AK EUROPA

Position Paper
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Economics

Directive to ensure a global minimum level of taxation for multinational groups of companies in the the Union

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Executive summary

In December 2021, the EU Commission put forward a proposal for a Directive to introduce a global minimum tax of 15 % in all Member States. The basis of the Directive is the OECD Inclusive Framework Agreement of 8 October 2021, where more than 130 countries agreed on common minimum tax rules (henceforth October agreement). Although AK is in favour of much stricter corporate tax rules in principle, it recognizes the October agreement as an important step towards more tax justice. However, this must be followed by further progress. The proposed Directive should therefore be judged not only on whether it consistently translates the October agreement into EU law, but also on whether it facilitates or at least does not hinder improvements in the future.

The key demands for effective minimum taxation in the EU are:

- More ambitious implementation of the minimum tax in the Union territory by (prospectively) increasing the minimum tax rate and deleting the substance carve-out
- For this purpose: Establish an option for Member States to adjust key parameters, such as the level of the minimum tax rate, after a transition period without amending the Directive (adjustment clause); the starting level may not be undercut in the process (non-regression clause
- Supplementary: Mandatory scientific evaluation of the minimum tax with regard to its economic effects such as revenue, evasion, etc. (evaluation clause)
- Deletion without replacement of the option to introduce a domestic top-up tax, as it thwarts the intended effects of the minimum tax and lacks an economic evaluation that would allow an informed political decision
- Explicit option to reduce the revenue threshold for the IIR top-up tax to below 750 million EUR, as provided for in the October agreement
- Removal of the exemption for groups "in the initial phase of their international activity"
- Ensure full compatibility between minimum tax and complementary national measures that combat profit shifting, e.g. alternative minimum taxes on book profits or controlled foreign company (CFC) taxation
- In the event that sufficient improvements to the Minimum Tax Directive cannot be achieved under unanimity: Consider alternative implementation possibilities through national implementation or enhanced cooperation
- Consistent pursuit of other tax dossiers such as unitary taxation for big multinationals within the EU (BEFIT) or the (further) strengthening of corporate tax transparency
- Harmonization of minimum tax and CFC rules and expansion of national leeway in the taxation of low-taxed controlled foreign companies (in the EU)
- Strengthening of state aid rules, especially in the area of R&D incentives, so that the containment of tax competition is not counteracted by new funding competition

The Minimum Tax Directive should come into effect as early as 1 January 2023. AK welcomes this ambitious timeframe. However, it is obvious that draggers like Hungary or Estonia try to use the tight timeframe to put the willing states under (time) pressure. This pressure must not be yielded to. An effective minimum tax with a minor lag is more important than a weak compromise for the sake of unanimity. Willing Member States have alternatives to unanimity (national implementation, enhanced cooperation). It must not be a justification for further concessions to tax havens. On the contrary, the draft must improve significantly towards the October agreement, and beyond, if it is to be a political success.

AK's position

The proposed **Directive** obliges all EU states to introduce a global minimum tax of 15 % for large corporations based on the October agreement of the Inclusive Framework. The rules are based on the OECD Model Rules published in December 2021 and are intended to ensure a coherent and uniform implementation of the minimum tax in the internal market. The legal basis is Article 115 TFEU, which requires the consent of all Member States (unanimity).

The main difference between the proposed Directive and the OECD Model Rules is that the EU minimum tax not only refers to multinational groups and their low-taxed foreign companies, but also covers domestic business units and large-scale domestic groups.

An **impact assessment** on the proposed directive was not provided. The Commission justifies this by saying that the OECD had already submitted one at the end of 2020 and that the EU had "no policy options to choose from" anyway because of the October agreement. The OECD estimates the global additional tax revenue from the minimum tax at 150 billion USD. However, the results at the country level are classified.

The Commission is pursuing an ambitious **timeframe**. The resolution of the Directive and the implementation in the Member States should take place in 2022, and the minimum tax should become effective as of 1 January 2023. The vast majority of Member States have taken a constructive stance, but some are blocking the process – in addition to notorious draggers like Estonia and Hungary, Malta and Poland are also trying to drag out the process. To make matters worse, the U.S. has so far not delivered on its promised reform of GILTI.

