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PLATFORM FOR TAX GOOD GOVERNANCE

Fair Corporate Taxation – Achievements and Remaining Challenges

Discussion paper for the Platform on Tax Good Governance

Meeting of 19 December 2018

The purpose of this paper is to identify what has been achieved and what remains to be done in the context of fair corporate taxation within the EU. The paper is intended as a first basis for discussion and therefore is not exhaustive. As with the previous paper focusing on competitiveness, this paper should also be read in the widest context of the EU tax agenda, which has both fairness and competitiveness as objectives.

Platform members are invited to contribute their own views on how the EU and its Member States can promote fair corporate tax policy, and what approach to fair corporate taxation would be most appropriate for the future.

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This is a Commission services working paper prepared by DG TAXUD for discussion purposes. It does not represent a formal Commission or Commission services position or policy. The paper is therefore without prejudice to any position which may be taken by the Commission in the future.

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INTRODUCTION

The corporate tax systems in place today were largely conceived in the 1920's at a time when multinational enterprises were mostly industrial companies selling tangible products. This made source taxation relatively simple to apply, with taxing rights based on physical presence. To resolve cross-border disputes on corporate taxation, bilateral treaties were chosen as the preferred tool, rather than a multilateral approach. The concern was mostly to prevent double taxation.

From the early 1990s, in the EU, in a context where economic and political integration led to more cross-border activities, the focus was on preventing tax obstacles. Member States adopted the Parent-Subsidiary Directive and Interest and Royalties Directive. With the introduction of the euro and the ensuing suppression of currency risks, the mobility of capital increased. It has also facilitated tax arbitrage by MNEs.

The non-legally binding Code of Conduct for Business Taxation in the Council was created in 1997 to address harmful tax competition in the Single Market. The European Commission proposed an EU-wide harmonisation of corporate taxation for the first time in 2001¹, followed by a proposal for a Common Consolidated Corporate Tax Base (CCCTB) in 2011 (relaunched in 2016).

As corporate tax planning has become more sophisticated and competitive forces between Member States have increased, concerns about non taxation and corporate tax avoidance came to the fore. Since the economic crisis in 2008 and several tax scandals, the governments and the public opinion worldwide have pushed for addressing aggressive tax planning (ATP). The EU has shaped an ambitious agenda to fight ATP. At international level, progress has been achieved through the G20/OECD Base Erosion and Profit Shifting (BEPS) project.

FAIRNESS OF CORPORATE TAXATION: WHAT IS AT STAKE?

Globalization and digitalization have opened up and reinforced the possibilities of aggressive tax planning (ATP) for MNEs. ATP includes exploiting loopholes in a tax system and mismatches between tax systems. It may lead to double non-taxation or double deductions. The main channels of ATP are debt shifting, misuse of transfer pricing, location of Intellectual property rights, treaty shopping or artificial avoidance of permanent establishment status. For example, moving intellectual property rights from high to low-tax countries, using intra-company loans from low-tax to high-tax countries or using intra-group transactions by overpricing exports from low-tax to high tax countries can enable MNEs to reduce their tax liabilities.

ATP affects government revenues, contributes to distortions of competition between firms, undermines social cohesion and may increase inequalities. It affects also national accounts statistics, notably through misuse of transfer pricing and through the relocation of assets in low-tax countries with hardly any actual economic activity associated to them.

¹ European Commission (2001): Towards an Internal Market without tax obstacles: A strategy for providing companies with a consolidated corporate tax base for their EU-wide activities, COM(2001) 582 final, Brussels.

More specifically, it has been estimated that the revenue losses from profit shifting within the EU amounts to about EUR 50-70 billion.² In 2018, two studies using different approaches estimate a loss for EU28 around EUR 40 billion.³ Governments of countries whose tax base is eroded are forced to raise revenue from other taxes or have to reduce public investments. ATP has spillover effects as profits shifted to or through one country implies tax base loss for another country.

Second, ATP distorts the level-playing field as companies that engage in such practices may significantly reduce their tax bill. Multinational enterprises that engage in ATP benefit from a competitive cost advantage that can allow them to gain market shares and raise entry barriers to the detriment of other firms. There is evidence of a link between tax planning and higher mark-ups and increased industry concentration.⁴ ATP should also be assessed in a broader economic context. ATP opportunities can be an element of the attractiveness of a country and have an impact on the real capital investments the MNE will make in this country.

Thirdly, the loss of revenues due to ATP may have an impact on social spending, such as access to quality education, healthcare or welfare services, and on redistribution. Furthermore, it has been found that the increasing pay gap between firms accounted for the majority of the increase in income inequality in the United States, as well as a substantial proportion for the UK, Germany, and Sweden (Bloom, 2017). ATP could reinforce both income and wealth inequalities by benefiting some categories of workers and shareholders of MNEs. On tax consent, awareness of unfair practices may encourage other taxpayers to stop complying with their own tax obligations and may contribute to public discontent.

ACHIEVEMENTS

The EU has shaped an ambitious agenda against ATP and taken several initiatives to boost tax transparency and ensure that companies pay tax where they make their profits. Given the cross-border nature of ATP, it is important to act in a coordinated manner. This coordination has taken place through various fora: Council, Code of Conduct, the European Semester and state aid rules.

