OPINION

European Economic and Social Committee

The role of corporate taxes in corporate governance

The role of corporate taxes in corporate governance
[Own initiative opinion]

ECO/552

Rapporteur: **Krister ANDERSSON**

EN

Plenary Assembly decision	25/03/2021
Legal basis	Rule 32(2) of the Rules of Procedure
	Own-initiative opinion
	Resolution
Section responsible	Economic and Monetary Union and Economic and Social Cohesion
Adopted in section	23/11/2021
Adopted at plenary	08/12/2021
Plenary session No	565
Outcome of vote (for/against/abstentions)	223/4/11

1. Conclusions and recommendations

1.1 The EESC believes that the response in the private sector to the Recovery Plan and NextGenerationEU will be key to delivering and effectively achieving a greener and digitalised economy. Public policies must therefore provide the appropriate incentives. Economic policies, in particular tax policies and policies impacting on corporate governance, must provide for an efficient decision-making process and efficient allocation of resources, promoting the achievement of social objectives.

1.2 The EESC assesses that, to deliver a sustainable green and digitalised economy, the debt-equity financing distortion in taxation needs to be addressed.

1.3 The EESC urges Member States to make their tax systems more neutral with regard to debt and equity financing. This would encourage diversification of financing sources and make the European economy more resilient.

1.4 The EESC welcomes the initiatives taken by the EU Commission to present measures addressing the debt/equity bias in corporate tax systems by the first quarter of 2022.

1.5 The EESC stresses that for new firms and for investors seeking greener and digitalised investment opportunities, a well-functioning capital market is essential. The EESC therefore calls for further steps toward the completion of the Capital Markets Union (CMU).

1.6 Investment in new, green technology is perceived to be very risky and equity financing is therefore often used. Dividends help increase liquidity in the market, also to the extent that they may be perceived as too short-term, and are an important source of financing.

1.7 The EESC believes that capital markets and private funds can play a crucial role in encouraging the path of companies towards a sustainable greener and digitalised economy. Any policy action by the European legislator concerning taxation, company law and corporate governance should enhance such a role.

1.8 Under the influence of European directives and regulations, the EESC notes that national company laws are an integral part of the judicial system in each Member State, allocating rights and accountability to appropriate levels in the legal structure. Rules need to be country-specific when it comes to the composition of boards of directors, allowing the owners to decide.

1.9 The EESC encourages the European Commission to undertake concrete initiatives to establish similar carbon taxes in the Member States in order to harmonise the efforts to achieve an effective reduction of CO_2 levels. An ideal outcome would create uniform conditions across the EU single market with regard to the emissions/reductions to be taxed, as well as the specific methods and rates of taxation for equal impact on the level of CO_2 in the atmosphere.

1.10 The EESC reiterates that Member States should, in particular, adopt a comprehensive and symmetrical environmental tax policy on the effect of CO_2 on global warming. There is a need to introduce taxes with both positive and negative rates. The revenues raised from CO_2 taxes should be used to finance incentives for CO_2-reduction techniques locally, regionally and nationally.

1.11 The EESC notes that, while the sale of forest products is taxed as income for the owner, it should be recognised that planting trees and the growth of forests reduces CO_2 in the atmosphere and should therefore, in a symmetrical tax approach to global warming, be encouraged by a negative CO_2 tax. This would be an important measure for achieving climate objectives.

1.12 The EESC underlines the need for a universal agreement on, and globally coordinated implementation of, the OECD/G20 tax package. In order to promote digitalisation of the European economy, it is important that unilateral rules in Europe do not prevent further adaptation of new business models.

2. **Introduction**

2.1 The COVID-19 outbreak gave the European economy both a supply shock, disrupting supply chains, and a demand shock, caused by lower consumer demand. As a result, investments by European companies decreased substantially during the pandemic, while the overall amount of bank deposits has risen.

2.2 However, the recovery is gaining momentum and is well underway. In order to reshape the European economy in line with the objectives stated by the Commission to achieve a more sustainable, greener and digitalised economy, investments must support environmental goals while digitalisation contributes to an increase in productivity, taking into consideration the transformation of the labour market. Both private and public initiatives are needed if we are to meet environmental, economic and social objectives.

2.3 The EU's long-term budget, including the *Recovery Plan* and *NextGenerationEU* tools, will implement the largest public stimulus package ever financed in Europe.

