The international governance of corporate tax avoidance: A paradigm shift from tax competition to international cooperation?

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Since the 1970s, constraints on public revenues have resulted in a policy condition of austerity while tax competition has induced governments to retrench welfare programs, rather than enhance tax revenues. Yet, after the global financial crisis, governments intensified efforts to increase tax revenues, through international measures to combat corporate tax avoidance and evasion. These efforts complement, rather than replace, the earlier focus on retrenchment but may have the potential to reduce pressures of austerity in the medium term. The article investigates three initiatives at international tax policy coordination, with the aim of assessing their potential to limit tax competition and to generate revenue increases.

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Introduction[1]

While during the post-war period advanced industrialized capitalist countries improved protection against social risks by expanding social spending, since the 1980s the growth of social spending slowed down. Peter Flora characterized European welfare states in the 1980s with the term *Growth to Limits* (Flora 1986), the title of a multi-volume study. With the increase in the number of benefit recipients due to rising unemployment, early retirement, and the maturation of social programs, social spending had gone up, while at the same time tax competition forestalled a further growth of tax revenues. In short, rising needs for expenditure met with a limited scope for further increases in revenues (Greve 2020, Greve 2021, Starke 2021). Many observers have characterized this situation with the term austerity, that is, a condition of fiscal policy-making characterized by constrained fiscal resources relative to identified expenditure needs, or expenditure wishes by governments.

Governments can respond to austerity by increasing tax revenues or by cutting spending (retrenchment), or a combination of both. Yet, tax competition, enabled by capital mobility and the policy choices of low-tax jurisdictions, limits the ability of governments to raise revenue levels. Public social expenditure continued to increase for the OECD average, from 14.4 per cent of GDP in 1980 to 21.1 per cent in 2022 (OECD 2022). This increase was funded to a considerable extent by governments issuing new public debt. Public debt increased for the OECD countries as a whole from 36.6 per cent in 1990 to 129 per cent in 2020 (World Bank 2023). During the same period, tax revenues in per cent of GDP remained about constant (OECD 2022). While since the 1980s, many countries have combined rate cuts with measures to broaden

the tax base in corporate income tax, revenues from corporate income tax have not increased in tandem with rising expenditures; and fluctuates between about 2 and 3.5 per cent of GDP (OECD average), depending on the business cycle (OECD 2021b). These OECD averages hide important differences among countries, yet they show that the widespread growth in public expenditures in OECD countries was overall made possible much more by debt, rather than by increases in revenues.

The aftermath of the Global Financial Crisis (GFC) was characterized by renewed efforts at welfare retrenchment in many OECD countries (Bremer and McDaniel 2020), when as a result of bank bailouts, economic stimulus measures, and in the case of the Eurozone the constraints of monetary union and its Excessive Deficit Procedure (EDP), governments faced renewed pressures of austerity. Yet, different from previous periods of austerity, measures intended to contain expenditure growth were accompanied by efforts to coordinate internationally to prevent the erosion of the tax base through tax avoidance and tax evasion and to limit tax competition.

The agreement in 2021 on a global minimum rate in corporate income tax of 15 per cent and a 'global digital services tax', both engineered by the G20 and the OECD, are the most significant initiatives so far towards revenue enhancement through international cooperation in the field of corporate taxation. At the same time, governments also adopted measures targeting tax avoidance and tax evasion by high net-worth individuals, in particular the automated exchange of information, under the framework of the Global Reporting Standards, and the Foreign Account Tax Compliance Act (FATCA) in the United States, adopted in 2010. Other initiatives are at the stage of policy formulation or debate, such as the European Commission's proposal to harmonize corporate tax bases. While many of the most relevant initiatives are thus not yet in effect, and thus it is too early to observe any possible effect on tax revenues, they may indicate a re-balancing in policy responses to the pressures of fiscal consolidation, that is, a complementing of retrenchment efforts with efforts to stop the erosion of revenues through tax avoidance and tax evasion, as opposed to a predominant focus of effort on retrenchment. At the same time, though, such an optimistic interpretation might be challenged by referring to what critics consider the piecemeal and inadequate character of the measures so far adopted.

