Towards a fair tax system that reduces inequality

Oxfam analysis, background and agenda for EU action on tax justice and transparency

October 2019

In 2018, 26 people owned the same as the 3.8 billion people who make up the poorest half of humanity.[1] As economic growth benefits the rich, the rest of society suffers, and the world's poorest, women in particular, are hit the hardest.

Fair and progressive tax systems are one of the most powerful tools to reduce inequality, when they are combined with spending for universal, free and accountable public services. Taxing companies' profits, particularly those of large corporations, is one of the most progressive forms of taxation.

Oxfam works around the world to reduce inequality. A reform of the international corporate tax system is key to end extreme inequality and enable people to lift themselves out of poverty.

What can the European Union do to enhance tax justice?

The EU has the mandate and responsibility to foster tax policies that contribute to eradicating poverty and inequality for EU citizens and ensure a positive impact for developing countries.

Over the past years, the European Parliament and the European Commission have been playing a critical role in proposing new, progressive tax systems. However, many of these efforts have been stifled by opposition from EU member state governments. Oxfam has identified four main areas where the EU can and must play a key role:

1. EU blacklist of tax havens
2. Tax competition and harmful tax practices within the EU
3. Minimum Effective Tax Rate and the OECD/BEPS 2 tax reforms
4. Public country-by-country reporting

1. EU blacklist of tax havens

What is at stake?

Tax havens are used by multinational corporations and the super-rich to avoid paying their fair share of taxes. This deprives governments, in developing countries in particular, of important resources to fund essential public services like education and health, which benefit the poorest and women first. The UN estimates that developing countries are losing around USD 100 billion each year due to tax avoidance by multinational corporations.[2] The recent international tax investigation "Mauritius Leaks", published in July 2019, shows how tax havens like Mauritius distort the working of the global economy and cause significant losses for developing countries. EU tax rules and policies can directly improve this situation.

What has the EU done so far?

In 2017, the EU published a blacklist and a 'grey list' of tax havens. These lists, officially known as **list of non-cooperative jurisdictions for tax purposes,** are compiled by member state governments. Governments screen third countries according to three criteria: transparency, fair taxation and commitment to the OECD anti-BEPS package[3]. Countries that fail any of these criteria feature on the black list, unless

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1 Oxfam (2019). Public Good or Private Wealth? https://www.oxfam.org/en/research/public-good-orprivate-wealth

2 UNCTAD (2015). World Investment Report 2015: Reforming International Investment Governance. https://unctad.org/en/PublicationsLibrary/wir2015_en.pdf

3 BEPS stands for Base Erosion and Profit Shifting and anti-BEPS measures refer in this case to the G20/OECD action plan initiated in 2013 and presenting different measures for countries to tackle corporate tax-avoidance practices and aggressive tax-planning schemes.

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they commit to reform, in which case they are added to the 'grey list'. Since its last review in November 2019, 8 countries and other jurisdictions feature on the blacklist, and further 34 on the 'grey list'.

What are the weaknesses of the EU tax haven blacklist?

Nevertheless, the EU blacklisting process remains weak. Five of the world's worst tax havens identified by Oxfam – Switzerland, Singapore, Hong Kong, Jersey and Mauritius– are currently neither on the blacklist nor on the 'grey list', due to shortcomings in the EU criteria for tax havens and the methodology applied. Also, none of the ten most corrosive corporate tax havens listed the 'Corporate tax haven index' of May 2019 are on the EU's tax haven blacklist and only four are on the EU's 'grey list'.[4]

Moreover, the blacklisting process does not apply to EU member states, even if five of them – Cyprus, Ireland, Luxembourg, Malta and Netherland – fail the EU's own criteria and would appear on the blacklist if they were not given an automatic exemption. This has also been highlighted by the European Parliament that called on the Commission to label those countries as EU tax havens.[5]

Further concerns are related to the transparency of the entire blacklisting process and the screening of developing countries. The Code of Conduct Group (CoC Group), the body within the Council in charge of screening the countries, works behind closed doors, publishing only a part of its documents, and late in time. Also, a number of developing countries has been blacklisted by the EU for failing to comply with international standards that they have not had a chance to agree on, and which, in some cases, they do not have the capacity to implement. [6]

What should the EU do?

