Polish Economic Institute

EU Member States lose EUR 170 billion per year due to EU tax havens

Nearly EUR 960 billion – this is the size of the European Union's current budget. That astronomical sum, however, is ⅕ lower than 7-year cumulative losses due to taxes escaping across the borders of the EU Member States. The mere elimination of artificial profit shifting by multinational corporations between jurisdictions would lead to the recovery of EUR 420 billion, i.e. an amount exceeding the EU's appropriations for cohesion policy. Germany, the United Kingdom and France suffer the highest CIT losses related to the functioning of tax havens. The most recent report of the Polish Economic Institute and Bank Gospodarstwa Krajowego, entitled 'Tax unfairness in the European Union. Towards greater solidarity in fighting tax evasion', demonstrates that many problems in Europe could be solved by reducing the scale of cross-border tax avoidance and evasion.

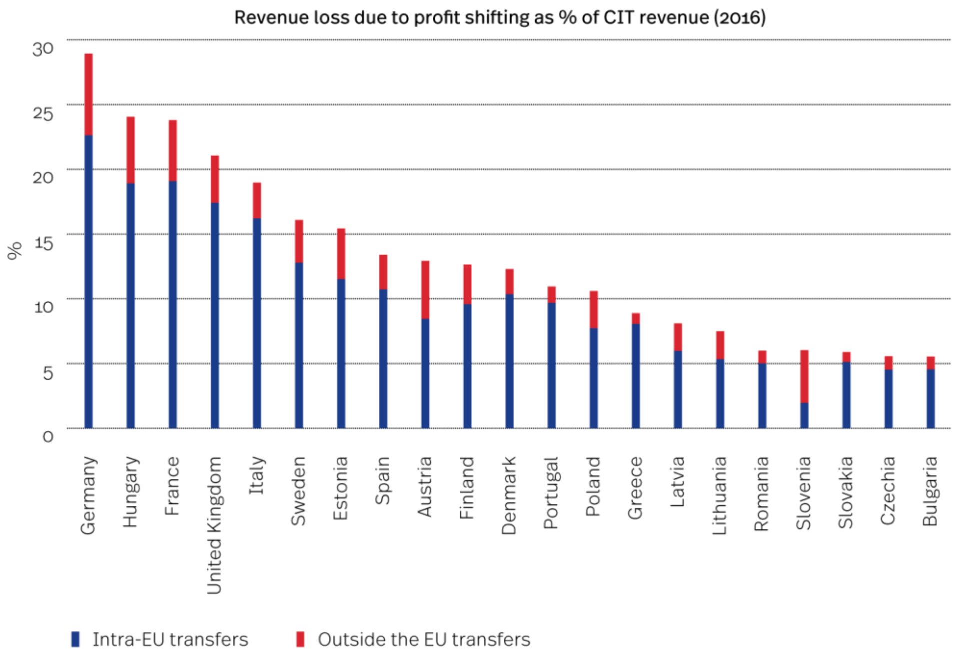
– *Analysing data on tax avoidance in Europe can lead to the sad conclusion that solidarity is only a declared rather than pursued value in the European Union. Losses resulting from the use of international transactions for tax fraud and tax avoidance reduce EU Member States' revenues by around EUR 170 billion annually. The Union should take integrated measures to seal the tax system in order to have an additional source of financing for the new budget, to be constructed without the United Kingdom, a major payer. Those funds could also contribute to the Just Energy Transition budget or to projects implementing the Green New Deal* – emphasises Piotr Arak, the Director of the Polish Economic Institute.