To boost tax transparency, the Council agreed to the automatic exchange of information on tax rulings and on country-by-country reporting (CbCR) amongst tax authorities. Recently, it adopted rules to ensure the mandatory disclosure of ATP schemes by intermediaries.

To create a minimum protection for all Member States' corporate tax systems, the Council adopted the Anti-Tax Avoidance Directives (ATAD 1&2) which sets out legally binding anti-abuse measures, applicable as of 1st January 2019 and 2020, such as interest limitation rules to discourage artificial debt arrangements, controlled foreign companies rules to deter profit shifting to a low or no-tax country, exit taxation rule to prevent companies from avoiding tax

² Dover, R., Ferrett, B., Gravino, D., Jones, E., and S. Merler (2015), Bringing transparency, coordination and convergence to corporate tax policies in the European Union, European Parliament Research Centre Study.

³ Own computations based on T. Tørsløv, L. Wier and G. Zucman (2018), *The Missing Profits of Nations* and Alvarez-Martinez, M., Barrios, S., d'Andria, D., Gualdo, M., Nicodème, G. and J. Pycroft (2018).

⁴ Sorbe, S. and A. Johansson (2017) International tax planning, competition and market structure, OECD Economics Department Working Papers n°1358

when re-locating assets, hybrid mismatch rules to prevent exploitation of mismatches between tax systems and general anti-abuse rule to counteract ATP when other rules do not apply.

The fight against aggressive tax planning is also about ensuring that partner countries play fair. A list of non-cooperative tax jurisdictions outside the EU was agreed for the first time at the end of 2017. Countermeasures vis-à-vis listed countries are at the discretion of Member States, but minimum administrative measures have to be taken, including reinforced monitoring of transactions and/or audits. Work is ongoing to see how these countermeasures can be further coordinated and strengthened.

In accordance with competition law, Commission has conducted a number of state aid procedures in the past years, asking some countries to recover tax amounts unduly unpaid by certain firms.

Finally, the European Semester looks at country-specific challenges, and stresses the necessity to reform national tax rules and regimes.

REMAINING CHALLENGES

To provide for a fair, modern and competitive corporate tax framework, the Commission has tabled in 2016 a comprehensive solution, the Common Consolidated Corporate Tax Base. In order to ensure a level playing field between all types of companies and of making the digital companies contribute fairly to the budget of EU Member States, the Commission has proposed in 2018 a taxation of the digital economy. Both proposals remain to be adopted by the Council.

To increase tax transparency, a Directive on public country-by-country reporting was proposed by the Commission in 2016, but has not been adopted yet by the Council.

To ensure that already agreed decisions are effective, a thorough **monitoring of the effects of the implementation of Anti-Tax Avoidance Directives** is necessary given the intensification of tax competition, which encourages countries to develop new tax advantages to attract foreign investments.

Combatting the erosion of the EU tax base by outbound payments is also an issue. Because the Interest and Royalty Directive (IRD) and the Parent Subsidiary Directive (PSD) have suppressed or relaxed withholding taxes on interest, royalty and dividend payments, it is all the more important to ensure that these payments are not used by companies to engage in ATP. Such payments can freely circulate within the EU and then be channelled to third countries where they might be little or not taxed. The 2011 proposal for a revision of the IRD was meant to tackle this issue.

Agreeing on adequate defensive measures by Member States to accompany the EU black list would encourage third countries to comply with high EU good governance standards.

More broadly, **the issue of a minimum effective taxation** is becoming an increasingly important one. It has been discussed in the context of the fair taxation of the digital economy, the reform of the Code of Conduct, and the revision of the IRD. It is all the more relevant since the US, with their latest tax reform, has de facto introduced a minimum effective taxation on the profits of their MNEs. Such a reflection is particularly important given that Member States are

currently competing in lowering their corporate tax rate and/or allowing narrowing of their base.

Safeguarding Double Tax Conventions (DTCs) against ATP is also important. When engaging in ATP, companies exploit mismatches and loophole in national legislation as well as in DTCs. In order to streamline and coordinate the amendment to the vast network of bilateral tax treaties, the OECD put in place a framework, the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (the Multilateral Instrument, or MLI). However, the effectiveness of the MLI will depend on the number of DTCs included in the MLI and on the scope of the changes agreed (opt in and opt out possible for each article of the MLI).

Addressing remaining loopholes in Member States regimes and practices is also crucial. To give just a few examples, corporate tax residence rules or capital allowance rules, if not properly designed, can be used to engage in ATP. Coordination on transfer pricing is also important. Finally, as Member States are competing for relocation of businesses, it is also true for the relocation of wealthy individuals with special tax incentives, which leads to attracting business and profits (e.g. golden visa regimes, where immigration visas or citizenship are exchanged against investments).

Topics for Discussion

1. What do you consider are the key elements needed to ensure EU fair corporate taxation?
2. What should be the main areas for future action against ATP?
3. What kind of economic impacts of ATP are for you the most worrying: budgetary impact, distortion of competition, impact on inequalities and social cohesion, distortion of national account statistics?