Committee: ECOFIN

Topic: The question of taxation of global corporations

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Summary

Headline corporate income taxation rates have plummeted by around 20% since 1980. It is estimated that as much as 40 per cent of multinational corporate profits are relocated to tax havens yearly, reducing global corporate tax revenue by 200 billion dollars. Outdated regulations fail to attend to the challenges of today's globalised society, leading to global corporations taking advantage of loopholes through tax avoidance strategies and profit shifting. This environment has created intense international tax competition, the "race to the bottom", where nations fight for Foreign Direct Investment and decrease their taxation rates, causing mutual harm and lower tax revenue overall. Although global corporate regulations might restrict development, a fully collaborative approach to a solution to the global corporation taxation issue must be reached, especially to protect the vulnerabilities of LEDCs in this competition.

Definition of Key Terms

Globalisation – the process by which businesses or other organisations develop international influence or start operating internationally.

Tax havens – a country or independent area with low rates of taxation.

Double taxation – the imposition of taxes by two or more jurisdictions on the same income asset or financial transaction.

Base Erosion and Profit Shifting (BEPS) – also known as corporate tax avoidance, are corporate tax planning strategies that aim to "shift" profit from higher-tax to lower-tax jurisdictions, "eroding" the tax "base" of the higher-tax jurisdictions (causing them to lose tax revenue).

Multinational corporation – a corporation that operates throughout different countries and jurisdictions.

Foreign Direct Investment (FDI) – a long-term investment by an investor in an enterprise in another country, resulting in lasting interest and the investor's significant influence on the management of said enterprise.

Transfer pricing – the price one division in an organisation or corporation charges another for the supply of goods and services. Corporations usually raise transfer prices in countries with a lower rate of taxation.

Tax competition – the reduction of a country's fiscal burdens (e.g., taxation rates) to attract Foreign Direct Investment (FDI).

Bilateral tax agreement – an agreement between countries pertaining to the issue of double taxation, especially in the case of an individual or (global) corporation that carries out activities in more than one country.

LEDCs – Less Economically Developed Countries

MEDCs – More Economically Developed Countries

MNE – Multinational enterprise

Background Information

The issue of the taxation of global corporations addresses both the rate of taxation and the right to taxation. In such cases, for instance, when dealing with multinational corporations with activities throughout several countries, both aspects of the matter are relatively unclear.

There are two possible approaches to corporate taxation: territorial and worldwide. Most MEDCs opt for territorial, meaning only domestic corporate profits earned are subject to taxation, with certain exceptions. A worldwide system would mean that both domestic and foreign profits of a corporation would be subject to tax. However, significant consideration must be made to double taxation and bilateral tax agreements.

In our digital age, previous regulations concerning the taxation of global corporations have become majorly outdated. Due to the exponential growth of tech companies and the digital market, awarding taxation rights based on physical presence in a jurisdiction is no longer appropriate and could lead to the exploitation of cross-border tax loopholes.

The current climate of international tax competition, also known as the "race to the bottom", makes it so that nations must keep decreasing their taxation rates in order to keep up with the global "peer pressure" and attract Foreign Direct Investment. For example, between the years of 2004 and 2014, Ireland allowed the Apple corporation to pay nearly no corporate tax, resulting in what the European Commission estimated to be nearly 13 billion euros of unpaid fines.

The "race to the bottom" tends to particularly benefit corporations: for every percentage drop in the average tax rate of a low-tax jurisdiction, profits reported there by foreign corporations of US multinationals increase by between 3.5 and 7 per cent.

Global corporations are increasingly applying corporate tax avoidance strategies and shifting profit from higher-tax to lower-tax regions through methods such as transfer pricing. Base erosion and profit shifting increase tax competition for Foreign Direct Investment, as higher-tax jurisdictions must keep up with tax havens, which seem infinitely more attractive to corporations as a way of decreasing their taxation burden and increasing profit.

However, overly ferocious tax competition leads to mutual harm for both high and low-tax jurisdictions. Nations erode each other's tax revenue: lower-tax jurisdictions "take" taxation money from higher-tax jurisdictions, as they are seen as the more advantageous option to foreign investors; however, by reducing their taxation rates, the lower-tax region itself will already be collecting less tax revenue overall, causing both parties to lose out on profit simultaneously. This vicious competition cycle causes nations to rely on other sources of financing or to reduce public spending as a whole, which is sure to have countless knock-on effects.

Less Economically Developed Countries are disproportionately affected by this issue, as they are highly reliant on corporate income tax to fund necessary public goods, as they might still be in the progress of economic development. Such tax competition could pressure these countries into tax policies that endanger taxation as a key source of revenue.

