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The G20 Resolutions: Breakthrough to Better International Taxation?

In the face of growing resentment over how the digital economy is taxed, the finance ministers of the G20 countries have agreed an ambitious reform agenda for international taxation. Many digital companies generate high revenue in Europe, but pay hardly any profit taxes there. Current taxation rules also provide for companies to pay taxes on profits not where they sell their products, but where they develop or manufacture them. US digital companies, however, also pay little tax in the United States.

In Europe, low taxation of the US internet giants' profits has whetted appetites: the European Commission has proposed introducing heavier taxes for internet companies where they make their sales, i.e. in the so-called "market" countries. The G20 finance ministers have taken up this idea. However, taxation rights of market countries are to be extended not only for internet companies, but for all companies.

Germany as a Loser under Market Country Taxation

What would be the consequences? The pressure exerted by tax competition to reduce taxes would ease. Sales markets aren't as easy to relocate as patents or production sites. However, countries with export surpluses such as Germany would lose tax revenue. Today, for example, Volkswagen pays its profit taxes mainly in Germany, even though the company sells most of its cars abroad, mainly in China. In the future, a larger share of profits would be taxed in China.

The Implications of a Minimum Tax

That is why Germany has put a second proposal on the G20 agenda: global minimum taxation that works with two instruments. First, companies resident in high-tax countries would pay additional taxes at home on the profits of their subsidiaries abroad, provided that the foreign tax rate is lower than the minimum rate. Second, payments by domestic companies to foreign recipients would also be subject to the minimum tax. For example, if a German company makes a payment to Google for advertising and cannot prove that Google pays the minimum tax rate on that payment, the German company must pay the tax to the German treasury. Fiscally, Germany would benefit from this.

Obstacles to Implementation

Politicians are already celebrating the G20 resolutions as a breakthrough to a fairer tax system. They are to be implemented as early as 2020. That's pretty optimistic. The G20 resolutions are still rather vague and implementing them will be complicated. Many countries, including Germany, already collect taxes on certain foreign profits. However, broadening these to cover any and all payments to foreign recipients would be new and would greatly increase the administrative burden. Each payment abroad would have to be checked to see whether the recipient taxed it at a high enough level. What happens, for example, if the payment goes to a country that compensates taxes through subsidies? Ultimately, all foreign tax systems would have to be continuously monitored to ensure that they comply with the minimum taxation requirements. This would call for a new international certification system. It is illusory to require every national tax authority to monitor this.

Relocating taxation rights to market countries is even more complex and would require a whole new set of rules. One proposal is to split out "routine profit" from global group profits and tax this portion as before, with the rest partially taxed in the market countries. Determining global profit would require an agreed common tax base, but this is an area where not even the Europeans can yet find consensus. Profit splitting is also highly complex – and growing complexity opens up new tax avoidance opportunities.

A Worthwhile Venture, but an Uncertain Outcome

It is surely illusory to believe that these obstacles can be overcome in under a year. Nevertheless, it is right for G20 countries to attempt to take coordinated action against tax avoidance. Efforts to date have mostly been unilateral and have often resulted in tax chaos, double taxation, and discrimination against cross-border investments. Internationally coordinated action against both non-taxation and double taxation would be a step forward. Whether it will really happen will become clear when plans for implementation begin to take more concrete shape. Only then will we find out whether the G20 states that stand to lose out will participate or not. If the reform package fails, the German government will at least have managed to avert the risk of fiscal losses resulting from a relocation of taxation rights to market countries without minimum taxation.

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Published under the title „Unternehmensbesteuerung: Der Teufel steckt im Detail", Handelsblatt, 26 June 2019, p. 48