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Yuri Biondi

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Yuri Biondi\*

# Corporate Control and Exceptions to Minimum Corporate Taxation: A Step Toward Fairness or Financialisation?

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**Abstract:** The European Commission is currently seeking to implement the OECD/G20 agreement on minimum corporate taxation, in view to ensuring a minimum effective tax rate on large multinational corporate groups and protecting the level playing field for business and society. In fact, the proposed ruling introduces scope exceptions for groups directly or indirectly controlled by governmental entities, non-profit organisations, and investment and pension funds. These scope exceptions may provide incentives for controlling parties to restructure the corporate group in view to avoid taxation, if the minimum effective tax threshold is constraining and material. Furthermore, it may provide a tax competitive advantage for groups controlled by those parties.

**Keywords:** tax avoidance, global wealth chains, multinational companies

**JEL Classification:** F23, G32, H26, K34, M41

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## Accounting, Corporations and Tax Avoidance

1. Corporate Control and Exceptions to Minimum Corporate Taxation: A Step Toward Fairness or Financialisation?, by Yuri Biondi, <https://doi.org/10.1515/ael-2022-0054>.
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\*Corresponding author: Yuri Biondi, CNRS, Paris, France, E-mail: [yuri.biondi@gmail.com](mailto:yuri.biondi@gmail.com)

3. Board Level Employee Representation and Tax Avoidance in Europe, by Sigurt Vitols, <https://doi.org/10.1515/ael-2019-0056>.
4. Fair Value and Corporate Taxation: Out through the Door, Back through the Window?, by António Martins, Cristina Sá and Daniel Taborda, <https://doi.org/10.1515/ael-2021-0046>.
5. The Autonomous Taxation of Corporate Expenses in Portugal, by Ana Dinis, António Martins and Cidália Lopes, <https://doi.org/10.1515/ael-2019-0023>.
6. The Accrual Accounting Principle and its Implications for Portuguese Tax Courts Decisions, by Daniel Taborda and João Sousa, <https://doi.org/10.1515/ael-2019-0030>.

## 1 Implementing Minimum Corporate Tax in Europe

On 22 December 2021, the European Commission has proposed a Council Directive ensuring a minimum effective tax rate for the global activities of large multinational groups. The proposal includes a common set of rules on how to calculate this effective tax rate, so that it is properly and consistently applied across the European Union (EU). This may protect the level playing field for European businesses, ensuring that all of them are paying their fair share of corporate tax.

The EU proposal draws upon the recent global tax reform agreement reached by the Organization for Economic Co-operation and Development (OECD)/G20 Inclusive Framework in October 2021, a working group of 141 countries and jurisdictions that concentrated on the Two-Pillar Approach to address the tax challenges of the digital economy: Pillar 1 concerning the partial reallocation of taxing rights; and Pillar 2 concerning the minimum level of taxation of profits of multinational enterprises. This approach aims to bring fairness, transparency and stability to the international corporate tax framework. As pledged, the European Commission is now seeking to implement Pillar 2 of the global agreement, making global minimum effective corporate taxation a reality for large group companies located in the EU.

As a matter of fact, international taxation is both a strategic game with guile, and a policy instrument (Avi-Yonah, 2011; Biondi, 2017). On the one hand, a stampede of lobbyists and consultants proactively seek to exploit loopholes in view to avoid taxation. On the other hand, policy-makers are quite willing to play this game to pursue special economic interests or policy results.

In this context, surely well-intended initiatives pursuing fairness in taxation might end up fostering further financialisation and assetisation in corporate affairs.<sup>1</sup>

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<sup>1</sup> Broadly speaking, the notion of tax fairness points to a ‘positive principle of taxation’ (Biondi, 2017) in which each and every constituent pays its fair share of a tax (Scherer & Schmiel, 2021); financialisation points to the increasing role played by financial actors, technologies and mind-sets in

## 2 Evil is in the Details: Exceptions to the Proposed Tax Ruling

From this perspective, this note aims to bring attention to widely-defined exceptions introduced by the proposed tax rulings. As for these exceptions may be instrumental to play this very game with harmonised minimum corporate taxation.

