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Future-Proofing Tax – Green, Digital, Fair and Global Co-operation What are sustainable tax systems from the perspective of business?

The elements Accountancy Europe has chosen to describe future proof, sustainable taxation are fitting - "Green, Digital and Fair". Sustainability is usually considered to consist of three pillars: economic, environmental and social. The term ESG is also often mentioned, meaning Environmental, Social and Governance, informally "profits, planet and people". Although sustainability is a much wider concept than taxation, these pillars can give support to the concept of sustainable tax systems as well. But one element must be added: global co-operation.

When thinking about what a future-proof taxation system should be like, one must also understand that taxation is a toolkit, not a goal. We need to know the goal we are trying to reach before deciding what tax tools to use. If the goal is to increase R&D-investment, a R&D-tax incentive might be thought of. Lowering personal income taxation is likely to make working more rewarding and make it easier for companies to hire skilled workers. To lower emissions, we have higher taxes on fossil fuels. Like Ronald Reagan once said, "If you want more of something, subsidize it; if you want less of something, tax it."

Green

The whole world has suffered from the difficult COVID-crisis. Need for additional tax revenues is acute. However, we have an even more severe crisis on our hands. The climate change is and will keep causing devastating humanitarian crisis, but the economic effects and their part in humanitarian crisis have not been discussed or taken seriously enough.

Green taxation includes self-evidently energy and environmental taxation and is tightly linked to emission trading system and global (floor) price of carbon. Much is being done to ensure that energy taxation is aligned with EU's climate objectives set out in the Fit For 55 -package and Green Deal. For example, the energy tax directive is being updated. In the revision of the energy tax directive¹ it is described that:

"Taxation plays a direct role in supporting the green transition by sending the right price signals and providing the right incentives for sustainable consumption and production. In this context, effective environmental taxation and the removal of incentives for fossil fuel consumption throughout the EU are needed to deliver the greenhouse gas emission reductions together with other regulatory measures."

However, the concept of green is closely linked to other taxation as well. **When planning future-proofing changes in taxation, the effect to the environment should always be taken into account in all taxation.**

Technology Industries of Finland (TIF) has created an industry road map² towards a low-carbon society. The road map supports the Finnish government's goal of a carbon neutral Finland by the year 2035, and EU's goal of carbon neutrality by the year 2050. The road map includes an integral part of the Finnish export sector as the forest industry, chemistry industry and energy industry

¹ https://ec.europa.eu/info/sites/default/files/revision_of_the_energy_tax_directive_0.pdf

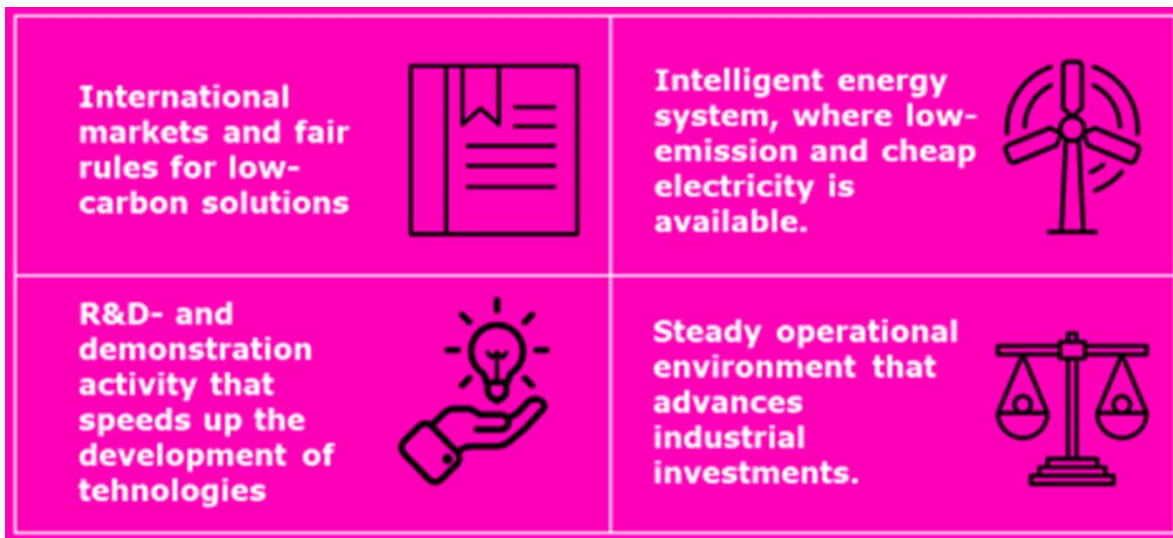
² <https://teknologiateollisuus.fi/en/focus/environment-and-sustainability/technology-industries-finlands-low-carbon-roadmap-solutions>

