EUTAX Observatory

The New Face of Corporate Tax Competition

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NOTE

Summary

This policy note highlights the main conclusions of the Working Paper entitled "Declining Tax Rates of Multinationals: The Hidden Role of Tax Base Reforms" (2025) by EU Tax Observatory researchers Sarah Godar and Jules Ducept.

The effective tax rate of multinational companies declined by 2.7 percentage points in the European Union between 2014 and 2022, shows a new EU Tax Observatory analysis of a decade of corporate tax reforms. The decline was exacerbated by tax competition between Member States. During that period, corporate tax reforms generated a tax revenue loss equivalent to 3.5% of tax collected from sample firms.

The analysis reveals that Member States are shifting away from the traditional "cut rate – broaden base" corporate tax policy towards base-narrowing tax policies. The contribution of statutory rate reforms to the decrease in effective tax rates is estimated to be 0.9 percentage points. Despite multiple anti-avoidance reforms adopted to protect the tax base against erosion, the net contribution of base reforms represents an additional reduction by 0.6 percentage points.

The implementation of the Global Minimum Tax is likely to accelerate the shift towards base-narrowing tax policies. Public announcements by governments show countries inside and outside Europe are increasingly reforming their incentive regime to be compliant with the Global Minimum Tax. This will require an inclusive conversation on the nature and the extent of tax incentive policies in the context of fair tax competition.

Introduction

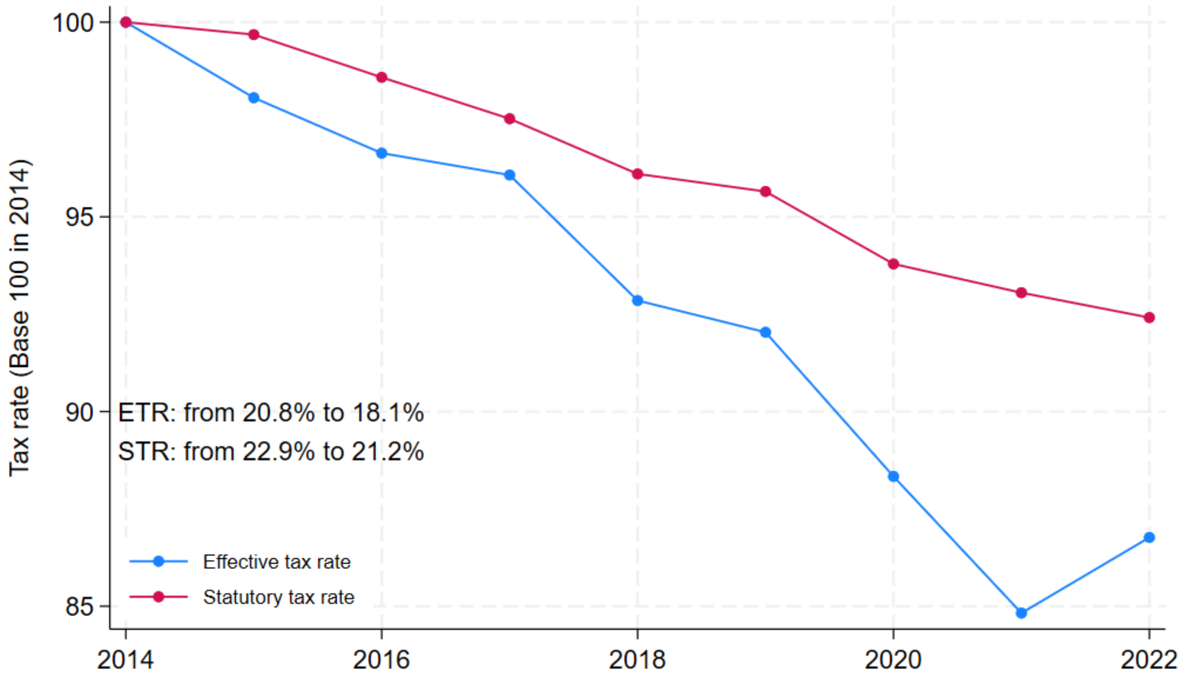
Fighting profit shifting and base erosion practices of multinational companies has been at the center of the International and European tax policy agenda over the past decade with multiple reforms ranging from EU Anti-Tax Avoidance directives to anti-Base Erosion and Profit Shifting action Plans and the 15% Global Minimum Tax on Multinational Corporations. But what has been the concrete impact on effective tax rates of multinational companies?

