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Time to pay up

A minimum tax rate for companies across the world is overdue

Read this article in German.

People expect companies to pay their fair share towards the common good, be they a multinational tech giant, major furniture retailer or coffee shop chain. Germany, like many other countries, is losing out on billions of euros of tax revenue every year by letting companies get away with moving profits to tax havens.

This is partly because of existing gaps in tax legislation. But also the increasing digitalisation of companies and widespread digital business models offer certain opportunities that companies can exploit. Unlike traditional economic systems, which relied on manufacturing and industry, many digital business models no longer need to be physically present in a country – making it easier to accumulate tax-optimised profits at a low or even zero tax rate.

That's why we're working with our European and international partners to make tax fairer in the era of globalisation and digitalisation. We need harmonised standards and multilateral cooperation in our global tax policy. After all, international challenges cannot be solved at a purely national level. It's national unilateralism that companies take advantage of to move to countries that offer low tax rates. An international consensus, on the other hand, can create the pressure and obligations needed for low-tax countries to change direction and prevent companies from paying minimal tax. The OECD and G20 have made significant progress in recent years by tackling base erosion and profit shifting (BEPS).

Closing legal loopholes

But that was just the first step in the right direction, and one that addresses only certain scenarios where no tax was being paid at all. This doesn't cover cases of extremely low taxation, whereby just 1 per cent

might be paid. That's the next step: introducing an effective minimum tax rate and closing huge tax loopholes that are perfectly legal at the moment. Doing so would directly target the cause – companies actively exploiting different tax rates – and not just play around with the symptoms.

Let's be clear: there's nothing fundamentally wrong with tax competition. But what it should not do is create a borderless tax competition and race to the bottom. Not only does that make balancing the budget more complicated, it's unfair on hard-working people who also pay their share.

It is not just the EU that is talking about redistributing taxation rights. There are also discussions at an international level at the G20 and OECD, involving many emerging and developing countries. The G20 has commissioned the OECD to create a globally accepted standard by 2020 to ensure the digital economy is taxed properly. And in Germany, we too are deeply engaged in these discussions: we want to see everyone pay their fair share of tax so that prosperity in Germany is not compromised.

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That's why finance minister Olaf Scholz has proposed that we adopt an effective minimum tax rate. Much like the minimum wage, the idea is to ensure that multinationals pay at least a minimum tax rate, wherever they are in the world. This is not intended to massively change the long-accepted taxation principles. Only certain aspects that have already been introduced into the BEPS process will be consistently and coherently developed.

The proposed model would essentially mean that if a subsidiary abroad is taxed on profits below a certain effective minimum tax rate, the country in question could claim the difference from the parent company. A set of measures is being rolled out to develop some of the BEPS recommendations even further, such as addressing hybrid structures (adopting different company forms abroad for tax advantages) and enforcing controlled foreign corporation rules (taxing domestic shareholders on the income of a foreign subsidiary).

Other targets for action are undercapitalisation, whereby a company keeps its equity low and is financed by shareholder loans to artificially reduce profits by citing interest payments, and treaty benefits – using loopholes in international tax treaties. This also includes tackling all low-

tax income – whether it is income from interest, royalty payments, services or goods – by setting a limit on low taxation.

A spiral of debt

There would also be a ban on deducting operating expenses on low-tax payments abroad. To complement that, treaty law should be amended to ensure a contracting state is not restricted by the double taxation agreement, as long as the income is taxed at a low rate in the other state. At the moment, double taxation agreements often only prevent 'virtual double taxation', whereby there's a right to taxation but it's not exercised. But we don't live in a virtual world. We live in a real world, where there needs to be effective, not just virtual, double taxation.

The controlled foreign corporation rules we have in Germany would therefore be strengthened, expanded and rolled out globally. This would significantly reduce the prospect for aggressive taxation structures, which digital business models, in particular, take advantage of. However, there would also be regulations put in place to set a lower limit for tax cuts to put the brakes on the ongoing race to the bottom.

The latest tax cuts widely welcomed by companies in the US are a prime example. Tax cuts do not necessarily lead to more investment in machinery and production capacities. Often they are only used for share buybacks, benefiting the company's share price and, in turn, its shareholders, while continuing to put the state under pressure and force it into a spiral of increasing debt.



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