have joined together with technology industry to create a common overall view of the path towards a low-carbon society.

TIF's low-carbon road map 2035

Most of the emissions reduction methods are based on electrification of processes and machinery, increasing energy- and material efficiency, circular economy, and applying digital solutions.

Prerequisites:



Source: Technology Industries of Finland's low-carbon road map 2035 – June 2020

All of the prerequisites identified in the low-carbon roadmap can be promoted using taxation tools. For example:

- International markets and fair rules are linked especially to global co-operation. If unilateral of EU-level taxes are implemented, there is a risk of carbon leakage due to loss of competitiveness. Global solutions should be prioritised, like a global (floor) carbon price.
- Low emission and competitive energy prices is a crucial prerequisite. Updating the energy taxation directive to better incentivize use of low-emission electricity and disincentivize fossil fuels is an important change.
- Supporting green R&D-innovations to boost low carbon solutions is an indispensable condition to reach the low-carbon goals set. R&D-tax incentives are an important tool to support R&D-innovations. On 18 May 2021 the Commission's CCCTB proposal was withdrawn and replaced with the Commission's new BEFIT (the Business in Europe: Framework for Income Taxation) proposal³. It is unclear whether the BEFIT proposal will include an R&D-super tax incentive, similar to the one that was included in the preceding CCCTB-proposal. Our opinion is that such a R&D-tax incentive should definitely be added to the BEFIT proposal. Even a separate R&D-directive proposal could be introduced to ensure a swift implementation.
- Steady operational environment means for example that taxation is steady and predictable and digital tools are used to make taxation as simple as possible. Globally unique tax

³ https://ec.europa.eu/commission/presscorner/detail/en/ip_21_2430

systems are likely to cause expensive tax disputes, double taxation, heavy administrative costs, possible protective counter tax legislation and increased tax burden for EU companies. This does not enhance proper functioning of the Digital Single Market (DSM) and is likely to harm the competitiveness and growth throughout the EU.

Even though there is a vast demand for additional tax revenues, revenue raising should not be the primary objective when drafting environmental taxation. If tied to the goal of lowering emissions, effective environmental taxation should result in declining emissions - and declining tax revenues. However, investing in green will increase tax revenues. In TIF's low-carbon road map we identified an annual potential increase in exports of EUR30bn, in Finland alone. With increased green export we can also grow carbon handprint, meaning emissions lowering potential. By selling low-carbon solution products and services globally, we can reduce emissions globally.

Why do companies invest in green?

There is no "hidden catch" why companies invest in green. Companies are not individual organisms or driven by artificial intelligence. Companies are run by people. The employees, management and the owners are individuals with families, just like the rest of us. Most of them want to save the planet for the future generations. For example, in April 2021⁴ more than 300 US companies' executive officers called for bigger emission cuts to combat climate change, to set a new goal to cut carbon dioxide, methane and other emissions at least 50 % below 2005 levels by 2030. We are all in this crisis together.

