



Time for the EU to close its own tax havens

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Tax havens in the time of the Covid-19 pandemic

No one should be surprised that a tax haven acts selfishly, undermining its neighbours. But it has still been shocking to see the Netherlands object to joint debt issuance for EU member states ravaged by COVID19. Whether or not eurobonds eventually go ahead, the EU should act decisively to end the corporate tax abuse that allows a handful of member states, led by the Netherlands, to strip their neighbours of their rightful revenues.

The Netherlands alone is responsible for other EU members losing more than \$10 billion of corporate tax revenue every year. With the health costs and economic damage of the pandemic now clear, we lay out an urgent agenda for EU policy to end this tax abuse once and for all.

Inequalities and interdependencies

The pandemic has laid bare a series of interdependencies, in the EU as elsewhere. Among these, three stand out. First, that the personal and economic wellbeing of everyone in societies is dependent upon the quality of public services such as healthcare, and upon their inclusion of all people in society. Second, and relatedly, the pandemic has confirmed in stark terms that inequalities hurt everyone. Social distancing, for example, becomes impossible if households on lower incomes are faced with a choice between working unsafely, or being unable to buy food. Third, the intertwining of EU countries with each other – politically, economically and socially – means that each is fully exposed to others' weaknesses in health and other areas.

Unlike many other regions, the EU's close economic and monetary union means that it can take major steps that respond to these interdependencies. An obvious way is through the joint issuance of public debt, or eurobonds, to support the urgently needed expenditures on the immediate health and economic impacts of the crisis. The joint issuance would reduce the overall risk of holding the debt, compared to individual national bonds, which implies a lower overall cost for governments. Given the range of debt yields at present, however – e.g. -0.28% on Netherlands 10-year bonds, but 1.64% on Italian 10-year bonds - some governments would likely pay more under joint issuance, while others would see substantial savings.



Figure 1. 10-year government bond yields over time

Joint issuance would therefore be a deliberate act of solidarity: an overall saving for governments, but with some additional costs borne by the richest (those facing lower current costs of debt). Historically, governments in the richest economies (typically in the west and north of the eurozone) have resisted such initiatives – arguing that the poorer economies of the south and east should be ‘more responsible’, enacting ‘austerity’ measures in order to lower their (individual) borrowing costs.

Human nature, happily, is to be less punitive and to show solidarity – especially in times of crisis – and so the prospect of eurobonds to fight COVID has become realistic. But last week Dutch prime minister Mark Rutte said there were “no circumstances” in which the Netherlands would accept the plan.

The cost of the Netherlands tax haven

The objection is particularly striking, given that the Netherlands is one of the countries that have benefitted most from membership of the EU. In particular, this is true because it plays a key role in the profit shifting strategies of multinational corporations. In the case of US multinationals, \$70 billion of profit are booked in the country, with just \$3.4 billion paid in tax – an effective tax rate of 4.9%.

Those profits represent around 8% of Dutch GDP, an amount larger than the total of profits booked in the entire European Union, excluding the other leading corporate tax havens of Ireland and Luxembourg. To put it another way: the Netherlands, with just 17 million people and less than 1 per cent of world GDP, accounts for four times more

of the declared profits of US multinationals than does the entire continent of Africa (\$18 billion).

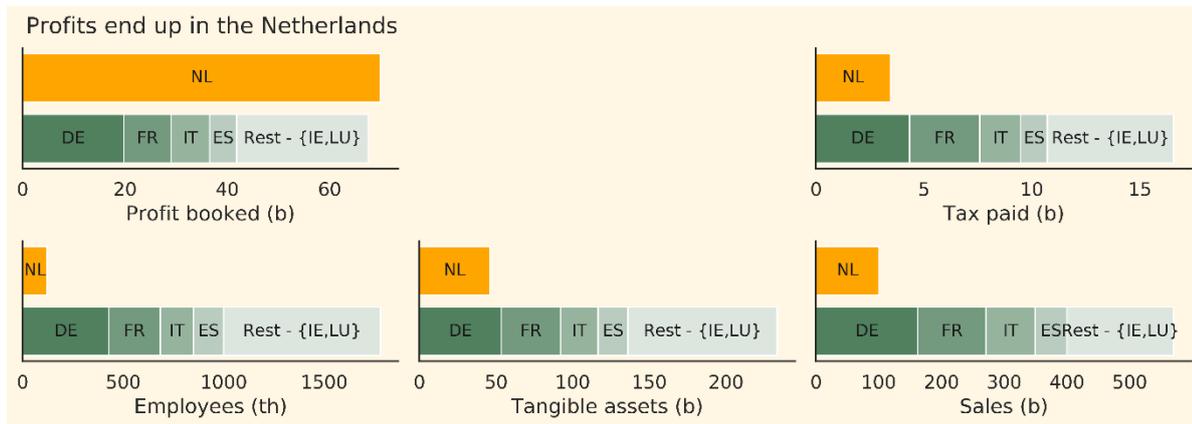


Figure 2. Profits, taxes, employees, tangible assets and sales in the Netherlands compared with other European countries. Note that the amount of profits booked in the Netherlands does not correspond with the measures of economic activity

