POLSKI INSTYTUT SPRAW MIĘDZYNARODOWYCH
THE POLISH INSTITUTE OF INTERNATIONAL AFFAIRS

NO. 133 (1829), 14 JULY 2021 © PISM

BULLETIN

Tax Ambitions in the EU and Their Global Context

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Along with the effects of the COVID-19 pandemic and digitalisation of the economy, there is growing political pressure from several Member States to communitarise EU tax policy. The ambitious plans outlined by the European Commission (EC) for the coming years must be placed in the wider global context, including the agreement reached in July at the OECD/G20 on establishing a common framework for taxing multinationals. However, the lack of support for this project from Estonia, Ireland, and Hungary in particular puts into question the possibility to implement the EC proposals.

Taxes are the domain of the Member States, and decisions about harmonisation at the EU level, such as setting a minimum levy on a particular item, must be unanimous. So far, only a minimum VAT rate (established in 1993) and an excise duty on selected products (partly in 1992) have been harmonised. In contrast, the negotiations of the common consolidated corporate tax base (CCCTB) have been ongoing for 10 years, and the last attempt to introduce a digital tax ended in failure. The EC's recent ambition stems from the accelerating pace of negotiations of a global agreement on the harmonisation of corporate income taxes (CIT) and coping with the economic consequences of the pandemic. In the last year, national governments have significantly increased spending, raising public debt. This prompted the launch of the Reconstruction Fund and drawing loans at the community level. The European Council obliged the Commission to present proposals for new sources of financing EU expenditures, including new taxes.

Global Dimension. At the beginning of July, 132 countries (139 negotiating) signed the groundbreaking BEPS 2.0 agreement, proposing to harmonise CIT as part of the OECD/G20 process. The negotiations, which have been in progress since 2018, accelerated with the change of U.S. administration, which wants to use a global agreement to persuade Congress to support legislation to increase the CIT rate in the U.S. During the negotiations, the U.S. won the promise of the withdrawal of digital levies imposed by some countries (e.g., France, the UK, Italy). Of EU countries, Estonia, Ireland, and Hungary have not joined the agreement. Cyprus did not participate in the process.

The agreement has two pillars. The first specifies new rules for the division of tax revenues between states where a company generates profit by offering services and selling goods. This concerns enterprises with annual turnover exceeding €20 billion and profitability (i.e., profit before tax) above 10%. Financial services and mining activities will be excluded. The second pillar introduces a minimum effective CIT rate of 15% at the global level for companies with annual revenues over €750 euros. With the new provisions, the tax authorities of a state where the headquarters (or parent company) of the international corporation is located, may impose on the company an additional tax equivalent to the difference between the rate applied in the country of foreign branch registration (e.g., in the tax haven) and the minimum global CIT rate. Transport companies and subsidies received from countries on investments in fixed assets (factories, machines) will be excluded. The OECD estimates that the introduction of these two pillars alone will increase annual incomes for the countries concerned by €150 billion.

Objectives of the EU Tax Programme. In May this year, the EC adopted a Communication on business taxation in the 21st century. It announced that the EC will present by the end of the year an application for combating tax avoidance through shell companies (firms formally registered in a given country to obtain favourable fiscal conditions but operationally limited).

By the end of 2022, the EC will propose provisions introducing a requirement for the annual publication of the effective tax rate for certain multinational enterprises operating in the EU. In addition, the message outlines the legislative plans concerning CIT in accordance with the BEPS 2.0 agreement. The EC will propose draft Directives implementing its provisions to achieve greater harmonisation in EU countries (including those that are not OECD members). The EC wants to go beyond the OECD agreement and will be proposing by the end of 2023 a new taxation framework for enterprise income in Europe—BEFIT. It will replace the non-finalised CCCTB project by proposing a different formula to determine the division of tax revenues between the states in order to better reflect the realities of today's economy, especially digitalisation. In July, the Commission presented its projects for the Carbon Border Adjustment Mechanism (CBAM) and a revised EU emissions allowance trading system (EU ETS). It also intended to present a new European digital tax, but due to the BEPS 2.0 negotiations, it will only do so in October.

Divisions between EU Member States. The states present three general approaches to the taxation issue.

Sceptics include Cyprus, Estonia, Ireland, Luxembourg, and Hungary, which try to attract large corporations by offering preferential tax rates. Ireland blocked the introduction of the EU digital tax in 2019, arguing it should be at the global level. The July agreement of 132 countries was rejected by these three countries because the 15% global minimum CIT rate was pressured by the G7. In Hungary, the CIT rate is 9%, and in Ireland 12.5%. In Estonia, CIT is 20%, but only from derived capital (e.g., paid in the form of a dividend).

Another group supports tax harmonisation at the EU level, such as the minimum CIT rate. France, Germany, Italy, and Spain dislike EU tax competition and strive to coordinate national regulations. France, Italy, and Spain supported the EC proposal in 2019 to change the voting system in the EU Council on tax matters to a qualified majority. These countries have high CIT rates, and a global agreement through the OECD will contribute to increasing their influence on tax matters.

The third group are the "in-betweeners". This includes Poland and the other Visegrad countries except Hungary, and the Baltic States, with the exception of Estonia. This group is characterised by pro-investment tax policy consisting of relief, special economic zones to attract foreign investors, and domestic development of companies. At the same time, they support solutions at a global level, but with reservations. Poland, for example, wants to combat the shifting of revenues to tax havens, but underlines the need to introduce exceptions to the 15% CIT rate. The negotiated agreement includes some of their proposals.

Perspectives. At the next G20 leaders' meetings, support for the OECD consensus is expected. Technical conversations on the details of the agreement, including the scope of relief and incentives permissible under the second pillar, will also take place. Next year, each country is to introduce relevant national provisions implementing the agreement so that it is fully in force by 2023. However, the result of the global CIT negotiations have proved to be unsatisfactory for Estonia, Ireland, and Hungary. If they do not sign up to the agreement in the coming months, they may block consensus on EU directives introducing the provisions of BEPS 2.0. This would mean the EU cannot harmonise tax law and, in the long-term, the certain failure of projects such as BEFIT. Given the probability of this, several of the countries highly motivated to introduce the tax changes may switch to enhanced cooperation to achieve harmonisation amongst a group of Member States. It is in Poland's interests to help shape this cooperation in accordance with the BEPS 2.0. terms with favourable provisions for companies investing in the domestic economy.

The lack of unanimity of the Member States on the OECD agreement is in turn unfavourable for Poland, for whom it is a key tool for fair taxation toward digital giants in the EU. Implementation of the first pillar of BEPS 2.0 will affect several dozen international tech corporations, some of which operate in Poland. However, without Ireland's participation—where many of these firms, such as Apple and Facebook, are registered—the EU will not achieve the principle of fairness in taxation across the Union.