The purpose of this article is to analyse the capacity of recent international initiatives at international cooperation in the field of corporate income taxation to induce a shift from tax competition to revenue enhancements. The article focuses on three initiatives: (a) the Base Erosion and Profit Shifting Initiative by the OECD and the G20, which started in 2012; (b) the adoption in 2021 of a global minimum tax and a digital tax by the OECD and the G20, (c) measures proposed or adopted by the European Union, in particular the proposal for a Common Consolidated Corporate Tax Base. These proposals are located at different stages, with the first two being adopted, but not yet implemented,

and the last one being at the stage of decision-making. Since it is thus too early to assess their impact on tax revenues, even if adopted, the analysis focuses on their capacity to limit tax competition in principle, if implemented effectively. Clearly, these are early days to assess the capacity of these initiatives to re-balance fiscal policy towards revenue-enhancement. We are also dealing with a moving target, rather than a settled body of international regulations, with discussions about reform proposals being ongoing at several international organizations and fora. Thus, the effort made in this article towards an assessment of these three initiatives can only be preliminary.

The article is structured as follows: After briefly discussing the nature of corporate tax competition and tax avoidance in the next section (section 1), the article will discuss three initiatives of international coordination intended to limit corporate tax competition or to combat corporate tax avoidance: The Base Erosion and Profit Shifting (BEPS) action plan by the OECD and the G20 (section 2), the Global Minimum Tax and the Digital Services Tax, also developed by the OECD and the G20 (section 3); and finally measures either proposed or adopted by the European Union (section 4).

What is the problem?

International tax competition restricts the ability of national governments to raise taxes on mobile assets, and creates incentives for governments to lower tax rates in order to attract investments (see e.g. Devereux, Lockwood and Redoano 2008, Genschel and Schwarz 2011, Swank 2016). This holds in particular for the taxation of profits by multi-national corporations (MNCs), since the latter possess better opportunities for shifting assets and income to low-tax jurisdictions and tax havens, compared to wage-earners and smaller companies without cross-border operations (Devereux, Griffith and Klemm 2002). While OECD countries have since the 1970s not experienced a general erosion of revenues from corporate income tax, revenues from corporate income tax do account for a much smaller share of overall tax revenues than income taxes and social security contributions by individuals. For the OECD average, revenues from corporate income taxes accounted for 8.2 per cent of total tax revenues in 2021, while social security contributions accounted for 26.6 per cent, and income tax on individuals accounted for 24.5 per cent (OECD 2022). While these data cover up important differences across countries, the funding of public expenditures relies primarily on taxes on individual income and on payrolls, rather than on corporate income or on capital income, a fact that scholars have attributed to the constraints of tax competition (see e.g. Genschel and Schwarz 2011).

MNCs can take advantage of tax competition by shifting profits to low-tax jurisdictions, which can either be legal (tax avoidance) or illegal (tax evasion), or in some cases occupy a grey zone between the two. While MNCs are supposed to report their profits where their economic activities (production, sales,..) are

located, they do in practice often use a variety of accounting methods to shift their profits to low-tax jurisdictions, thereby reducing the profits reported in those high-tax jurisdictions where often a large part of their economic activities is located. This shifting of profits across borders gained public attention in recent years through high-profile leaks of documents covered in the media, including the Luxembourg Leaks in 2014, the Panama Papers in 2015, and the Paradise Papers in 2017. These documents illustrate the strategies used by MNCs and wealthy individuals to reduce their tax payments by shifting profits and assets into low-tax countries and tax havens, both legal and illegal ones. The enhanced media coverage raised also public awareness of the issue.

