Tax incentives and inter-nation equity

CEP-GLOBTAXGOV Seminar

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WIRTSCHAFTS UNIVERSITÄT WIEN VIENNA UNIVERSITY OF ECONOMICS AND BUSINESS

Prof. Dr. Pasquale Pistone

Outline

1. The regulatory purposes of taxation seen from a legal perspective
2. Tax incentives in cross-border scenarios
3. Tax incentives vs unintended non-taxation
4. The GloBE proposal in a nutshell
5. GloBE, tax incentives and inter-nation equity
6. Conclusions and points for discussion

1. The Regulatory Purposes of Taxation

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- The levying of taxes secures revenue to fund public expenditure (revenue collection goals), but also allows the State to discourage undesirable behaviours or encourage the desirable ones (regulatory purposes)
- The regulatory purposes of taxation deviate from equality and thus must have a constitutional justification (e.g. promotion of economic growth, protection of the environment, etc.), as well as (in the EU) be compatible with the prohibition of State aids when affecting business
- The recovery from COVID19 is likely to justify a massive use of tax incentives, reflecting the respective national policies, but with possible major repercussions in cross-border situations
- Tax incentives pursue regulatory goals, which reduce the tax burden and thus make a certain behaviour economically more attractive
- Their repercussions in cross-border scenarios are more complex both from an economic and a legal perspective

2. Tax incentives in cross-border situations

- In a pre-BEPS legal environment economic literature concluded that tax incentives have a limited impact on FDI
- International tax coordination has meanwhile enhanced global tax transparency and strengthened the fight against base erosion and profit shifting (BEPS Project): closing the loopholes and setting numerous constraints to international tax planning
- However, MNEs still exploit cross-border tax disparities and pay little tax
- The BEPS 2.0 Project pursues further coordination to achieve fair taxation
- States may react to low or zero taxation by applying compensatory taxes
- Tax incentives are an intended lowering of taxes for genuine purposes
- In cross-border situations their effect is similar to the one that the BEPS Project counters, thus raising the issue as to whether low or zero taxation may be compensated

3. Tax incentives vs unintended non-taxation

- Tax incentives pursue genuine regulatory goals: non-taxation is an intended consequence of tax policy by the State that grants them
- The BEPS Project has reacted to harmful tax competition, applying anti-abuse measures to preserve taxing powers of the country of value creation
- The BEPS 2.0 Project pursues the prevention of the race to the bottom, envisaging the establishment of a global minimum corporate tax rate (GloBE)
- Thin dividing line between tax incentives (intended non-taxation) and abusive practices, including exploitation of cross-border tax disparities (unintended non-taxation): requires attention to avoid spillover effects of GloBE
- Compensation of genuine tax incentives in cross-border situations may vulnerate inter-country equity and the right of countries to remain the masters of their own tax policy

4. The GloBE Proposal in a Nutshell

- Endorsement of G7 on 5 June 2021: proposed 15% minimum rate
- GloBE Proposal for minimum level of tax: based on the idea "that global action is needed to stop a harmful race to the bottom on corporate taxes"
  - Comparison with VAT system after the Scrivener Plan
- Two GloBE rules may have a significant impact on tax sovereignty and nexus:
  - Income Inclusion Rule: "top-up tax" in the other country
  - Switch-over Rule: switch from exemption to credit method
- What is the real aim of the GloBE Proposal?
  - Does GloBE aim to counter only abusive/harmful practices? Or does it go beyond and intend to achieve international tax coordination?

5. GloBE and Inter-Nation Equity

- GloBE and Jurisdiction Not to Tax: A Sovereignty Issue
  - Jurisdiction not to tax *vs.* (expansion of) jurisdiction to tax
  - Critical issue with tax sparing: a form of bilaterally agreed intended tolerance of the jurisdiction not to tax
- Inter-nation equity
  - One country grants tax incentives for a genuine tax policy goal and attract investment
  - May the residence country of the investor compensate lower taxation by levying its own taxes on value created in the other State?
  - No such issue in purely domestic situations: hidden tax protectionism?
  - GloBE as a policy tool to promote some form of capital export neutrality?
- Additional critical issues: lack of coordination of income with turnover taxation; the risk of carve-outs

6. Conclusions and points for discussion

- International tax coordination is desirable to pursue global fair taxation
- But in practice, what does this concretely entail?
- Can it lead to the end of national tax sovereignty?
- Can it justify the end of tax incentives?
- Can the global desirability of countering the race to the bottom ignore the legitimate aspiration of developing countries to foster their economic development?
- And how about international agreements (e.g. Art. 66.2 TRIPS: tax incentives for promoting the transfer of technology)?
- POSSIBLE IDEAS: GloBE carve-out for the least developed countries; international standards for genuine tax incentives (including for economic development and environmental protection) with strict global enforcement,…

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Prof. Dr. Pasquale Pistone

IBFD Academic Chairman
WU Jean Monnet ad personam Professor
Associate Professor, Univ. of Salerno

E-Mail:
pasquale.pistone@wu.ac.at