GLOBAL MINIMUM CORPORATE TAX: THE TWILIGHT OF TAX AVOIDANCE FOR 'BIG TECH'?*

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The exponential growth in the importance of the digital economy and the dilemmas surrounding it fill a large part of today's legal discourse. Demonstrating the unheard-of advance of this new economic segment, a 2018 Commission report found that the largest digital companies had an average annual growth rate of around 14% in the seven years preceding the report, compared to 0.2% for 'traditional' transnational companies (European Commission 2018), and five of the six largest companies in the world were digital companies (Ross 2021).

Introduction

The legal discourse around the digital economy is, in my view, mainly concentrated around three areas of law: tax law, competition law and data protection law. The aim of this article is to review the path towards a global minimum corporate tax under the auspices of the OECD and the potential impact of the proposed legislation.

1. The need for regulation corporate tax at the global level

Before turning to the issues surrounding the specific draft, I think it is useful to briefly review the digital characteristics that have created the need for regulation at the global level.

First and foremost, it is worth noting that the current rules that underpin tax liability are clearly based on the physical aspects of the company. In essence, the imposition of tax is based on the physical presence of a company in the State concerned, with its establishment, means of production and employees. This is what we call the territoriality principle, which until recently was able to play its role as the basis of the tax law of the States. But with the rise of the digital economy, a very different approach is needed to lay the foundations for a modern tax system (Csabai & Czoboly 2016). The digital company, however, does not rely on tangible factors of production but primarily on the sale of intangible goods. A physical presence is not necessary for the provision of digital services, the place of provision (and hence of value creation) and the physical presence of the company are separated, and this simple fact undermines the system of the determination of tax liability based on the territorial principle (Varga 2020).

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2. Challenges raised by the existence of digital companies

Since the digital company provides online services that cross national borders, i.e., it is not geographically delimited, it is free to 'move' its place of establishment for tax purposes. Therefore Ireland, with its very low corporate tax rate (its strikingly friendly attitude towards monopolistic giants through various selective tax breaks (European Commission 2016), has become the European bastion of Big Tech (IFSC 2021).

It is worth saying a few words about Ireland's aggressive tax planning tools, which have contributed greatly to the demand for a global corporate minimum tax. The conceptualised 'double Irish' is a profit shifting scheme that allowed a US company to account for its European sales in the form of royalties through its Irish subsidiary, which, although Irish incorporated, is tax resident in Bermuda or other offshore havens. By using this method, the company avoids both domestic and Irish tax liability. This is because under Irish tax law, tax residence is determined by the place of management (specifically management). Thus, the Irish subsidiary of a US transnational company, managed from Bermuda, is 'taxed' under Bermudian rules. The 'double Irish-Dutch sandwich' is very similar, except that by including a Dutch company, an additional tax base erosion is created by the deduction of royalties. Two Irish subsidiaries and a Dutch subsidiary are required, the US company transfers intellectual property rights to Irish company A, Irish company A then sublicenses the intellectual property rights for a royalty to the Dutch company, which sublicenses them to Irish company B, which is a subsidiary of Irish company A and (thanks to the Irish legislation described above) is based in Bermuda or another quasi 'tax-exempt' jurisdiction. Thanks to the ongoing royalty deductions (under Irish law, royalties on IPR licences are deductible from the tax base), the tax base payable is significantly reduced. All of these tax avoidance techniques are perfectly legal, but the Irish government banned their introduction in 2015 and ordered companies already using them to stop using them by 2020.

Another aspect of the problem is that corporate tax rates vary significantly due to the lack (or perhaps impossibility) of harmonising international tax law. Hence the logical conclusion for the digital company's management to establish its physical presence in a country with the lowest possible tax rate.

By the way, I would like to point out that there has been a steady downward trend in corporate tax rates around the world in the so-called 'race to the bottom', as countries have sought to encourage investment and attract capital-intensive companies by lowering corporate tax rates to improve their competitiveness. For the reasons outlined above, many states have tried to come up with some form of regulation to impose taxes on digital companies that generate revenue in their markets but do not pay taxes. Of these, the French attempt has perhaps had the greatest repercussions, given that it has sparked a small-scale trade war with the United States (Office of the United States Trade Representative 2019), where the Donald Trump administration has seen the French effort as an attack on US companies (Portfolio 2019). The digital tax was eventually suspended.

