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European Economic and Social Committee – International Monetary Fund
Joint Public Debate
"Taxing Multinationals in Europe"

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Statement by Prof. Dr. Christoph Spengel

1. The IMF proposal in a nutshell: CCCTB and minimum corporate tax rate

In its report "Taxing Multinationals in Europe" the IMF proposes a joint implementation of a Common Consolidated Corporate Tax Base (CCCTB) with a minimum corporate tax rate across the European Union. The arguments put forward in the report to justify such a far-reaching proposal for reform are manifold:

(1) Combat the erosion of corporate tax revenues stemming from tax competition and profit shifting.
(2) Increase corporate tax revenues to re-finance deficit spending due to the COVID-19 pandemic.
(3) Relocation of taxing rights to market jurisdictions as an answer to the increasing importance of digital business models based on the exploitation of mobile intangible assets.

2. CCCTB and minimum corporate tax rates: an old hat

It is well known that a CCCTB reduces compliance costs and makes – due to consolidation – profit shifting via transfer prices impossible. In particular, preferential tax regimes such as IP-boxes simply will be netted out.

The arm's length principle, however, is substituted by the apportionment of consolidated group profits to group members located in different member states. Since under formulary apportionment, the effective tax burden is a direct function of the nominal corporate tax rate and the apportionment factors such as assets, labor and sales, multinationals may enter into substantive tax planning by relocating the place of production, that means assets and labor, to low tax jurisdictions. Such a relocation is promoted by a CCCTB since the transfer of functions constitutes no taxable event due to the elimination of intra-group profits.

Given the considerable EU-wide range of nominal corporate tax rates, tax competition within the EU presumably will increase. This inevitably raises the question whether a CCCTB should be combined with a minimum tax rate on corporate profits?

A minimum corporate tax rate has two objectives: it protects an efficient allocation of resources and, thus, the economic goals of the European Union's treaties. Moreover, it protects the autonomy of member states with respect to the personal income tax. The latter, the personal income tax, has not been addressed in the IMF Report. I will explain this afterwards.

All this has already been made very clear soon after the release of the Commission's staff working paper on "Company Taxation in the Internal Market"[1] two decades ago in 2001.[2] Given this, one has to ask why these efforts have not been taken up by the European Council? There might be several reasons:

- The harmonization of tax bases, the consolidation of individual profits of group members, the apportionment of consolidated profits to group members and a minimum corporate tax rate might be considered as too far reaching. In addition, it is crucial to set the concrete level of the minimum tax: should it be 10 per cent or 21 per cent as proposed recently by U.S. Department of the Treasury?[3] In the latter case, on average, all EU Member States would be considered as low tax jurisdiction. Moreover, a CCCTB lacks of clear guidance with regard to transition into and out of the system, meaning that the suggested exit and entry rules are not yet specified.[4] Today, we have to acknowledge that EU Member States have not even found a compromise on a Common Corporate Tax Base as proposed by the European Commission in 2016.[5] In addition, the Notional Interest Deduction (NID) would offer new tax planning opportunities since an interest income is effectively tax exempt with sincere backlashes to the personal income tax.

- The loss in corporation tax revenue due to tax competition and tax planning is not that pronounced. Both the studies based on micro- and macro-data reveal low percentages in forgone revenues and semi-elasticities respectively. In addition, at least for me, it remains unclear whether the studies cited in the IMF report consider the impacts of the Anti-Tax-Avoidance Directives (ATAD I+II), the confidential Country-by-Country Reporting (DAC 2) and the disclosure of cross-border tax planning strategies (DAC 6) on profit shifting? Moreover, we have to acknowledge that the reduction of corporate income tax rates was accompanied by a sharp increase of the personal income tax on both dividends and capital gains. Finally, several major industries such as the US[6] and the UK[7] have announced to increase their corporate income tax rates (in the US from 21 to 28 per cent and in the UK from 19 to 25 per cent).

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1 Cf. Company taxation in the internal market, Commission staff working paper, COM(2001) 582 final.
2 Cf. Sørensen, To harmonise or not the harmonise?, CESifo Forum 2002, p. 35; Ruding, ECTR 2005, pp. 2-3; Spengel, Common Corporate Consolidated Tax Base – Don't forget the tax rates!, ECTR 2007, pp. 118-120.
3 Cf. U.S. Department of the Treasury, The Made in America Tax Plan, April 2021, p. 11.
4 Cf. Spengel, Concept and Necessity of a Common Tax Base – an academic introduction, Schön/Schreiber/ Spengel (Eds.), A Common Consolidated Tax Base for Europe, 2008, pp. 40-41.
5 Cf. Proposal for a Council Directive on a Common Corporate Tax Base, COM(2016) 685 final.
6 Cf. U.S. Department of the Treasury, The Made in America Tax Plan, April 2021, p. 3.
7 Cf. https://www.gov.uk/guidance/corporate-tax.

