G7/EUROPE: The politics behind (and ahead for) the tax deal

- Engineering global political support for the G7 deal on corporate taxation will be tricky, especially for Pillar 2.
- The risk of transatlantic trade frictions has been lowered but remains alive, as the highly political tax debate is unlikely to be overcome by global technical agreements.
- Any EU legislation implementing the deal is unlikely to be ready before 2023.

One of the main critiques to the deal reached by G7 finance ministers is that the minimum corporate tax rate agreed under the so-called Pillar 2 of negotiations is rather low, especially considering the initial US proposal (21%). The fear is that the low rate will act as an anchor point for a race to the bottom, motivating the clustering of tax regimes around a 15% rate. Looking specifically at the European case, however, this is unlikely. Most EU capitals have no intention to lower corporate taxes. They a) need additional fiscal revenue in the post-pandemic period and b) are confronted with political majorities favoring fairer corporate taxation. Moreover, Pillar 2 should be comparably easy to enforce since any profits shifted to jurisdictions that continue to apply rates below 15% could be taxed by a company's country of origin (so-called "country by country top-ups").

The deal reached under Pillar 1 (requiring the most profitable multinationals to pay tax in the countries where they operate) is more complex politically. On the geopolitical front, it could help lower the risk of new transatlantic trade confrontations: if passed, Pillar 1 could incentivize countries such as France, the UK, and Spain to shelve their national digital tax (plans), thus avoiding additional US tariffs. However, this depends on Pillar 1 receiving political backing in US Congress. Therefore, the Europeans are unlikely to move before US sign-off. The risk of digital taxes and transatlantic trade tensions may have been somewhat lowered by a clearly more cooperative approach on all sides. Still, for now, these risks remain far from having been removed.

A deeply political debate

Even if Pillar 1 were to pass in US Congress, this would not mean that the (digital) tax debate and concomitant transatlantic trade risks would disappear immediately. The tax debate consists of more than just technical-legal problems and global power dynamics; nor does it simply emerge from pandemic-related fiscal challenges, even if their prospect has added an additional level of urgency. Instead, this debate results from deep economic and social changes in rich democracies over recent decades.

The rise of the new, globalized knowledge economy has created domestic political pressures to tax, specifically, big tech companies as its most visible winners. The deeply political nature of this conversation means that it is unlikely to be ended by high-level, technical agreements in various global governance fora. In looming election campaigns – for instance, in Germany and France – the agreement can serve as handy proof of governments' determination to increase tax fairness. But beyond this, the tax question goes to the heart of whether, how, and to which degree transfers should be organized – not just between countries, but also within (rich) economies – between winners and losers of the new socio-economic order of the digital age. As the underlying social and economic transformations show no sign of abating, this conversation will likely continue.

The battles ahead

In Brussels, meanwhile, the largest member states and the European Commission will try to gain additional leverage from the G7 deal in their push for an EU-wide corporate tax framework, a so-far elusive outcome given the resistance of some smaller member states. But the EU will face internal challenges. Its backers will push for the agreement to be implemented at the EU level, which will require Union legislation. Given the usual timeframes for EU policymaking, negotiations between EU countries are unlikely to start before 2023. Taxation is normally subject to unanimity voting in the Council (where member states meet), raising fears that those EU jurisdictions with favorable tax regimes could potentially block the application of the agreement.

Meanwhile, the next major milestone is the gathering of 139 countries at the 30 June-1 July OECD meeting on cross-border taxation. This will be followed by the G20 meeting of finance ministers in Venice on 9-10 July. The main battle in the coming weeks is likely to be about carving out exemptions for specific economic sectors and geographic areas. Given the need to iron out the technical details of the package, a final deal is unlikely to be ready before October, after which countries will have to ratify it.

In Europe, political pressure to tackle the taxation issue is only bound to increase. The Commission has recently become much more vocal regarding “aggressive fiscal planning” practices allowed by some member states. The recent EU agreement on public country-by-country reporting by big multinationals is an example of how the mood is changing in Europe. This might not lead to immediate tax harmonization across Europe. However, it has been agreed by qualified majority voting rather than unanimity, which might also matter for the G7 deal. Increased tax transparency could turn out to be a powerful tool in what will likely remain a major political debate for years to come – between countries and within the modern digital economies currently emerging in rich democracies.

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