### 2.1 Scope Exception

A look at scope exceptions already introduced by the OECD/G20 agreement raises some concerns. The EU Commission (2021a) proposal's scope and scope exceptions are stated as follows (Chapter 1, General Provisions, p. 8):

The scope of the Directive is defined by reference to constituent entities located in the Union that are part of MNE groups or large-scale domestic groups (consisting of Constituent Entities as members) with a consolidated group revenue of at least EUR 750 million in at least two of the four preceding years. For various policy reasons, such as to preserve the tax neutrality principle and in line with the OECD Model Rules, the following entities are excluded from the scope of the Directive: governmental entities, international organisations, non-profit organisations, pension funds and, provided that they are at the top of the group structure, investment entities and real estate investment vehicles. Entities that are owned at least 95% by excluded entities are also excluded from the scope of the Directive.

This statement resonates with the OECD/G20 Agreement's scope, which reads as follows (see OECD, 2021a, Annex A – Statement on a Two-Pillar Solution to Address the Tax Challenges Arising From the Digitalisation of the Economy, 1 July 2021):

#### Scope

The Global anti-Base Erosion Rules (GloBE) will apply to MNEs that meet the 750 million euros threshold as determined under BEPS Action 13 (country-by-country reporting). Countries are free to apply the Income Inclusion Rule (IIR) to Multi-National Enterprises (MNE) headquartered in their country even if they do not meet the threshold.

Government entities, international organisations, non-profit organisations, pension funds or investment funds that are Ultimate Parent Entities (UPE) of an MNE Group or any holding vehicles used by such entities, organisations or funds are not subject to the GloBE rules.

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business and society (Klinge et al. 2021; Biondi, 2013 for further analysis and references); assetisation points to a prevailing process which imposes financial investment and rent-seeking as the key rationale for corporate affairs, along with commodification and its speculative logic (Birch & Muniesa, 2020).

Moreover, the OECD (2021b) model rules for Global Anti-Base Erosion – GLoBE (Pillar Two) define excluded entities at Article 1.5 as follows:

Article 1.5. Excluded Entity

1.5.1 An Excluded Entity is an Entity that is: (a) a Governmental Entity; (b) an International Organisation; (c) a Non-profit Organisation; (d) a Pension Fund; (e) an Investment Fund that is an Ultimate Parent Entity; or (f) a Real Estate Investment Vehicle that is an Ultimate Parent Entity.

1.5.2 An Excluded Entity is also an Entity: (a) where at least 95% of the value of the Entity is owned (directly or through a chain of Excluded Entities) by one or more Excluded Entities referred to in Article 1.5.1 (other than a Pension Services Entity) and where that Entity: i. operates exclusively or almost exclusively to hold assets or invest funds for the benefit of the Excluded Entity or Entities; or ii. only carries out activities that are ancillary to those carried out by the Excluded Entity or Entities; or (b) where at least 85% of the value of the Entity is owned (directly or through a chain of Excluded Entities), by one or more Excluded Entities referred to in Article 1.5.1 (other than a Pension Services Entity) provided that substantially all of the Entity's income is Excluded Dividends or Excluded Equity Gain or Loss that is excluded from the computation of GLoBE Income or Loss in accordance with Articles 3.2.1(b) or (c).

This scope exception implies that financial holdings which are directly or indirectly controlled by the following entity types are excluded from the ruling: governmental (state-controlled) entities; international entities; non-profit organisations; pension funds or investment funds. According to the EU Commission (2021b) proposal, this exception is introduced

because such entities are usually exempt from domestic corporate income tax in order to preserve a specific policy outcome. This may be because the entity is carrying out governmental/quasi-governmental functions, or to ensure that funds or pensions do not risk double taxation.

