

## GUEST EDITORIAL

### Why Should EU Countries Support a UN Framework Convention on International Tax Cooperation

Countries across the world currently face multiple crises that are greater, deeper, and potentially more catastrophic than ever before. These crises include stagnation, inflation, external debt, and significant economic distress affecting a large portion of the population. We also confront global challenges such as climate change, which is no longer a distant future concern but a reality we are already experiencing, even as adaptation efforts remain significantly underfunded. Despite the enthusiasm surrounding the sustainable development goals<sup>1</sup> agreed upon in 2015, we are actually regressing and falling behind in achieving many of these goals, especially in the past three years.

Additionally, extreme inequality has created societies that are increasingly difficult to live in, as the rich shield themselves with barriers while the poor face various threats to their existence, including violence that has its roots in inequality and insecurity.

Our current taxation systems have contributed to inequality rather than alleviating it. Indirect taxes, for instance, are typically regressive, disproportionately affecting disadvantaged groups such as the poor and women, especially when they are implemented as flat rates. Direct taxes can also be regressive, as wealthy individuals can exploit various tax avoidance methods with the help of accountants and lawyers, allowing them to pay minimal taxes. These disparities have significant implications not only for the wealthy and the poor but also for workers, employers and gender dynamics.

The gendered impact of fiscal policies is not widely recognized. Tax systems in most countries result in women being disproportionately burdened by taxation. Furthermore, inefficient and unjust tax systems lead to the loss of potential revenue for governments, impacting the provision of essential social services and the realization of citizens' social and economic rights. This, in turn, affects women's roles as providers for their households, their health, education, security, and overall well-being. Similar disparities can also be observed when considering the impacts of fiscal policies on indigenous communities

and racial and ethnic backgrounds, indicating the regressive nature of our tax systems along various dimensions.

Similarly, some of the largest companies pay very little tax by shifting profits to low-tax jurisdictions or utilizing loopholes in accounting practices. These existing systems exacerbate income inequality and provide avenues for the affluent to evade their tax responsibilities. Moreover, corporate taxation is characterized by multinational corporations (MNCs) paying lower rates than domestic companies.

However, not all of this can be attributed solely to our domestic political economy. The international context exacerbates the situation.

The current global tax architecture, established by the League of Nations about a century ago when MNCs and tax havens were not prevalent, is inadequate for today's world. This outdated architecture did not anticipate companies manipulating their profits to be recorded in jurisdictions with lower tax rates or exploiting double taxation treaties to further reduce their tax liabilities. Consequently, effective tax rates often become laughably low or even non-existent.

In the past couple of years, we have witnessed a significant surge in profits, particularly in sectors such as pharmaceuticals due to the pandemic, oil companies benefiting from the Ukraine war, and financial institutions capitalizing on speculation driven by soaring food and fuel prices that have caused devastation in many countries. However, corporate profit taxation has not seen a corresponding increase.

This means we are essentially giving away money to large corporations due to an outdated tax architecture that fails to serve its intended purpose. The funds we are relinquishing rightfully belong to citizens and could be utilized for essential social services, public infrastructure investment, transitioning to greener practices, and addressing climate change adaptation. It is a result of our own political and economic choices that we find ourselves deprived of these crucial resources.

A similar problem exists with regard to the taxation of wealth and the incomes of the extremely wealthy.

#### Notes

<sup>1</sup> <https://sdgs.un.org/goals>.

Occasional revelations such as the Panama Papers shed light on how wealthy individuals and families can hide significant amounts of wealth through offshore tax avoidance and evasion structures. Unfortunately, we have allowed this to happen by creating loopholes and maintaining opaque legal systems that fail to disclose the beneficial owners of assets. By implementing measures such as requiring the naming and disclosure of beneficial owners of companies, funds, trust structures, financial wealth and other types of relevant assets, and establishing wealth registers accessible to tax authorities worldwide, we would have the means to effectively tax extreme wealth. Currently, our ability to do so is limited.

