



**MINIMUM CORPORATE INCOME TAX:
IMPLEMENTATION CHALLENGES
AND A WAY FORWARD
FOR THE EUROPEAN UNION**

The European Union's Directive¹ which aims to establish a global minimum corporate income tax (CIT) of 15 per cent for multinational enterprise groups (MNEs) with more than 750 mln. euros in revenue (hereinafter the Directive) is a pivotal point in international taxation toward limiting cross-border competition. Adopted in December 2022 and swiftly implemented a year later, the Directive reflects the European Commission's (the EC) proactive approach "to put an end to tax practices of MNEs that allow them to shift profits to jurisdictions where they are subject to no or very low taxation, the Organization for Economic Co-operation and Development (OECD) has further developed a set of international tax rules to ensure that MNEs pay a fair share of tax wherever they operate".²

In light of the EC's call for rapid implementation of the Directive, a critical examination reveals inherent flaws in the adopted minimum CIT model that may undermine the European economy, its competitiveness, and value creation. These concerns relate to the current revenue threshold, ambiguity over the use of preferential CIT regimes, and legal uncertainty surrounding a rushed transposition of the Directive by some Member States and late implementation by others.

The corporate income tax is known to have serious adverse effects on economic growth and well-being, which makes its harmonisation undesirable. The complexities and flaws implicit in the minimum CIT regime preclude its rapid and smooth implementation. These concerns relate to the current revenue threshold, ambiguity over the use of existing preferential CIT regimes, and legal uncertainty surrounding a rushed transposition of the Directive by some Member States and late implementation by others.

From Tax Competition to Competition for Subsidies?

Globalisation-related pressures have led countries across the world to reduce CIT rates, making taxation more business-friendly. Despite the decrease in tax rates, tax revenues are not falling.³ Tax competition plays a vital role in maintaining the efficiency of state expenditure by incentivizing governments to exercise fiscal discipline and to prioritize essential spending. By incentivizing governments to keep tax rates low and thereby attract investment and retain businesses, tax competition sustains sound fiscal policy, promotes efficient allocation of resources and minimizes government waste.

For a long time, the EU considered tax competition as a tool that "offers more transparency and allows Member States to consider both their market competitiveness and budgetary needs in fixing their tax rates."⁴ The perceptions have changed: tax competition is now seen as an "unfair" game. Now, the EU

¹ Council Directive (EU) 2022/2523 of 14 December 2022 on ensuring a global minimum level of taxation for multinational enterprise groups and large-scale domestic groups in the Union, <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32022L2523&%3Bqid=1682496237741>

² Ibid.

³ Cozmei, C (2015), Is It any EU Corporate Income Tax Rate-Revenue Paradox?, <https://www.sciencedirect.com/science/article/pii/S221256711500372X>

⁴ European Commission, "Council Directive on a Common Consolidated Corporate Tax Base (CCCTB)", published on March 16, 2011, <https://eur-lex.europa.eu/legal-content/EN/ALL/?uri=CELEX:52011PC0121>. ⁵ A Qualified Refundable Tax Credit (QRTC) or a Marketable Transferable Tax Credit (MTTC). A tax credit is an amount that taxpayers can subtract directly from taxes owed to a government. PwC, "PWC's Pillar Two Country Tracker", updated on April 26, 2024, <https://www.pwc.com/gx/en/tax/international-tax-planning/pillar-two/pwc-pillar-two-tracker-full-data-v2.pdf>.

prioritizes CIT revenues over moving toward more efficient forms of taxation, such as value added or environmental taxes.

Abolishing tax competition, popularly referred to as the race to the bottom, will require new ways to attract investment. Instead of the tax race to the bottom, we might see an escalating race for subsidies dictated by political, not market preferences, and ultimately resulting in overproduction, overconsumption and misallocation of resources. OECD guidelines already allow a specific form of subsidies through refundable tax credits.⁵ This has led countries to introduce such subsidies (if they are not in place already) or to adapt the existing forms of tax incentives to match the new rules.⁶

Minimum CIT and Existing Preferential Tax Regimes

The Directive creates legal uncertainties for countries that apply preferential CIT regimes to exempt certain types of investments from CIT or have special expense recognition rules, e.g., investment projects, free economic zones, R&D, patent boxes, etc. Contracts between investors and national governments that fall under such regimes typically have a defined timeframe and extend far beyond 2024.

The legitimate interests of companies that have invested in and committed to specific jurisdictions because of their lower or zero tax rates must be protected even if they fall under the scope of the minimum tax rules. However, under the minimum CIT regime, new carve-outs will be available and they will reduce the effective rate depending on the number of employees in a company and the value of tangible fixed assets.

The minimum CIT regime makes the use of tax reliefs inherently misleading, as affected companies will be liable to pay the top-up tax afterwards. A lack of answers about how existing exemptions can be used further creates additional uncertainty about tax costs, investment returns, and administrative adjustment costs.

This calls for immediate action in addressing the compatibility of preferential CIT regimes with the minimum CIT and their further application.

Indexing to Inflation

OECD member countries agreed to apply a global minimum tax to MNEs with an annual turnover above €750 million and a branch in a given country with a turnover of at least €10 million and a profit of €1 million in 2021. The EU's €750 million proposal originated from the Council directive on a Common Consolidated Corporate Tax Base (CCCTB) adopted in 2016.⁷ Given that the threshold was first

⁵ A Qualified Refundable Tax Credit (QRTC) or a Marketable Transferable Tax Credit (MTTC). A tax credit is an amount that taxpayers can subtract directly from taxes owed to a government. PwC, "PWC's Pillar Two Country Tracker", updated on April 26, 2024, <https://www.pwc.com/gx/en/tax/international-tax-planning/pillar-two/pwc-pillar-two-tracker-full-data-v2.pdf>.