At the core of corporate efforts to reduce their tax payments are strategies to under-report the amount of profit generated in high-tax countries and report those profits instead in low-tax countries. The latter can either be jurisdictions with low statutory tax rates, or jurisdictions with favorable tax arrangements for specific types of investments and assets. One example of a favorable tax arrangement are special tax exemptions for intellectual property rights, which create incentives for firms to relocate these rights. In Luxembourg, for instance, the statutory tax rate on corporate income is 29.22 per cent, but income from intellectual property and royalties are taxed at only 5.7 per cent, with the effect that many companies that are tax-registered in Luxembourg pay taxes at an effective rate well below the statutory 29.22 per cent.

Available research in economics shows that the scope of profit shifting is considerable. The OECD estimates that globally about 4 to 10 per cent of corporate tax revenues are lost due to profit shifting. This is equivalent to about 100 to 240 billion US $ per year (OECD 2016:2). A study by Dover et al, commissioned by the European Parliament, finds that revenue loss of EU member states due to profit shifting could amount to around 50 to 70 billion Euros, the authors note that this is a lower-end estimate. If other factors, such as the effects of special tax arrangements and inefficiencies in tax collection are included, the total revenue loss due to corporate tax avoidance amounts to 160 to 190 billion Euro, again a conservative estimate according to this study. (Dover, Ferrett, Gravino et al. 2015:5). It should be noted furthermore that profit shifting is not necessarily illegal, and most of what MNCs do to minimize their tax liabilities rather exploits opportunities and loopholes created by existing international treaties and inconsistencies between the tax codes of different countries, rather than violating any laws.

Because of the importance of legal avenues for profit shifting, and the simultaneous political difficulties in achieving an international harmonization of tax rates, early efforts by high-tax countries focused on closing avenues that enable profit shifting, rather than on regulating tax competition as such. The main initiative at international cooperation in this field is the Base Erosion and Profit Shifting initiative by the G20 and the OECD, which we will turn to in the next section.

The Base Erosion and Profit Shifting Project by the OECD and the G20

At the G20 summit in Los Cabos, Mexico, in 2013 G20 government leaders mandated the OECD to develop new regulations intended to limit profit shifting, known as the Base Erosion and Profit Shifting project, or BEPS. The principal goal of the BEPS project is to make sure that MNCs pay their taxes 'where economic activities take place and value is created' (OECD 2016). The OECD's Committee on Fiscal Affairs has developed a set of proposals for reforms to international tax regime, that leaders of the G20 approved at their summit in Anatalya on November 15-16, 2016 (Eccleston and Johnson 2021).

The approach of the BEPS initiative is one of incremental reform, whereby the OECD proposed 15 measures ('actions') that are intended to close accounting loopholes and make sure that companies report profits in that country were the economic activity that created the profit occurred. One key component of the BEPS plan is 'country-by-country' reporting (CbC Reporting), which requires MNCs with an annual turnover of more than 750 million USD to report key indicators for each country in which they operate, including the number of employees, sales, and capital assets, and taxes paid. This information is to be exchanged between tax authorities in different countries and is supposed to make it easier for them to identify inconsistencies between the accounts filed by MNCs. The OECD did however not follow demands by NGOs and academics to make CbC reports public. Within the EU, however, large MNCs are required to publicly disclose their CBC reports by 2024 by the Directive (EU) 2021/2101, which will be discussed in section 4 (European Union 2021).

Other rules in the OECD's BEPS action plan includes, inter alia, recommendations to limit profit shifting via interest deduction, to prevent the artificial avoidance of permanent establishment status, and rules tightening the documentation of transfer prices (OECD 2016).