A new EU Tax Observatory working paper by Sarah Godar and Jules Ducept which findings are summarized in this policy note analyzed the impact of nearly 300 tax reforms implemented by European Member States between 2014 and 2022 to find out that the effective tax rate of multinational firms decreased by 2.7 percentage points over the decade.

Over that time period, the average statutory tax rate decreased from 23% to 21% - its lowest level since the signing of the Maastricht Treaty – a 0.21 percentage point decrease per year. Effective tax rates of multinational firms – defined as the ratio of corporate taxes paid to net profits - decreased from 20.8% to 18.1%, a faster drop of 0.34 percentage point per year – suggesting the drop in effective tax rate is not only due to cuts in statutory rates.

Building on the findings of the working paper, this policy note explores the role of tax reforms reducing the tax base (base-narrowing reforms) on the decline of effective tax rates. It outlines how countries are shifting away from the traditional "cut rate – broaden base" approach. Finally, it discusses how base-narrowing reforms may play a preponderant role in the future of corporate tax competition in the context of the implementation of the Global Minimum Tax.

Figure 1: Tax Rates of Multinationals’ Affiliates in the European Union

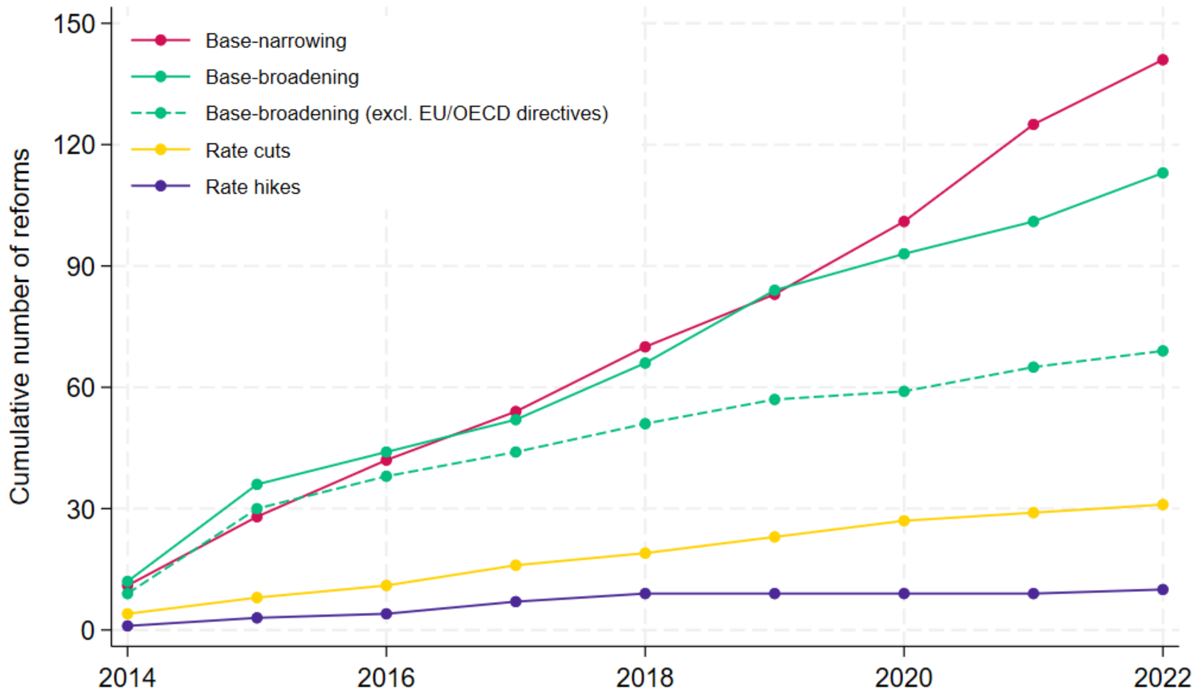


Notes: This figure presents the evolution of corporate tax rates in the European Union from 2014 to 2022. The red curve represents the average statutory tax rate, while the blue curve represents the average effective tax rate of multinationals’ affiliates. Both are normalized to 100 in 2014.