There are also plenty of financial reasons why companies demand for swift actions to fight the climate change. In energy intensive companies even up to 40 % of company's all costs can consist of energy costs. These energy intensive companies have a remarkable incentive to cut energy consumption, because it would vastly lower the companies' costs. In addition, all nature's catastrophes are extremely costly, losing a factory or a storage due to floods or forest fires, not receiving components or raw material due to shutdowns. No company can afford to lose their employees to nature disasters.

A small stinging example: extinction of bees⁵ will cost tens to hundreds⁶ of billions of euros per year. This is how much it will cost, if humans have to do their work, pollinating plants with tiny brushes. Bees pollinate 70 of around 100 crop species that feed 90 % of the world. Most of fruit and vegetables rely on bees so plants like coffee would become extinct. Without plants also animals would be malnourished. The climate crisis is hitting developing countries harder than the developed countries. Aiming towards green is very much linked with being fair.

To help companies to identify and minimize their emissions, TIF has in October 2021 published a tool called Climpactor.⁷ It is a tool designed to allow companies calculate their climate impacts (company and products), and to determine the company's social handprint.

⁴ <https://www.nytimes.com/2021/04/13/climate/business-executives-climate-change.html>

⁵ <https://www.bbc.com/future/article/20140502-what-if-bees-went-extinct>

⁶ <https://www.globalcitizen.org/en/content/life-without-bees-hand-human-pollination-rural-chi/>

⁷ <https://climpactor.fi/>

Fair

The fair global allocation of taxation rights is an important and vast question, that must be addressed. When talking about European Union, the question is a bit easier to grasp because the EU Member States are somewhat more homogeneous in their economic situation. The European Commission has proposed that the recovery package (RRF) and long-term budget (MFF) would be partially funded with new own resources, including various taxes. EU taxation must be fair to all EU Member States. Introducing multiple taxation models where more taxing rights are allocated to big consuming countries will lead to more tax revenues to large Member States. The EC must always perform a reliable impact assessment to evaluate the new taxes' effect to all Member States of the EU.

The global taxation system must be always considered in its entirety. Indirect taxes (value added taxes, excise taxes) generate significant taxes in the residence country of the customer. Larger markets with more consumers naturally receive a larger share of such indirect taxes. This should be borne in mind when considering proposals which will result in shifting tax revenues away from smaller research and development intensive exporting countries.

Qualified majority voting (QMV) in taxation matters would result to small Member States losing their sovereignty to decide in taxation matters. In the most important taxation matters unanimous decisions have been reached (e.g. Anti-Tax Avoidance directive, exchange of information between tax authorities). Thus, QMV in taxation matters is unnecessary. The climate crisis is such an important matter, that reaching unanimity will happen.

BEFIT directive proposal must be fair to all Member States and different types of economies

A new BEFIT-directive proposal is expected 2023. Preliminary comments indicate that the OECD's Pillars elements would be used as building blocks of the BEFIT. The tax base calculation would be based on the rules of Pillar 2 and the allocation formula would use elements from Pillar 1 rules. The basic idea seems to follow the ideology of the CCCTB proposal. However, it should be carefully considered whether a model created 20 years ago mirrors the current world. In the original proposal allocation formula was based on sales, tangible assets and payroll (amount of employees and paid salaries). In case these factors would be given an equal weight, the sales factor would unequally benefit bigger markets.

- This is especially true concerning digitalised economy companies, where tangible assets can be nonexciting, and the businesses derive much of their value from intangible assets. Such an allocation formula does not courage member states to invest into companies boosting digitalisation and new technologies, R&D etc. The value of digitalisation, also to the environment, must be understood and recognised.
- Apportionment formula of sales, tangible assets and payroll does not value environmental issues, efficiency, productivity, value add. It does not give weight to benefits of circular economy, digitalisation, automatisisation, robotics etc. It could hinder the companies' incentives to find environmentally friendly, effective solutions.
- Such a formula could also lead to inefficient group structures: equity and assets trapped to companies (and not to investments), personnel and fixed assets (or leasing/renovation costs) located in countries with lowest tax rate.

