difficult to make it happen?

Governments – competition or cooperation?

First of all, governments are not all just passive victims of corporate tax avoidance. Through measures known as 'harmful tax practices', which are often sold as 'attracting investments', some governments are helping multinational corporations to avoid taxes on profits made in other countries. The already mentioned governments of Luxembourg and Ireland, are far from alone in this 'race to the bottom'.

Second, some governments seem to feel a strong sense of protection towards 'their' multinational corporations. Even in cases where these corporations have engaged in dodging taxes worth billions of euros , this 'parental instinct' often seems to prevail as long as a minimum number of

jobs are maintained in the country. Some governments also tend to hold back on taxing foreign corporations, because they fear that other governments might start taxing 'their own' multinationals.

The EU should show leadership by introducing a short-term tax on digital giants, as well as the Common Consolidated Corporate Tax Base.

Last but not least, progress is further complicated by the question of how to split 'the pie'. In other words, how should the right to tax the profits made by a multinational corporation be distributed between all the countries where it operates? In the ancient tax rules we have today, the 'solution' was to let corporations move profits across borders freely, as long as it happened through internal trading between its subsidiaries using prices that corresponded to those set between independent companies. In reality, this system proved very easy for corporations to manipulate, and it was so opaque that no government could really predict where the profits would actually end up. Of course, the profits were eventually found – tucked away in tax havens around the world – and it became clear that many multinational corporations pay very little tax. This effectively means that today, governments are fighting about small crumbs while corporations keep a large share of pie untaxed.

Who's at the table (and who's on the menu)?

The fight about 'how to split the pie' is central to finding 'global solutions'. The Organisation for Economic Co-operation and Development (OECD) – also known as the 'rich countries' club' – has been the key decision-maker on tax policy over the last 50 years. Controversially, the OECD has adopted some rules for splitting the pie that favour countries where these corporations are headquartered (mostly OECD countries) at the expense of the countries where the corporation has its business activity (including many developing countries). Those who are not at the negotiating table are therefore concerned that they will be 'on the menu'.

It's highly problematic that more than 100 developing countries were excluded recent OECD and G20 tax negotiations, and have only been given the following offer: If they commit to the almost 2,000 pages of

decisions that have already been agreed, they can get a seat at the table when the discussions about taxing the digital economy continue. Some of the developing countries have accepted this offer – but many have not. Instead, a coalition of more than 130 developing countries – known as the Group of 77 – is continuing to call for an intergovernmental tax negotiation at the UN, where all countries can participate as equals.

It's time for the EU to accept this invitation, and start a transparent and truly global UN negotiation to stop international tax dodging. But the need for a global agreement must not be an excuse for inaction. First movers among both developing and developed countries can help to increase the political will for action, and pull governments out of the very expensive political stalemate they currently find themselves in. The EU should show leadership by introducing a short-term tax on digital giants, as well as the Common Consolidated Corporate Tax Base, which will fundamentally change taxation of multinationals. It is high time to show that no corporation is too big to pay taxes.



Tove Maria Ryding
Brussels

Tove Maria Ryding is the Policy and Advocacy Manager for Tax Justice at the European Network on Debt and Development (Eurodad), and well as a member of the coordinating committees of the Financial Transparency Coalition (FTC) and the Global Alliance for Tax Justice (GATJ). Shehas co-authored several reports on issues related to international tax avoidance and evasion, including 'Tax Games - the Race to the Bottom' (2017) and 'Survival of the Richest' (2016).