These measures are not impossible; they simply require political will. The key is to generate the necessary political determination to reshape the global structure. While we can make significant changes within our own countries, having a global architecture that supports these efforts would strengthen these moves and greatly amplify their impact.

Currently, MNCs have the ability to manipulate their profits by shifting them to different countries. For instance, they may generate significant revenues in one country but claim that they should be paid to their subsidiary in Ireland or some other low tax jurisdiction due to intellectual property rights. The global system allows such practices because it treats each segment and subsidiary of a corporation as an individual entity. As a result, MNCs typically pay only a fraction of what domestic companies pay, which restricts competition.

However, we have the power to prevent this. If MNCs are treated as a single entity and taxed accordingly based on their sales, employment, and assets in each country to determine their share of global profits, we can ensure fairness. This only requires a system that calculates taxes for MNCs based on their actual economic presence, eliminating the incentive to manipulate profits.

Additionally, implementing a minimum tax floor would fight tax competition and the race to the bottom in tax rates. With a good incentive system, if one country chooses not to enforce the minimum tax, other countries would take the difference.

It is crucial to establish a global system to enable these changes. The international community recognized this after the global financial crisis, and the G20 mandated the OECD to put an end to base erosion and profit shifting<sup>2</sup> of multinationals in 2013. A decade of

negotiations later, the 2021 global tax deal at the OECD/G20 under the BEPS Inclusive Framework, known as the ‘Two-Pillar Solution’<sup>3</sup> was delivered.

This is a step in the right direction, as it finally acknowledges that multinationals are unitary businesses and the need for a global minimum tax. But it is insufficient in the face of current challenges.

For example, under Pillar Two, the Global Anti-Base Erosion rules sets a very low minimum global tax rate (15%), which is further reduced by various carve-outs and loopholes. This is unlikely to reduce financial incentives for MNCs to shift profits to tax havens, as the carve-outs for real economic activity will give firms incentives to move production to countries which offer tax rates below 15%. This risks exacerbating the race-to-the-bottom in corporate income tax rates.

It is also a missed opportunity to raise more revenues. The current agreement will only bring an estimated USD 155–192<sup>4</sup> billion additional revenue globally, while a 25% minimum rate (as we propose at the Independent Commission for the Reform of International Corporate Taxation, or ICRIT<sup>5</sup>) could generate USD 500 billion a year.<sup>6</sup>

Pillar One is narrow in scope, including only around 100–200 MNEs, and it allocates just a small fraction of global profits for reallocation with no real justification. The result is that the revenue potential is very limited. But unlike the 15% minimum tax that is being implemented in many EU countries and considered in some others, Pillar One is unlikely to ever come to life. For Pillar One to work, it requires the US to ratify a treaty due to the number of US multinationals in scope. This requires the support of two-thirds of the Senate, which is politically difficult in any year, and near-on impossible in an election year. Recent estimates released by the staff of the US Joint Committee on Taxation<sup>7</sup> indicating that Pillar One, if implemented in 2021, would have resulted in a loss in US Federal receipts of USD 1.4 billion, further points to a political dead end.

Meanwhile, countries in desperate need of resources cannot wait forever. This is why they should consider implementing alternatives,<sup>8</sup> such as digital services taxes and withholding taxes.

Overall, the Two-Pillar Solution reflects current power relationships between north and south, benefiting principally developed countries, and does little to bring new additional resources to developing countries. Yet they are

## Notes

<sup>2</sup> <http://www.g20.utoronto.ca/2013/2013-0906-declaration.html#:~:text=We%20welcome%20the%20establishment%20of,and%20where%20value%20is%20created.>

<sup>3</sup> <https://www.oecd.org/tax/beps/statement-on-a-two-pillar-solution-to-address-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-october-2021.pdf>.

<sup>4</sup> <https://www.oecd.org/tax/beps/presentation-webinar-economic-impact-assessment-global-minimum-tax-january-2024.pdf>.

<sup>5</sup> [www.icrit.com](http://www.icrit.com).

