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The Transposition of the OECD-Proposed Tax Reform at the European Union level

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Abstract

In the context of increasing economic interdependence, tax reform has become critical on the international agenda due to widespread tax avoidance by multinational companies and digital giants. The OECD has proposed tax reforms to address these challenges, aiming for a fairer distribution of tax revenues among countries.

This paper examines the necessity and impact of implementing the OECD's tax reforms within the EU, considering the diverse tax systems of member states.

The analysis reveals an upward trend in profits transferred to tax havens globally. EU tax havens like the Netherlands, Ireland, and Luxembourg are significant recipients of these profits. The OECD reforms, by reallocating profits and establishing a minimum tax, are expected to reduce the attractiveness of these havens. The impact will vary: less developed EU countries may lose foreign investment opportunities, while more developed countries could benefit from increased tax revenues and fairer profit distribution.

Key words: tax reform, multinational companies, tax havens, European Union
J.E.L. classification: H25, H26, H32, F23

1. Introduction

In the context of globalization and increasing economic interdependence between states, tax reform has become a topic of paramount importance on the international political and economic agenda, given the phenomenon of tax avoidance encountered among multinational companies and digital giants. Consequently, the Organization for Economic Co-operation and Development (OECD) has proposed a series of tax reforms aimed at addressing the fiscal challenges of the digital economy and ensuring a fairer distribution of tax revenues among countries.

Within the European Union (EU), the implementation of the OECD's proposed tax reforms can generate a series of specific challenges and opportunities, considering the diversity of the member states' tax systems and the need to harmonize national legislations with community directives and regulations. The transposition of the OECD tax reform at the EU level involves adapting tax rules and coordinating economic policies to ensure a uniform and effective application across the Union.

Given these aspects, this paper aims to analyze the two pillars of the tax reform plan proposed by the OECD, the necessity of implementing these pillars at the level of the European Union member states, as well as the process of transposing the tax reform and the potential positive or negative consequences.

In this study, we will address the legal and technical aspects of the implementation, as well as the economic implications of this reform, using a quantitative approach based on simple statistical methods. The goal we aim to achieve through this analysis is to highlight the challenges and opportunities generated by the transposition of the OECD tax reform in the member states of the European Union, taking into account the difference in the levels of development between the member states.

2. Literature review

The problem of tax avoidance is quite old, being well known in the specialized literature. In the context of this issue, what brings novelty is the intensified attention that political decision-makers have given to it in recent years (Nebus, 2019).

With the phenomenon of globalization, increased capital mobility, economic liberalization, and the advancement of the information revolution have led to heightened fiscal competition among states. Fiscal competition involves reducing the tax burden to attract foreign direct investment. While foreign direct investment generates benefits, the consequences of this practice are controversial, especially in the context of rising budget deficits and public debts in European Union countries. The issue arises when all countries decide to lower tax rates, with some researchers arguing that this could lead to tax rates falling below the optimal level for funding and providing basic public goods and services to the population. (Guziejewska et al, 2014).

To address multinational companies' tax avoidance issues and hence the fiscal competition between states, a global reform plan was discussed within the Organisation for Economic Co-operation and Development (OECD) and G20. Following debates in July 2021 among countries involved in negotiations at the OECD, an agreement on the outline of new tax rules was reached in October, endorsed by 137 jurisdictions at that time.

The OECD/G20 fiscal plan aims primarily to ensure a more equitable distribution of profits and taxes among countries, taking into account the global activities of multinational companies. This plan is structured around two main pillars. The first pillar requires multinational companies with annual revenues exceeding 20 billion euros to redistribute 25% of their profits to countries where they conduct economic activities, provided that the profit margin exceeds 10%. Extractive industries and regulated financial services are excluded from this pillar. The second pillar encourages multinational companies to avoid tax havens and introduces an additional tax for companies with total revenues exceeding 750 million euros that pay an effective tax rate below 15%. Moreover, the parent jurisdiction of multinational companies has priority in collecting the missing taxes (Khudyakova and Sidorova, 2022).

Regarding the European Union, since its establishment, tax harmonization among member states has been a priority objective. However, harmonization of corporate income tax has not succeeded in being fully achieved. Significant differences between the tax rates of member states have been extensively addressed in the literature. Nonetheless, tax harmonization remains a goal for member states, with the hope of preventing the relocation of companies to regions with lower tax rates. Thus, the aim is to avoid capital outflow (Contell et al, 2018).

3. Research methodology

The purpose of this paper is to highlight the challenges and opportunities generated by the transposition of the OECD/G20 tax reform in the member states of the European Union, taking into account the difference between the levels of development between the member states.

In this sense, we propose a quantitative approach based on simple statistical methods to highlight the situation of the profits transferred at the European level, compared to the global level, as well as the profits transferred to tax havens, especially those in the European Union.