3. No link between COVID-19 deficit spending and the taxation of MNE in the European Union

Different to the IMF report I would not link the harmonization of the corporate income tax for multinational enterprises in Europe to Member States deficit spending due to the COVID-19 pandemic. There is no evidence at all that MNE's benefited most from such deficit spending. Rather, transfer payment to individuals prevail.

If, at all, given that economic recovery happens faster than expected in 2020, it is necessary to increase taxes in Europe, I refer to the value added tax (VAT). Although VAT has been harmonized across the European Union for decades, it is the most vulnerable tax with regard to illegal tax fraud. According to a forecast of the European Commission, the VAT Gap could amount to EURO 164 billion in 2020.[8] This amount is huge, and it is an annual loss in tax revenue. Contrary to increasing the corporate income tax by way of levying minimum taxes, Member States should take all efforts to close the VAT gap, blueprints are on the table for a long time.

4. CCCTB & Formulary Apportionment by Sales do not relocate taxing rights to market countries

Different from the unified approach (Pillar 1) still under discussion within the inclusive framework of the OECD where a share of consolidated residual profits – the so-called Amount A – shall be allocated by sales to market jurisdictions without any physical presence, a CCCTB and formulary apportionment by the sales factor foresees no taxing rights for consumer markets in case of pure exports. Although the CCCTB is apportioned with regard to sales by destination, a physical presence of a group member in the consumer market still is required. Otherwise, a so-called throw-back rule will become effective which is explicitly mentioned in Art. 94 No. 4 of the 2011 proposal for a CCCTB Directive: "If there is no group member in the Member State where goods are delivered or services are carried out […] the sales shall be included in the sales factor of all group members in proportion to their labour and asset factors."[9]

Regarding the inter-nation allocation of taxing rights, the OECD's Pillar 1 and the CCCTB are based on fundamentally different concepts.

5. Way out

The role of VAT is surprisingly not at all considered in the current political discussion and in the IMF report. Yet, billions of tax revenue are at stake if consumption taxes are not collected appropriately. Enforcing VAT on digital services thoroughly is a crucial step to generate and protect tax revenues in market jurisdictions. Furthermore, the increasing relevance of the sharing economy contributes to a defragmentation of the economy and the appropriateness of small-business VAT exemption regulations is debatable for highly digitalized interactions between market participants with systematic and

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8 Cf. European Commission, Study and Reports on the VAT Gap in the EU-28 Member States (https://ec.europa.eu/taxation_customs/sites/taxation/files/vat-gap-full-report-2020_en.pdf).

9 Cf. Proposal for a Council Directive on a Common Consolidated Corporate Tax Base (CCCTB), COM(2011) 121/4.

complete knowledge of transactional data. Platform providers could be integrated in the process of consequent VAT collection.

Referring to the taxation of MNE’s in a digitalized world, one should first understand value creation in digitalized business models.[10] Second, based on this understanding, following recommendations of leading tax scholars, a more systematic profit split approach combining traditional transfer pricing methods for routine tasks with a more flexible approach for hard to compare transactions of digital corporations should be taken up.[11] They argue that this reform proposal, which recommends allocating the profits based on residual gross income, would be an improvement in comparison to the existing system on several dimensions. The idea to re-examine the formulary apportionment of residual profits and to combine this approach with traditional transfer pricing methods has been regularly discussed in the academic literature.[12]

[10] Cf. Olbert/Spengel, International Taxation in the Digital Economy: Challenge Accepted?, WTJ 2017, pp. 3-46; Ludwig/Olbert/Spengel, Transfer Pricing for Data Businesses – How to Apply the Arm‘s Length Principle to the Digital Economy, Pistone/Webber (Eds.), Taxing the digital economy: the EU proposals and other insights, 2019, pp. 27-47.

[11] Cf. Devereux/Auerbach/Keen/Oosterhuis/Schön/Vella, Residual Profit Allocation by Income, 2019. SSRN Scholarly Paper No. ID 3358291. Available at: https://papers.ssrn.com/abstract=3358291.

[12] Cf. Avi-Yonah/Benshalom, Formulary apportionment: Myths and prospects-promoting better international tax policy and utilizing the misunderstood and under-theorized formulary alternative, WTJ 2011, pp. 371-398.