Implementing Guidelines to Ensure Fair Tax Distribution in Multinationals

G20

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Introduction

After the stock market collapse and the Lichtenstein Tax Scandal in 2008 which lead to a global recession, forced people and governments to finally recognize the implications globalization and digitalization can lead to. Realizing that globalization not was not only beneficial but also facilitated tax evasion and avoidance, permitting a strong sense of unfairness.

High net-worth individuals, to this day, although action has already been taken by, for example, the Organization for Economic Cooperation and Development (OECD), manage to hide their assets offshore due to bank secrecy and lack of transparency. Loopholes within the international tax regulations grant multinational enterprises (MNEs) to legally transfer their profits to low tax jurisdictions.

On the 26th of October 2020, an article published by the BBC quotes David Archer, global taxation spokesperson for ActionAid International, an NGO that focuses on the eradication of poverty and injustice globally: "Women and young people are paying the price for an outdated system that has allowed big tech companies, including giants like Facebook, Alphabet, and Microsoft, to rack up huge profits during the pandemic while contributing little or nothing towards public services in countries in the global south."

When David Archer says "outdated system" he hits the nail on the head. Because of the ongoing digitalization a tax system based on nexus and profit allocation, which was developed in a brick-and-mortar economic situation, is naturally outdated and begs for a modernized, improved, redeveloped framework.

Definition of Key Terms

Tax

Money that inhabitants or companies or organizations are obligated to pay to the government supervising their state and/or country of residence or establishment. This money is used for all government expenses such as education, infrastructure, defence et cetera.

Tax avoiding

Tax avoidance is somewhere between saving tax on the one hand and evading tax on the other. Saving tax is completely legal and we all do it. House owners, for example, can deduct mortgage interest from their taxable income. On the other hand, anyone engaging in tax evasion is acting illegally. This could be a painter, for example, who fails to declare a paid job to the Tax Office. Tax avoidance is somewhere in between, Jan Vleggert, Professor of Tax Law, explains. 'It may be legal under the law, but there are people who think it is undesirable or immoral. It applies

to some large multinationals who divert their profits to so-called tax havens with very low rates of tax.'

Aggressive Tax Avoidance

Tax avoidance goes against the purpose of the law, whilst not literally breaking it.

Tax Nexus

The term "nexus" is used in tax law to describe a situation in which a business has a tax presence in a particular state. A nexus is basically a connection between the taxing authority and an entity that must collect or pay the tax.

Double taxation

Double taxation is income or profit being taxed. For example, a company pays corporate dividends and as it generates profit it pays income tax.

Multinational enterprises (MNEs)

A multinational enterprise, also known as a multinational corporation, transnational corporation, international corporation, or simply multinational, is a corporation operating and/or registered in multiple different countries, whilst also selling products and/or services.

Offshore

When something is 'offshore' it is located in a foreign country, often in order to pay lower taxes.

Tax Haven

An informal term for a jurisdiction with advantageous tax regulations, often 'offshore'. There are no established boundaries to what is or what is not a tax haven.

Foreign Tax Credit System

The foreign tax credit system is a tax system designed to minimize double taxation on worldwide income.

BEPS

Base Erosion and Profit Shifting (BEPS) is a term for MNEs tax planning and exploiting loopholes within ill-defined or differing parts in tax law in various jurisdictions in order to pay less tax.

Shell Company

A shell company is a company with no employees and no office, it can have registered assets: intellectual property, vehicles et cetera. They are sometimes used for tax evasion or money laundering.

General Overview

With the issue being relatively new, of the past 15/20 years, one would think they are not to be a primary centre of focus. However, in the political environment, the issue has been one of the main points of discussion during the past few years and this will continue to be the case, at least, in the near future. The Panama papers in 2016 and the Paradise papers in 2017 which revealed many tax avoidance schemes, caused disturbance among many members of the public and mounted even more pressure on politicians around the world to take action and react

For a long time, many countries have been using the foreign tax credit system. On voxeu.org (for the specific article see the bibliography), Michael Devereux, Clemens Fuest, and Ben Lockwood write: "But in one of the most striking trends in corporate taxation in recent years, there has been a significant switch to exempting foreign-source income from taxation. According to PwC Worldwide Tax Summaries, out of 37 high-income countries, 19 had an exemption system in 1998, rising to 27 in 2008. None of these 37 countries switched from exemption to a credit or other system during this period." Concluding that the foreign tax credit system has been used less and less over the past two and a half decades. Now the issue is that the foreign tax credit system was designed in order to ultimately have fair tax contribution among all multinationals irrespective of where they are located or where their market lies, however, because of the shift in tax systems multinationals basically are legally able to choose how much tax they pay, resulting in countries paying as little tax possible, tax avoidance. Tax avoidance, however, is not illegal in most countries, hence "multinationals basically are legally able to choose how much tax they pay".

