ARGUMENTS IN FAVOR OF INTRODUCING THE GLOBAL CORPORATE MINIMUM TAX

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Abstract: *In recent years, the multinational corporations have developed increasingly sophisticated and refined tax avoidance tax planning practices. As a result of these practices, many governments and international institutions have called for a reduction in tax bases and proposed various measures, which resulted in an agreement in 2021, which provided the introduction of the global corporate minimum tax. This paper presents a number of arguments in favor of introducing this measure by analyzing the literature and empirical research on the taxes paid by the multinational corporations.*

Key words*:* corporate tax; multinational corporations; tax avoidance.

JEL Classification Codes: H25, H26.

1. INTRODUCTION

The base erosion profit shifting is a concept used by the OECD to indicate the tax avoidance practices and strategies that multinational companies use to reduce their tax bases. These are materialized in a complex fiscal planning for the group of companies that generate tax avoidance. For any government, the erosion of tax bases leads to a loss of revenue and, consequently, a decrease in its capacity to meet the public needs. Numerous studies have shown that both globally and in the European Union, situations of erosion of the tax base paid by the multinational companies can be observed in countries where they actually operate through transfers of profits to jurisdictions with lower corporate taxes. Thus, there are real risks of reducing the taxes paid by the multinational companies in the countries where they actually operate.

As a reply to the public concerns about the erosion of the tax base and the transfer of profits by multinational companies, the OECD has launched several initiatives in recent years, which resulted in a comprehensive agreement in 2021 on implementing a tax reform for the large multinational companies. This reform has been defined in the form of 2 pillars which provide for a share of the profits made by multinational companies to be allocated for taxation in those countries where those companies carry on business and make profits, whether or not they have a physical presence there on the one hand, and the imposition of a minimum tax rate of 15% for the profits obtained by large multinational companies, on the other hand. Thus, the states could obtain higher tax revenues, mainly by establishing a fair method to share the taxes paid by the multinational companies.

This paper presents a number of arguments in favor of introducing this measure by analyzing the literature and an empirical research on taxes paid by the multinational corporations.

2. LITERATURE REVIEW

The multinational companies have the ability to manipulate the transfer pricing, to use the intra-group loans, or to conduct various financial transactions between the various components of the corporate group for tax planning purposes. The main ways in which the fiscal planning of the multinational companies is performed were summarized by Sebele-Mpofu et al. (2021):

- Income shifting through under or over-invoicing, respectively the reduction or increase of transfer prices in order to transfer profits from one fiscal jurisdiction to another;

- Debt shifting, respectively the over-financing through debt of affiliated enterprises in high tax jurisdictions, to reduce taxable profits by deducting interest;

- Tax havens, respectively the transfer of profits in jurisdictions with low taxation, in which financial secrecy is required and there is little cooperation or exchange of information with the regulatory authorities of other states;

- Use of intangibles in transfer pricing because it is difficult for tax authorities to demonstrate whether or not the price at which these intangible items were transferred is competitive.

An extensive review of the literature by Abu et al. (2020) revealed a higher intensity of profit transfers by the multinational companies related to tax havens, which reported lower profits or lower profit tax payments than the multinational companies not related to tax havens.

A study conducted in 2014 by Dhammika Dharmapala highlighted, by reviewing the existing literature, the massive increase in the interest of researchers to study these practices. The annual tax losses generated by the base erosion profit shifting globally were estimated at between USD 500 and USD 650 billion in studies published in 2016 and 2018 by Crivelli et al. (2016) and Cobham and Janský (2018). Research has also shown that economically less developed countries are the most affected by the consequences of these practices. According to the results of a 2021 survey (Álvarez-Martínez et al.), the base erosion profit shifting would have generated annual fiscal losses of EUR 36 billion for the European Union and EUR 100.8 billion, including EUR 96.8 billion for the USA. Considering the positive effect of the base erosion profit shifting represented by the reduction of capital cost for the multinational companies (which could stimulate investments), the authors of the mentioned research revealed that the tax optimization practices lead to a net loss of welfare, estimated at about 0,2% of GDP for the European Union and 0.4% for the USA.

Another research direction of the base erosion profit shifting suggests that the tendency to use these practices could be correlated with the size and form of the multinational ownership (Friedrich and Tepperova, 2021), so that governments could adopt differentiated regulations to protect against the potential tax losses.