The reception of the OECP BEPS action plan among academics and NGOs has been largely critical (Eccleston and Johnson 2021, Sikka 2015). According to the BEPS Monitoring Group, an independent group of tax lawyers, the OECD's BEPS project constitutes 'a patch up of existing rules … and do not provide a coherent and comprehensive set of reforms. Nevertheless, this is an important step on a longer road' (The BEPS Monitoring Group 2015:1). Allison Christians, professor of tax law at MCGill University, argues that, while BEPS provides marginal improvements in specific areas, it is unlikely to stop profit shifting (Christians 2016). Similarly, Ramus Corlin Christensen and Martin Hearson, two political economists specialized in global tax governance, describe the BEPS plan as moderate (Christensen and Hearson 2019:7-8).

The BEPS action plan has been criticized for three reasons. First, the reform package sticks with the existing architecture of the international tax regime, which is based on what is called the 'arm's length principle', that is, the principle of treating transactions between national affiliates of an MNCs as if they were independent entities, while, in reality, MNCs are integrated global entities. This keeping with the existing architecture hinders a more radical shift to taxing MNCs global profits.

Second, the OECD BEPS action plan, even though approved in principle by all OECD and G20 member states, are not legally enforceable in themselves and thus much depends on the willingness of member states to implement them. How strict governments will be in implementing the OECD's recommendations will partly depend also on public and media pressure.

Third, the formulation of the BEPS action plan has been criticized for its lack of inclusiveness. Being an organization of primarily advanced industrialized nations in the Global North, critics challenge the legitimacy of the OECD for adopting global tax standards. The OECD has established a forum called 'Inclusive Framework on BEPS' to allow non-members to participated in the formulation of the BEPS plan, a framework that included more than 130 countries, yet critics point out that developing countries had little genuine impact on the formulation of BEPS (Burgers and Mosquera 2017).

Despite these criticisms, the BEPS action plan is a significant shift in international tax governance. While before 2012, the role of the OECD in tax policy had focused on transparency and automated exchange of information to combat illegal tax evasion by high-net worth individuals, it now came to take on a new role in developing policies to restrict (legal) tax avoidance by corporations. While it is too early to say if the BEPS action plan will result in higher revenues from corporate income tax in high-tax countries, the initiative signals a paradigm shift from the tacit acceptance of corporate tax avoidance towards a more active approach of international cooperation. While its measures may have limited impact on tax revenues, it prepared the ground for more far-reaching measures that were adopted subsequently, in particular the global minimum tax, which the next section analyses.

The OECD/G20 initiative for a global minimum rate on corporate tax and a digital services tax

Efforts to regulate tax competition gained momentum during the Covid19 pandemic, which generated new demands for government expenditure. Based on a proposal by the OECD, the G20 finance ministers did agree in 2021 to the adoption of two measures: a global minimum rate on corporate income taxation of 15 per cent and a digital services tax. The global minimum tax rate allows the country where an MNC is headquartered to tax profits made by that MNC in countries that charge a rate of less than 15 per cent, thus in

effect creating a floor that is intended to limit any race to the bottom. The digital services tax consists of a formula for the allocation of global profits of large MNCs to countries for tax purposes. Firms with annual turnover of more than 20 bn Euro will for tax purposes have to allocate 20 per cent of their profits exceeding a 10 per cent margin in the countries where their sales took place. This formula thus intends to make sure that large corporations pay a part of their corporate tax in those countries where they sell their services and products. The digital services tax is understood to affect in particular large corporations operating in the digital economy, and thus able to do business in countries where they have no physical and legal presence (that is, avoidance of permanent establishment status). Some sectors, in particular financial services and oil and gas, are exempted from the digital services tax.

The agreement, which 136 countries representing about 90 per cent of global GDP had agreed to implement, marks an intensification of efforts to limit tax competition. The OECD had been working on the proposal since 2019 within its Inclusive Framework on BEPS. The Ministries of Finance of larger EU countries, in particular France, Germany, and the UK played a key role in promoting the reform (Giles 2021). The United States had previously been reluctant to consider limiting tax competition. Yet, a compromise became possible with the coming into power of the Biden administration in 2021.