2.4 The response in the private sector will be key to delivering and effectively achieving a greener and digitalised economy. Public policies must therefore provide the appropriate incentives. Economic policies, in particular tax policies and policies impacting on corporate governance, must provide for an efficient decision-making process and efficient allocation of resources.

2.4.1 For the funds allocated to Member States as a response to the COVID-19 pandemic, key indicators must be set up to understand how the money invested is spent in each Member State.[1]

2.5 The international tax landscape is undergoing its largest changes in the last hundred years. Taxable profit from some of the very largest companies will be relocated from the residence country to the country where sales take place and goods and services are delivered. Furthermore, a minimum effective corporate tax rate of 15 per cent has been agreed upon by

[1] To be effective, the money must be raised in a cost-effective manner and be well spent in Member States, contributing to investment that would not have been undertaken without the transfers.

some 136 countries in the OECD Inclusive Framework. Another important change is that VAT in Europe is to be levied according to a destination-based approach.

3. **The importance of proper incentives**

3.1 To achieve environmental objectives, firms, households and investors must be given proper incentives in the form of prices that reflect scarcity and externalities. Economic policies laying down economic or social objectives should be reflected in the prices with which private and public investors are confronted in the marketplace.

3.2 However, corporate tax systems treat debt financing more favourably than equity financing, in that interest payments are tax-deductible but not the cost of equity financing. This result in increased leverage (debt levels) and therefore vulnerability of the firms in times of economic turbulence.

3.3 To deliver a sustainable green and digitalised economy, the debt-equity financing distortion needs to be addressed. Dividends, which face double taxation (first at corporate level and then at shareholder level), are important not only as income for pensioners and for funding research institutions, but in particular as a source of funding for greenfield investment.

3.4 Investment in new, greener investment projects is associated with a high level of risk. Equity financing is therefore the preferred source of financing. A key area for enhancing private sector participation in green and digital investment is the removal of obstacles to sources of new investment capital.

3.5 For new firms and for investors seeking greener and digitalised investment opportunities, a well-functioning capital market is essential. The availability of capital is crucial for a successful outcome. Dividends help increase the liquidity in the market.

3.6 Sustainability is already a market-driven, competitive factor that is key to companies' ability to attract customers, employees and investors. Consideration for sustainability is good for the long-term survival of the company. Regulatory tools must be constructed in such a way as to support the pursuit of these goals in line with the basic principles of how businesses operate.

3.7 While there should be no interference with dividend policies or undue influence on the composition of boards of directors or enforcement of directors' liability toward a company, proper incentives for a greener economy are needed. The governance of a company must take into account corporate social responsibility, relevant European directives and the OECD guidelines for multinationals.

3.8 Global warming is a concern for us all, and companies should be paying the proper market price for emissions and reducing CO_2 in the atmosphere. This means not only taxes on CO_2 emissions but also subsidies for those activities that reduce CO_2 in the atmosphere.

3.9 Another important area for achieving the objectives of a greener and digitalised economy is taxation of increasingly digitalised firms. A global, consensual solution is needed and a comprehensive agreement is expected to be finalised before year end. Taxes on digital services should not harm innovation or disincentivise investments in digital technologies.

4. Debt/equity bias in corporate taxation

4.1 The debt/equity bias in the corporate tax systems affects socio-economic costs as well as firms' leverage and corporate governance. Excessive reliance on debt financing can undermine the achievement of the European Commission's objectives as companies become financially vulnerable, and the possibility of undertaking new and risky green investment projects will be adversely affected. The ability to pay dividends so that investors get to decide on whether to invest in new projects will be restrained.

4.2 The current tax rules make interest paid on loans deductible from the tax base, while that is not the case for equity payments. Equity payments consist of two parts: dividend payments and capital gains. These national rules make financing through debt clearly more advantageous than financing through equity.

4.3 A dedicated allowance intended to give companies more similar tax treatment for equity financed investment than they currently get for debt-financed investment could reduce corporate vulnerability and be a useful means to promote sustainable, greener and digital investment.

4.4 It is worth noting that if statutory corporate tax rates increase, it will be economically better for a company to invest using loans, thereby encouraging companies to focus on debt financing even more than before. A higher inflation rate and higher interest rates would have a similar effect, increasing incentives to invest using loans.

4.5 The EESC urges Member States to make their tax systems more neutral with regard to debt and equity financing. This would encourage diversification of financing sources and make the European economy more resilient.