Income Inclusion Rule (IIR):
Under the Income Inclusion Rule, the parent entity must pay a top-up tax for the low-taxed profits of its constituent entities worldwide. This means that if a group pays less than 15 % tax on its profits in one country, the parent entity, will have to top-up the difference in its country of residence.

Domestic top-up tax:
The IIR top-up tax can be extended to local entities of foreign groups optionally, thus eliminating the top-up tax at the level of the parent entity (domestic top-up tax). This means that the top-up taxation no longer takes place in the residence country of the parent entity, but in the residence country of the low-taxed entity. The option is of interest to EU tax havens such as Ireland that can raise additional revenues and receive a better position in the (remaining) tax competition (details on page five).

Undertaxed Payments Rule (UTPR):
Groups where no IIR top-up tax applies are subject to the UTPR top-up tax at the level of their constituent entities in the EU. For this purpose, the top-up tax is calculated for the entire group and allocated to the respective entities on a formula basis. The decisive factor is the branch's share of real capital depreciation and labour costs of the entire group. This backstop mechanism ensures that the minimum tax cannot be circumvented by relocating corporate headquarters to tax havens.

When calculating the supplementary tax, deductions for economic substance are also provided for (substance carve-out), which pushes the effective profit tax below 15 % despite the minimum tax.

How does the minimum tax work?

The operation of the minimum tax follows the well-known **GloBE rules** ("Global anti-Base Erosion"), which consist of the Income Inclusion Rule and the Under-taxed Payments Rule. In addition, there is the option to introduce a so-called domestic top-up tax. Within the scope of the Directive are corporate groups with revenues of more than 750 million EUR.

Position of AK

The minimum tax is a necessary but not sufficient step for fair corporate tax rules. At least agreed form of October 2021, it significantly **curbs incentives for profit shifting and tax competition**. The higher taxes for large corporation resulting from the minimum tax also contribute to more tax fairness for employees and SMEs as well as to additional tax revenues, which are

urgently needed in the wake of the ongoing political and economic crisis. In this context, the extension to domestic entities of multinational groups and large-scale domestic groups (necessary under EU law), should be emphasized positively, because it has the potential to increase the scope and effectiveness of the minimum tax.

However, the present draft is clearly **not ambitious** enough. The low ambition is regrettable because the EU would have the possibility to go beyond the international agreement and, for example, decide on a higher minimum tax rate or a lower substance carve-out within the single market. An ambitious minimum tax in the world's largest economic market would not only serve as an important role model internationally, but would also bring a substantial increase in potential tax revenues. For example, the EU's tax observatory estimates that Member States could more than double additional tax revenue by raising the minimum tax to 21 % from 83 billion EUR to 169 billion EUR.

The draft's **core problem**, however, is the **domestic top-up tax in connection with the substance carve-out**. It essentially benefits tax havens, which can leverage additional revenues at the expense of normal tax countries and thus "cushion" a deterioration in their tax competitiveness at significantly lower costs (details on page five). As a result, the minimum tax' dampening effect on tax competition can be expected to be considerably weakened. No economic impact assessment is available for the domestic top-up tax – either from the OECD, or from the EU. It is problematic in terms of democratic policy to adopt measures whose effects cannot be assessed. AK demands the national supplementary tax to be cancelled without replacement.

From AK's point of view, it is crucial that the Directive creates a basis for further (coordinated) **improvements of corporate tax rules** and does not lock the EU into on an insufficient compromise. Since tax scandals, budget crises and a corresponding pressure towards tax fairness are expected to continue in the future. Therefore, it would make sense to grant the Member States a kind of "adjustment clause", for certain parameters, which allows them – after a certain transitional period – to make adjustments to the minimum tax rate or the substance carve-out (in the Union territory) without the need for an amendment of the Directive. A non-regression clause is designed to ensure that these adjustments do not fall short of the baseline. In order to improve the basis for policy decisions, a mandatory, scientific evaluation should be envisaged, e.g. by the EU Tax Observatory.

If this flexibility for improvements is not feasible, **alternatives to unanimity** would have to be considered, e.g. via national implementation or increased cooperation amongst willing Member States. Looking ahead, ambitious implementation in the majority of Member States is preferable to a weak compromise in all Member States. Clearly communicating this approach in the negotiations could also increase the willingness to negotiate on the part of the "draggers".

