Creating a legal framework for universal corporation tax (in order to prevent tax havens)

G20

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Forum: Group of 20

Issue: Creating a legal framework for universal corporation tax (in order to prevent tax havens),

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Introduction

Government intervention, a complicated but fundamental economic concept. Government intervention refers to a lot of various methods by which a government can regulate or control the economic situation of a country. This can refer to subsidies, price floors and ceilings, amongst others, but naturally also includes taxation. For the government to ensure welfare over the population, they often require large amounts of funds.

However, large corporations such as MNCs find ways around the fair and equitable payment of these taxes, for example corporation tax. With this, the governments can invest less into the welfare of the society of their own nation, especially in a world where inflation is a current issue. Without substantial funds, member states are unable to support their populations, in a developing future, and this furthermore makes it increasingly difficult to develop the economic standpoint of the nation. However, there are new economic policies which are coming to place, such as the two Pillar approach, however these are not enforceable.

Definition of Key Terms

Legal Framework

A legal framework refers to a set of documents which can include the constitution, regulations, legislations and contracts set by a government or nation.

Multinational Corporations (MNCs)

A multinational company is a business which has its headquarters in one country but has operations in a range (one or more) of different countries. MNCs tend to be very large corporations, and as a result often have considerable power and influence in the world. For example, they can reduce transport and distribution costs by having operations closer to the supply chain, which in turn leads to greater economic power and lower costs.

Pillar 1

Pillar 1 refers to the OECD's idea and is the first in their "two pillar approach" to solving tax evasion issues across the globe. This idea is still on the drawing board and is yet to be decided. This refers to the taxation for operations for ALL companies, even shipping companies. MNCs such as Maersk would then also be expected to pay tax in every nation, since they have operations in nearly every nation worldwide. The idea behind Pillar one is that wherever a corporation has costs, there are revenues to be made. With Pillar 1, since this is still an idea on the drawing board and not fully decided yet, it is likely that a simple formula would determine the amount to be paid by each firm, but not much detail can be given on this issue at this time.

Pillar 2

In simple terms, Pillar 2 refers to the worldwide minimum corporate tax set by the OECD, an indirect tax of 15% of total revenue for the corporation in question. However, this only refers and applies to corporations with 750 million euros or more revenue in a fiscal year. The application of this indirect taxation is slightly more complicated and will be explained in further detail through the report. However, Pillar 1 is expected to be implemented by the agreeing member states by either 1 January 2024 or the start of 2025.

Shipping Companies

Shipping companies simply refers to a company that transports shipments of goods or resources over water. Companies such as DHL are then not considered to be shipping companies, as they also largely transport goods and resources by air and other means.

General Overview

Currently, there are already initiatives being taken regarding this issue. For example, the Base Erosion and Profit Shifting (BEPS) Project, which was started in 2012. This was a project surrounding the inequality within taxation and the problem of tax evasion. Over time, this project within the OECD led to multiple reports being published, which are outlined below in the timeline of key events, and led to the creation of the two Pillar approach.

The two Pillar approach refers to the Pillar 1 and Pillar 2 taxation plan of the OECD, as outlined above. Pillar 1 is still yet to be determined, but Pillar 2 is an already existing solution to the issue at hand. However, it is yet to be seen whether it can work, due to technicalities, exemptions, exclusions and the fact that this is not enforceable. These are later outlined in the possible solutions portion and will not be covered here in an effort to limit repetition.

Pillar 2 however, in short is a minimum tax of 15% of the total revenue within the operations of a corporation in a country, which the corporation in question is held liable to pay. This minimum amount is taxed on the revenue, notably not on the profit, and is similarly a form of corporate income tax. The OECD came to this conclusion in relation to the BEPS project as previously mentioned, and took into consideration the reservations of all supporting member states. The limitations of the Pillar 2 (which will be outlined later as already stated), might be covered by the first Pillar, however this is not naturally a known fact.

Furthermore, the impact of Pillar 2 being implemented in the January of 2024 by some member states, should serve as a smaller test to convince more member states of its effectiveness and to participate in the logistics needed. This includes the participation in the GloBE tax base.

Timeline of Key Events

Date	Event
2007-2008	Global Financial Crisis
2012	The start of the the BEPS (Base Erosion and Profit Shifting) Project.
2013	First BEPS report is published.
2015	Fifteen BEPS reports were published. one of these surrounding the idea that it is very hard to tax the digital economy. Since the majority of these corporations have few offices with fewer workers, yet extremely large revenue streams. This led to the OECD's two pillar approach.
17 November 2022	The consultation process on the minimum tax ordinance was

	closed.
2018 June 2023	Mandatory voting referendum held on the issue surrounding the BEPS project.
1 January 2024	The Pillar Two concept will be implemented by more than 100 countries worldwide. Including some EU member states such as the Netherlands.
2025	Most other countries follow suit and implement Pillar Two. However, as Pillar Two is not enforceable, not all member states follow suit.

Major Parties Involved

The Organization for Economic Cooperation and Development (OECD)

The Organisation for Economic Cooperation and Development is an international body which through cooperation work on finding solutions to a variety of problems which face the world. They take on social, economic and environmental issues, especially in regard to economics and therefore equitable and/or equal distribution of resources, goods and services. They also focus on improving education, and fighting international tax evasion, the topic of this report. The main importance they have is that they advise on public policies and set international standards.