The problem is that both constituent corporations and the corporate group which link them together are artificial entities whose legal-economic structure may be adjusted to respond to an evolving legal and regulatory framework (Biondi, 2020; Strasser & Blumberg, 2011). In particular, corporate groups provide opportunities to design their structure in a tax-reducing way, implementing tax avoidance schemes which were one of the reasons for those minimum corporate tax initiatives. Therefore, this scope exception may provide incentives for controlling parties to restructure the corporate group in view to avoid taxation, if the minimum effective tax threshold is constraining and material. Furthermore, it may provide a tax competitive advantage for groups controlled by those parties.

For instance, worried with weakening a national champion due to effective tax rate implementation, a national government may seek to acquire control over it. Under shareholder primacy, financial investors have already substantial

influence on corporate groups (Biondi, 2013): They may be willing to transfer control to investment funds and pension funds under management in order to avoid taxation. While block-shareholders who control corporate groups may establish foundations and transfer control to these non-profit organisations.

Under the current minimum corporate taxation initiatives, a wide definition of excluded entities is proposed, while the behavioural responses of groups and jurisdictions – especially tax havens – remain unknown.

Based on the OECD Model Rules, excluded entities are governmental entities, international organizations, non-profit organizations, and pension funds, as well as investment funds and real estate investment vehicles, but only if the latter are the ultimate parent entity (“Primary Excluded Entities”). In addition, excluded entities also comprise (a) entities that are 95% owned (by value) by one or more primary excluded entities and hold assets or invest funds for the benefit of primary excluded entities or engage in ancillary activities, and (b) entities that are 85% owned (by value) by one or more Primary Excluded Entities and substantially all of their income is from dividends or gains that are excluded from GloBE Income or Loss (together, “Secondary Excluded Entities”).

The various Primary Excluded Entities are specifically defined under the OECD Model Rules.<sup>2</sup> An entity is an “investment fund” if it satisfies the following seven criteria: (1) it is designed to pool financial and/or non-financial assets of at least some unrelated persons (2) in accordance with an investment policy; (3) it allows investors to reduce investment-related costs or to spread risk; (4) it is primarily designed to produce investment income or gain, or to protect against a particular or general event or outcome; (5) investors have a right to the earnings and/or gains from the fund assets based on their investment in the fund; (6) the entity or its management are subject to a regulatory regime where the entity is established or managed; and (7) the entity is managed by professional investment managers on behalf of the investors. The rationale behind this exclusion is not clear. Many financial investments are being conducted through private equity vehicles and there is no clear public policy consideration to exclude them from minimum corporate taxation. According to the EU Commission (2021a, p. 15)’s proposal,

Investment funds and real estate investment vehicles should also be excluded from the scope when they are at the top of the ownership chain, since, for those so-called flow-through entities, the income earned is taxed at the level of the owners.

It should be noted at least that no harmonisation of individual income taxation is currently pursued, leaving tax avoidance opportunities open for those ‘owners’, which by the way may be legal persons. According to Tørsløv et al. (2022),

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<sup>2</sup> See also EU Commission (2021a, article 3.25).

corporate profit shifting already reduces the tax burden for wealthy individuals, who concentrate the financial investment holdings in multi-national enterprises – directly or through investment funds - and thus benefit from the lower effective tax rate imposed on those profits.

Furthermore, a “governmental entity” is an entity wholly owned by a government and accountable to it (including by way of providing annual reporting), having as its principal purpose either (1) fulfilling a government function or (2) managing or investing assets of the government or the jurisdiction, provided it does not “carry on a trade or business”. The OECD Commentary on the Model Rules (OECD, 2022) has clarified that “holding assets” is intended to limit the eligible activities, i.e., that such assets may not be operated or used in an active trade or business by the entity. Nevertheless, under this definition, a typical sovereign wealth fund appears to be eligible as a “governmental entity”. According to the EU Commission (2021a, p. 14–5)’s proposal,

Certain entities should be excluded from the scope based on their particular purpose and status. Excluded entities would be those that are not profit-driven and perform activities in the general interest and which are, for these reasons, not likely to be subject to tax in the Member State in which they are located. In order to protect those specific interests, it is necessary to exclude from the scope of the Directive governmental entities, international organisations, non-profit organisations and pension funds from the scope of this Directive.