Data privacy – question linked to fair, digital and global co-operation

Many of the new proposed or introduced corporate income tax models include a difficult question related to data privacy. In the Digital Levy survey in April 2021 there was a question on “how to identify where the revenues/profits are generated and how to determine the place of taxation”. Options given were IP address and different variations of consumer geolocation data. OECD’s Pillar 1 Amount A blueprints’ revenue sourcing rules prioritised real-time geolocation data of the consumer or even the user. Preliminary information about the new BEFIT model hint, that these Pillar 1 revenue sourcing rules would be used also in the BEFIT directive.

Data privacy is a crucial element of sourcing rules. Tracking the individuals’ location is justified when trying to prevent crimes, such as credit card fraud, money laundering, trafficking. The instances using the data are usually authorities (police) or strictly regulated banks and the use of data is limited. The tax administrations can also access this type of data, but the use should be limited to similar use, to prevent crime, such as tax frauds. EU digital levy, Amount A and BEFIT, however, would be new tax systems based on gathering personal data solely for corporate taxation purposes.

There must be clear rules on how the consumer data is collected and used for taxation purposes, without jeopardizing the principle of data security, for example GDPR-rules. At a time when society is questioning the amount of personal data that is retained by companies, it seems to be a surprising course to suggest – to base the calculation of new taxes on personal location data, requiring companies to collect and store vast amounts of personal data for tax compliance purposes for an indefinite time.

As the market jurisdiction’s taxation rights would be allocated based on the users and consumers located in the jurisdiction, also the countries would have an incentive to gather location data of individuals. This is a fairness question for individuals. Who owns, stores and uses your personal data?

Under the GDPR-rules taxation might be an acceptable reason for the taxpayer company to collect personal geolocation or other relevant personal data. However, sometimes the tax-payer company does not have the consumer data but must rely on data gathered by a third-party company. What would be the legal situation concerning third-party companies or group companies not in a tax paying position? Would digital levy rules require changes to GDPR regulation and changes to all companies bound to GDPR rules?

In addition, there are practical problems with collecting geolocation data, for example:

- The individual user should not be tracked unless she/he gives her/his approval (enabling the feature on the device). This makes the coverage of the real-time geolocation data unreliable.
- The tax-paying company itself might not have access to this data but must rely on other group company or third-party data. Even small SMEs might be required to collect and distribute consumer data.
- If the user does not want to give access to geolocation data, must a company demand the user to allow geolocation tracking, i.e., obligatory for the user? Is this possible without changing data privacy legislation? Is this fair and sustainable?

Digital

In the above mentioned TIF's low-carbon roadmap, one of the most critical factors identified is digitalisation. Without digitalisation of all business, fight against climate change cannot be won. For example, cloud services are 93% more energy efficient with 98% lower carbon emissions than on-premise computing.⁸ Additional compliance burdens and tax costs to the digitalising of the whole economy, which are done to enhance productivity and lower compliance costs, should not be created. A basic, easy-to-understand example of digitalisation is a newspaper. Traditional print-format newspaper must be printed on paper, which requires wood, water, and energy to be produced, fuel to be transported to the printing house and later to the stores near consumers. All excess newspapers must be shredded, creating garbage or stored to a warehouse, requiring large premises. An electronic newspaper is delivered with a press of a button. Like all digitalisation and electrification processes, important requirement is access to clean, carbon-free, globally competitively priced electricity. R&D tax incentives are a tool to support investments in digitalisation.

Taxation is always a combination, a two-way street: what we are paying and what is done with that money. When talking with our member companies in Finland, they say they are happy to pay 20 % of corporate income tax, if in exchange they have an efficient and simple tax system and tax certainty, educated, skilled employees and a well functioning infrastructure. All of these are and can be influenced by taxation, for example by:

- Easy taxation procedures: digitalised and automated taxation processes enable the company to concentrate on productive business activities, reduces risk of non-compliance.
- Low administrative costs: harmonisation of tax reporting (no unilateral variations of tax reporting forms in each EU Member State).
- Tax required to be paid only once: well-functioning, global dispute prevention and solving procedures.
- Tax certainty: sustainable, predictable and efficient tax legislation.