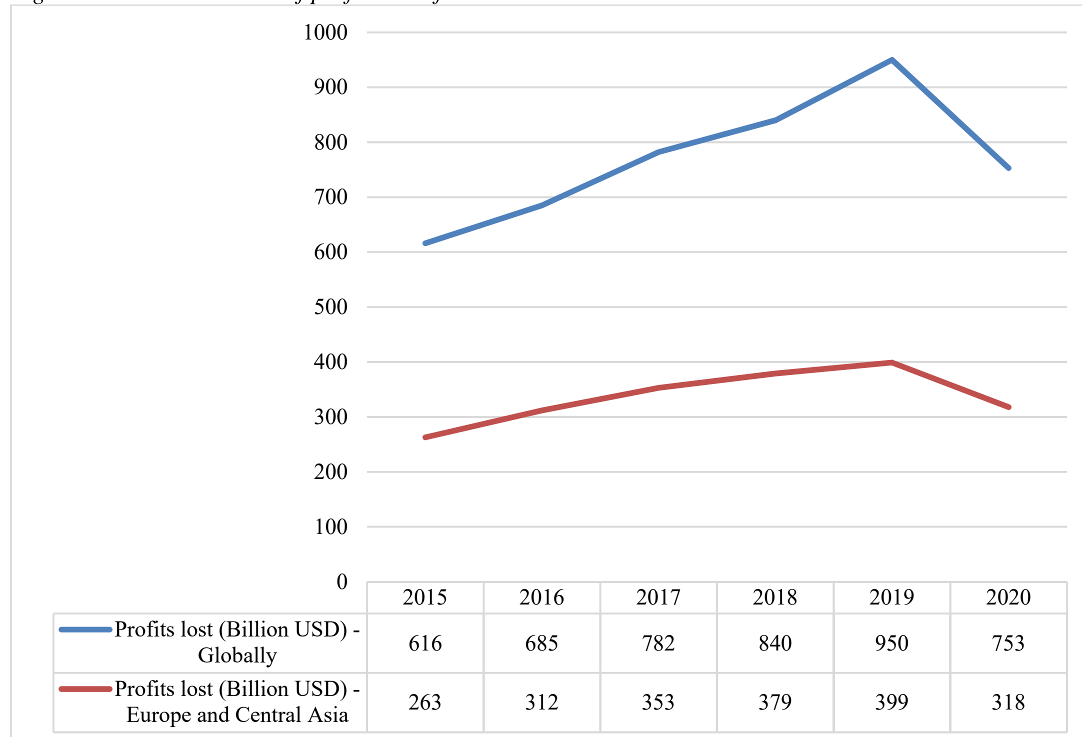
These approaches help us determine, at a descriptive level, the extent of tax avoidance, the necessity of implementing the reform plan, as well as its main opportunities or challenges.

4. Results

In this part, we propose an analysis of the evolution of the profit transferred to tax havens in the period 2015-2020, with the help of EU Tax Observatory data.

The data is based on two segments, one of them presents the situation at the global level, showing the approximate profit transferred to tax havens from all over the world, and the second segment considers the situation in Europe and Central Asia.

Figure no. 1 The evolution of profits transferred to tax havens



	2015	2016	2017	2018	2019	2020
Profits lost (Billion USD) - Globally	616	685	782	840	950	753
Profits lost (Billion USD) - Europe and Central Asia	263	312	353	379	399	318

Source: (EU Tax Observatory, 2024)

According to the chart based on data provided by the EU Tax Observatory - Atlas of the Offshore World, the profit transferred to tax havens globally showed an upward trend from 2015 to 2019, increasing from 616 billion USD in 2015 to 950 billion USD in 2019, a relative increase of 54.22%. It then significantly decreased in 2020, reaching 753 billion USD, a relative change of -20.74% for the period 2019-2020.

In the countries of Europe and Central Asia, during the period 2015-2019, the profit transferred increased from 263 billion USD in 2015 to 399 billion USD in 2019, a relative increase of 51.71%. It then decreased in 2020, reaching 318 billion USD, a relative change of -20.3% for the period 2019-2020.