The profits of US firms booked in the Netherlands amount to some \$575,000 per employee, which is 10 times more than the EU median. The equivalent numbers are \$46,000 in Germany, \$36,000 in France, \$45,000 in Italy, and \$34,000 in Spain. Without leeching the profits from its neighbours, the Netherlands would most likely receive a tenth of the profits or less – whereas those neighbours might obtain two to three times the tax revenue from US multinationals than they do currently.

By continuing to tolerate this behaviour, the EU is accepting that other members lose in the region of \$10 billion to \$15 billion each year (\$10.4 billion in 2017), in order for the Netherlands to take a cut of just a couple of billion dollars. On top of that, the Netherlands' behaviour has undoubtedly accelerated the race to the bottom in European corporate tax rates, which have fallen by around ten percentage points over the last decade – bringing further revenue losses across the region.

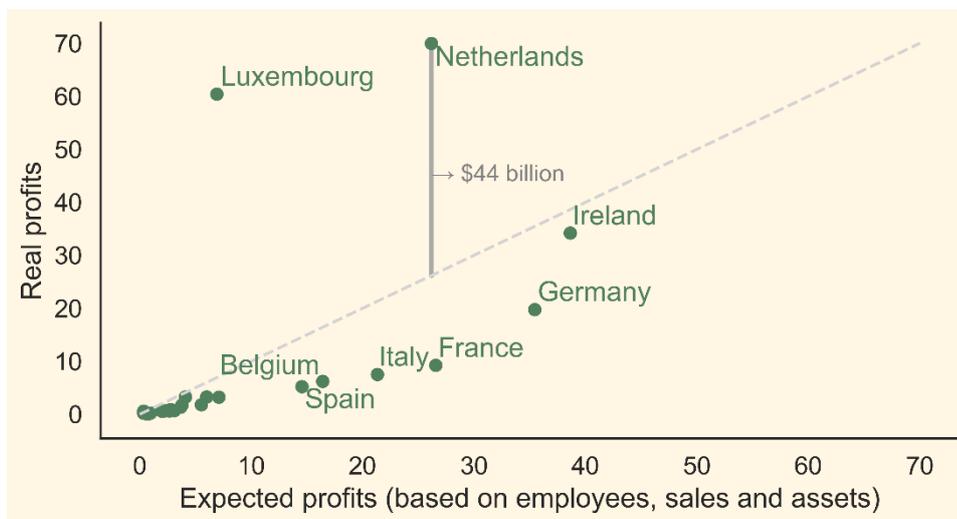


Figure 3. Expected profits (based on reported economic activity) versus profits booked in the jurisdiction. Profits are shifted to countries above the diagonal line

The Dutch model relies on the EU

For the Netherlands, the provision of tax haven services is central to the economic model. Financial flows through empty companies established for the purpose of profit shifting are estimated at \$4 trillion (five times the size of the country's GDP). This dirty business results in the creation of intermediate holding companies and also high value-adding service centers, headquarters and R&D. 'Success' in this area - that is, the Dutch reliance on this antisocial business model - has only increased with the EU crack-down on non-member tax havens.

The Netherlands achieves its extreme tax havenry by offering a mix of fiscal arrangements beneficial to international corporations. These mechanisms undermine the tax systems of other EU member states – precisely the countries with which it now refuses solidarity.

First, the Netherlands has an extensive Double Taxation Treaty (DTT) network which allows MNCs to substantially reduce withholding taxes on dividends, interest and royalty payments on financial flows to and from other countries and tax havens via the Netherlands. Second the Netherlands offer the possibility to sign secretive, arbitrary and in practice highly abusive individual tax rulings, which have been used to legitimize profit shifting and have often been challenged by the European Commission. For good reason, the Netherlands is the most secretive EU member state, according to the assessment of the 2020 Financial Secrecy Index. Third, the Netherlands has offered corporate ideal structures to avoid US taxes (e.g. the CV-BV structure). And finally, the Netherlands offers a variety of tax incentives. One of the more important is their 'innovation box' regime, offering a mere 7% tax rate on financial profits. No wonder ninety-one of the hundred largest MNCs in the world have financing firms in the Netherlands.

