Committee: ECOFIN

Topic: The question of taxation of Trans-national companies

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Summary

As the world has become more interconnected, interdependent and experienced economic globalisation, there has been a huge growth in the size, number and influence of trans-national companies. Yet, despite TNCs large profits, tax avoidance and evasion remain prevalent throughout the world and have recently received more media attention since it transpired that prominent TNCs such as Amazon, Starbucks, Facebook, Google and Apple pay little to no income tax on their massive international profits.

Transnational companies employ a number of techniques to benefit from the international nature of their transactions, the diversity of their assets (not just infrastructure but intellectual property) as well as from loopholes in the tax legislation of countries involved to evade and avoid taxes.

This is a serious problem as TNCs are depriving the governments of developing countries the income they need to investment in public services and infrastructure needed to sustain economic growth. Therefore, the resolution of this issue may be instrumental in removing a key obstacle to poverty reduction and the development of LEDCs.

As long as we have a globalised economy, the taxation of TNCs will remain on the agenda as the existence of at least some tax havens is certain and a global tax policy is unlikely. Yet, despite the difficulties at tackling tax evasion and avoidance, member nations must not give up efforts to resolve a problem that is set to continue. Particularly given the knock on effect on developed and developing economies alike and the current solutions only mitigating some of the problems with this issue.

Member nations need to rethink how Trans-national companies are taxed and this reports seeks to outline the context and problems of taxing trans-national companies.

As well as suggest possible solutions that delegates can build upon in committee.

Definition of Key Terms

Trans-national companies (TNCs)

These are large and powerful companies that sell products or services in more than one country

Tax Avoidance

A legal way of reducing the amount of tax a person or company would normally pay

Tax Evasion

Ways of illegally paying less tax than you should

Tax Haven

An offshore country that offers foreign visitors or companies little to no tax obligations. Usually these countries offer financial privacy and their economy benefits from the capital invested in banks and financial institutions.

Transfer- Pricing

Transfer pricing is a method of pricing goods and services transferred within trans-national company in order to reduce tax burdens and maximise profits by pushing profits to places where either the tax rates are more favourable, or where more loopholes exist to be exploited.

Arm's Length Principle

Comparing intra-firm trade with trade between different companies and requiring that both forms of trade follow the same rules.

Background Information

The following methods are used by TNCs to reduce their tax burden:

- **Transfer Pricing**

    Put simply, this is a common and effective method of tax avoidance, TNCs shift costs to companies based in high tax countries (the costs will be deducted from the profit, so little or no taxes will be paid anyway) and the profits shifted to companies in low tax countries. Historically, this was mainly with physical goods, but in more recent years intangible goods like intellectual property rights (e.g. patents and licenses). TNCs can set up companies in a tax havens, where it doesn't pay tax on licensing fees.

A company controls the rights to the brands of the TNC and its international affiliates pay that company the licensing fee. The affiliates in high tax companies bear the costs and moves its profits by paying the licensing fee to a company in a low tax country.

- **Tax Havens** – usually meet the following criteria:

  1) No to low taxes

  2) Low level of regulation

  3) Strong secrecy guaranteed (This can also be found in high tax countries e.g. USA and Germany)

The Impact of tax evasion and avoidance

Transfer pricing and other principles of tax avoidance, now enshrined in thousands of bilateral tax treaties have led to two main consequences:

1) **Encouraged governments to compete for investment and revenue by offering low taxes and preferential Tax Regimes**

   - In 1985 the global average statutory corporate tax-rate was 49%. In 2018 it was 24%. Ireland boasts a rate of 12.5% and Bermuda 0%

2) **Tax competition has encouraged TNCs to move their profits to low tax countries.**

   - In 2016 around $1trn of global profits were booked in investment hubs such as the Cayman Islands, Ireland and Singapore. They apply an average effective tax rate of 5% on the profits of non-resident companies

   - There is a large discrepancy between where the tax is paid and where real activity takes place. Analysis by the OECD (The Organisation for Economic Co-operation and Development) suggests that TNCs report 25% of their profits in investment hubs, but only 11% of tangible assets and less than 5% of their workforce.

   - This has increased as TNCs make more money from intellectual property. The share of American transnationals’ foreign profits placed in tax havens has increased from 30% 20 years ago to 60%.