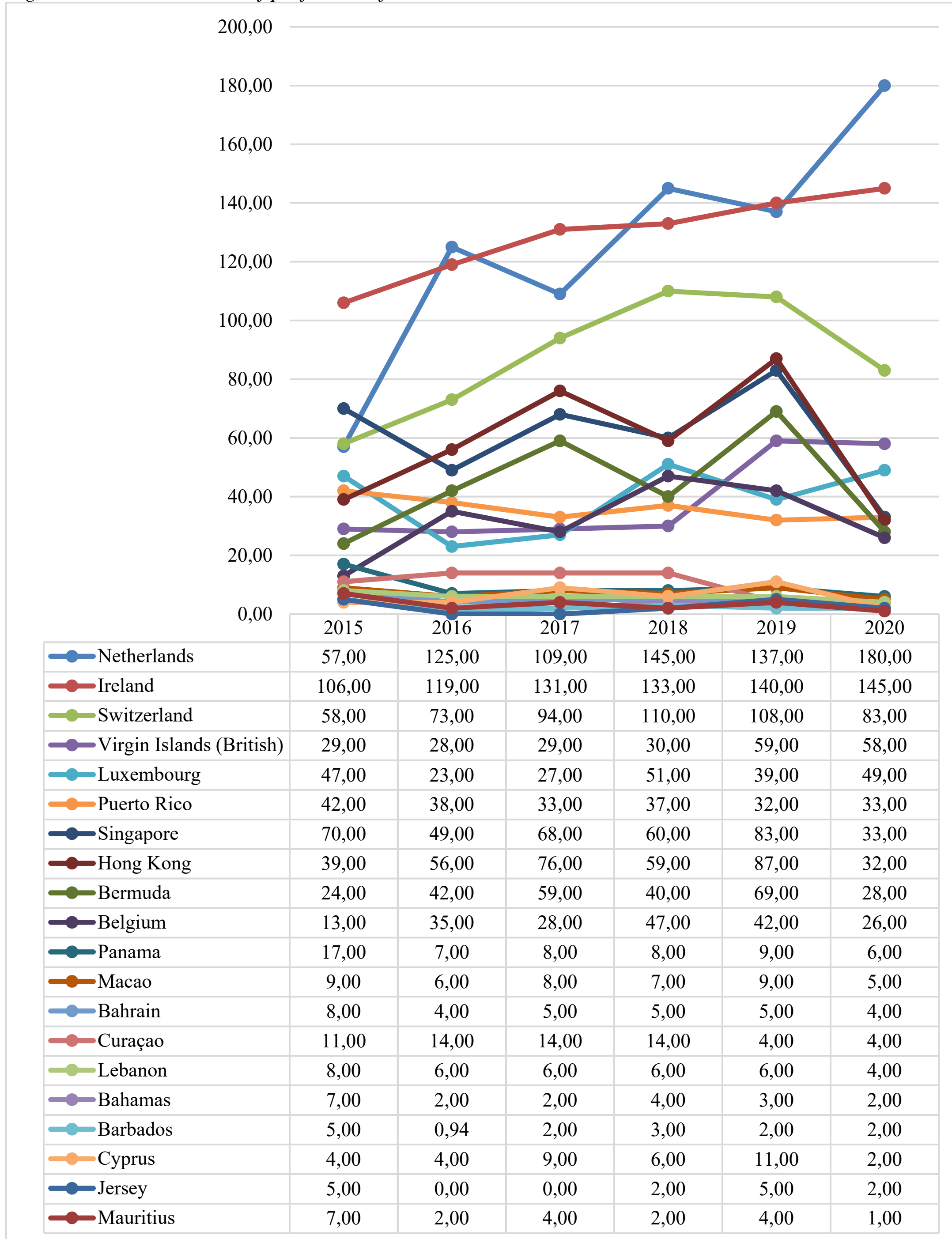
According to these data, of the total profits lost globally, only Europe and Central Asia lose approximately 42.23%, a significant percentage, considering that the rest of the world loses approximately 57.77%.

Until now, the tax reform plan proposed within the OECD/G20 framework should reduce the general percentage of profits lost at the European level, due to the reallocation of a part of the profit transferred to where it was made and the minimum taxation with 15%, as the reform plan mentions. However, the impact on the economy of the European Union must also be evaluated from the perspective of tax havens in the Union that attract Foreign Direct Investments (FDI) from multinational companies that transfer profits there and of course, from the perspective of the level of development of each member state's economy.

Regarding tax havens, we propose an analysis of the evolution of the profits transferred to the most appreciated tax havens by multinational companies, in order to determine the impact on those in the European Union. The degree of appreciation being established depending on the extent of the profits transferred.

Therefore, the following graph includes the distribution of profits in tax havens, showing an evolution of transferred profits and a ranking of the most attractive EU and non-EU tax havens, being the first twenty.