The Minimum Tax Directive provides a good basis **for progress in other tax dossiers**, e.g. for the introduction of unitary taxation of large multinationals within the EU (BEFIT) or for strengthening the tax transparency rules under the Accounting Directive. These initiatives must be granted high priority. In addition, it must be ensured that complementary national measures to combat profit shifting, such as alternative minimum taxes on book profits or CFC rules are not restricted by the Minimum Tax Directive, but are considered compatible or recognized as "adjusted covered taxes". In this context, strengthening the national leeway in CFC rules in accordance with Article 7 of the Anti Tax Avoiding Directive (EU) 2016/1164 should also be considered. The EU should seize the momentum of the October agreement and use an ambitious implementation of the minimum tax as the basis for further improvements in the area of corporate tax rules and tax fairness.

Position on individual provisions of the directive

Article 2: Scope (revenue threshold)

In scope of the Directive are all subsidiaries and permanent establishments (referred to as constituent entities) belonging to a group with more than 750 million EUR in consolidated revenues. State-owned enterprises, international organizations, NGOs, and transparent pension, investment, and real estate funds are excluded.

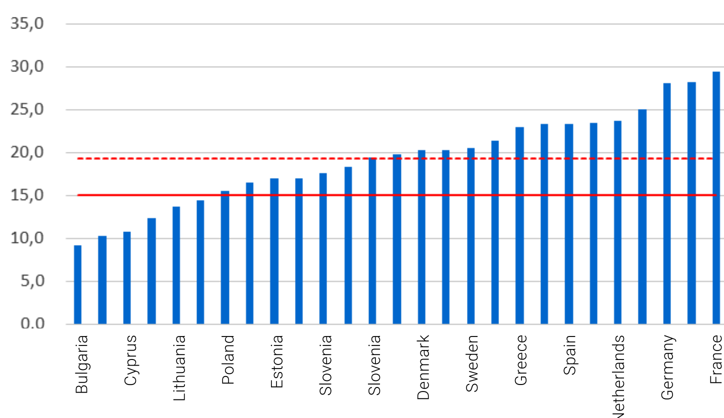
On the revenue threshold, the Directive falls behind the October agreement. The Agreement states: "Countries are free to apply the IIR to MNEs headquartered in their country even if they do not meet the threshold." The Directive does not entail a comparable explicit option to reduce the revenue threshold. If a country wants to impose a minimum tax on corporations below the threshold, this would have to be done outside the Directive. This should be possible because the Directive does not contain any requirements for "smaller groups" or other restrictions (e.g. analogous

to Section 401 of the VAT Directive) that would prohibit Member States from extending the IIR top-up tax to groups with less than 750 million EUR of revenue. However, as Member States would no longer be bound by the requirements of the Directive, the implicit option could result in different national applications. In the interests of coordinated implementation, an explicit option to lower the turnover threshold should be added to Article 2 of the Directive.

Article 3: Definitions (minimum tax rate)

In the definitions in Article 3, the "minimum tax rate" is defined as "15 %". This figure is well below the average effective corporate tax rate of EU Member States and is therefore an important, but not sufficient, step towards curbing profit shifting and tax competition (see figure one). Due to the relatively low minimum tax rate, the additional tax revenue for Member States is also considerably below the potential from higher minimum tax rates. AK demands a higher minimum tax rate or sufficient flexibility of the Directive, so that willing Member States can increase the minimum tax rate in the Union territory, at least in the medium term.

Figure 1: Effective Corporate Tax Rates in EU Member States 2020



Source: OECD.

Article 10: Option to introduce a domestic top-up tax

The optional domestic top-up tax is regulated in Article 10. It allows Member States to extend the IIR top-up tax to low-taxed constituent entities of foreign groups resident in their territory, regardless of whether the controlling parent entities are subject to the IIR top-up tax or not. Since the domestic top-up tax comes before the IIR top-up tax in rule order, it reduces the IIR top-up tax at the level of the parent entity. This means that the taxing right on low-taxed profits of multinationals is transferred from the parent entity's residence country to that of the low-taxed entity.