EU member state governments and the European Commission should reform the blacklisting process to make it an effective tool in the fight against global tax dodging.

They should strengthen the **criteria for, and the methodology of, the blacklist** by:

- **Including economic indicators** that can help to better identify countries which facilitate tax dodging and have been proven to disproportionally attract profits from other countries.
- **Expanding its narrow definition of harmful tax practices** so that it includes all harmful tax rules used in both developed and developing countries to attract profit-shifting by multinationals.
- **Adding zero-tax and low-tax regimes as a criterion** to identify tax havens and blacklist them, as those will always attract tax dodging companies.

Member states should also increase the **transparency** of the process and inform the Parliament in detail ahead of any proposed change to the list.

Lastly, member states should take into consideration the particular situation of **developing countries**, allowing countries to decide, based on their national priorities and capacities, if to join the OECD BEPS Inclusive Framework and/or adopt the OECD BEPS minimum standards. At the same time, the EU should provide more and better support to developing countries to comply with international standards and apply sanctions for blacklisted countries that are proportionate to the real harm of their tax practices.

2. Tax competition and harmful tax practices within the EU

What is at stake?

In 2015, multinational corporations shifted an estimated USD 600 billion in profits to tax havens, of which 30% of were moved to tax havens within the EU.[7] Research shows that the revenue losses caused by aggressive corporate tax planning in the EU in 2015 ranged from EUR 50-70bn to EUR 160-190bn.[8]

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4 Tax Justice Network (2019) Corporate Tax Haven Index https://corporatetaxhavenindex.org/

5 European Parliament (2019) Report on financial crimes, tax evasion and tax avoidance http://www.europarl.europa.eu/doceo/document/TA-8-2019-0240_EN.pdf

6 Oxfam (2019) Off the hook https://oxfamilibrary.openrepository.com/bitstream/handle/10546/620625/bn-off-the-hook-eu-tax-havens-070319-en.pdf

7 T. R. Tørsløv, L.S. Wier and G. Zucman (2018). The Missing Profits of Nations. NBER Working Paper No. 24701. https://gabriel-zucman.eu/files/TWZ2018.pdf

8 European Parliamentary Research Service (2015) Bringing transparency, coordination and convergence to corporate tax policies in the European Union http://www.europarl.europa.eu/RegData/etudes/STUD/2015/558773/EPRS_STU(2015)558773_EN.pdf

Nevertheless, taxation is a sensitive area for EU governments, and many EU member states insist on maintaining national control over their tax system. While indeed some differences between national tax systems should be allowed, EU governments should recognize the high cost of tax competition, particularly in the field of corporate taxation. Very low corporate tax rates in some countries and excessive deductions and credits have led to a race to the bottom in corporate taxation. In 1997, the average official rate for corporate income tax in the EU was 35.2%, and by 2018 it had fallen to 21.9%.[9] This deprives governments of significant resources in their budgets and harms their ability to fund essential public services like education and health care.

Oxfam also found that five out of the 28 EU countries – Cyprus, Ireland, Luxembourg, Malta and Netherland – have harmful tax practices in place, such as patent boxes, attracting a disproportionate amount of profits.[10]

What has the EU done so far?