Figure no. 2 The evolution of profits transferred to the most attractive tax havens



	2015	2016	2017	2018	2019	2020
Netherlands	57,00	125,00	109,00	145,00	137,00	180,00
Ireland	106,00	119,00	131,00	133,00	140,00	145,00
Switzerland	58,00	73,00	94,00	110,00	108,00	83,00
Virgin Islands (British)	29,00	28,00	29,00	30,00	59,00	58,00
Luxembourg	47,00	23,00	27,00	51,00	39,00	49,00
Puerto Rico	42,00	38,00	33,00	37,00	32,00	33,00
Singapore	70,00	49,00	68,00	60,00	83,00	33,00
Hong Kong	39,00	56,00	76,00	59,00	87,00	32,00
Bermuda	24,00	42,00	59,00	40,00	69,00	28,00
Belgium	13,00	35,00	28,00	47,00	42,00	26,00
Panama	17,00	7,00	8,00	8,00	9,00	6,00
Macao	9,00	6,00	8,00	7,00	9,00	5,00
Bahrain	8,00	4,00	5,00	5,00	5,00	4,00
Curaçao	11,00	14,00	14,00	14,00	4,00	4,00
Lebanon	8,00	6,00	6,00	6,00	6,00	4,00
Bahamas	7,00	2,00	2,00	4,00	3,00	2,00
Barbados	5,00	0,94	2,00	3,00	2,00	2,00
Cyprus	4,00	4,00	9,00	6,00	11,00	2,00
Jersey	5,00	0,00	0,00	2,00	5,00	2,00
Mauritius	7,00	2,00	4,00	2,00	4,00	1,00

Source: (EU Tax Observatory, 2024)

Within the graph, the top 20 tax havens that received transferred profits are organized in descending order of profits from the year 2020. Thus, Malta, which received a profit of 12 billion in 2015 USD, received only 0.30 USD billion in 2020 and is no longer included in the ranking from the graph.

According to the graph, the Netherlands stands out with a significant increase in transferred profits, from 57 billion USD in 2015 to 180 billion USD in 2020. This consistent increase suggests that the Netherlands has become an increasingly attractive place for companies seeking tax optimization. Favorable tax policies and a well-developed financial infrastructure contribute to this trend.

Ireland, which was in first place in 2015, also recorded an increased flow of transferred profits, from 106 billion USD in 2015 to 145 billion USD in 2020. Ireland is known for its very advantageous tax regime, including a low corporate tax rate and various tax benefits offered to multinational companies. This makes Ireland one of the main destinations for profit transfers.

In Switzerland, transferred profits initially increased from 58 billion USD in 2015 to a peak of 110 billion USD in 2018, followed by a significant decline to 33 billion USD in 2020. This fluctuation can be attributed to changes in international tax regulations and global pressures for tax transparency, which have affected Switzerland's attractiveness as a tax haven.

The British Virgin Islands registered relative stability in transferred profits, with values fluctuating between 28 and 59 billion USD over the analyzed period. They remain a popular destination due to flexible tax regulations and the anonymity offered to investors.

In Luxembourg, the volume of transferred profits varied considerably, with a minimum of 23 billion USD in 2016 and a maximum of 51 billion USD in 2018, stabilizing at 49 billion USD in 2020. Luxembourg continues to be an important financial hub due to its advantageous tax policies and stable legal framework.

It is noteworthy that all European Union tax havens are included in this ranking, except for Malta, which was also part of the top 11 appreciated tax havens in 2015. Additionally, the top two places that received significant values of transferred profits are tax havens in the European Union.

Therefore, the implementation of the two-pillar tax reform proposed by the OECD/G20 would have a significant impact on the tax havens within the European Union. The Netherlands, Ireland, and Luxembourg would see a reduction in the profits transferred to them, as the tax advantages offered by these jurisdictions would be diminished. The redistribution of taxing rights and the establishment of a global minimum tax would contribute to more equitable taxation and discourage aggressive tax avoidance strategies.

Also, considering these sums of money that arrive in countries with tax facilities, following the application of the tax reform based on the two pillars proposed by the OECD/G20, the implications seem to be different for the less developed countries compared to the developed ones in the European Union. The less developed countries would be at a disadvantage because they could lose opportunities to attract foreign direct investment by offering attractive fiscal incentives, thereby reducing their competitiveness relative to more advanced economies. In contrast, developed countries could benefit from the reform by increasing equity in the global tax system, which would lead to a fairer redistribution of multinational profits. Therefore, the developed countries of the European Union would gain additional tax revenues.

5. Conclusions and recommendations

The implementation of the OECD/G20 tax reform should reduce the overall percentage of profits lost in Europe by reallocating a portion of the profits to the jurisdictions where they were generated and instituting a minimum 15% tax. This reform would impact the economies of EU member states differently based on their levels of development and their roles as tax havens.

An analysis of the most attractive tax havens shows that the Netherlands, Ireland, and Luxembourg receive significant amounts of transferred profits. The reform would likely reduce these profits due to diminished tax advantages. For less developed EU countries, the reform may result in lost opportunities to attract foreign direct investment through fiscal incentives, reducing their competitiveness. In contrast, more developed EU countries could benefit from increased tax equity and additional tax revenues, leading to a fairer redistribution of multinational profits.

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