Importantly, companies could not use the Netherlands to avoid taxes if it were not an EU member. Much of the tax avoidance is straightforward. For example, for every coffee sold in Starbucks Italy, a payment is made to Starbucks Netherlands for the use of the brand. This reduces the profits of Starbucks in Italy and increases the profits of Starbucks in the Netherlands. The payment cannot be taxed due to the 2003 Interest and Royalties Directive, which abolished withholding taxes inside the EU. Without the European Union, the Netherlands would not be able to strip Italian profits.

Our Corporate Tax Haven Index draws on a series of objectively verifiable criteria to establish a ranking of the most aggressive jurisdictions in the world. With the EU increasingly active against non-members, it is unsurprising that member states and their dependent territories take 13 of the top 20 spots. The Netherlands emerges as the most dangerous EU member state, ranking 4th behind only the British Virgin Islands, Bermuda and the Cayman Islands. Related research shows that the Netherlands also has the 5th most aggressive set of double tax treaties, driving down the withholding tax that other countries can retain.

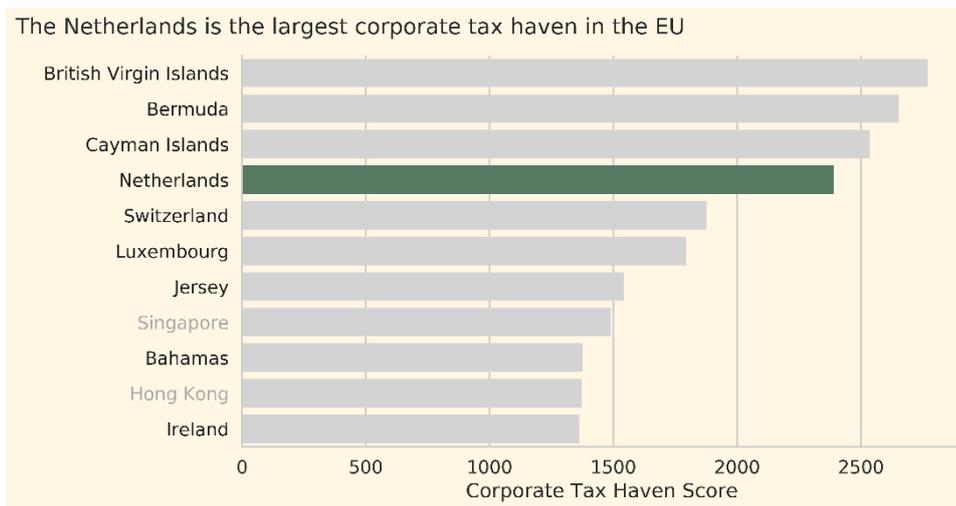


Figure 4. Corporate tax haven score of worst jurisdictions on the 2019 Corporate Tax Haven Index. All states shown except Singapore and Hong Kong are either EU member states, UK Crown Dependencies or UK Overseas Territories

EU inaction

An obvious question is why EU countries such as Italy and Germany continue to tolerate their exploitation by the Netherlands, Ireland, Luxembourg and others. There are two main reasons.

First, the ideological grip of the low tax lobby has been powerful. Even in countries that lose the most in revenues, such as Germany, business voices have effectively resisted steps that could curtail their opportunities for profit shifting. Recognising the growing public dissent, German business has also been at the forefront – along with their US counterparts – in resisting basic tax transparency, in the form of public country by country reporting that would reveal the discrepancies between where their economic activity takes place, and where their profits are reported for tax purposes.

The second reason for a lack of EU action has been the embedded political bias to inertia in this area. Specifically, tax matters require unanimity, and countries such as the Netherlands or Luxembourg consistently oppose legislation aimed at curbing tax avoidance - see for example the countries opposing reforms during the "Special Committee on Tax Rulings and Other Measures Similar in Nature or Effect".

This unanimity requirement has long been defended in the name of 'tax sovereignty' - the idea that individual countries should have full control over their own tax policies. This is a fundamentally flawed conception of sovereignty, however. Tax sovereignty is in reality complex and interdependent, because tax policies in one state affect the ability of others to set their own tax policies – with no better, or perhaps no worse, example than the effect of the Netherlands on the corporate tax sovereignty of its neighbours.