The two pillars of the reform, the digital services tax and the global minimum rate, reflect compromises between the US on the one hand and large EU states on the other. The digital services tax was a concession of the Biden administration in return for the adoption of the global minimum rate (Giles 2021). The digital services tax is expected to affect in particular large US MNCs operating in the digital economy (such as Google, Facebook, or Amazon), and result in the re-allocation of some of the corporate income tax they pay to other countries, mostly in the EU. After some larger EU countries had proceeded with adopting digital service taxes unilaterally (in particular France, Italy, and the UK), the US began to consider the adoption of a global digital services tax. In return, other countries had agreed to drop their new unilateral digital services taxes once the new agreement is ratified (Giles and Strauss 2021). In short, a global compromise became possible after some countries had moved ahead unilaterally, which put reluctant actors under pressure.

How much additional tax revenue is the OECD/G20 plan for a digital tax and a global minimum rate expected to generate? The OECD estimates that the digital tax will generate extra corporate tax revenues globally of 4 per cent, or 84bn USD, whereas it estimates the global minimum rate to generate an additional revenue of 0.5 per cent, or 12bn USD, of global corporate tax revenues (Bruder 2021). The economist Michael Devereux estimates the size of additional revenues to about 4 to 5 per cent of what corporations already pay (The Economist 2022) The additional revenues expected to be generated

from the reform are thus likely to be moderate. More significant is likely to be the shifting of corporate tax revenues across countries due to the reallocation formula of the digital tax: The OECD estimates that the taxing rights to profits of about 125bn USD, from about 100 MNCs, will be re-allocated by the digital tax (OECD 2021a). Yet, the most important effect of the reform will probably the prevention of future tax cuts, rather than the direct effect on tax revenues. One should keep in mind though that countries that want to attract foreign investments may compensate investors for a higher tax burden in other ways, for instance by offering investment subsidies, as Switzerland for instance has announced it intends to do (Jones 2021).

The European Union

Within Europe, the measures adopted by the OECD and G20 are complemented by initiatives by the European Union. Some of these measures serve to implement the OECD/G20 recommendations within the EU, others go beyond what the OECD and G20 have adopted. The most relevant initiatives by the EU level are the proposal by the Commission for a Common Consolidated Corporate Tax Base (CCCTB) and its proposal introduce public Country-by-Country reporting within the EU.

The Common Consolidated Corporate Tax Base (CCCTB) is a policy proposal by the European Commission, first presented in 2011, that aims to consolidate corporate profits at the EU level so as to make the shifting of profits for tax purposes among EU member states unattractive to MNCs. According to that proposal, large MNCs would have to report their profits for the EU as a whole, rather than for each member state. Deductions for investments and R&D apply. In a second step, EU-wide profits would be apportioned to individual member states, using a formula that includes sales, tangible assets, payroll sum and number of employees per country. Finally, as a third step, each member state would then be allowed to tax its share of the corporation's EU-wide profit according to its own tax rates and rules (Valenduc 2018). The Commission has re-launched its initiative for a CCCTB in June 2015 (European Commission 2015b), yet the proposal is stalled in the Council due to opposition by low-tax countries. In May 2021 the Commission announced its intention to withdraw the proposal and replace with a new one, called BEFIT (European Commission 2021:11). In short, the CCCTB, if ever adopted, would still allow member states to decide on their tax rates and would thus not eliminate tax competition, yet it would make it unattractive for MNCs to use accounting methods to shift profits to low-tax countries. As a result, the effects of tax competition might thus shift from competition over profits to competition over investments.

While the adoption of CCCTB seems remote, the EU did adopt other measures intended to limit tax avoidance by MNCs. One measure is the adoption

in 2021 of public country-by-country reporting for large MNCs, as mentioned earlier (Directive (EU) 2021/2101). A limited form of public CbC Reporting was already in place for the banking sector under the 4th Capital Requirements Directive (CRD IV, Directive 2013/36/EU) adopted in 2012 (European Union 2013).