3. INCLUSIVE FRAMEWORK ON BASE EROSION PROFIT SHIFTING

Combating the base erosion profit shifting has been an important topic on the agenda of international organizations. In June 2016, at the initiative of the Group of Twenty Finance Ministers and the Central Bank Governors (G20), the inclusive framework on base erosion profit shifting was created to develop measures to combat the base erosion profit shifting and to monitor their implementation. Numerous debates on this topic by the representatives of many states and jurisdictions around the world have led to the conclusion of an agreement on the implementation of international tax regulations. According to the OECD (2021a) "the agreement marks the beginning of a new era of international co-operation which acknowledges the need for simpler approaches to the rules and standards. The agreement is the first serious multilateral step in a paradigm shift relating to the global income allocation system".

Even since 2015, the OECD published an action plan with 15 measures on cross-border taxation, covering the following areas: transfer pricing, fiscal jurisdiction and measures to combat the erosion of the tax base, as follows:

- ✓ *Action 1:* Addressing the fiscal challenges of the digital economy
- ✓ *Action 2:* Neutralizing the effects of hybrid arrangements
- ✓ *Action 3:* Tightening the rules for foreign controlled companies
- ✓ *Action 4:* Limiting the erosion of the tax base by limiting the deductibility of interest expenses and financial payment
- ✓ *Action 5:* Counteracting harmful tax practices, taking into account the transparency of information and the substance of transactions
- ✓ *Action 6:* Preventing the misuse of double taxation treaties
- ✓ *Action 7:* Preventing the misuse of Permanent Headquarters status
- ✓ *Action 8:* Ensuring that transfer pricing results are consistent with value generation: intangible assets.
- ✓ *Action 9:* How to allocate risks and capital between affiliates
- ✓ *Action 10:* High risk transfer pricing transactions
- ✓ *Action 11:* Establishing methodologies for collecting and analyzing data on the base erosion profit shifting
- ✓ *Action 12:* Establishing rules for reporting aggressive taxpayer tax planning schemes
- ✓ *Action 13:* Reviewing the transfer pricing documentation and report for each country
- ✓ *Action 14:* Streamlining the mechanisms for resolving tax disputes
- ✓ *Action 15:* Developing a multilateral legal instrument

Following the debates on these measures and the agreement reached within the inclusive framework on the basis of erosion profit shifting, a set of solutions grouped in 2 pillars will be developed:

Pillar I will ensure a more equitable distribution of the taxable rights of the profits for the multinational companies among the countries in whose territory these profits were obtained. Thus, part of profits will be allocated for taxation to the countries in which the respective companies carry out commercial activities and make profits, regardless of whether or not they have a physical presence there.

Pillar II requires a minimum overall corporate tax rate of 15% for the entities that are members of a multinational company with an annual revenue of more than EUR 750 million in at least two of the four fiscal years immediately preceding the one being tested. At the end of 2021, the OECD published the rules of the tax model, called the GloBE Rules, needed to help participating states implement Pillar II. The document published by the OECD (2021b) details how to determine the income / loss for each member entity of the multinational company, to cumulate the revenues of the constituent entities located in the same jurisdiction and to calculate the effective tax rate within GloBE. If the actual tax rate is below the minimum corporate tax rate (15%), an additional tax rate will apply. The document also contains rules on acquisitions, disposals and joint ventures. A study conducted under the auspices of the OECD to assess the impact of the introduction of Pillar II highlighted the possibility of generating additional global tax revenue of about USD 150 billion (Hanappi and González Cabral, 2020).

4. ANALYZING THE CORPORATE INCOME TAXATION IN THE MEMBER STATES OF THE EUROPEAN UNION

According with the provisions of the tax reform agreement concluded in the framework on the basis of erosion profit shifting, a directive has been proposed at EU level to ensure the payment by groups of large companies operating in the Member States of a tax calculated by the application of a minimum tax rate of 15% for each jurisdiction in which it operates. The directive will also apply to companies in the financial sector, with the exception of pension funds or investment funds which are parent entities of a multinational group. The effective tax rate will be established for each tax jurisdiction by dividing the profit tax paid by the taxpayer to the taxable income. If the effective tax rate for entities in a particular jurisdiction is below the 15% minimum, then Pillar 2 rules are triggered and the group must pay an additional fee. These measures are argued by the existence of a large volume of unpaid taxes by groups of companies using various tax avoidance strategies, mentioned by the European Commission in the Annual Report on Taxation 2021.

