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The EU must act for tax justice

The global agreement on a minimum tax is a historic step towards tax justice. Yet, the EU's implementation can and should go beyond this agreement

The tax dodging of multinationals inflicts global tax losses of USD 312bn every year, as the new State of Tax Justice 2021 report shows. Fortunately, this is set to change thanks to the global agreement on a global minimum tax rate on corporate profits in October 2021. To ensure that this historic step towards more tax justice does not remain the last, the EU minimum tax directive planned to implement the international agreement to allow member states the flexibility to go beyond it.

With the EU Commission's proposal planned before Christmas 2021, the political marathon of reforming international corporate taxation is now entering the next phase. As early as in 2013, the G20 finance ministers commissioned the OECD to draw up new plans to stop corporate tax dodging and avoidance.

The first result was the 15-point action programme to tackle base erosion and profit shifting (BEPS) in 2015. This was followed by the 2-pillar solution to address the tax challenges of the digital economy in 2019, which has since received the approval of 136 states of the OECD Inclusive Framework.

The two pillars

Pillar 1 provides that a certain proportion of the profits of the world's biggest multinationals will be reallocated to countries where the companies' customers are based. This will particularly affect US tech companies, which have avoided having a physical presence in most of these market economies, thereby also avoiding paying taxes on their profits there.

Pillar 2 sets out a global effective minimum tax rate that ensures that corporations have to pay a certain minimum level of tax on their profits –

wherever they operate. For a long time, the minimum rate seemed to settle around the Irish tax rate of 12.5 per cent, but the new US administration has pushed it towards 15 per cent. This is a historic success that many observers could never have dreamt of coming true even six months ago.

However, this success at the global level doesn't yet guarantee consistent implementation across the EU because a proper tax directive requires all member states to approve it.

The opposition of Europe's tax havens

Some EU tax havens – not least Ireland – have been consistently lobbying against the minimum tax. But the sceptics were ultimately won over by concessions in the final negotiations. Because of Irish resistance the agreed wording was a minimum rate of '15 per cent' instead of 'at least 15 per cent'. Hungary was able to secure an agreement on a sort of transition period. And Estonia was given an extended *de minimis* rule, exempting micro-profits from the minimum tax rate.

There's trouble brewing beyond the EU too.

The governments of tax havens know they can't prevent the introduction of the minimum tax rate. With the minimum tax on Global Intangible Low-Taxed Income (GILTI) the US has shown that a global minimum tax rate can also be implemented at the national level. The tax havens' strategy is, then, to secure a seat at the negotiating table and achieve as many amendments as possible.

Whereas Ireland and others would simply prefer to have no minimum tax at all, there are strong forces in Europe that demand bolder measures against tax dodging and competition. Civil society organisations, various political parties in the European Parliament, and trade unions have repeatedly spoken out in favour of a higher minimum tax rate, demanding that the EU's implementation should go beyond the international agreement.

In fact, the October agreement allows member states to agree on a higher minimum tax rate within the common market and extend it to a larger number of corporations.

Developing countries aren't satisfied

Under the international agreement, the minimum tax rate only applies to companies with a turnover of €750 million, even though smaller companies are also shifting their profits. These reforms would benefit the vast majority of member states. After all, 70-80 per cent of EU corporate profits are shifted within the EU itself. But tax havens such as Ireland and Hungary are less interested in this, of course.

In addition, there's trouble brewing beyond the EU too. Developing and emerging countries are far from satisfied with the international agreement. While concessions have been granted to Ireland and other EU havens, their calls for a greater redistribution of taxing rights and a higher minimum tax have largely fallen on deaf ears.

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Argentina's finance minister even described the outcome as a 'bad deal for the developing world'. The OECD's role in spearheading the international tax negotiations has also been openly questioned. It was only at the end of October that 134 developing and emerging countries – including G20 heavyweights such as India and China – declared that they were in favour of the UN playing a more prominent role in tax matters.

If the political basis of the agreement crumbles at the global level, this will of course have repercussions for the EU. Incidentally, this also applies to the US, where the White House has been trying for weeks to get its ultra-narrow Democrat majority on implementation course. Sceptics are pointing out that a tightening of GILTI could hurt the competitiveness of the US economy, if Europe and other regions fail to implement their minimum taxes.

The EU should act with courage

The minimum tax directive is a balancing act: On the one hand, the EU needs to implement the agreement, and fast. The minimum tax rate is to come into force as early as 2023. On the other hand, it needs to be able to respond to the different needs of member states and stakeholders. If the EU is locked into the October agreement by Ireland and others, that could well be the last progress on corporate tax justice we'll see for decades.

The Irish Finance Minister Paschal Donohoe made it quite clear: 'I can't

see in my lifetime these kind of circumstances developing again. ... 15 will mean 15.' Europe would hardly be able to act internationally and could even become an obstacle to global reform – with the risk that the lack of coordinated solutions will lead to a patchwork of national measures, as we've seen with digital taxes.

To secure multilateral tax coordination in the future, the EU's minimum tax directive must allow for some flexibility for member states. In the short term, the October agreement will be the lowest common denominator. However, in the medium term, after a transitional period of five to ten years, member states should be given the possibility to opt-out and apply a higher minimum tax rate within the Union.

The international agreement on the OECD's 2-pillar approach was a huge step towards greater global tax justice. But it would be a fatal mistake to believe that it is enough of reform. Another Pandora Papers scandal and the next budget crisis are as sure as night follows day. At the latest then, there will be enormous public pressure to adjust the new regulations to ensure companies pay their fair share.

EU states don't have to shy away from political negotiations. With enhanced cooperation or national implementation, there are alternatives to unanimity if necessary. Member states shouldn't hesitate to use them as leverage in asserting their position against EU tax havens.



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