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G7 fighting inequality – Oxfam policy note
Support a comprehensive tax reform committing to put a stop to corporate tax dodging and harmful tax competition

The international tax landscape has seen a multitude of reforms over the past five years. But despite a proliferation of initiatives, the reforms have been unable to fundamentally transform an almost century-old international tax system based on outdated rules such as the arm's length principle or the separate entity approach to tax multinationals. As a result, **multinational corporations are still paying less taxes than before the 2008 financial crisis**[1] **and as much as 40% of multinational corporations' foreign profits are shifted to tax havens.**[2]

On 9 June 2019, G20 countries officially gave the greenlight to an OECD-led work programme to develop a set of proposition to develop a consensus-based solution to reform our international corporate tax system and address the challenges of taxing multinational corporations in the digital era. Options on the table go beyond how to tax digital giants, and rather considers the broader challenges of a growing digitalized economy. It provides unique chance to reform the system, put a stop to corporate tax dodging and end the race to the bottom in corporate income tax rates. Revenues lost to tax dodging and the race to the bottom in tax limit funding available for essential services which primarily harms women and girls.

The G7 should support the establishment of a new set of global rules to fundamentally redesign the tax system to make it fair and ensure developing countries have an equal voice in the process by:

1. **Supporting an overhaul and transformative international reform of corporate income tax** leading to an equitable rebalancing of taxing rights between developed and developing countries for all economic sectors. Redistribution of taxing rights should allocate profits based on corporations' global activity and a combination of criteria such as consumption, employment and production factors.

2. **Support the setting of a minimum effective tax rate at a fair level**. The minimum effective tax rate should be set globally, applied on a country-by-country basis without carve-outs, and set at a high enough rate to effectively curb profit shifting and generate additional revenues where economic activity takes place.

Both pillars are essential and complementary to fundamentally reform our corporate income tax system and put an end to the race to the bottom in corporate income tax rates.

Reforming our tax system can help tackle inequality

A transformative reform of the international corporate tax system would be in line with the broad objectives set by the presidency of the G7 to tackle inequalities and to reshape a broken economic system. Addressing inequalities means reforming a corporate tax system designed 90 years ago by and for a small number of developed economies at the expense of developing countries.

[1] FT (2018) Multinationals pay lower taxes than a decade ago, https://www.ft.com/content/2b356956-17fc-11e8-9376-4a6390addb44
[2] Zucman & al (2018) The Missing Profit of Nations, Working Paper 24701 https://gabriel-zucman.eu/files/TWZ2018.pdf

Such additional revenues yielded by a more equitable reform of the international tax system are critical to increase funding for essential services that primarily benefit women and girls, reduce inequality and achieve SDGs.

Three critical elements need to be recalled when building the consensus based approach:

- **Fairness:** It is time to make the international tax system fit for the reality of a much more globalized and digitalized business environment and it is time to recover fairness to deliver on SDGs and contribute to reducing inequalities especially in developing countries.
- **Sufficiency:** it remains critical that this program of work and set of reforms leads to a significant increase in revenues collected from large corporations.
- **Inclusiveness:** all countries must have an equal voice in the decision-making.

The G7 should therefore recall the urgency of putting the interests of developing countries at the very forefront.

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ANALYSIS OF THE OECD PROGRAMME OF WORK

TOWARD A FAIR REDISTRIBUTION OF TAXING RIGHTS?

Where should corporate profits be taxed? The current system is limited by the inefficiency of two very strong principles that are outdated and have proved to be failing: the arm's length principle to control transfer pricing and the need to have a physical presence in the territory for taxing purposes. Such principles have created multiple loopholes in the international tax system and allow for artificial profit shifting to tax aggressive jurisdictions. The loopholes deriving from these principles explain how profits generated from sales and other digital activities in one territory can remain largely untaxed. Current rules also don't take into account the value directly generated by customers and digital users. The current international tax system requires a total overhaul.

New rules discussed under the so-called "pillar one" could be a historic opportunity for many countries – including many developing countries - to be able to tax multinational corporations including the tech giants based on the profits they generate in every/their country.

All options on the table suggest to allocate a share of a multinational's profits according to a distribution key. Suggested distribution keys are based on a formulaic approach using criteria reflecting the role of consumption markets in generating profits. Impact assessments of the different options will be carried out in the coming months. The main areas of negotiations will focus on the share of profits distributed with a formulaic approach and the criteria used in the formula.

Oxfam supports the principle of a formulaic approach on all revenues (routine and non-routine), using a set of criteria recognizing different factors generating profits such as consumption, employment and production factors.

Oxfam supports a complete revision of the permanent establishment definition to ensure a level-playing field between source, residence and market countries.

SETTING UP A MINIMUM EFFECTIVE TAX RATE

A minimum corporate effective tax rate, set at an ambitious and sufficient level, and applied to profits in every country would remove the incentive for companies to move their profits to low or zero corporate tax countries – effectively making tax havens out of business – and put an end to the damaging tax competition between countries that has seen the global average rate of corporate income tax fall from just over 29.42 percent in 2000 to 23.79 percent in 2018.

But the broader concept of a global minimum tax must address three critical issues: the implementation method, exemptions and of course, the rate.

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- **Implementation methods**

Two implementing principles are currently discussed

• The **income inclusion rule** would allow countries where multinational corporations are headquartered to tax profits whenever they are subject to low or very low taxation in the subsidiaries of the corporations. Should some countries refuse to set their tax rate in line with the global standards, additional revenues would be yielded by countries with the largest number of companies headquartered (ie. developed countries).

• **The Tax on Base Eroding Payment (TBEP)** would allow each country to deny a deduction to profits shifted to a country applying an effective tax rate below the global standard. Should some countries refuse to set their tax rate in line with the global standards, source countries, in particular, would benefit from the rule.

In Oxfam's view, both are necessary and complementary, with the TBEP being prioritized in case of conflict.

- **Exemptions and rate**

Both low rate and exemptions put the viability of the rule at risk. Exemptions could render the minimum effective tax rate largely ineffective. A minimum effective rate below the global average corporate income tax rate will not stop profit shifting to low tax jurisdictions

Oxfam supports the set-up of a fair and reasonable minimum effective tax rate without any carve-outs and applied to all profits (both active and passive income streams).

THE NEED FOR AN INCLUSIVE DECISION-MAKING PROCESS

Negotiations are taking place under the OECD Inclusive Framework and will involve all 129 member states and jurisdictions (as per June 2019). Such level of implication is already an improvement compared to the first round of negotiations, which were limited to developed economies and a handful of big developing countries.

However some developing countries will not be able to participate because they have not yet signed-up to the four BEPS minimum tax standards – a prerequisite for membership of the OECD Inclusive Framework. An inclusive decision-making process is even more necessary at this stage as the new set of rules that are being discussed may impact all countries' tax base, regardless of their participation in the Inclusive Framework. As such, **Oxfam proposes to temporarily lift the requirement for developing countries to commit to implement existing BEPS minimum standards prior to joining the separate work on BEPS 2.0**.

But being around the table does not mean having an equal voice in the process. There are concerns that poor countries are not adequately represented on the Inclusive Framework steering group that leads the negotiations while developed countries are over-represented: **only 5 out 24 members of the OECD Steering Group are not G20 countries. Oxfam supports a redistribution of seats in order to reflect all views – especially developing countries – within the OECD Steering Group.**

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G7 countries can signal their support for a transformative reform of the international corporate tax rules aiming at fairly redistributing taxing rights among countries and setting up a fair minimum effective tax rate.