The domestic top-up tax has enormous implications for the operation of the minimum tax. It not only affects the allocation of tax revenues, it also weakens the dampening effects on tax competition. A key objective of the GloBE rules is to give tax havens an incentive to increase their national corporate income tax rates. The reasoning is simple: By ensuring that corporations pay at least 15 % minimum tax, tax havens have the opportunity to raise higher tax revenues by increasing the national corporate income tax without suffering an (additional) decline in their tax competitiveness. This incentive is now removed because the additional revenue is obviously easier to achieve through the domestic top-up tax than by raising the national corporate income tax. The need tax havens to adjust is reduced to a minimum.

In addition, the domestic top-up tax exacerbates the problematic incentive effects of the substance carve-out. The carve-out allows corporations to deduct a certain percentage for real capital depreciation and labour costs when calculating the top-up tax, thus "pushing" the effective profit tax below 15 % (details on page eight). This allows tax havens to "cushion" the effect of the minimum tax significantly by lowering the national corporate income tax. In Figure 2, the problem is illustrated using a low-taxed business unit of a multinational corporation. In the classical GloBE system, according to the October agreement, the parent entity has to pay an IIR top-up tax in the residence country. Although the tax haven can counteract the increase in the effective tax rate by reducing the national corporate income tax, it must accept budgetary losses. The effect of the domestic top-up tax is to reduce or even eliminate these budgetary losses, which considerably increases the incentive for further tax dumping. Of course, the numerical example neglects many relevant aspects, but the tendency is clear: For tax havens such as Ireland, there is a strong incentive to invest the additional revenue generated by the domestic top-up tax in a revenue-neutral reduction of the national corporate income tax. In extreme cases, tax havens can maintain the current effective taxation levels for inward FDI without fearing major budgetary shortfalls. The problem is well known; see e.g. the highly regarded paper of the Oxford University Centre for Business Taxation.

Figure 2: Effects of the national supplementary tax - numerical example

	Status quo	October agreement		Directive with national supplementary tax	
		Static	Dynamic	Static	Dynamic
	Tax haven, country of domicile of business unit				
Profit	100	100	100	100	100
National corporate income tax	12.5 %	12.5 %	9 %	12.5 %	9 %
Substance carve-out	-	40	40	40	40
Domestic top-up tax (percentage)	-	-	-	2.5%	6%
Tax revenues	12.5	12.5	9	14	12.6
	Normal tax country, country of domicile of parent company				
IIR top-up tax percentage	-	2.5 %	6 %	0 %	0 %
IIR top-up tax	-	1.5	3.6	0	0
	Group level				
Total taxes paid	12.5	14	12.6	14	12.6
Effective tax rate	12.5 %	14 %	12.6 %	14 %	12.6 %

Source: Own calculations. (National) supplementary tax = Supplementary tax percentage * (profit - substance allowance).

An assessment of the economic impact of the domestic top-up tax is complicated by the fact that neither the OECD nor the EU Commission have presented a quantitative evaluation. The genesis of the rule is also questionable in terms of democratic policy, because it was effectively imposed on the GloBE rules as a (seemingly) "technical detail" via the OECD Model Rules. It is not mentioned in the October agreement. AK demands the complete deletion of the domestic top-up tax from the Directive, as it is not backed by the October agreement, neither in wording nor in spirit. Negative allocation effects vis-à-vis third countries are possible, but do not justify incentives for further tax dumping.

The argument that the domestic top-up tax is not to be questioned, because Member States could introduce it anyway, is misleading:

- It is possible that the discrimination of otherwise comparable entities simply because of group affiliation could be ruled unconstitutional in some Member States. With the precedence of EU law over national law, the domestic top-up tax could reduce these barriers
- The domestic top-up tax also makes an economic difference, because it eliminates the IIR top-up tax at the level of the parent entity. If the domestic top-up tax would solely be a national matter, the 14 % and the 12.6 % effective tax rate in figure two would result in an IIR top-up tax at parent level of 0.6 % and 1.44 % respectively, that is effectively prevented by the domestic top-up tax.

The fact that the domestic top-up tax is necessary under EU law in order to "preserve the tax policy sovereignty of the Member States" (as the proposed directive argues) is not convincing, because the free structuring of the national corporate income tax already ensures this sovereignty.