At the same time, the importance of taxes paid by groups of companies in the tax systems of the Member States is low, as can be seen from EUROSTAT statistics (Figure 1).

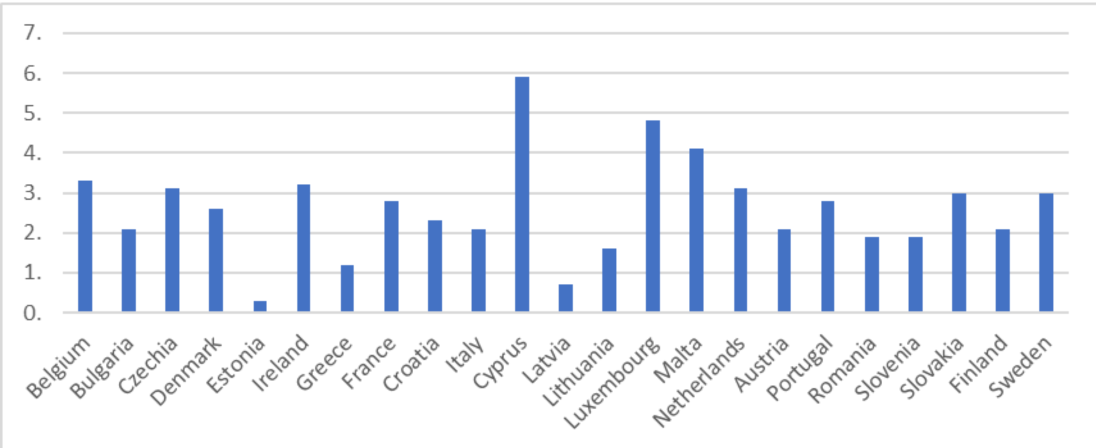

Figure 1. Taxes on the income or profits of corporations as shares of GDP in 2020
Note: Data not available for Germany, Spain, Hungary and Poland

The high level of taxes on the income or profits of corporations as shares of GDP in countries such as Malta, Luxembourg, Cyprus, Ireland or the Netherlands is determined by the existing competitive tax regimes in these states which lead to foreign direct investment by special-purpose vehicles, entities without real economic activities on the territory of these states. As the European Commission points out (2018), the unusually high level of foreign direct investment by special-purpose vehicles is one of the indicators of aggressive tax planning.

In recent years, the decrease in the share of taxes on the income or profits of corporations in the total tax revenue in some European countries can also be noticed (Figure 2).

