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## Unanimity rule and corporate tax revenue in the EU

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**Politicians accuse corporations of sneakily shifting their profits to tax havens. In fact, revenues in low-tax countries such as Ireland and Malta have risen sharply over the past 20 years. However, revenue development in large countries like Germany or France is not poor. Interestingly, EU countries in favor of the unanimity rule in tax issues show higher growth rates in tax revenue than countries preferring a qualified majority system.**

As tax policy has come under increased scrutiny by the European public, the European Commission is concerned about diminishing corporate tax revenues in the EU member states and proposes – amongst other measures – an EU-wide corporate tax on revenue of digital activities (European Commission, 2018a). An attempt of coordinated work on and implementation of this digital services tax (DST) recently failed because several member states voted against it.

Critical voices attribute this failure to the unanimity rule governing the EU decision-making process on tax policy. To overcome this situation, a qualified majority voting shall replace the unanimity rule. This means that at least either 55 percent of the member states or member states representing 65 percent of the EU population must approve a proposal. Indeed, projects like the Com-

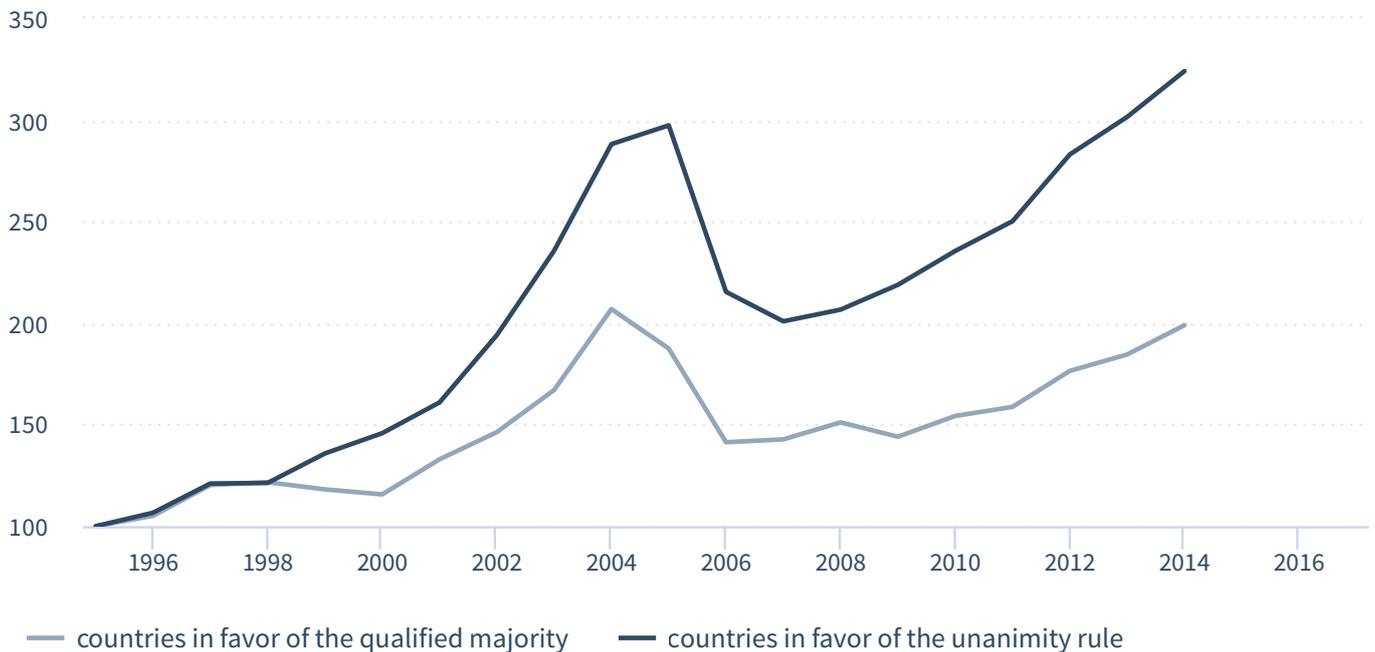
mon Consolidated Corporate Tax Base (CCCTB) or the implementation of the DST seem to be blocked due to the veto of single member states.

The discussion about the voting system however distracts from substantive arguments. The intended DST is supposed to be applied to companies' revenue stemming from digital services. This tax design raises questions on the discrimination of digital business models in comparison to traditional business models. Furthermore, the focus on turnover instead of profits may threaten the economic viability of companies because tax liabilities arise even in the event of losses. This contradicts the principles in international taxation to tax profits, ultimately resulting in a risk for jobs and investments.