Articles 14-15: Calculation of the qualifying income or loss

The basis for the qualifying income (or loss) of a constituent entity is the balance sheet after-tax income (or loss) based on the accounting standard of its parent entity, adjusted by a small number of additions and deductions. Additions include adjusted covered taxes in accordance with Chapter 4;

deductions include qualified dividends and increases in the value of investments.

In principle, the approach chosen is to be welcomed because the recourse to the existing financial statements reduces the administrative burden. Whilst it is true that the international accounting standards are not fully consistent or are not applied in a fully consistent manner, which also gives rise to tax planning opportunities, it should be borne in mind that the consolidated financial statements are ultimately prepared for capital markets. This means, there is an incentive to report high earnings, which runs counter to any structuring incentives to reduce the minimum tax. What is clear is that the tax authorities must examine and possibly estimate the minimum tax, if the returns are not comprehensible – as with other taxes.

One disadvantage of the chosen approach is that accounting standards such as IFRS, US GAAP, etc. are set by private associations and escape democratic control. Therefore, the Directive should provide that a competent steering group, e.g. the Code of Conduct Group, continuously monitor the development of the standards and their application for minimum tax purposes. If necessary, it shall make proposals to adjust the profit determination rules in Chapter 3.

AK makes the case for reducing structuring opportunities in the determination of profits to a necessary minimum. In this sense, a prohibition of deductions for (lump-sum) provisions should also be considered. These invite tax planning and are excluded from deduction in the majority of tax systems for good reasons.

Article 16: Exemption of profits from shipping

The exemption of income from international maritime transport (Article 16) is rejected. There are few sectors of the economy where the harmfulness of location competition and the associated dumping of fiscal, labour, and environmental standards is as evident as in international maritime transport. The global minimum tax could have counteracted this. However, AK is aware that the political scope of the EU is very limited on this issue due to the October agreement.

Articles 19-22: Computation of adjusted covered taxes

The adjusted covered taxes for the respective business unit are taxes actually paid on (distributed) income, to which (essentially) the deferred tax expense (reduced to the minimum tax) is added. Deferred tax liabilities that are not paid or reversed within five years must be taxed subsequently (with certain exceptions).

In accordance with Article 22, a separate deferred tax asset may be recognised for losses up to the minimum tax rate and added to the adjusted covered taxes in profit years ("qualifying loss election"). Unused portions of the claim may be carried forward.

AK takes a critical view of the use of deferred taxes to adjust for timing differences in tax performance. The October 2020 Pillar Two Blueprint rightly rejected this approach as complicated and susceptible to tax planning (paras. 292 to 294). The BEPS Monitoring Group argues similarly. AK recommends returning to the approach in the Blueprint: actual tax expense supplemented by a loss carry-forward as defined in Chapter 4.2 of the Blueprint.

Article 23: Allocation of adjusted covered taxes

Profit taxes levied at the level of the ultimate parent company for controlled foreign entities are allocated to the respective constituent entity. This is appropriate.

There is, however, a need to adjust the list of passive earnings under Article 23 (6). This should be harmonised with the CFC rules pursuant to Article 7 (2) of the Anti Tax Avoiding Directive (EU) 2016/1164 and extended to include

- the income from finance leases,
- the income from the activity of banks and insurance companies and other financial activities
- and from billing companies.

For harmonising minimum tax and the CFC rules, the low tax criterion pursuant to Article 7 (1b) of the Anti Tax Avoiding Directive (EU) 2016/1164 should allow a minimum level of 15 % irrespective of the level of the national corporate income tax rate. In order to ensure effective applicability of CFC taxation within the Union beyond "wholly artificial arrangements ", an extension to domestic situations should be considered – as in the case of the IIR top-up tax.

Importantly, the Minimum Tax Directive must not preclude national measures to combat profit shifting and has to be sufficiently flexible to allow such measures to be recognised as compatible with the minimum tax and to be classified as "adjusted covered taxes" when calculating the effective tax rate.

Article 27: Substance Carve-Out

The substance carve-out allows a deduction of 5 % of the book values of the "eligible tangible assets" as well as "eligible wage costs" of "eligible employees" of the group in the respective territory (Article 27). In a transitional period of 10 years, the values are 8 % and 10 % respectively (Article 46).