An opposite point of view states that tax competition can be beneficial in many ways, such as causing governments to reduce wasteful spending. This reasoning also says that corporate tax regulations hinder business incentives and harm development and economic growth by discouraging Foreign Direct Investment. It is also seen to further globalisation – as it encourages FDI and economic activity spread over different jurisdictions – and, in turn, global economic growth, development, and the access of those around the globe to different products or services.

In conclusion, any attempt to regulate the matter of the taxation of global corporations must be fully collaborative, with no countries on the sidelines. If only some nations coordinate, they actively make themselves more vulnerable to tax competition from those who do not.

Major Countries and Organizations Involved

The United States – The rise of the American "tech giants" such as Alphabet (Google), Amazon, Apple, Meta (Facebook), and Microsoft has brought the issue of taxation in the digital age to the forefront of public conscience. The United States has claimed that harsh measures of digital taxation unfairly target American "Big Tech" companies and has threatened to impose tariffs on countries that implement digital service taxes.

American Samoa, Anguilla, Bahamas, British Virgin Islands, Costa Rica, Fiji, Guam, Marshall Islands, Palau, Panama, Russia, Samoa, Trinidad and Tobago, Turks and Caicos Islands, US Virgin Islands, Vanuatu – are jurisdictions currently listed in the European Union's list of non-cooperative jurisdictions for tax purposes (February 2023), meaning they have failed or refused to fulfil their commitments to comply with tax governance criteria.

Albania, Andorra, Antigua and Barbuda, Armenia, Aruba, Bahrain, Barbados, Belize, Bermuda, Bosnia and Herzegovina, Botswana, British Virgin Islands, Cabo Verde, Curaçao, Dominica, Faroe Islands, Fiji, Macedonia, Grenada, Greenland, Isle of Man, Jamaica, Jordan, Republic of Korea, Liechtenstein, Malaysia, Maldives, Marshall Islands, Mauritius, Mongolia, Montenegro, Morocco, Nauru, Oman, Panama, Peru, Qatar, Saint Lucia, San Marino, Serbia, Seychelles,

Swaziland, Switzerland, Thailand, Tunisia, Turkey, UAE, Uruguay, Vietnam – were listed in the EU non-cooperative jurisdictions for tax purposes watchlist (2018).

The Organisation for Economic Co-operation and Development (OECD) – was founded in 1961 and currently has 38 member countries. It is a forum dedicated to discussing economic progress, world trade and domestic and international economic policy coordination.

Timeline of Events

1923 – League of Nations report preventing double taxation.

1929 – British case of *Egyptian Delta Land and Investment Co. Ltd. V. Todd*. The company was registered in London but did not have any activities in the UK and hence was not subject to British taxation.

1930 – Transfer pricing adjustments become a feature of many tax systems.

1934 – The Swiss Banking Act of 1934 heavily strengthened the principle of absolute bank secrecy, with protection from any government.

1957 – The Bank of England rules that transactions undertaken by British banks but not located in the United Kingdom were regulatorily not seen as taking place in the United Kingdom.

1987 – Ireland establishes the Irish Financial Services Centre in Dublin with a low corporate tax rate.

1990 – Between sixty and one hundred tax havens on Earth (depending on the definition applied). Approximately half of international lending and one-third of FDI was routed through these tax havens at this time.

1994 – James R. Hines Jr. publishes the revolutionary Hines–Rice paper, creating, for the first time, an academic list of 41 tax havens and seven major tax havens, and using the term "profit shifting".

1995 – OECD issues transfer pricing guidelines.

2013 – OECD and G20 introduce Base Erosion and Profit Shifting (BEPS) project, giving governments tools to prevent corporate tax avoidance.

2016 – the European Union adopts the Anti-Tax Avoidance Directive (ATAD), implementing the OECD's BEPS project's recommendations.

2017 – the European Union introduces mandatory disclosure regulations for tax planning intermediaries, aiming to identify BEPS issues and creates its first formal list of tax havens.

2021 – Global minimum tax agreement of 15% is reached.

Relevant UN Treaties and Events

United Nations Model Double Taxation Convention – was formed as a means of contribution to international efforts aimed at eliminating double taxation. It also discusses other matters pertinent to the issue at hand, such as rights of taxation, promoting FDI to LEDCs on acceptable conditions, and others.

Tax Inspectors Without Borders – a joint initiative of the OECD and UNDP in order to aid LEDCs in tax audits, including for corporations, through programmes. These programmes are usually 8-12 weeks of on-site or remote desk-based assistance over a period of 18-24 months.