- A study by Thomas Torslov of Kraka (Danish Think tank), Ludvig Wier and Gagriel Zucman of the University of California tried to quantify what would happen if there was a single common tax rate. They found that $670 bn would have moved in 2016- almost 40% of TNCs foreign earnings.
- Profits from France and the USA are reduced by 1/5
- Tax havens collect more revenue as a share of GDP– Hong Kong collects 1/3 of its corporate tax receipts by attracting profits from high tax countries and Ireland collects over half.

Major Countries and Organizations Involved

There are several non-UN organisations who have played an important role in recent years with regards to the taxation of TNCs.

OECD (The Organisation for Economic Co-operation and Development)

This is an intergovernmental organisation with 38 mostly rich countries. In 2015 the OECD estimated that tax avoidance robbed tax payers of $100bn-400bn (4-10% of global corporation tax revenues a year). Now following the fallout from Covid-19 and public spending under strain, many governments are looking to take back money lost to tax avoidance.

G7 – USA, Canada, France, Germany, Italy, UK and Japan

In June 2021 the G7 met in London and finance ministers agreed to two important ‘pillars’ of tax reform.

1) The largest and most profitable multinationals will be required to pay tax in the countries where they operate – and not just where they have their headquarters. The rules would apply to global firms with at least a 10% profit margin – and would see 20% of any profit above the 10% margin reallocated and then subjected to tax in the countries they operate.
2) The G7 agreed to a 15% global minimum corporation tax operated on a country by country basis, creating a more level playing field and reducing the ability for the G7 to undercut each other with more preferential tax rates.

USA - The Biden administration desires a minimum 21% corporate tax, applied to all profits within each jurisdiction separately

UN Tax Committee

The 25-member committee helps countries come up with forward thinking tax policies, avoid double taxation and curb tax avoidance and evasion in the context of a globalised world economy that is challenged by digitalisation and climate change. The current committee is made up of mostly of developing countries.

Timeline of Events

Date	Description
1968	The Committee of Experts on International Cooperation in Tax Matters was established.
1972	The Ad Hoc Group of Experts on Tax treaties between Developed and developing countries' report highlighted that "international tax evasion was viewed as a serious problem by developing countries substantially engaged in world commerce"
1988	The Convention on Mutual Administrative Assistance in Tax Matters is created.
1998	Harmful Tax Practices: An Emerging Global Issue is published
June 2021	G7 agree to a minimum 15% corporation tax and to tax TNCs where they operate.

Relevant UN Treaties and Events

Many of the earlier UN reports of the 1970s and 1980s have since been forgotten and there is a lack of substantial analysis of the ambitious ideas that many would consider ahead of their time. Especially given that many later reports failed to reference earlier work and that only in recent years have ideas first conceptualised decades ago been implemented to tackle this issue.

In 1972, ECOSOC decided to appoint the 20-member *Group of Eminent Persons (GEP)*, which was assigned to study the role of multinational corporations and their impact on development.

The 1974 GEP report explained that TNCs used increased communications technology and their global networks to advance the interests not of individual affiliates but the enterprise as a whole. It also remarked that a lack of continuity between international tax laws meant that TNCs could manipulate the system and avoid paying tax, rendering national tax policies ineffective. The report identified the problems of transfer pricing and tax havens and suggested “a policy framework which may be adequate for dealing with national corporations needs to be modified when dealing with multinational ones”. A report like this had not been seen before and paved the way for more research on what was originally an obscure issue.

Following the 1974 Report, a group of accounting experts known as GEISAR became the main forum for the UNCTC (**U**N Centre for Trans-national Corporations**)** to develop its international accounting and taxation policy.

In 1976 the OECD Guidelines for Multinational Enterprises and the 1977 GEISAR report outlined similar aims for what they wanted TNCs to do:

- publish annually the structure of the enterprise
- the geographical areas where the company operates
- sales by geographic area

The OECD’s guidelines remained voluntary but the GEP hoped that the authority of these IGOs and the pressure from the public would help encourage TNCs to follow them.

During the 1980s, GEISAR became more cautious and its remit narrowed as the IASC became a more important UN body in the discussions in international taxation and many felt that the original reports had been overly ambitious.

Eventually its aim was revised and achieving a standardised code of conduct on taxation became a long-term object despite the fact that it had been created to do just that. Unable to agree a code of conduct due to disagreements between Developed and developing nations led to the group's dissolution in 1994, after the UNCTC's abolition in 1992.