According to the Global Alliance for Tax Justice 427 billion USD is lost every year to tax havens, the money lost per second is equivalent to a nurse's annual salary or 34 million nurses per annum. Obviously, this is just a comparison, however, it is important to realize the impact fair tax distribution can have on a global scale. Jeffrey Sachs, one of the world's most praised economists, has stated that it would cost 175 billion USD for twenty years to end poverty a third of the yearly illegally avoided tax by MNEs. And according to an estimation made by the Brookings Institute, it would cost 54 billion to educate all children in the 46 lowest-income countries. Both these facts

are important to realize in order to understand the large injustice that is being done by many MNEs.

To give a little more insight I will now describe what broadly happened with the Panama papers. The Panama Papers were a number of documents containing private financial information on many world leaders, celebrities, sports personalities, and other influential and wealthy people. The documents did not only reveal names of involved persons but also exposed more than 214 thousand offshore tax havens. It is not illegal to have shell companies offshore, they can however be a way to avoid tax or launder money. Many of the documents did however reveal inappropriate and illegal activities. Significant names in the papers were names such as Salman of Saudi Arabia (King of Saudi Arabia), Khalifa bin Zayed Al Nahyan (President of the UAE, Emir of Abu Dhabi), Mauricio Macri (former president of Argentina), Silvio Berlusconi (former prime minister of Italy). Important to note is that these above have not been confirmed to have been involved with a scand.

Major Parties Involved

Organization for Economic Cooperation and Development (OECD)
The OECD is an organization consisting of 38 member states aiming to study and coordinate economic and social policy, to come to a solution on international problems, and create international policy, so also on the matter of tax.

European Commission
The European Commission is the executive body of the European Union (EU), it is responsible for initiating laws. In this case, the European Commission encourages the EU member states to cooperate in the tax matter. Additionally, they fight tax avoidance and tax evasion within their member states. Its policies momentarily only apply to EU member states but can be used as inspiration for other organizations and countries' policymaking.

G20
The G20 is a group of nineteen countries that together equate to 90% of the worldwide GDP and control 80% of world trade. The G20 has the aim to be a forum for cooperation and deliberation in the world financial system. The G20 hopes to create international policy in tax law to mainly prevent tax evasion.

Committee of Experts on International Cooperation in Tax Matters
Committee of Experts on International Cooperation in Tax Matters is a sub-body of the ECOSOC committee. It is tasked with providing a place for cooperative dialogue around global tax matters, establishing new issues concerning international tax, helping LEDCs implement tax regulations to avoid them becoming tax-havens. It has published two documents offering guidelines for tax treaties between MEDCs and LEDCs.

Timeline of Key Events

February 14th 2008	The Liechtenstein Tax Scandal became known to the public
November 5th 2017	Leaking of Paradise Papers
April 3rd 2019	Leaking of the Panama Papers
May 31st 2019	Program of Work to Develop a Consensus Solution to the Tax Challenges Arising from the Digitalization of the Economy by the OECD
October 8th 2020	Statement by the OECD/G20 Inclusive Framework on BEPS and delivery of the reports on the Blueprints of Pillar One and Pillar Two, and the Economic Impact Assessment.

Previous attempts to resolve the issue

4 November 2021, 137 countries and jurisdictions joined the two-pillar plan, aiming to ensure the fair distribution of tax among MNEs, created by the G20/OECD Inclusive Framework on BEPS. The two pillars of this plan entail:

- Re-allocating of taxing rights: Pillar one aims to ensure a fairer tax distribution among countries with a special focus on MNEs including digital enterprises. Warranting these companies to pay taxes not only in the jurisdictions where they are physically based, but also where they earn profits and conduct business activities.
- Global anti-base erosion mechanism: Pillar two establishes a global minimum tax rate of 15% on corporate tax. This way countries cannot 'compete' over corporate income tax trying to attract MNEs and their tax bases will be protected. The minimum will additionally add to the stabilization of the international tax system and the certainty of tax revenues.

Possible Solutions

The OECD and the G20 have made a good start, it is important that countries sign off on the agreement and implement the collectively agreed solutions in order to resolve the issue.

The reason why BEPS still happens a lot is because it is very 'questionable'. Countries should make clear global rules around BEPS to make it (near) impossible to find loopholes and that way pay less tax than they should.

The undeniable truth is that corruption influences tax evasion globally. Not only do corrupt officials enable tax evasion, but corruption within governments also

demoralize taxpayers, stimulating tax evasion. Hence, fighting corruption can be part of the solution.

Another part of the solution could be increasing the severity of the punishments given to people evading tax and others involved, this way they will be discouraged to start evading tax in the first place.

Appendix/Appendices

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