United Nations Manual for the Negotiation of Bilateral Tax Treaties between Developed and Developing Countries – a United Nations publication that aims to strengthen the expertise and understanding of tax officials in both LEDCs and MEDCs in carrying out bilateral tax treaties.

United Nations Code of Conduct on Cooperation in Combating International Tax Evasion – sets out guidelines in order to standardise and ensure the pursuit of combating international tax evasion or harmful tax avoidance strategies.

Previous Attempts to Solve the Issue/Possible Solutions

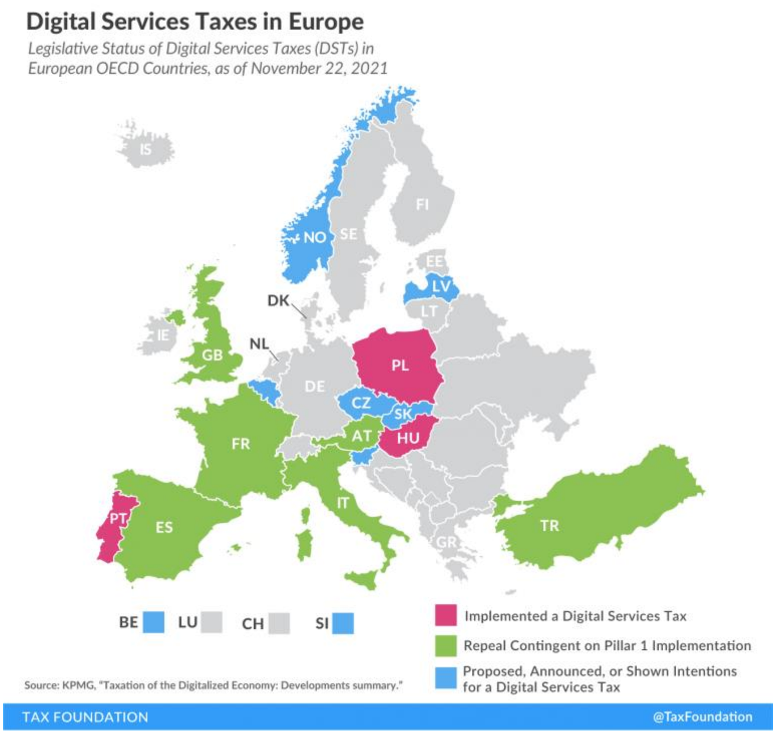
Global Minimum Tax – Negotiations with the Organisation for Economic Cooperation and Development (OECD) in October of 2021 resulted in more than 130 member nations agreeing to a new global tax regulation. In brief terms, the agreement consists of two pillars: Pillar 1, the new system of allocating taxing rights of global corporations – to jurisdictions where profits are earned –, and Pillar 2, rules (Global Anti-Base Erosion (GloBE) rules) to reduce opportunities for Base Erosion and Profit Shifting (BEPS). Additionally, the Global Minimum Tax agreement sets out 15 per cent as the minimum global taxation rate. Kenya, Nigeria, Pakistan and Sri Lanka refused to sign on.

The Pillar Two model to implement the GloBE rules includes outlining the multinational corporations to that apply for the minimum tax, developing a mechanism for calculating an MNEs effective tax rate, and applying this tax value to the mentioned MNE.

Criticisms of this agreement take several opinions, such as being preferential to MEDCs, discouraging economic growth and FDI or the minimum rate of 15% being too low. Regarding Kenya and Nigeria's refusal to adopt the agreement, this may be due to its conflict with their already-established digital service taxes, or the agreement's dispute resolution framework.

Destination-based cash-flow tax (DBCFT) – The DBCGT was proposed in the United States by the Republican Party in 2016. This proposal would make it so that profit is taxed based on its destination (where the goods end up) rather than where they were produced. It intends to, if adopted universally, ease the pressures of tax competition, as the taxation rate is dependant on the country of arrival, as opposed to the country of production. However, this system might be quite time-and-resource consuming to introduce, as it requires a substantial change of existing tax structures.

Digital service taxes (DSTs) – DSTs tax gross revenue from digital services. These are mainly directed at American global "Big Tech" corporations. As of now, countries have different specific regulations for DSTs (if they have them at all), and there is no global agreement on the matter. For example, DSTs in Austria only apply to digital advertising, whereas in Poland, they only apply to streaming services. The issues of double taxation must be taken into account when arriving at a consensus on digital service taxes.



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