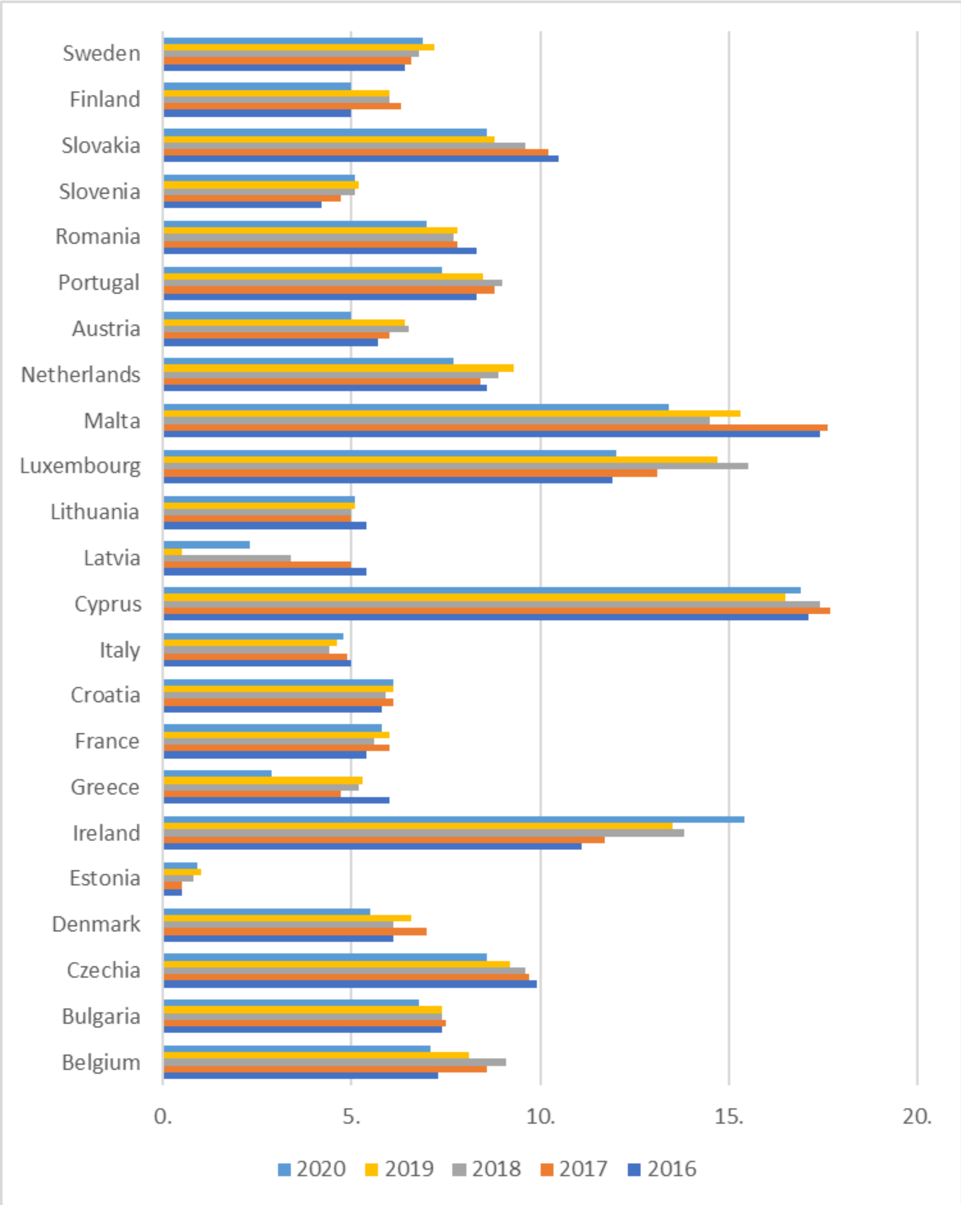

Figure 2. Taxes on the income or profits of corporations as shares of total during 2016-2020
Note: Data not available for Germany, Spain, Hungary and Poland

The fact that the multinational companies exploit the differences between the tax systems of the Member States of the European Union and pay taxes for lower revenues than local companies can be demonstrated by the differences between statutory corporate tax rates and the effective average tax rates for large corporations in non-financial sector (Figure 3).