⁶ Denmark, Finland, Ireland, Malaysia, the Netherlands and Norway have already implemented refundable tax credits or adapted the existing ones to the new requirements, while Switzerland, Belgium, Bermuda, Cyprus, France, Luxembourg, Hungary and Singapore are planning to introduce or adapt the existing tax credits to match the new rules. Ibid.

⁷ European Commission "COUNCIL DIRECTIVE on a Common Consolidated Corporate Tax Base (CCCTB)", published on October 25, 2016, <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52016PC0683>.

proposed eight years ago, accounting for inflation means that this threshold should be higher by at least €200 million.⁸

To avoid a disproportionate increase in companies' tax burdens, it is necessary to index the threshold of €750 million, which activates the minimum tax liability, and to provide for automatic indexation in the future. Otherwise, the number of in-scope companies will continue to grow.

Automatic indexation would protect groups of companies with a current turnover below €750 million from the risk of falling into a higher tax bracket due to inflationary increases in income. Indexation is particularly relevant for Central and Eastern European countries where the Consumer Price Index reached double digits in 2022.

Legal Uncertainty Around the Implementation of the Directive

A rushed transfer of the directive into national legislation by some member states and late implementation by others cause a great deal of uncertainty. While indicative of the EU's commitment to the OECD's global tax reform, the rapid enforcement of the Directive exacerbates the detrimental effects of the minimum CIT model.

With the Directive's adoption in December 2022 and implementation from the 31st of December 2023, some EU member states have not been able to meet the tight implementation deadlines. Six countries – Cyprus, Latvia, Lithuania, Poland, Portugal and Spain – are still late transposing the Directive into national law. Notably, a late implementation of the Directive and retrospective transposition of tax rules does not allow companies to ensure compliance.

The Directive provides that member states, in which no more than twelve ultimate parent entities of groups within the scope of this Directive are located, can delay application for six consecutive fiscal years beginning from 31 December 2023. Five countries, including Lithuania, Malta, Latvia, Estonia, and Slovakia, have used this provision to delay the application of the new rules until 2030 in hopes of alleviating additional administrative burdens for their tax administrators and businesses.

Other EU member states that implemented the Directive at the beginning of 2024 are still in the trial-and-error phase as they attempt to navigate the complexities of the global tax agreement.

Since the majority of EU countries have already implemented the minimum CIT regime, MNEs have to comply with complex administrative obligations deriving from the Directive from 2024 onwards regardless of their geographic location within the EU. A rushed transposition of the Directive into national legislation by some Member States and late implementation by others cause legal uncertainty. The scale of the problem is even more evident in light of the Directive's provision stipulating penalties for companies that “do not comply with their obligations to file a top-up tax information return and pay their share of top-up tax.”⁹ Penalties for non-compliance with the requirements of a backdated law violate legislative principles and should not be applied.

⁸ Eurostat, “Harmonized consumer price index”, viewed on 5 May 2024, and Lithuanian Free Market Institute's calculations, https://ec.europa.eu/eurostat/databrowser/view/prc_hicp_midx/default/table?lang=en

⁹ Council Directive (EU) 2022/2523 of 14 December 2022 on ensuring a global minimum level of taxation for multinational enterprise groups and large-scale domestic groups in the Union, <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32022L2523&%3Bqid=1682496237741>

An Ex-post Year for Simplifying the Minimum CIT Regime

A proper ex-ante impact assessment of the Directive was not carried out by the EC motivating that it had been done by the OECD. Nonetheless, the EC made significant deviations from the original OECD agreement, i.e. the Directive includes domestic groups in addition to multinationals.

Given that an ex-ante impact assessment of the EU Directive was not conducted, this year, which primarily involves information gathering and tax return filing, should be dedicated to thorough ex-post evaluations in order to pinpoint any weaknesses in the current model.

Using the first year as a preparatory phase is crucial if the CIT model is to be properly streamlined: it would provide indispensable insights for both companies and tax administrators and delineate guidelines for necessary simplifications of the tax model. A study¹⁰ carried out in 2022 suggested measures that would help reduce compliance costs, namely simplifying the procedure for calculating the effective minimum tax, considering the nominal corporate income tax rate in a given country and the real risks of deviating from international accounting standards in national law.

To ensure operational efficiency, a comprehensive simplification plan should be put in place by the close of 2024 and existing inadequacies should be addressed.

Conclusions

The rapid execution of the Directive, coupled with late adoption by certain member states and flawed provisions, has serious ramifications for the EU's competitiveness. The shift from tax competition to competition for subsidies and legal uncertainties arising from the delayed transposition of the Directive augment the challenges ahead. Europe has been growing less than the rest of the world for quite some time now and tax harmonization policies threaten even this modest growth.

Indexing the minimum tax liability threshold to inflation and providing for automatic indexation in the future can mitigate a disproportionate growth of the tax burden for companies and protect MNEs that are close to the threshold. Additionally, a thorough ex-post impact assessment is advisable. The year 2024 should be a preparatory phase with a focus on streamlining the compliance process and simplifying the minimum CIT regime in order to reduce the burden on businesses while sustaining the EU economy's competitiveness.

¹⁰ Döllefeld, C., Englisch, J., Harst, S., Schanz, D., Siegel, F. A Simplification Safe Harbor For Pillar 2. Tax Notes International, 2022.