Every year the European Commission issues the European Semester Country Reports, that are economic and social assessments for each EU countries. Since 2017 the Reports contain analysis, indicators and recommendations about aggressive tax practices. In the last edition, in February 2019, the European Commission identified in Cyprus, Malta, Luxembourg, Ireland and Netherland features in the tax system that may facilitate aggressive tax planning[11] and asked the governments to correct those. The European Parliament called on the European Commission to ensure clear follow-up on its finding to end these practices and make indicators on aggressive tax practices binding.[12]

To tackle the race to the bottom on corporate taxes, in 2016 the European Commission has also proposed new rules that would create one single EU system for calculating a company's taxable income, rather than applying many different national rulebooks. Known as **Common Consolidated Corporate Tax Base (CCCTB)**, this would provide companies with legal certainty and reduce the number of tax procedures by creating a unified and transparent corporate tax system for the EU. At the same time, it would reduce companies' chance to avoid taxation through aggressive tax planning. In March 2018 the European Parliament, which is only consulted on the file, approved the reform included in two separate proposals by the European Commission. The files have been blocked so far in the Council, which needs to approve them by unanimity.

What should the EU do?

First of all, member states should approve the two proposed reforms on CCCTB simultaneously as they would contribute to ending harmful tax competition in Europe.

EU governments should also ban the use of patent boxes and similar measures that entice companies to shift their profits from one country to another to avoid paying tax.

While the decision-making power on tax competition and harmful tax practices lies mostly with the member states, the Commission and the Parliament can play an important role as facilitators of further tax reforms. For instance, to monitor and call out harmful tax practices in Europe, the European Commission should expand its assessment on aggressive tax planning in its European Semester Countries' Reports and ensure strong follow-up and countermeasures.

3. Minimum effective tax rate, digital economy and the OECD/BEPS 2 tax reforms

What is at stake?

Governments have started reforming the international tax system over the past five years, but the system is still based on outdated rules, which do not work in a globalised economy. In particular, digitalization has

9 DG Taxation and Customs Union (2018). Taxation trends in the European Union. https://ec.europa.eu/taxation_customs/sites/taxation/files/taxation_trends_report_2018.pdf

10 Oxfam (2019) Off the hook https://oxfamilibrary.openrepository.com/bitstream/handle/10546/620625/bn-off-the-hook-eu-tax-havens-070319-en.pdf

11 European Commission (2019) 2019 European Semester: Country Reports – Cyprus, Ireland, Luxembourg, Malta, Netherlands, https://ec.europa.eu/info/publications/2019-european-semester-country-reports_en

12 European Parliament (2019) Report on financial crimes, tax evasion and tax avoidance http://www.europarl.europa.eu/doceo/document/TA-8-2019-0240_EN.pdf

prompted questions on how and where to tax intangible assets such as brand recognition or intellectual property.

G20 countries have recently launched negotiations to reform the international corporate tax system, addressing the challenges of taxing multinational corporations in the digital era. This work, which is being led by the Organisation for Economic Cooperation and Development (OECD), goes beyond the question of how to tax digital giants, and rather considers the broader challenges of a growing digitalized economy across all sectors. It provides a unique chance to reform the international tax system, put a stop to corporate tax dodging and end the race to the bottom in corporate income tax rates.

The OECD reform discussions also cover a proposal on a minimum effective tax rate (METR). Introducing such a minimum rate would reduce the incentive for companies to shift profits to low- or zero- tax countries, by putting a floor in the damaging tax competition between countries.

Negotiations go beyond the exclusive club of OECD countries and involve 135 member states and jurisdictions. This is 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.

What has the EU done so far?

The EU and the OECD have a long history of cooperation on tax policies. However, EU countries have not yet agreed on a common position on the OECD/BEPS 2 process.

On **digital taxation**, the EU has already presented its own proposals in March 2018[13]: a short-term proposal, and a more ambitious one for the long term. However, EU governments have put their discussions on halt to wait and see if a global solution will be agreed. They have committed to reopen discussions in case an agreement at OECD level is not reached by the end of 2020.[14]

What should the EU do?

Oxfam calls on EU member states, the European Parliament and the European Commission to support with one single voice an ambitious reform[15] at the OECD, and to swiftly proceed with a Europe-wide solution to taxing digital activities if a global solution is not agreed.