The EU directive on CbC reporting goes beyond the BEPS action plan by the OECD and G20 by requiring that MNCs make their report publicly available. The demand for public disclosure of country-by-country reports came from NGOs, such as the Tax Justice Network and the European Network for Debt and Development (Eurodad 2017, Meinzer 2017), and is intended to facilitate public scrutiny of MNC's tax records. Public CbC reporting met resistance from the business community: BusinessEurope, the largest federation of business interest associations in the EU, opposed the directive, as well as notably the Federation of German Industries, one of its largest members, while some groups representing small and medium-sized firms spoke out in its favor. One factor that contributed to enabling the passing of the directive was Germany abandoning its opposition (Augusto 2021, Melchior, Pena and Schumann 2021).

While the two initiatives discussed so far, CCCTB and CbC reporting, met with considerable political obstacles, including opposition from some member states, a number of other, smaller and more incremental measures, were adopted by the EU during the preceding years without much political conflicts. In January 2016, the European Commission presented a proposal for a comprehensive Anti-Tax Avoidance Package, which the Council adopted in June that year, and which includes, inter alia, new limits on the deductibility of interest payments, rules regarding controlled foreign companies, and rules against treaty shopping (Directive (EU) 2016/1164) (European Commission 2016). Moreover, the EU adopted rules for the automatic exchange of information on national tax rulings through the Revised Administrative Cooperation Directive, which make it easier for national tax authorities to detect abusive practices by MNCs (European Commission 2015a). Another measure relevant for corporate tax avoidance is the establishment by the EU of a list of tax havens, which does however not include any EU member states (Meinzer and Knobel 2015).

To sum up, in recent years the European Union has become much more active in combating corporate tax avoidance. While during the Eurozone crisis the European Commission, in its role as the watchdog of the Stability and Growth Pact, acted as an enforcer of austerity policies in the crisis-hit countries, it put greater emphasis on "social" initiatives during the subsequent years, including for instance the European Pillar of Social Rights (Vesan and Corti 2019). At about the same time, the Commission also intensified its initiatives against corporate tax competition and tax avoidance, in particular through the re-launch of its CCCTB proposal in 2015. Since the EU Treaties require unanimity among the member states for legislation in the field of tax

policy, and since several member states rely on corporate tax policy to attract investors (e.g. Luxembourg, Ireland, Netherlands, Hungary), harmonization of tax policies appears however unlikely, despite the Commission's initiatives in this area. Yet, the measures adopted so far, such as the rules for public CbC reporting, would have been unthinkable before the Global Financial Crisis and show a build-up of political momentum for reform that did not exist in earlier periods.

Conclusion

It is too early to assess the impact of efforts of international cooperation by the OECD and by the EU on tax revenues, since many of the policies discussed are not yet in effect, or not even adopted. Available estimates suggest that the impact of the measures adopted so far on tax revenues is likely to be moderate. Yet, the initiatives do indicate a paradigm shift from tax competition to international cooperation, and the political momentum generated by them may result in more far-reaching initiatives in the future. The sustained media attention to tax avoidance and tax havens, together with the continued need for governments to increase revenues in order to address expanding needs for public spending caused inter alia by demographic ageing and climate change mitigation, make it appear likely that corporate tax avoidance and tax competition will remain high on the political agenda.

The global minimum tax rate and the digital services tax provide a basis of international agreement that governments could potentially expand. For example, policymakers might decide to raise the global minimum rate, or expand the scope of the digital services tax, and use it as the platform for developing a system of what is called *formula apportionment*, that is, a global system of allocating profits to countries for tax purposes, based on indicators such as sales and payroll sum per country. The further development of the policy initiatives discussed in this article will be a litmus test for the capacity of the institutions involved to transform international tax governance from competition to cooperation.

Noter

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