During the 1980s and after the crises of the 1970s the policies of developing nations towards TNCs began to change and the UN's influence in matters concerning the taxation of TNCs began to decline as other forums such as the IASC (Inter-Agency Standing Committee), OECD or EU were chosen to lead co-operation on tax policy between countries.

Whilst there was a resurgence in interest of the issue in the 1990s and early 2000s as the corporate social responsibility agenda of the time led to calls for greater transparency and regulation of TNCs, any UN involvement was mostly focussed on human rights, good governance and anti-corruption efforts. Hence the lack of recent UN led treaties, resolutions or conventions on the taxation of TNCs.

Previous Attempts to solve the Issue

- In the 1972 GEP report, multilateral exchange of information was highlighted as a possible solution to fraud and tax evasion. It would be years before multilateral exchange of information initiatives put forward by the OECD, G20 and EU.
- In 1988 (later amended in 2010) the OCED in conjunction with the Council of Europe developed the Convention on Mutual Administrative Assistance in Tax Matters which facilitates co-operation over national tax laws and the exchanging of information. Since 2009, the G20 had consistently encouraged countries to sign up and all have. It is hoped (as outlined by many of the aforementioned reports) that greater communication between member nations would make it easier to identify and address tax avoidance by TNCs.
- In 1996 the G7 was called upon to develop measures to counter harmful tax practices by TNCs. In response to this, in 1998, the OECD published Harmful Tax Practices: An Emerging Global Issue. This report identified the harmful practices and nature of tax havens and preferential tax systems. It recommended the adoption of the '3Rs':

1. **Refrain** from adopting new measures or strengthening existing measures.
2. **Review** existing measures that constitute harmful tax practices
3. **Remove** harmful features of preferential tax regimes within a five-year period

- The Report also established a new international body, the Forum on Harmful Tax Practices, to implement the measures outlined in the Report - for instance by drawing up a list of countries that engage in tax haven practices. The forum updates and re-releases the report regularly.

Possible Solutions

Any solution will undoubtedly require compromise, the system of taxing TNCs has been in place for almost a century. The current methods used by TNCs to avoid taxation and the inability to resolve the issue until now shows how difficult a resolution to this issue is. Compounded by the inevitable differences and arguments between high tax countries who want to ensure the burden of corporate tax falls where it is meant to and low tax countries who feel their tax sovereignty is being impeded and wishing to protect a tax system that has largely benefited them. Yet, a solution can be found if there is widespread agreement between member nations, as unilateral action will reduce TNCs' ability to move to another country and use the same methods to avoid taxation that would play an important role in funding public services and economic development. Particularly after the Covid-19 pandemic.

1) **A minimum corporate tax rate**

   - It is unlikely that all member nations would adopt this, but the adoption by a significant number of the largest and most influential economies would restrict the ability for TNCs to pass the tax burden on to workers by shifting production abroad or moving to countries with tax haven practices by reducing the differences between corporate tax rates of countries.

   - The USA currently prefers a minimum rate of 21% but a rate of 10%-15% is more realistic (the OECD estimating that a minimum rate of 12.5% would raise $23 bn - 42bn – and another $19bn – 28bn by reducing transfer pricing)

- The G7 has already agreed to a minimum rate of 15%
- Economists differ on whether the burden of an increased corporate tax rate would land on workers. In 2015 a paper published by Kevin Hassett (later chairman of Trump's Council of Economic Advisors) and Aparna Mathur of the American Enterprise Institute concluded that a 1% rise in corporate tax rate is associated with a 0.5% drop in wages – suggesting the burden lands on workers. But Kimberly Clausing, an economist and the current deputy assistant secretary at the America's Treasury Department found no clear relationship between corporate tax and wages. Meanwhile, an analysis of the German economy in 2017 found that more than half the burden is placed on workers.
- Though the impact on workers depends on how badly the workers' economic prospects are affected if capital moves out of the country and the greater level of capital per worker, the more each worker suffers if the capital leaves.

2) **Reallocate taxing rights so that the profits can be levied according to the location of the company's sales.**
    - This would stop TNCs paying no tax in countries where they operate
    - Yet, transfer pricing and other tax avoidance methods would continue.
3) **Considering Trans-national companies as one entity, rather than separated in affiliates.**
4) **Greater Regulation**
5) **Greater Communication and Exchange of Information on TNCs tax evasion and avoidance.**

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