AK is critical of the substance carve-out for two reasons: It reduces the potential additional tax revenues of the minimum tax and sets incentives (especially in combination with the domestic top-up tax) for tax dumping. AK demands the substance carve-out within Union territory to be cancelled.

If this is not possible, AK recommends at least to restrict the "eligible employees" according to Article 27 (1a) to dependent employees with a regular employment contract. As it stands, the article includes "independent contractors under the direction and control of the Group" in addition to salaried employees. This is logically inconsistent because an independent contractor is legally a separate entity and, as such, cannot be considered part of the economic substance of in-scope entities. In addition, the formulation involves considerable discretion, including legal grey areas that regularly have to be clarified in court proceedings, which makes the delimitation complex and susceptible to structuring. Corporations often use contracts with legally independent but de facto economically dependent contractors to circumvent ordinary employment contracts and the associated labour protection rights. Excluding such legal constructions from the substance carve-out would therefore also have a positive steering effect under labour law.

Article 31: Revenue threshold for mergers and demergers

Article 31 provides for special rules on the revenue threshold for mergers and demergers. In order to make the demerger of parts of the group to avoid the revenue threshold less attractive, Article 31 should be amended as to retain all corporate parts resulting from a demerger in the scope of the minimum tax for a period of several years, even if the conditions of Article 31 (4) are not met.

Articles 45-46: Simplifications for groups "in the initial phase of their international activity"

Article 45 provides for certain simplifications in the determination of the top-up tax in the first year of application of the rules. That is legitimate.
However, Article 46, which provides a top-up tax exemption for corporations "in the early stages of their international activity", is problematic.
Corporations that

- are active in a maximum of six states
- and which tangible assets have a net book value of less than 50 million EUR,

shall be exempt from the top-up tax for five years, even though they exceed the revenue threshold of 750 million EUR. This is most likely to benefit groups with digital business models, as they are less reliant on tangible assets and physical branches.

Moreover, the provision is not covered by the October agreement. The OECD Model Rules "only" provide for an exemption from the UTPR top-up tax, but not from the IIR top-up tax. AK demands the abolition of the temporary exemption, or at least the restriction to the OECD Model Rules.

Other: R&D incentives

The minimum tax also covers tax expenditure and direct government funding for R&D, a particularly active area of competition amongst states. In the last 10 years, virtually all Member States have set up input- or output-based subsidies, with tax subsidies such as patent boxes or depreciation allowances becoming increasingly important compared to traditional direct subsidies. Effective containment of these programmes is important to avoid unnecessary tax losses and distortions in the internal market.

Figure 3: R&D incentives and minimum tax - numerical example

	Direct funding	Patent Box
Pre-tax profit	200	200
Tax rate	10 %	5 %
Tax	20	10
Promotion	10	0
After-tax profit	190	190
Effective tax rate	9.5 %	5.0 %

Source: Own calculations

R&D incentives are included in the minimum tax according to the following system: Direct subsidies are part of the "qualifying income", and tax subsidies are reflected in "adjusted covered taxes". For the calculation of the effective tax rate and thus for the top-up tax, this system makes a significant difference. It can easily be shown that tax subsidies have a much stronger impact on the effective tax rate than direct subsidies for the same subsidy amount (see figure three). In order to ensure that Member States do not (over)compensate for the reduced scope for tax incentives by expanding direct subsidies, it is important to establish accompanying regulations in state aid law.

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About us

The Austrian Federal Chamber of Labour (AK) represents by law the interests of about 3.8 million employees and consumers in Austria. It acts on behalf of its members in fields of social-, educational-, economical-, and consumer issues both on the national and on the EU-level in Brussels. Furthermore, the Austrian Federal Chamber of Labour is a part of the Austrian social partnership. The Austrian Federal Chamber of Labour is registered at the EU Transparency Register under the number 23869471911-54.

The main objectives of the AK EUROPA Office established in 1991 in Brussels are the representation of AK towards the European Institutions and interest groups. Other objectives are the monitoring of EU policies and transfering relevant iInformation from Brussels to Austria, as well as to lobbying the expertise developed in Austria and positions of the Austrian Federal Chamber of Labour in Brussels.