In this case, they are the ones who work on the technicalities within Pillar 1 and 2 and are the ones who strive to implement through working together with the member states. However, frameworks set by the OECD are not officially enforceable to disagreeing parties, as this could be seen as an attack on the sovereignty of any member state or nation.

The United States of America (USA)

The USA and various member states are not taking part in the two Pillar approach set by the OECD. However, there are promises made that these member states are soon to join and simply are addressing reservations surrounding the issues internally. However, the fundamental issue within the solution of the OECD is that companies like Google which are based in the United States of America in this case, simply have the economic power to transport their operations elsewhere where they do not face undesirable economic consequences. Furthermore, the United States of America has the so called GILTI laws, which according to them prove effective. This is a set of tax regulations set exclusively in the United States of America, which target offices which sell intangible products and services, such as Google, which requires much more data collection and analysis workers than any other type of facility, (with the exclusion of software developers).

Possible Solutions

Pillar 2 Improvements

As previously mentioned, Pillar 2 is a legal framework set by the OECD in relation to the global minimum tax. However, Pillar 2 has limitations. For example, Pillar 2 refers only to corporations who makeover 750 million euros in revenue in a fiscal year. However, this brings drawbacks as there are only a handful of companies, and corporations making 500 million euros of revenue per year could already manage the theoretical costs to move operations to a non-Pillar 2 nation. A way to improve Pillar 2 and help solve the issue of tax havens would be to target all businesses.

Furthermore, the technicalities within Pillar 2 leave individuals untargeted. However some of the largest limited liability companies are held by individuals. Given that a company's operations can't be taxed in the country where they are located due to the member state's disagreement with the two-pillar approach, this tax can be levied to the next step of ownership. For example, if a company's base operations are located in the United States of America, where Pillar 2 can't be collected, and a company has the office which oversees this in the Netherlands (a highly unlikely situation), the 15% indirect tax of the revenue would then be collected in the Netherlands, or at least the amount within the 15% which is above the ETR (the effective tax rate). With respect to this, more information can be found on the final source under the section of further reading on this report.

However, only the organizations which have a stake of ownership (hence shares) within the company would be required to be liable for this tax, and not the individuals who have a stake in the company. This unfairness within the rules leads to loopholes where individuals with large stakes in MNCs can earn millions tax free, whilst MNCs and other types of large corporations are held accountable.

This unfairness can also be seen in the fact that Pillar 2 is not applicable to shipping companies, leading to irregularities within rules and regulations. There is a distinction made between corporations such as Maersk and DHL, whilst the services they offer and their operations can largely be seen as similar. These exemptions and exclusions should also be taken into account and considered, as these create unfairness between industries.

Pillar 1

Needless to say, the completion of Pillar 1 with similar consideration to exclusions and exemptions. Pillar 1 is outlined in the definition of key terms, and is currently still an idea on the drawing board with the basic idea being that wherever any business has costs, a tax should be paid. The amount of this tax is still to be determined and advised on by the OECD and its supporting member states as a part of the BEPS project.

The reevaluation of already existing taxation and unity between member states

The idea behind Pillar 1 and Pillar 2 are to promote a standardized taxation amount which can be collected by member states to combat tax evasion. Whilst the two-pillar approach arguably does exactly this, another solution is to the reevaluation of already existing legal frameworks within member states as to allow them to come to an agreement regionally regarding a minimum taxation of certain kinds of corporations. Areas of the world are already known for certain types of goods, products or economic and allocative power, and to this legal frameworks could be created in order to target certain industries in certain areas.

Further Reading

- This source above shows a progress report on the Pillar 1 of the two Pillar approach, and the possibilities for some formula they propose, or the direction in which these formulas should go and what factors should be taken into account.
    a. "Progress Report on Amount a of Pillar One – Two-Pillar Solution to the Tax Challenges of the Digitalisation of the Economy - OECD." Oecd.org, 2022, www.oecd.org/tax/beps/progress-report-on-amount-a-of-pillar-one-two-pillar-solution-to-the-tax-challenges-of-the-digitalisation-of-the-economy.htm. Accessed 18 Dec. 2023.
- This source gives a background understanding of how certain member states of the EU stand on the issue of taxation. Part b shows the highest rated tax havens worldwide, and this gives an idea why many multinational corporations often place their headquarters within these borders, along with banking reroutes to skirt regulations. However, this source is outdated by

2-3 years and therefore, there are likely more updated versions which can be found online as well.

a. "EU List of Non-Cooperative Jurisdictions for Tax Purposes." Europa.eu, European Council, 18 Dec. 2023, www.consilium.europa.eu/en/policies/eu-list-of-non-cooperative-jurisdictions/. Accessed 18 Dec. 2023.
b. Super User. "Corporate Tax Haven Index - 2021 Results." Taxjustice.net, 2021, cthi.taxjustice.net/en/. Accessed 18 Dec. 2023.

- This source gives more of a general background understanding on Pillar 2 and how it came to be.
    a. PricewaterhouseCoopers. "Pillar Two - Taxation of the Digital Economy - Tax - Onze Dienstverlening - PwC." PwC, 2021, www.pwc.nl/en/services/tax/taxation-of-the-digital-economy/pillar-two.html. Accessed 18 Dec. 2023.

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