To add a domestic dimension, Hungary has also tried to find a way to tax the digital giants, in the form of an advertising tax. Under this, Hungarian-language advertising on the Internet became a taxable activity, which also made companies that are not registered in Hungary subject to the tax. Google brought an action, but the Court of

Justice of the European Union found no evidence that the Hungarian legislation would disadvantage companies not established in Hungary, and only found infringements in the system of sanctions.

However, efforts at Member State level are not sufficient to tackle global tax avoidance by transnational corporations. The United States has typically been hostile to isolated attempts to tackle the problem, and it typically requires large-scale cooperation. The blueprint eventually began to take shape within the OECD at the request of the G20 countries. The aim was to develop a structure that could adequately address the problem of profit shifting and tax base erosion. On 8 October 2021, 136 countries agreed within the OECD on a draft reform of the tax system for transnational corporations based on two pillars (OECD 2021).

The first pillar develops rules on profit shifting to ensure a fairer distribution of profits between jurisdictions for large income transnational corporations. In simple terms, this means that the right to tax is partially shifted from their home jurisdiction to the jurisdictions in whose markets they do business and generate profits, whether or not the company has a physical presence there. Multinational companies with global turnover above €20 billion and a profit margin above 10% will be subject to the new rules, and 25% of profits above the 10% threshold will be transferred to the jurisdiction of the market concerned. The first pillar is expected to shift $125 billion of taxing power per year (OECD 2021).

The second pillar provides for a specific tax rate, which after lengthy negotiations was finally set at 15%. It is important to note, however, that the new legislation under discussion will apply to companies with a turnover of over EUR 750 million, so the aim is not to standardise all corporate tax practices, but to target the largest companies, mainly through their subsidiaries. Indeed, the tax avoidance practices of transnational companies (as can be seen from the schemes described above) clearly suggest that the network of subsidiaries is a key element in these mechanisms. It is the transfer pricing machinations and intellectual property relations between subsidiaries (in particular the endless system of sub-licences) that make the profit shifting practices of these firms so effective.

The global corporate minimum tax also essentially seeks to remedy the problem by eliminating transfer pricing, with the undoubtedly necessary premise of treating the group as a single, huge economic entity, which clearly implies that it does not recognise sales (and hence profits) without the involvement of a 'third', external party. It thus negates the transfer of profits between the group's subsidiaries (Sikka 2015). The initiative has been signed by 136 OECD member countries, whose economic output accounts for 90% of world GDP. The proposal is certainly a step forward and a necessary one, but I would like to point out some rather worrying factors. Previous opponents of the proposal (including Hungary) have succeeded in drastically extending the transitional period for entry into force of certain provisions. In my view, this will result in a 'dilution' of the package of measures, given the unparalleled economic and political leverage potential of the target group.

I would also like to draw attention to the fact that, in my view, it is inevitable that states will continue to have a significant interest in providing tax breaks and other selective benefits to 'Big Tech' companies with significant R&D potential and which are innovation strongholds. This was particularly the case in Ireland, where the Commission highlighted billions in tax avoidance by Apple.

There is also the dilemma of the reaction of tax havens, such as Bermuda, the Cayman Islands, and the Isle of Man, which have joined the initiative, but whose economic attraction is their low or non-existent tax rates. There is a risk that they will not let this undoubtedly significant advantage melt away. This is also true, albeit to a lesser extent, for states such as Hungary, which is the last EU Member State to join the supporters of the global minimum corporate tax rate; that is, states that wish to maintain their competitiveness through low corporate tax rates. It should be mentioned that in 2021, Hungary raised a last-minute objection to the adoption of the 15% minimum corporate tax by the European Union, thereby preventing the agreement that would have raised the minimum tax to legal force in the Union. There is a chance that the European Union (without Hungary) will introduce the global minimum tax within the framework of strengthened cooperation.

Conclusions

To sum up, I find the initiative absolutely desirable and revolutionary in its kind, as it has resulted in a broad international agreement in an area that typically falls within the competence of nation states, and one which has seen minimal harmonisation of legislation. At the same time, I see several pitfalls in this concept: the very colourful toolbox of tax optimisation, conflicts of interest between developing and leading economies, the Big Tech lobby and the reservations of tax havens and 'reluctant' states could easily render an otherwise blessed initiative weightless.

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