Defending tax sovereignty for EU members would be best achieved by removing the requirement for unanimity, to allow joint decisions over the minimum standards that all should meet. By drawing a line under the extent to which the Netherlands can undermine others' revenues, tax sovereignty for all would be enhanced.

An urgent agenda for change

The proposal for eurobonds is not without its own problems. The EU is no stranger to imposing 'austerity' on poorer members, and conditionality on participants could play a similar and damaging role here. But any proposals should be evaluated on their merits, with the more hard-pressed EU members able to decide in the interests of their citizens whether to proceed.

What should be unacceptable is the possibility that a single tax haven could block a valuable tool to raise resources in the face of a terrible human crisis. For now, EU members should simply set aside the objection and act together as they wish.

But this episode should also focus minds on the antisocial nature of the EU's own tax havens. The Netherlands' lack of solidarity is not a new phenomenon, but rather one which has characterised their behaviour within the union for many years – along with that of Ireland, Luxembourg, and lesser others including Malta and Cyprus.

It is time for the EU, finally, to say 'no more': no more tax abuse, no more profit shifting, and no more exploitation of fellow member states by the Netherlands and others. The agenda to achieve this change is clear and contains three components.

First, the EU should adopt the long-debated Common Consolidated Corporate Tax Base without further delay. Specifically, EU member states should assess the taxable profits in their jurisdiction on a unitary basis, taking a share of each multinational's global, consolidated profits in proportion to the share of the multinational's employment and sales in the country in question. At a stroke, this approach cuts through transfer pricing manipulations and the difficulties posed by digital companies, on a consistent and transparent basis. Immediately, too, it ends the possibility of profit shifting within the EU and puts an end to the Dutch model of corporate tax havenry.

Second, EU member states should agree a minimum effective corporate tax rate of at least 25%, including a ban on tax rulings that can undermine this, to end the race to the bottom and eliminate any remaining incentives for profit shifting within the bloc. A short-term excess profits tax – perhaps 50% or even 75%, on profits above some initial level – would ensure pro-social redistribution in this time of need, from companies such as Amazon that stand to profit disproportionately from government decisions to lock down societies.

The third measure is the simplest: transparency. EU members should require all multinationals to publish annually their country by country reporting, showing the location of their employment, sales, declared profits and tax paid. This will provide full accountability, allowing the public to confirm both that multinationals are paying their fair share, in the right places, and that EU member states too are behaving in solidarity.

These steps, taken together, would end the tax havenry of the Netherlands and others; would raise important new revenues for all EU members to support their COVID responses and beyond; and would establish the basis for accountable corporate tax sovereignty long into the future.

Annex: Methodological note

Country-by-country data was obtained from the IRS SOI Tax Stats (<https://www.irs.gov/statistics/soi-tax-stats-country-by-country-report>). Revenue losses were calculated in two steps. In the first step we estimated the relationship between log-profit and log-employees, log-sales and log-assets using a linear regression ($R^2 = 0.863$). We used this model to calculate the expected profits in each country. In order to maintain the total profits constant, the extra profits (real profits minus expected profits) were distributed to all countries according to the estimated model. This allows us to obtain the profit shifted (real profits minus expected profits, including redistribution). In the second step, revenue loss is calculated as the product of profit shifted and the effective tax rate in the country.

To calculate revenue losses and profit shifted that can be directly attributable to the Netherlands, we multiplied the estimated value by the share of profit shifted to the Netherlands (44%).

Data on healthcare expenditures comes from Eurostat (table hlth_sha11_hf). Data on coronavirus cases comes from the European Centre for Disease Prevention and Control.

All data can be found at https://www.datawrapper.de/_/i9dNo/.

Revenue losses per country due to the Netherlands

Country	Cases	Cases per million	Profit shifted to NL (millions)	Revenue loss (millions)	Revenue loss (% healthcare expenditures)
Spain	135,032	2,890	4,192	993	0.99%
Italy	132,547	2,193	6,208	1,555	1.04%
Germany	99,225	1,196	7,051	1,545	0.44%
France	74,390	1,110	7,783	2,731	1.07%
Belgium	20,814	1,822	4,586	1,038	2.37%
Netherlands	18,803	1,091	-43,785	-2,156	-2.96%
Austria	12,297	1,389	1,670	539	1.45%
Portugal	11,730	1,140	1,081	258	1.53%
Sweden	7,206	707	1,230	282	0.56%
Ireland	5,364	1,105	1,987	254	1.26%

Table: The Tax Justice Network • Source: Eurostat hlth_sha11_hf, IRS SOI Tax Stats, European Centre for Disease Prevention and Control • Created with Datawrapper