In order to be sustainable and fit for future, taxation procedures must be efficient and effective. Steady operational environment that advances investments is also a part of a well-functioning, appealing Digital Single Market. Reporting, collecting and crediting of tax should be as efficient and simple as possible. Taxation procedure tools and real time economy are means to enhance this. Digitalisation and automation of taxation procedures could lead to notable savings both to companies and tax administrations, as well as reduce tax gaps and tax evasion. Tax reporting requirements, forms, systems and deadlines vary in each country. Compliance costs and a risk of non-compliance could be lesser if MNEs wouldn't have to report in all jurisdictions. Centralising corporate income taxation procedures to the home country of the group (like MOSS: mini-one-stop-shop in the EU for VAT matters) would minimise the administrative burden significantly and help to eliminate double taxation and tax disputes. Much has been done in the recent years to improve exchange of information and co-operation between the competent tax authorities. The OECD's Pillar 2 global tax base calculation rules could enhance also harmonizing tax reporting. However, a lot of work needs to be done with simplification of the calculation rules of Pillar 2 before

⁸ Microsoft and WSP conducted a research in 2018 called "*The Carbon Benefits of Cloud Computing: a Study of the Microsoft Cloud*". The methodologically used on the research was supervised by Stanford University experts.
<https://www.microsoft.com/en-us/download/details.aspx?id=56950>

it can be used more widely. Tax reporting should be harmonised within the EU, in co-operation with companies and by using solutions also enhancing real-time economy.

Why do we need Real-Time Economy?

Real-Time Economy (RTE) is an environment where financial and administrative transactions connecting citizens, businesses and public sector entities are in structured standardised digital format generated automatically and completed in real time. For example, eInvoice and eReceipt are important building blocks of RTE. Instead of having all financial documents on paper and carrying them to the accountant, this could be done without manual work, automatically.

RTE has lots of savings potential to public and private sector alike. It could also minimise tax gap. The European Commission's Action Plan for simplifying taxation should be advanced so that changes support RTE. The taxation models and processes of the Member States vary a lot. The Commission should take notes from small, digitised countries. Subtle harmonisation of VAT reporting and corporate tax base calculation could lead to savings and help especially SMEs to expand their business cross-border.

The Finnish Tax Administration is the first country in Europe to combine all taxation software and processes into one system.⁹ The savings for the Tax Administration alone were estimated a total of approx. 6,5 % decrease in the total annual costs of the Finnish Tax Administration. The taxation procedures have been digitalised almost fully. Savings to companies due to the decrease in compliance costs, interest expenses and tax disputes cannot be fully estimated. Automation also minimises the tax gap and tax evasion. The Finnish Tax Administration has also invested in software robots (estimated savings equivalent to 1,3 % of total annual costs) blockchain and AI. Similar savings could be achieved in all countries with investments in the automation of taxation. In addition to savings both to companies and member states, automation of taxation would mean an appealing location for businesses to function and grow. The EU could invest in developing automated and digitalised taxation procedures, which would improve tax certainty.

The real-time financial data is valuable for the company to boost business and creating new business models. The Nordic countries are on an implementation stage of the Nordic Smart Government¹⁰ -project, which is a vision of a data driven Nordic region, where data and digitisation enable value creation by sharing data across the Nordic region in an automatic, secure and intelligent manner, for example to reduce administrative work and to enhance innovation and growth.