4.6 In the proposed revised directive on the Common Consolidated Corporate Tax Base from 2016, an allowance for growth and investment (AGI) was introduced to reduce the debt/equity bias and to promote investments in R&D. The AGI would be provided by making the increase in equity deductible from the taxable base, subject to certain conditions[2].

4.7 The EU Commission has announced that a draft directive addressing the debt/equity bias will be presented in the first quarter of 2022[3]. The EESC is looking forward to seeing a detailed proposal and providing comments on it.

---

2 An amount equal to the defined yield on the AGI equity base increases would be deductible from the taxable base. The defined yield would be equal to the yield of the euro area 10-year government benchmark bond in December of the year preceding the relevant tax year, increased by a risk premium of two percentage points. See the Council directive on a Common Corporate Tax Base, COM(2016) 685 final, 2016/0337 (CNS) (2016).

3 Debt Equity Bias Reduction Allowance (DEBRA), Communication on Business Taxation for the 21st Century, COM(2021) 251 final.

5. Corporate governance in company law

5.1 Besides taxes, regulations may enhance or reduce the effect of incentives created by other means. Direct regulations governing ownership and the ability to use funds as investors and corporate boards see fit may create difficulties for responding to some desirable objectives.

5.2 It is important for a well-functioning economy to have proper rules and regulations affecting the operation of businesses and markets. Shareholders should hold the management of a firm accountable if means are used for personal benefit and not for increasing the value of that firm[4]. A number of laws regulate acceptable corporate behaviour in terms of combatting tax fraud, tax avoidance and money laundering[5], as well as extensive agreements on market codes on corporate behaviour in Member States. As announced in the European Green Deal and the Commission's Communication on the (COVID-19) Recovery Plan, it is important for sustainability to be embedded in the corporate governance framework. The Commission issued a public consultation to collect the views of stakeholders with regard to a possible initiative on sustainable corporate governance[6].

5.3 The EESC shares the vision of a greener, digitalised European economy in the future, with fairness, growth and effective taxation, thus creating an environment conducive to investment and job-rich growth. To redirect investment flows, it is paramount that capital be available for the new green economy. Availability of investable funds, together with certainty about rules and upholding the rule of law, are important factors for the successful transition of the European economy.

5.4 The EESC shares the Commission's view that companies should contribute to the achievement of a greener, sustainable and digitalised economy, thereby focusing on long-term objectives and a fair distribution between countries and citizens.

5.5 The EESC firmly believes that ultimate control over corporate activities and accountability for them should lie with the shareholders. The owners of a company should be held accountable. The current system of Member States' corporate governance codes and company laws relies indeed on shareholders, who are the owners of the company, and who ultimately exercise control over the company's strategies and priorities by appointing the company's board of directors. This accountability means that shareholders are responsible for the company's finances and conduct and they should lose capital if the company experiences losses. Such a basic well-established principle should not be changed or undermined.

5.6 Long-term objectives and positive social externalities should, of course, be taken into proper consideration by companies both in their daily operations and in their investment decisions.

---

4 It must be forbidden to use company funds for luxury spending among managers that is not related to business objectives.

5 See EESC opinion *Combat tax fraud, tax avoidance and money laundering*, OJ C 429, 11.12.2020, p. 6.

6 Consultion on Sustainable corporate governance, period 26 October 2020 - 08 February 2021.

This is increasingly required by the market standards, by sectoral rules regulating production and by investors across the world, which often demand ESG standards within corporations[7].

5.7 Under the influence of European directives and European regulations, national company laws are an integral part of the judicial system in each Member State, allocating rights and accountability to appropriate levels in the legal structure. Rules need to be country-specific, also when it comes to the composition of boards of directors. EU governance and recommendations should ensure fair competition and fair values regarding the conduct of a company.

5.8 In order to facilitate the required role of private funds for the Commission's priorities, it is crucial that capital is not locked-in in companies and that funds can easily be invested in EU-defined key sectors.

5.9 A well-functioning capital market in the EU is essential for new investments in particular. The EESC therefore calls for further steps toward the completion of the Capital Markets Union (CMU)[8].