The rise of base narrowing tax policies

Between 2014 and 2022, EU governments have implemented 295 tax reforms. Nearly 60% were aimed at reducing corporate taxes (70% when excluding national implementations of EU/OECD anti-avoidance regulations). Splitting reforms between statutory rate changes and changes in the definition of the tax base, the authors unveil that base reforms represent the bulk (254 reforms, or 86%) of the reforms implemented. Among base reforms that stem from independent national initiatives, two-third (141 reforms or 67%) narrowed the definition of the tax base. This represents more than 15 base-narrowing reforms per year throughout the Union (or more than 5 per country over the decade). The multiplication of these base-narrowing reforms can explain why the effective tax rate of multinational companies drops faster than the statutory tax rate across the Union.

Figure 2: Cumulative Tax Reforms



Notes: This figure presents the cumulative number of tax reforms over the period 2014-2022. The dashed green line presents base-broadening reforms excluding anti-avoidance regulations enacted upon the initiative of the European Union or the OECD.

A classification of base reforms reveals that the most frequent base-narrowing reforms implemented are often tied to industrial policy objectives, such as strengthening investment (38 cost-based investment reforms), promoting R&D activities (19 R&D incentive reforms), or granting preferential treatment to profit arising from intellectual property (10 IP regime reforms). On paper, these regimes could boost growth and innovation for Member States. However, it is possible that these regimes merely intensify tax competition between Member States, leading to a reallocation of investments and profits from one Member State to another, without any real economic effect. If these measures primarily attract profits for tax planning purposes, the proliferation of base-narrowing reforms in the future may undermine the development of a unified and ambitious European industrial policy.

The large impact of base-narrowing reforms is partially softened by the adoption of many anti-tax avoidance regulations often stemming from international agreements. Such regulations often expand the tax base by curtailing aggressive tax avoidance mechanisms. Between 2014 and 2022, Member States transposed 54 reforms corresponding to anti-tax avoidance regulations: 44 of them were related to ATAD 2016 and BEPS recommendations.