We also call on member states to support a minimum effective tax rate at a fair level. This rate should be set globally, applied on a country-by-country basis without carve-outs, and set at high enough to effectively curb profit shifting. The EU should also ensure **equal representation of developed and developing countries** in the global tax reform talks**.**

4. Public country-by-country reporting

What is at stake?

Tax avoidance and aggressive tax planning are facilitated by a lack of transparency when it comes to a company's taxes, particularly on the amount of taxes a company pays in each country. The solution is to require multinational companies to disclose how much money they make and how much they pay in taxes for each country they operate in. This would allow citizens to hold companies accountable for the impact they have on their communities and contribute to ensuring that taxes are paid where they are due, providing adequate revenue to fund critical public services.

What has the EU done so far?

Some basic rules on country-by-country reporting are already in place, but most of the information is not public and the rules do not apply to all companies. Since 2016, tax authorities can access and exchange fiscal information about the biggest companies in Europe. This information is not publicly available though, barring citizens and tax administrations in many developing countries from accessing it to identify tax cheats.

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13 See Oxfam's analysis: "EU digital tax proposal: updating tax rules for the 21st century," https://d1tn3vj7xz9fdh.cloudfront.net/s3fs-public/eu_digital_tax_plan_-_oxfam_analysis_and_background_info.pdf

14 Council of the European Union (2019) ECOFIN Report to the European Council on tax issues https://data.consilium.europa.eu/doc/document/ST-9773-2019-INIT/en/pdf

15 Oxfam recommendations on OECD/BEPS2 tax reforms: https://www.oxfamnovib.nl/Redactie/Downloads/Rapporten/Oxfam%20Policy%20Note%20BEPS%202.0.pdf

Public country-by-country reporting is already mandatory in some industries, such as the extractive and the banking sector.

A **legislative proposal on public country-by country reporting for all big multinational corporations** has been proposed by the European Commission in 2016 and adopted by the European Parliament in 2017. It has been blocked by EU member states in the Council ever since. The Parliament has voted to improve the original proposal put forward by the Commission, but there are still loopholes that would allow certain businesses to keep a part of their activities in the dark. The new Parliament has also called the Council to move forward in a resolution in October 2019.[16]

What should the EU do?

It is crucial that the new European Parliament, the new European Commission and member states commit to improving corporate tax transparency in the EU.

Member states should promptly reach an agreement on the proposal and allow the trilogue negotiations among the Council, the Parliament and the Commission to start.

The European Commission and the European Parliament should ensure that public country-by-country reporting remains on the EU's political agenda, and lawmakers should increase pressure in their respective member states to move governments into action.

MEPs and the European Commission should also push for ambitious legal requirements[17] to be included in the final text of the Directive when the trialogue negotiation will start.

Oxfam's recommendations

1. The European Union should take effective action against tax havens inside and outside the EU. The Commission and the Council should strengthen the EU tax haven blacklist, and the European Commission should better use European Semester to target EU tax havens.
2. In particular, the Commission and the member states should strengthen the definition of harmful tax practices, ban patent boxes and similar measures, and develop economic analysis to better identify tax avoidance practices. The Council working group handling the tax haven list should be more transparent, and the European Parliament should get a say.
3. Member states governments should swiftly adopt and implement the two proposals on (C)CCTB.
4. Commission, Parliament and member states should develop a common and ambitious EU position for the ongoing international tax reform talks. They should ensure equal representation for developing countries and introduce a minimum effective tax rate.
5. EU member states governments should agree on ambitious and effective rules for public country-by-country reporting.

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[16] European Parliament (2019) State of play of the disclosure of income tax information by certain undertakings and branches - public country-by-country reporting https://www.europarl.europa.eu/doceo/document/TA-9-2019-0048_EN.pdf

[17] Oxfam and other CSOs' recommendations on public CBCR: https://www.epsu.org/sites/default/files/article/files/Joint%20Paper%20on%20CBCR%20post%20EP%20final.pdf