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Global Minimum Taxation and EU Competitiveness: What Now?

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Introduction

A few weeks ago, the US Trump administration announced its departure from the so-called 'global tax deal', which includes all negotiations at the Inclusive Framework both regarding the OECD Pillar One and Pillar Two. In practical terms, and in the exclusive context of Pillar Two (Global Minimum Tax), this means that the United States will not implement any of the OECD acronyms, aka IIR, UTPR, and QDMTT. At the same time, Europe navigates in exactly the opposite direction, dealing with the domestic implementation of a Directive approved by unanimity back in 2022 [Council Directive 2022/2523], and which has the specific purpose of transposing the OECD Pillar two — the acronyms— into the laws of 27 Member States. To add some drama to an already confusing global scenario, the Trump administration announced that any attempt to tax US MNEs in Europe (e.g., with a UTPR) would imply an automatic retaliation, most likely, with his new favourite tool: tariffs.

This article analyses the current scenario for Europe, especially from the perspective of its competitiveness vis-à-vis other regional blocks and other global commercial actors, including the United States. It argues that despite the lack of economic rationale from the US government regarding tariffs, Europe has self-inflicted new legal barriers (i.e. the EU Directive on Pillar Two), restricting its general capacity to compete for capital as an economic block. This does not only challenge Europe in the short-term, responding to the new global scenario, but also in the long-term, redefining its role in the global economy.

Pillar two: tax competition and tax competitiveness at stake

For anybody who follows the debate on Pillar Two, it is easy to understand that Pillar Two reduces the incentives for countries to attract capital using their corporate income tax system for this purpose. Indeed, Pillar Two requires that every single entity of a MNE group (over a certain thresholds of annual revenues) pays a minimum effective corporate income tax rate of 15%, whatever the multinational group operates. If a country goes below the effective tax rate (ETR) in a certain year, a "top-up tax" is triggered, and it is captured somewhere, including in the low-tax country via a Qualified Domestic Minimum Top-up tax (QDMTT). In other words, countries cannot use corporate income tax incentives freely anymore because many of those incentives will ultimately reduce the domestic ETR triggering a top-up tax. That is, Pillar Two establishes a floor for tax competition while at the same time reduces the incentives to shift profits to low-tax

jurisdiction. So far so good.

When the EU implemented these rules in the EU Directive on Pillar Two also attended to the aims of reducing tax competition and profit shifting. After all, the EU mentality was that since Member States are sovereign in direct tax matters, it is better to avoid “excessive competition” or a so-called “race to the bottom”, both within and outside the EU. However, here is precisely the problem.

The EU Directive does not only affect MNE groups that operate worldwide, but also those operating exclusively within the European internal market. In other words, while European thought (perhaps) that Pillar Two would reduce incentives for European countries to compete reducing their corporate income tax rates, remaining competitive in terms of substance (i.e., payroll and tangible assets), they did not contemplate that similar restrictions in a pure intra-EU context could end up affecting its own competitive position in the global economy. And this is precisely what was put on evidence in mid-January 2024 when the Trump administration disclosed its intention to withdraw from the global tax deal. If an EU Directive will force Member States to impose top-up taxes in exclusive intra-EU scenarios, but other global economic actor as relevant as the United States (or China) will not have to deal with this, ‘EU competitiveness is without doubt at stake.

The shift towards competition outside corporate income taxes

Pillar Two does not eliminate tax competition. In fact, it simply shifts it to other places, including consumption taxes like Value Added Tax (VAT) or personal income taxes (PIT), and non-tax areas like subsidies. Will Europe compete now like this?

While VAT is harmonised among Member States, offering exemptions on VAT has a major issue since it makes the tax regressive. Moreover, and at least from a pure revenue perspective, it seems to be risky that Europe shifts competition to VAT considering the importance of VAT as a tax revenue generator. The story is rather different with PIT. In this field, Member States are still free to decide what to do, offering an escape door for Member States to compete in a world post-Pillar Two. We have witnessed some of this competition already with Member States offering special tax regimes for wealthy individuals, or “flat” income taxes to alleviate their tax burden while they bring capital into their countries. However, this highlights an important question: does Europe want Member States to jump individually on this, or maybe it is better to think about a harmonised system of special regimes for individuals instead? After all, if Pillar Two is shifting competition to personal income taxes, but at the same time is reducing the EU competitiveness, harmonised special tax regimes for individuals may not be that insane after all.

Competition via subsidies deserves a separate mention. Although it is still unclear to me why ‘subsidy competition’ needs to be preferable to ‘tax incentives competition’, especially taking into consideration bribery and corruption as distortive factors, it is evident that the EU Directive on Pillar Two is forcing Member States to offer grants and subsidies rather than tax incentives. The interesting issue is that while Member States are pushed in this direction, a different European legal constraint — State Aid law–– restricts Member States’ capacity to subsidize specific undertakings. Two contradicting policies, indeed. If the European Union want to define its future role in the global economy, it should start from reshaping these contradicting policies, making perhaps the application of State aid rules a bit more lenient, at least if the aim is that Member States compete properly using subsidies or grants for this purpose.

Reactions to the new global scenario

The announcement of the US Trump administration, although surprising in terms of timing, it was predictable. In fact, it had already been announced since the *Make America Great Again* campaign that anything smelling like 'international commitment' would be removed from the Trump agenda. This was raised regarding the U.S. participation in NATO (North Atlantic Treaty Organization) and other international agreements like the Paris Agreement or the World Health Organization (WHO), and now it is simply materializing with respect to the global minimum tax of the OECD. Therefore, one does not need to be very smart to understand what happened, and the challenge for Europe is evident. What can the Europeans do now? There are a few options on the table.

First, Europe could decide to make the US regimes of GILTI and CAMT as Pillar Two equivalent. Indeed, although not the same, they resemble the idea of minimum tax very much. In fact, this resemblance is perhaps the reason –– and not the altruism of the US–– why previous US administrations did not see issues of participating in a 'global tax deal' that, after all, would imply no major legislative reform in that country. In other words, the cost of cooperating was always low, so why not? Second, Europe could decide to extend the so-called "UTPR safe harbour" to cover fully the four-year administration of Trump. That is, preventing to bother the big brother up north, and reducing the escalation of tariffs worldwide. Although sensitive, this option has one major drawback: it needs to be revised in four years, and nobody can tell now what will happen then. Third, Europe could consider the contingent application of the IIR, UTPR, and QDTT in the EU Directive. In other words, the top-up tax will be triggered only in those cases in which a similar rule applies somewhere else. Although this has logic from the perspective of a country (or a block of countries) willing to maintain its competitiveness in a global economy, it is unlikely to happen, especially considering the pressure from the OECD, and the fact that the EU is an important part of it. Fourth, and finally, the UTPR should simply be repealed from the EU Directive. If all Member States agree that EU competitiveness is as important as the individual Member States' capacity to compete, this is indeed the 'second best world'. In fact, it prevents a commercial war while it keeps happy those in love with the wave of minimum taxes.

Final remarks

Europe is currently facing a significant dilemma. On the one hand, it seeks to maintain its strong stance in supporting the OECD BEPS and BEPS 2.0, a position no one else has embraced as fully. On the other hand, it is experiencing internal struggles, limiting its own 'internal market' while more competitive economies continue to grow — a quick trip to Shanghai or Shenzhen makes this painfully clear. However, trying to balance both is no longer feasible. If Europe wants to remain a contender for capital as an economic block, it is time to make bold changes and decide just how far ahead or behind it wants to be in the next 30 years. The moment to act is now.

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