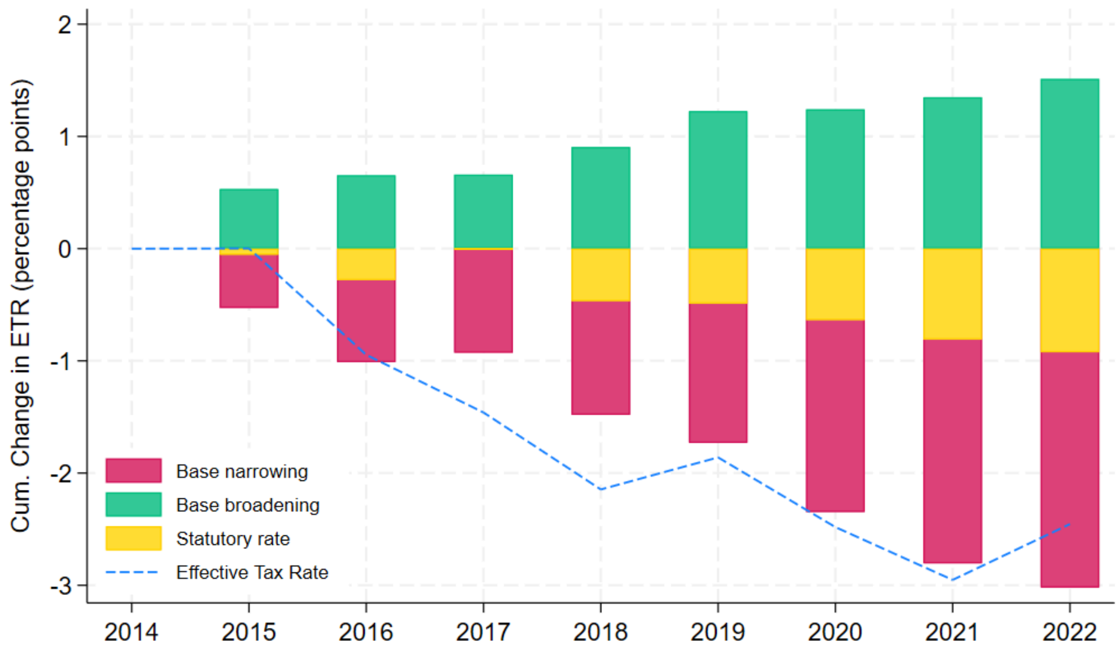
Table 1: Categories of Tax Reforms

	Increasing	Decreasing
Base Reforms	113	141
Anti-tax avoidance regulations	54	0
Cost-based investment regimes	9	38
Research and Development regimes	3	19
Intellectual Property regimes	4	11
Allowances for Corporate Equity regimes	2	6
Loss carry regimes	17	7
Taxation of capital gains and dividends	5	7
Withholding taxes on dividends, interests, and royalties	2	3
Other reforms	17	50
Statutory Rate Reforms	10	31
Total Number of Reforms	123	172

Notes: This table presents our categorization of the corporate income tax reforms implemented in the European Union from 2014 to 2022. The total number of reforms refers to the sum of statutory tax rate and tax base reforms.

Simulations run in the working paper estimate the contribution of statutory rate reforms to the decrease in effective tax rate to be 0.9 percentage points, versus 2.1 percentage points for base-narrowing reforms. But the effect is largely compensated by base broadening measures, which contributed to a 1.5 percentage points increase in effective tax rate. Thus, the net contribution of base reforms represents an additional reduction of the effective tax rate by 0.6 percentage points. Taken together, all reforms generated a tax revenue loss equivalent to 3.5% of tax collected from sample firms.

Figure 3: Change in Effective Tax Rate



Notes: This figure plots the estimated cumulative contribution of each reform factor to the development of the average effective tax rate paid by affiliates of multinational enterprises.

A Shift from a "cut rate – broaden base" tax policy

International institutions have long advocated for a "cut rate-broaden base" approach to tax policy. [1] In March 2025, Secretary General of the OECD stated that "the broadest possible tax base combined with low rates is generally more efficient and effective than a system with many exemptions and loopholes" during the 2025 EU Tax Symposium.[2] But this approach previously identified in the literature seems to be rather the exception than the rule in the EU in recent years.

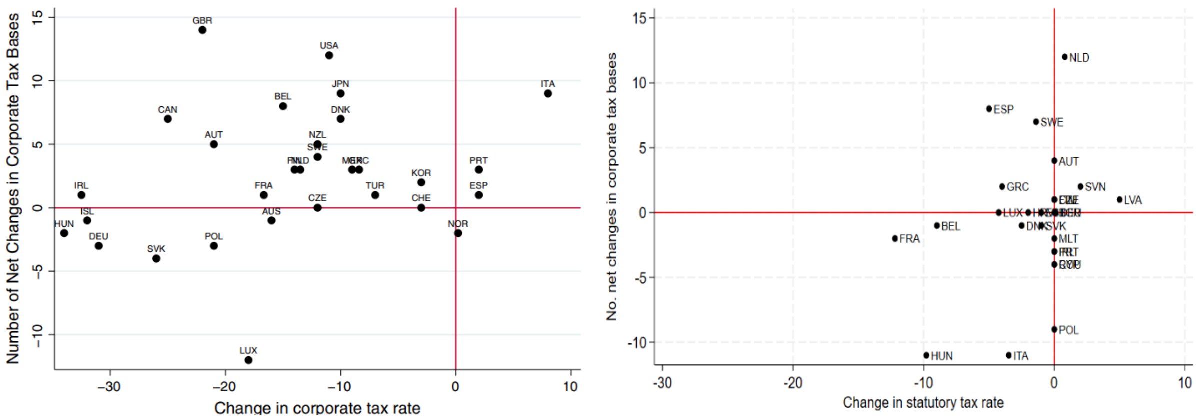
12 countries have cut their tax rate but only 3 of them adopted more base-broadening than base-narrowing measures. Instead, 6 countries combined rate cuts with more base-narrowing than base-broadening measures. 6 countries have left their statutory rate unchanged but implemented more base-narrowing than base-broadening reforms.