5.10 The liquidity of the capital market is important for investments to be undertaken. Dividend payments, also to the extent they may be perceived as too short-term, contribute to the pool of funds available for new investments in the green and digital sectors[9]. They are therefore crucial for a well-functioning capital market when they are invested, either in new ventures or in the firm paying the dividend. If dividends are paid out to the investor, the investor may always opt to reinvest in the existing company or in another company. However, if earnings are retained, the investor must liquidate shares as the only way to invest in new ventures. It might be good for old companies and investors if retained capital appreciates in value, but it will not make new funds available for new ventures or greenfield investment.

5.11 Dividend payments give investors an opportunity to continuously refine their investment strategy, contributing to green, sustainable, ethical and digital projects. This has already been witnessed in many cases on capital markets and in the private equity field (such as, for example, investing in battery production for electric cars, or carbon free steel production).

5.12 New companies should be fully allowed to grow and seek financing from dividends paid to shareholders of old, existing companies, thereby allowing a new allocation of capital, in line with the Commission's priorities. Tax incentives for new, green investment could be considered.

5.13 The EESC believes that capital markets and private funds can play a crucial role in encouraging the path of companies towards a sustainable greener and digitalised economy. Any policy action

7 ESG criteria refer to environmental, social and corporate governance factors that are taken into account when investing in a company. Although their origin dates back several decades, they have become a reference for socially responsible investing in recent years.

8 See EESC opinion *A Capital Markets Union for people and businesses (new action plan)*, OJ C 155, 30.4.2021, p. 20.

9 Whether there is short-termism in dividend policy has been challenged by many researchers, see e.g. *Corporate Governance and Short-Termism: An in-depth Analysis of Swedish data*, (2021) by Martin Carlsson-Wall et al., Stockholm School of Economics. Their empirical findings, based on the years 2000-2019 for 786 unique firms and 7 389 firm-years, show no material indications of financial short-termism.

by the European legislator concerning company law and corporate governance should enhance such a role.

6. Incentives for CO_2 reduction

6.1 To underpin the transformation of the European economy and to achieve climate objectives, taxes should be used[10]. It is important that firms and households face the same incentives so that a reduction of CO_2 in the atmosphere can be achieved at as low a cost as possible.

6.2 The EESC encourages the European Commission to undertake concrete initiatives to establish similar carbon taxes in the Member States in order to harmonise the efforts to achieve an effective reduction of CO_2 levels. An ideal outcome would create uniform conditions across the EU single market with regard to the emissions/reductions to be taxed, as well as the specific methods and rates of taxation for equal impact on the level of CO_2 in the atmosphere.

6.3 Member States should, in particular, adopt a comprehensive and symmetrical environmental tax policy on the effect of CO_2 on global warming. There is a need to introduce taxes with both positive and negative rates. The revenues raised from CO_2 taxes should be used to finance incentives for CO_2-reduction techniques locally, regionally and nationally.

6.4 While the sale of forest products is taxed as income for the owner, it should be recognised that planting trees and the growth of forests reduces CO_2 in the atmosphere and should therefore, in a symmetrical tax approach to global warming, be encouraged by a negative CO_2 tax. This would be an important measure for achieving climate objectives.

6.5 An ideal outcome should create uniform conditions across the globe with regard to the emissions/reductions to be taxed, as well as the specific methods and rates of taxation for equal impact on the level of CO_2 in the atmosphere.

7. Avoiding disincentives to digitalisation

7.1 The use of data and new business models have triggered a need to review international taxation principles of how to allocate tax revenues among countries. It is important to reach and implement a global consensus.[11]

7.2 The tax package includes a proposal for an effective corporate minimum tax of 15%. The OECD/G20 agreement aims to limit tax competition, in particular from countries with tax rates below the threshold, and it states that "the MLC (Multilateral Convention) will require all parties to remove all Digital Services Taxes and other relevant similar measures with respect to all companies, and to commit not to introduce such measures in the future. A detailed definition

---

10 See EESC opinion on *Taxation mechanisms for reducing CO_2 emissions*, OJ C 364 of 28.10.2020, p 21.

11 See EESC opinion on *Business Taxation for the 21st Century* (ECO/558).

of what constitutes relevant similar measures will be finalised as part of the adoption of the MLC and its Explanatory Statement". [12]

7.3 The EESC considers it important for proper rules to be put in place promoting further digitalisation of the European economy, so that the objective of a greener and digitalised economy can be realised.

Brussels, 8 December 2021

Christa SCHWENG
The President of the European Economic and Social Committee

____

12 OECD/G20 Base Erosion and Profit Shifting Project Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy, 8 October 2021, p. 7.