Therefore, governmental and non-profit entities involved in commercial activities are not generally excluded, while those pursuing general interest missions may keep benefiting from their legitimate domestic exemption and thus maintaining their eventual exclusion from domestic corporate taxation granted by local jurisdictions. However, it is not entirely clear why either governmental or non-profit entities which manage sovereign or private financial investments should be excluded.

In sum, in case of ultimate parent entities which are excluded, the minimum corporate tax obligation shall be moved down to lower-level constituent entities of the corporate group submitted to the ruling. However, due to the artificial nature of both corporate groups and involved corporations, such a wide definition of scope exceptions affords the hazard to encourage corporate restructurings and reorganisations in view to shift taxable income up to financial holdings which are excluded from minimum taxation.

## 2.2 Substance Carve-Out

Another exception concerns a so-called ‘substance carve-out’, that is, the exclusion for Substance Based Income Exclusion (SBIE). The SBIE is determined based on 5% of the Eligible Payroll Costs plus 5% of the carrying value of Eligible Tangible Assets. Accordingly, groups will be able to exclude from the top-up tax an amount of income that is at least 5% of the value of tangible assets and 5% of payroll.

According to the EU Commission (2021b) proposal, “the policy rationale for a substance carve-out is to exclude a fixed amount of income relating to substantive activities like buildings and people. This is a common aspect of corporate tax policies worldwide, which seek to encourage investment in economic substance by multinational enterprises in a particular jurisdiction. This exclusion also focuses the rules on excess income, such as that related to intangible assets, which is more susceptible to tax planning.”

This may be a well-intended rule to maintain incentives for foreign direct investment by groups. But it may provide an incentive for those groups to displace localisation of corporate activities to obtain specific tax results. Worst, it may pave the way for structuring opportunities within corporate groups without real economic change, by shifting control over tangible assets and payroll across corporate entities through legalistic and accounting gimmicks.

From this perspective, recent evolution in international accounting standards appears to favour the unbundling of the set of property rights related to assets and their control by reporting entities.<sup>3</sup> This may enable structuring opportunities to displace tangible assets through the corporate group notwithstanding their physical location in some jurisdiction. In a similar vein, some corporate groups have been implementing dedicated entities controlling employees which operate within and across borders; moreover, some groups may have recourse to unconsolidated business partners or vehicles in order to reduce the actual number of employees and payroll amount in a given jurisdiction. In this respect, the EU Commission (2021a, article 27.3) provides that “eligible employees shall be deemed to be located in the jurisdiction where they perform activities for the MNE group”.

### 3 Concluding Remarks

The proposed EU rules on minimum corporate taxation are supposed to be applied to any large group, both domestic and international, including the financial sector, with combined financial revenues of more than €750 million a year, and with either a parent company or a subsidiary situated in an EU Member State.

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<sup>3</sup> According to the EU Commission (2021a, article 3.22)’s proposal: ‘acceptable financial accounting standard’ means international financial reporting standards (IFRS and IFRS as adopted by the EU pursuant to Regulation (EC) No 1606/2002) and the generally accepted accounting principles of Australia, Brazil, Canada, the Member States of the European Union, the members of the European Economic Area, Hong-Kong (China), Japan, Mexico, New-Zealand, the People’s Republic of China, the Republic of India, the Republic of Korea, Russia, Singapore, Switzerland, the United Kingdom and the United States of America.



By proposing widely-defined exceptions, the EU initiative affords the hazard to foster further financialisation of corporate affairs, rather than promoting their fairer contribution to taxation and thus public spending. These exceptions may provide incentives for controlling parties to restructure the corporate group in view to avoid taxation, if the minimum effective tax threshold is constraining and material. Furthermore, it may provide a tax competitive advantage for groups controlled by those parties.

Eventual adoption and implementation of this ruling will say if some of those groups will be treated more equally than others under this law.

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