To avoid any increasing tax burden on small and medium size companies (SME), the proposal of the European Commission only addresses companies with an annual worldwide turnover of more than € 750 million and revenue in the EU of minimum € 50 million (European Commission, 2018a). In fact, these thresholds imply that the tax will be mainly applied to large US digital corporations like Google, Amazon, Facebook and Apple (GAFA). Therefore, the idea of the DST might provoke an analogous response by the US administration.

# Corporate tax revenue increases stronger in EU member states in favor of the unanimity rule

Index with 100 for the year 1998



Sources: Eurostat; German Economic Institute

The main argument of the proponents of such a tax is that multinational digital companies can shift profits easier than traditional businesses to tax havens. There is empirical evidence for this hypothesis as digital firms often lack physical establishments in a country although generating a significant share of their revenue from there. While multinational enterprises (MNE) with a digital business model pay an effective tax rate of around 8 to 9 percent on average, the rate for traditional MNE amounts to 22 percent (ZEW/Universität Mannheim/PwC, 2018). However, this difference can at least partly be explained due to the existence of patent boxes and depreciation rules primarily applicable to the digital industry. Still, there is a real challenge for the tax authorities to determine the location where the added value was created and to tax the profits accordingly, especially when an MNE has no physical presence in a jurisdiction. Thus, a clear definition of a “significant digital presence” is necessary in order to allocate profits more appropriately (European Commission, 2018b).

Given the heated debate it might come as a surprise to some that the data do not show an eroding corporate

tax base in the member states. On the contrary - on average, the corporate tax revenue in the EU member states has increased significantly from 1998 to 2017 (EU28 except Croatia due to data restrictions). However, there are substantial differences between the EU countries. Interestingly, in those countries advocating the current system, tax revenue increase has been much stronger than in countries in favor of changing the EU voting system explained above (figure).

This does not mean that large industrialized countries could not record a rise in corporate tax revenue. In Germany, for example, corporate tax revenue (corporate tax, local business tax and solidarity tax) increased by a total of 80 percent in the 20 years from 1998 to 2017. Thus, corporate tax revenue in Germany grew faster than economic output. While in 1998 the share of corporate tax revenue in the gross domestic product (GDP) was equal to 2.4 percent, in 2017 the figure was 2.7 percent. Although smaller states such as Malta or Ireland can apparently divert some of the corporate profits to their advantage, the major industrialized countries are barely feeling it, as Maltese or Irish tax revenue remain relative-

vely low overall. Below, the tax revenue development per EU member state is illustrated (index with 100 in 1998 for total corporate tax revenue) by dividing them into two groups: in favor of the unanimity rule and in favor of a qualified majority rule (Becker, 2019).

**Countries in favor of the unanimity rule:** Estonia (301), Lithuania (488), Latvia (309), Finland (122), Sweden (235), the Czech Republic (357), Hungary (267), Cyprus (266), Ireland (313), Slovakia (454), Poland (226), Denmark (190), Croatia (no data), Luxembourg (220), the Netherlands (150), Slovenia (396) and Malta (892).

**Countries in favor of a qualified majority rule:** Germany (181), France (214), Spain (198), Austria (211), Belgium (235), Portugal (188), Greece (96), Bulgaria (260), Romania (273) and United Kingdom (133).

**Italy** (131) is not considered since the country is pendant between the two groups.

The development of corporate tax revenue indicates that smaller countries succeed in increasing their revenue significantly. A main reason is the application of special corporate tax incentives, e. g. patent boxes. Those tax discounts contradict the idea of a level playing field. However, small jurisdictions inside and outside the EU need possibilities to grow. Since their markets are too small to be recognized by MNE in terms of sales volume, they are seeking other ways to attract companies.

To find a solution for this ambivalent situation a smart EU tax policy is needed, i. e. harmonization of national tax rules (not necessarily tax rates). A better cooperation between national tax authorities has already been established, e. g. by the automatic exchange of information in tax matters and the project against Base Erosion and Profit Shifting (BEPS). However, further steps should follow. A suitable approach is the CCCTB. The CCCTB would abolish the arm's length principle as the main pillar of the current transfer pricing scheme and replace it with a different understanding of added value. A profit split, e. g. by using turnover, number of employees and capital invested as the allocation key, could ensure that

digital companies pay their fair share in every country they are active in. The destination country of goods and services would be strengthened in terms of the tax base, since, amongst others, sales volume is considered. However, this would substantially affect the tax revenue in the member states. The estimated range lies between plus 62 percent in France and minus 97 percent in Luxembourg (Hentze, 2019). Therefore, it is not surprising that those member states which fear losing parts of their tax revenue are not in favor of the CCCTB. It might be worth noting that the idea for a DST currently does not have sufficient support from member states, even if a qualified majority voting system was to be used. But if cooperation in tax matters between the EU countries is reasonably enforced, using existing tools and formats, there is no further need to tackle the voting scheme.

## Literature

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