[1] https://www.oecd.org/en/publications/choosing-a-broad-base-low-rate-approach-to-taxation_9789264091320-en.html

[2] https://www.youtube.com/watch?v=fw5bPrifzRs

Figure 4: Statutory Rate and Corporate Base Reforms

Panel A: 1980-2004 (Kawano and Slemrod 2016)   Panel B: 2014-2022 (Ducept and Godar 2025)

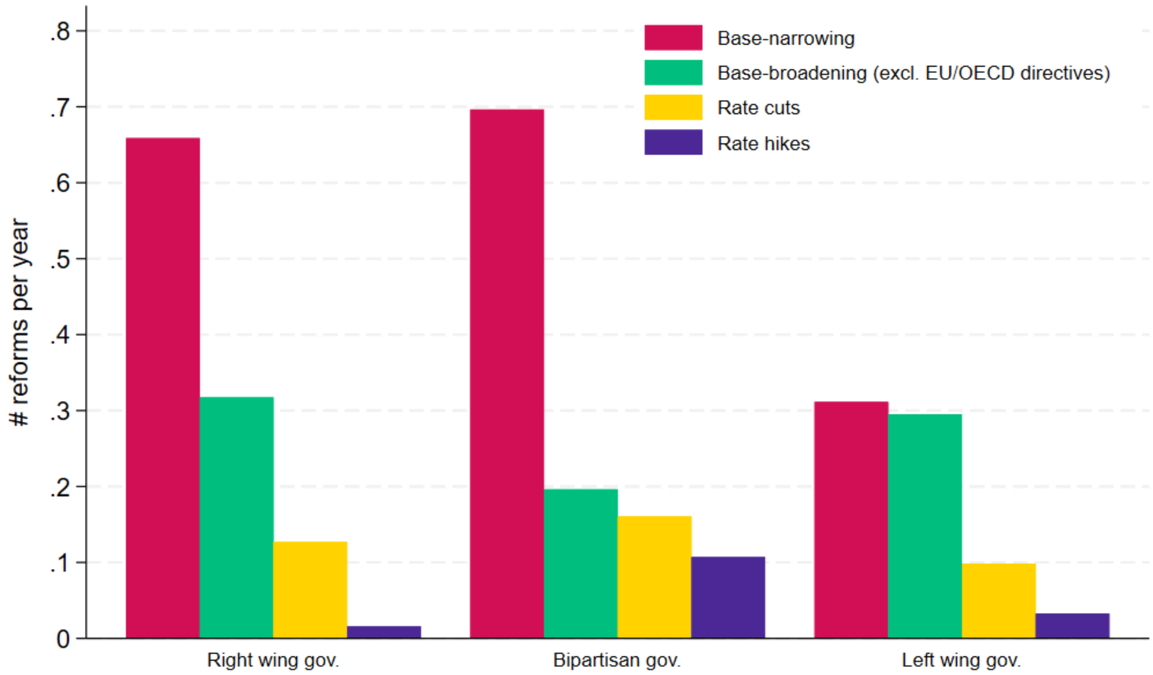


Notes: The panel on the left of this figure is a replication of Figure 1 in Kawano and Slemrod (2016), covering OECD countries over the period 1980-2004. The panel on the right is a replication of Figure 2 in Ducept and Godar (2025), with the x- and y-axes rescaled in order to allow for a direct comparison. Both figures plot the number of net changes in corporate bases against the change in tax rate in percentage points. A negative net change in corporate tax bases implies that more base-narrowing than base-broadening reforms were implemented.

The analysis shows tax competition between Member States exacerbates the decline in effective tax rate: cuts to the tax rates are more likely the higher a Member State's statutory rate is compared to the Union average: for every additional statutory rate point above the average statutory rate of other EU Member States, a country is 15% more likely to implement a rate cut. Similarly, the likelihood of implementing tax base-narrowing reforms increases with the distance to the average effective tax of multinational firms in the Union: for every additional percentage point above the average effective tax rate of other EU Member States, a country is 5% more likely to implement a base narrowing reform.

The pressure of tax competition applies to governments of all political affiliations: although left-wing governments are less likely to adopt base narrowing reforms than right-wing or bipartisan governments, governments of all political orientations have enacted relatively similar categories of reforms while in office.