So much has been taken by so few from so many

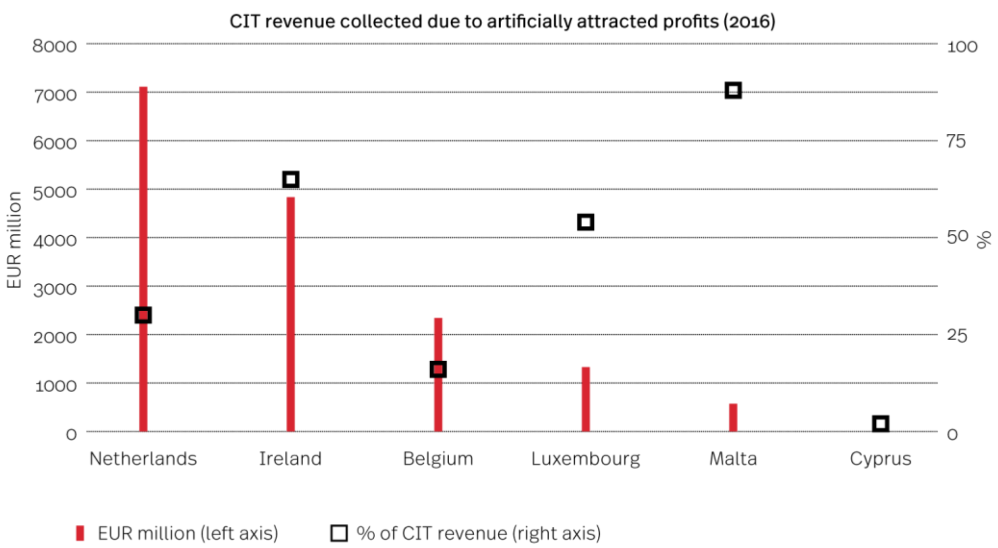
In the past two decades, the effective corporate income taxation in EU Member States has dropped by 8 percentage points (from 24% to 16%). Multinational companies freely shift their profits from the countries of operation to lower-tax jurisdictions within the EU. According to data for 2016, the countries worst hit by losses due to artificial profit shifting were Germany (EUR 18 bn), France (EUR 11 bn) and the United Kingdom (EUR 14 bn). The result is a terrible loss of public revenue which must be compensated by other financing sources.

Six EU Member States benefit from tax competition within the EU. Referred to as internal tax havens by the European Commission, these are: Belgium, Cyprus, Ireland, Luxembourg, Malta and the Netherlands. These countries intentionally implement legal regulations conducive to artificial profit transfers. Moreover, they also tend to be used by transnational corporations as intermediaries in further transfers to traditional tax havens, such as the Cayman Islands or the British Virgin Islands. Unless the EU takes effective action to combat tax havens, the situation will undermine trust and solidarity between Member States.

↘ Chart 1. Most of the EU Member States lose a huge part of CIT revenue due to artificial profit shifting...



↘ Chart 2. ...but some of the EU Member States benefit a lot from this process



The European Union as a whole loses EUR 170 bn annually due to cross-border tax avoidance and evasion. The sum includes EUR 60 bn and EUR 46 bn shifted by large corporations and wealthy individuals respectively. Furthermore, the situation is made worse by the enormous VAT gap in EU Member States, an average of 12% of VAT revenue. A significant part of the gap results from the use of cross-border transactions

by companies and criminal groups to extort VAT, which generates losses of EUR 64 billion every year.
– *Assets held by wealthy individuals in tax havens account for 10% of the EU's GDP; about 75% of the wealth is not reported to the tax authorities at all. We are losing huge amounts of money, while at the same time cutting the budget for cohesion policy which facilitated the EU's faster growth in previous decades. All it takes is to stop the leakage of money to tax havens. Those countries benefit very few and hurt us all* – says Jakub Sawulski, head of the macroeconomics team of the Polish Economic Institute.

What should the EU do to improve the situation?

There are several ways of resolving the problem of tax avoidance. The solutions proposed include blacklisting the EU Member States identified as tax havens and giving the European Commission the power to impose sanctions on countries classified as non-cooperative tax jurisdictions. Another remedy may be the establishment of an EU-wide minimum rate on corporate income, calculated using a tax base that disallows the deduction of payments most often utilised for tax avoidance, such as interest and royalties.

Poland has been leading the charge in the EU with regard to tax avoidance and combating the phenomenon. Specifically, it is vital to push for the taxation of profits where they are generated and for tax flows to be transparent across the EU. Therefore, on 22 January, during the World Economic Forum in Davos a debate will be held with the participation of the Prime Minister of the Republic of Poland Mateusz Morawiecki, the OECD Secretary-General Ángel Gurría and the Minister of Finance of the French Republic Bruno le Maire. World leaders and decision makers will discuss how to eradicate tax evasion together. This is one of the basic conditions for meeting the global challenges faced by the international community.

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The Polish Economic Institute is a public economic think-tank whose history dates back to 1928. The research areas of the Polish Economic Institute are primarily foreign trade, macroeconomics, energy and the digital economy as well as strategic analyses regarding key areas of Poland's social and public life. The Institute provides analyses and expertise for the implementation of the Strategy for Responsible Development as well as the popularisation of Polish scientific research in the field of economic and social sciences in the country and abroad.

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