Global co-operation

Sustainable tax system should be green, digital and fair. But global co-operation should be added to the list. Always, when possible, a global tax model should be preferred and supported. Introducing globally different EU-wide corporate income taxation systems does not support companies to locate in the EU, and results in additional administrative costs, hitting the SMEs

⁹ <https://www.oecd.org/tax/forum-on-tax-administration/publications-and-products/introducing-a-commercial-off-the-shelf-software-solution.pdf>

¹⁰ In the Nordic Countries, a project called Nordic Smart Government started in 2016. <https://nordicsmartgovernment.org/> The aim is to have a digital ecosystem with both privately and publicly owned solutions, where different actors work together to ensure efficient data flow and e.g. to remove the businesses' administrative burdens related to mandatory reporting to the government by automating reporting of financial data, also to be utilised in taxation.

hardest. Thus, does not promote level playing field. Globally different tax systems are likely to cause expensive tax disputes, double taxation, heavy administrative costs, possible protective counter tax legislation and increased tax burden for EU companies. This does not provide for proper functioning of the Digital Single Market (DSM) and is likely to harm the competitiveness and growth throughout the EU.

On 8 October 2021 a ground-breaking agreement was reached by 136 countries and jurisdictions representing more than 90 % of the global GDP, on the OECD's Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy.¹¹ On 30 October 2021 the agreement was endorsed by worlds biggest economies, the G20-countries. They called for the OECD Inclusive Framework -countries to swiftly develop the model rules and multilateral instruments with the view to get the new rules into effect at a global level in 2023.

Pillar One would reallocate some of the large and profitable companies' profits to be taxed in the market jurisdictions. Pillar Two introduces a global minimum corporate tax rate of 15 %. The pillar aims also to set global rules to calculate effective tax rate. A lot of details need to be still worked out, such as revenue sourcing rules, allocation mechanism, elimination of double taxation, dispute prevention and resolution. The European Commission has announced that there will be an EU-directive proposal introduced for both pillars in 2021-2022.

The rollback of unilateral measures is one of the details that still need to be agreed upon in the OECD's Two-Pillar Approach. The EC is still reluctant to drop their plans of introducing an EU-level digital levy. The threat of an EU digital tax and the unilateral DSTs in many countries has caused continuous friction between the trade relations of Europe and other countries, especially the US. Globally different EU-level tax model would harm competitiveness by triggering protective countermeasures. The EU should refrain from creating their own globally different tax systems. The principal goal should be to reach a well-functioning, simple global solution to the tax challenges arising from the digitalisation of the global economy. Different set of tax rules for some companies, based on their business and location is not fair taxation. Any tax on the activities of corporations should be linked to profit, not revenues. Otherwise also loss-making companies will be hit by additional taxes.

Green and global co-operation

Even though green taxation is needed, this is the element most relying of global co-operation. If unilateral of EU level taxes are implemented there is a risk of carbon leakage due to loss of competitiveness. Should companies be impacted with heavy environmental taxation and wide emission trading system causing additional manufacturing, transportation costs and emission trading system costs, there is a risk manufacturing will be transferred to countries of lower costs but not so green manufacturing. The EU identifies the risk.¹² However, this must not be an excuse to not do anything. Hence the crucial role of global co-operation. We must have global carbon price, starting for example with a global floor carbon price, which has been discussed between the G20 countries.¹³

¹¹ <https://www.oecd.org/tax/international-community-strikes-a-ground-breaking-tax-deal-for-the-digital-age.htm>

¹² https://ec.europa.eu/clima/eu-action/eu-emissions-trading-system-eu-ets/free-allocation/carbon-leakage_en

¹³ <https://www.reuters.com/business/environment/imf-chief-urges-g20-adopt-carbon-price-floor-reach-climate-goals-2021-04-22/>



Technology Industries of Finland (TIF) represents Finnish technology industries and has over 1,600 member companies, sizes varying from small SMEs and start-ups to world leading MNEs. The technology industry is comprised of five sub-sectors: electronics and the electrotechnical industry, mechanical engineering, metals industry, consulting engineering and information technology. Technology industry is the most important export industry in Finland, with operations constituting over 50 % of all Finnish exports and responsible for 70 % of all private investments in R&D carried out in Finland. Over 300,000 Finns work in technology companies, while a total of around 700,000 people work in the technology sector directly or indirectly (of a total population of 5,500,000). For further information of TIF's member companies, please see <https://teknologiateollisuus.fi/en>

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