Figure 5: Tax Reforms by Political Orientation of Governments



Notes: This figure presents the number of reforms by political orientation, divided by the number of years the respective government is in office. The reforms are split into four groups: base narrowing, base broadening, rate decreasing, and rate increasing. Base broadening reforms exclude anti-avoidance regulations enacted upon the initiative of the European Union or the OECD.

What future for tax competition?

In October 2021, close to 140 countries and jurisdictions endorsed a 15% global minimum tax on multinational firms known as Pillar Two of the OECD Two-Pillar solution to profit shifting. This is the first-time countries collectively agreed on a minimum level of taxation for multinational firms. Some hailed the end of corporate tax competition.

Today, that agreement is under heavy pressure to be dropped from the new US tax administration, leaving Europe at a crossroads. Should the block backtrack and allow the return to the days of unregulated tax competition with the risk of undermining tax fairness, eroding public trust in governments to regulate the rules of competition, and preventing governments from raising essential revenues to invest in strategic autonomy, industrialization, decarbonization and social fairness? Should it give a free pass to US multinational firms to play according to their own rules? Or should it uphold the principles of the 2021 agreement?

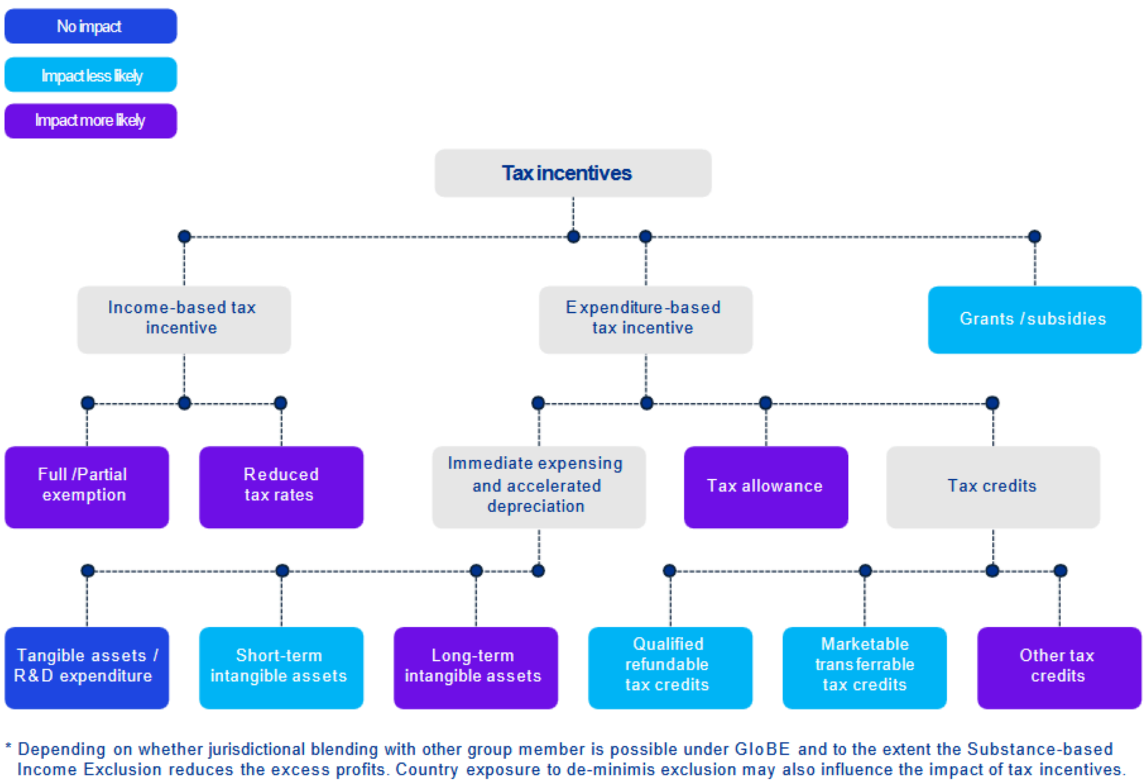
An important feature of the agreement is that it contains self-enforcement mechanisms with two safety nets ensuring the 15% tax on profit is effectively enforced even if some countries choose not to apply the agreement — a vital feature to prevent non-participating countries from undermining the implementation of the global agreement.