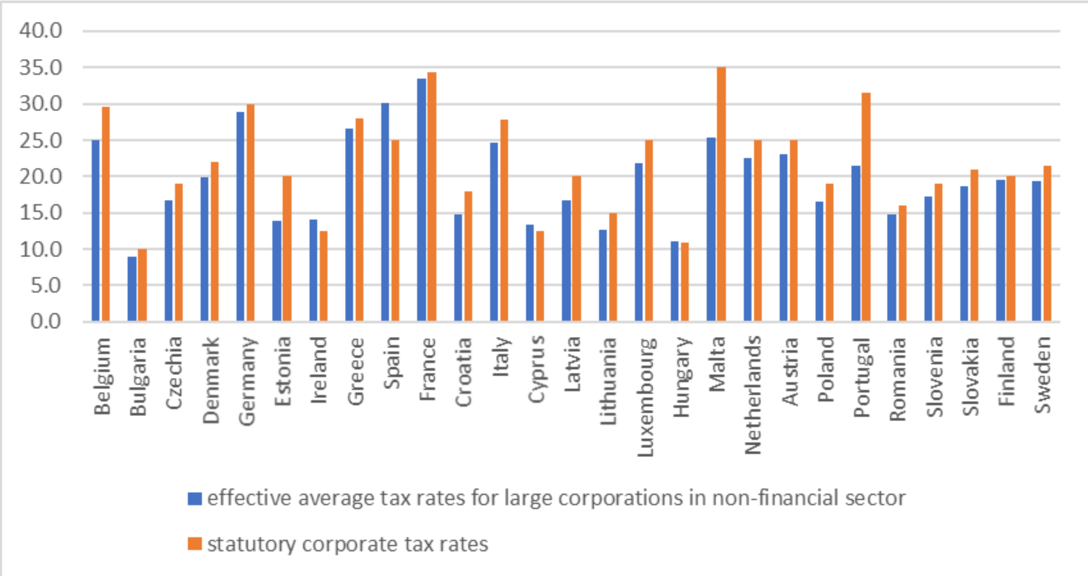

Figure 3. Differences between statutory corporate tax rates and effective average tax rates for large corporations in non-financial sector in 2021

In general, in the period 2006-2019, at EU-28 level, the trend of evolution of effective average tax rates for large corporations in non-financial sector was similar to that of statutory corporate tax rates, which proves that effective average tax rate for large corporations in the non-financial sector is influenced by the statutory corporate tax rate (Figure 4).

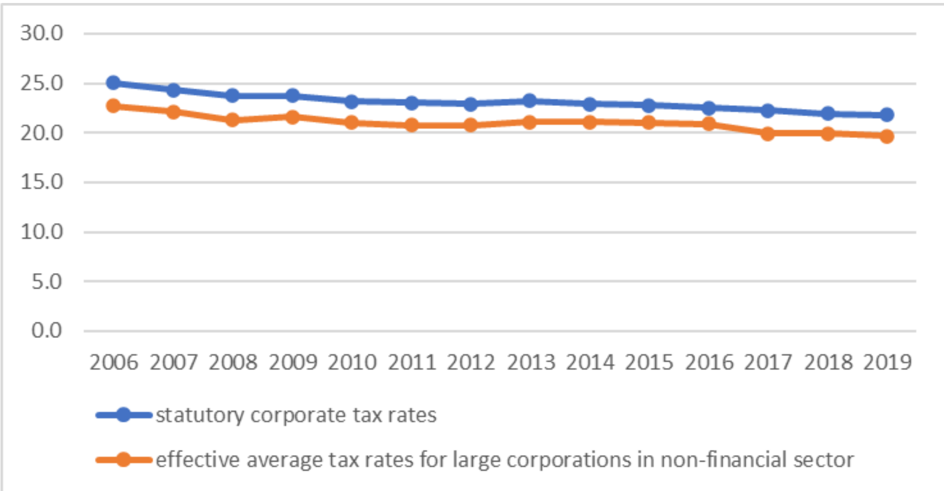

Figure 4. The evolution of effective average tax rates for large corporations in the non-financial sector and statutory corporate tax rates in the EU-28, for the period 2006-2019

The decrease in statutory corporate tax rates in the EU-28 was more pronounced than the decrease in effective average tax rates for large corporations in the non-financial sector in 2014-2016, but subsequently the difference between the two rates increased to over 2 percentage points.

5. CONCLUSIONS

The purpose of tax collection is to collect the revenues necessary for governments to be able to have finances and to spend public money for goods, works, social actions, etc. which are required and expected from governments. Multinational companies provide an important part of the profit tax collected by governments.

The analysis of corporate income taxation in the Member States of the European Union shows the decrease of the corporations' contribution to the fiscal revenues of most states, through the paid profit taxes.

The preferential tax regimes in some Member States, the competition between the Member States seeking to attract foreign direct investment, and tax avoidance practices used by the multinational companies are factors that erode tax bases with potentially negative implications for the supply of public goods.

Introducing the global minimum tax paid by the multinational companies in the jurisdictions in which they operate is an important step in reducing tax competition between states, which will no longer be tempted to sacrifice some of the tax revenue to attract large investors. Since taxation will perform in the jurisdictions where companies operate and make profits, whether or not they have a physical presence there, the multinational companies will be discouraged from using excessive tax planning practices to maximize revenue by speculating tax differences between different states, which also involve tax havens.

In conclusion, the international tax reform aimed at taxing large multinational companies will contribute to a fairer distribution of the benefits generated by the activity of these companies, but also to the increase of the tax revenues of the states with relevant consumptions.

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