<sup>6</sup> <https://www.taxobservatory.eu/www-site/uploads/2021/10/Note-2-Revenue-Effects-of-the-Global-Minimum-Tax-October-2021-1.pdf>.

<sup>7</sup> <https://www.jct.gov/publications/2024/jcx-7-24/>.

<sup>8</sup> <https://www.icrit.com/an-emergency-tax-plan-to-confront-the-inflation-crisis>.

the ones in desperate need of fiscal resources to finance poverty reduction, adaptation to climate change and meeting development targets.

No wonder countries in the Global South have successfully called for and are now advancing a new intergovernmental process at the United Nations. Negotiations towards a United Nations Framework Convention on International Tax Cooperation<sup>9</sup> (UN Convention) have now started, following a General Assembly vote in November 2023 of a resolution tabled by Nigeria on behalf of the African Group. The UN Convention provides a platform to rework the current defective international tax rules towards more comprehensive solutions and thereby generate a bigger tax pie to be shared among countries. The UN process can also broaden the scope of the Two-Pillar Solution focused on corporate taxation, to include protocols on wealth, capital taxation and environmental taxation.

The UN is a body with a rules-based decision-making process and universal membership, meaning that all countries can participate. This will lead to a negotiation agenda that is built collectively, giving more legitimacy to the outcomes of the process, more understanding by all parties involved, and so, more chances of ultimate implementation and compliance.

However, many OECD countries and in particular EU countries have shown frustration with this attempt led by the Global South to draft a new international tax architecture. They claim that they are concerned about the risk of duplication with the Two-Pillar Solution. However, nothing prevents countries from implementing these if they wish while also establishing a UN Convention, since the two address different issues. In fact, a fresh negotiation may allow countries to learn from the strengths and weaknesses of the Two-Pillar Solution to craft more effective solutions.

Some suggest that in this new inter-governmental process, the same unequal power dynamics that we have seen in the OECD/g20 Inclusive Framework<sup>10</sup> will persist. This may be true to an extent, but a more inclusive process, where all countries are represented, should enable a much more transparent and open discussion. In addition, the different voting rules, greater transparency and ability of countries to form groups can make a very big difference to the dynamics of engagement.

The UN may suffer some of the same power imbalances as the OECD, but the transparency and broad democratic principles ensure that, as with the shaming of the US for its lack of ambition at the United Nations Framework

Convention on Climate Change,<sup>11</sup> there is at least some scope to regulate bad actors and to collectively agree more ambitious outcomes.

The EU has long recognized the shortcomings of the international tax system and has been key to advance the global agenda around corporate taxation. Its support of the OECD Two-Pillar Solution deal has taken us some steps along the way, but it is clearly insufficient. Importantly, European countries will not lose the OECD if they participate in the negotiations for a UN Convention. They can fully implement the current Two-Pillar Solution, if they judge it worthwhile, long before any UN Convention and protocols are developed and ratified.

But the EU stands to gain a great deal if it can work with others at the UN to achieve a comprehensive UN convention. This is not just about taxation, but also about the future role of the EU in a changing world.

The geopolitical world is fragmented and suffering a crisis of legitimacy. It is very important for EU countries to be seen as thinking multilaterally. EU states have long committed to support lower-income countries – many of them former European colonies – to overcome the global inequalities in taxing rights that they face. In the context of current global conflicts, the geopolitical and strategic benefits from siding with the demand of Global Majority countries for an inclusive process at the UN – instead of insisting on the exclusionary dominance of the OECD – would be substantial.

So it is important for the EU to come to this negotiation in good faith and support a comprehensive UN Convention. This has the potential to deliver a more inclusive and effective international tax architecture. Simultaneously it would improve the bloc's political standing around the world and enable EU countries to show solidarity at a time where they are rebuilding their relationship with Africa and the Global South.

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<sup>9</sup> <https://financing.desa.un.org/un-tax-convention>.

<sup>10</sup> <https://www.oecd.org/tax/beps/about/>.

<sup>11</sup> <https://unfccc.int/>.