First, should a jurisdiction refuse to set up a domestic minimum effective tax of 15%, the country where the corporation is headquartered can tax the difference between the effective tax rate paid in the jurisdiction and 15% (a mechanism called "Income Inclusion Rule"). Second, should headquarter countries refuse to apply this rule, the countries joining the agreement can tax some of the untaxed profits themselves through a mechanism called the "Undertaxed Profit Rule." In essence, these mechanisms allow them to collect the taxes that non-participating countries would choose not to collect.

The Global Minimum Tax still leaves room for tax competition. As documented in previous EU Tax Observatory analysis, multinational firms will still be able to get an effective tax rate below 15% should they demonstrate economic substance (through substance carve-outs) and most importantly through the inclusion of incentives deemed "compliant" with the spirit of the Pillar 2 reform.

This is because the standard was developed together with a set of rules to harmonize the treatment of tax incentives across countries and jurisdictions to make sure the 15% minimum tax is levied upon a similar tax base. As a consequence, the Global Minimum Tax allows for certain base-narrowing reforms to be implemented without triggering a top-up tax. The figure below, provided by KPMG, illustrates the treatment of different tax incentives under the Global Minimum Tax.

Figure 6: Tax Incentives that Might Trigger a Pillar Two Top-up Tax



Notes: This figure presents different types of tax incentives and their impact on the GloBE effective tax rate. Source: KPMG 2025 [*https://assets.kpmg.com/content/dam/kpmgsites/xx/pdf/2025/02/pillar-two-and-tax-incentives-jan-2025.pdf*](https://assets.kpmg.com/content/dam/kpmgsites/xx/pdf/2025/02/pillar-two-and-tax-incentives-jan-2025.pdf)

The EU was the first major region to implement the Global Minimum Tax with a directive adopted in 2022. Previous EU Tax Observatory analysis estimates EU Member States could benefit up to 70bn€ in additional tax revenues. A comprehensive transposition of the Global Minimum Tax could change the nature of tax competition in Europe and beyond.

Although the average statutory tax rate across the Union of 21% suggests there is still room for rate cuts before hitting the 15% minimum rate, the room for unchecked tax competition through large rate cuts in corporate tax rates should be significantly curtailed by the agreement.

Tax competition will not end altogether, it will likely persist in other forms. The shift from “cut rate-broaden base” tax policies to competition on base-narrowing tax policies witnessed in the analysis is likely to intensify as countries redefine their incentive regime to be compliant with the Global Minimum Tax. Following the adoption of the Global Minimum Tax, governments started redefining their incentive regimes to be compliant with Pillar 2. As early as 2023, a *Bloomberg Tax article* described how countries like *“Bermuda, Switzerland, Ireland, and the Netherlands, are mulling tax relief such as qualified refundable tax credits, which are treated more favorably as grants under the minimum tax rules”.*[3]

Binding minimum taxes should be defended as an essential tool to fight the race to the bottom in corporate taxes. In particular, self-enforcement mechanisms such as the UTPR are essential tools to ensure the integrity of minimum taxes should some countries refuse to apply minimum standards.

In light of the findings of the Working Paper highlighting the prevailing role of base-narrowing reforms as a new form of corporate tax competition, an inclusive conversation on the nature and extent of tax incentive policies will be required to foster competition to harmonize practices in order to limit the tax policy gap.

[3] https://news.bloomberglaw.com/product/tax/bloombergtaxnews/exp/eyJpZCI6IjAwMDAwMThiLWE1ODYtZDM4OS1hYmNmLWZmZWViOTJjMDAwMCIsImN0eHQiOiJUUE5XIiwidXVpZCI6InNuSnZrSkVrQ0xoQTJPd0thR0tIWkE9PW9XRERuNExsY3RMZE4xTGRrRTFIRkE9PSIsInRpbWUiOiIxNzAxODU3NzAxMTIxIiwic2lnIjoiRzl6VmpOaGFKMko5VnlWV1FEYW9kREwrTlU0PSIsInYiOiIxIn0=?source=newsletter&item=body-link&region=text-section

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Ducept, J. and Godar, S. (2025). Declining Effective Tax Rates of Multinationals: The Hidden Role of Tax Base Reforms. *EU Tax Observatory Working Paper No. 30*