The big read

Next steps in corporate tax policy: an EU perspective

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Speed read

The European Commission is pursuing a comprehensive agenda of tax reforms, to make corporate taxation in Europe fairer, more effective and more growth friendly. The first step is to boost tax transparency as the bedrock for further reforms, which started with the launch of the Tax Transparency Package in 2015. The EC has gone further since, with proposals for public country by country reporting and further plans to secure greater transparency on beneficial ownership and better oversight of the facilitators and enablers of tax avoidance. The second leg of the EC's fair tax campaign is to pursue effective corporate taxation; in other words, to ensure that companies are taxed where they make their profits. Initiatives here include: the new Anti-Tax Avoidance Directive, to ensure consistent application of BEPS among member states; the EC's External Strategy for Effective Taxation, to address external risks; and, plans to publish a common list of non-cooperative jurisdictions in 2017, to tackle those countries which refuse to play fair. EU state aid work is also making a vital contribution to fair and effective taxation throughout Europe. Our anti-avoidance initiatives are as much about creating a growth friendly single market, as they are about delivering fairness for taxation. The overarching aim is to deliver a clear, coordinated and stable EU approach to corporate taxation, which is far preferable than a mix of different national policies. Key to this is the development of common consolidated corporate tax base (CCCTB), which the Commission will relaunch in the coming weeks. The CCCTB offers a change to fundamentally overhaul corporate taxation in Europe, whilst also respecting national sovereignty. The EC will pay attention to new trends and challenges as they emerge; and believes that closer coordination remains the only path to effective solutions on corporate tax matters.

In many ways, it is fair to say that we are witnessing a generational shift in corporate taxation, both in the European Union (EU) and internationally. Coordination is increasingly becoming the accepted approach in this policy area, resulting in reforms that would have been unimaginable a decade ago. At an international level, the automatic exchange of information is now the global transparency standard and around 85 countries have signed up to the Multilateral Competent Authority Agreement. A similar number of countries have also committed to the OECD's base erosion and profit shifting (BEPS) project, to make corporate taxation fairer and more efficient, and more are expected to come on board through the inclusive framework.

This trend for coordinated change is clearly visible at the EU level. There is a new political appetite to work together on cross-border tax issues, which is delivering impressive results. EU member states are today considering topics that were almost taboo a few years ago, such as effective taxation in the single market, and agreeing on common solutions. Moreover, there is a tangible change of pace in tax negotiations at the EU level, which have traditionally been very slow due to the unanimity rule. For example, it took member states six years to agree on a modest revision of the Savings Tax Directive, proposed by the Commission in 2008. By contrast, this year alone, the highly ambitious Anti-Tax Avoidance Directive was agreed in less than six months and new rules for country by country reporting between tax authorities were adopted in just 40 days.

This shift in pace and attitude in EU corporate tax policy can be attributed to two main factors. The first is the intense public pressure that has built up in the wake of the economic and financial crisis and recent tax scandals exposed in the media. Citizens' outrage at the stories of large scale corporate tax avoidance focused political minds. This created both a tipping point and a determination to deliver real and lasting changes to the way companies are taxed.

Second, it has become increasingly evident that isolated national action no longer works in meeting the challenges of today's fast paced, mobile and global economy. Cross-border challenges must be met with cross-border solutions. Shared goals can only be reached through shared action. Indeed, two of the most pressing demands on Europe today – growth and social justice – rely heavily on member states pulling in the same direction towards the same end goals. EU tax policy's primary focus, therefore, is on supporting these efforts.

Working for fairer and more effective taxation in the EU

Since the very beginning of the current mandate of the European Commission, President Jean-Claude Juncker has listed fair and effective corporate taxation among the Commission's top political priorities. Fighting tax evasion and avoidance have been central to this agenda. There are solid reasons, both economic and social, for giving this issue such high importance at EU level.

First, Europe is working to rebuild a strong and stable economy, founded on jobs, growth and investment. The Commission has launched a multi-pronged strategy to this end, which includes a multi-billion euro investment plan, the establishment of a Capital Markets Union, the completion of the Banking Union and a new European Pillar of Social Rights for healthier labour markets.

In this drive towards sustainable economic prosperity, taxation also has a vital role to play. Corporate taxation should deliver sustainable revenues, the right incentives for investment and expansion, and overall confidence in the system. Currently, however, it does not. The European Parliament estimates that corporate tax avoidance is costing member states between €50bn and €70bn a year. No country can afford this shortfall in public revenues, which eats into funding for public investment and compromises growth friendly policies. Moreover, tax competition between countries has led some governments to shift the tax burden to less mobile bases, such as labour, which is damaging for growth and a disincentive for employment. Therefore, tackling tax avoidance is a crucial step in securing a tax environment that supports our wider economic agenda.

Second, our greatest asset in the EU is the single market, and we are working to make it stronger. To do this, we must ensure that businesses enjoy legal certainty, a level playing field and minimal obstacles as they operate cross-border in Europe. However, the current corporate tax environment fails to deliver on this front too. Many companies – particularly the smaller or more local ones – suffer serious competitive distortions due to the aggressive tax planning of their larger counterparts. We estimate that domestic companies are paying 30% higher tax than their multinational rivals, as a result of tax avoidance. Recent state aid cases have revealed that some of the world's largest companies are paying near to no tax on their European activities, while ordinary, smaller businesses must pay the headline rate. Added to this, member states' different national responses to tax avoidance create uncertainty, administrative burdens and legal challenges for companies in the single market, as well as higher risks of double taxation. It is essential to remove these obstacles and distortions, for a healthier business environment in the EU.

Finally, if we want to maintain the European social model and overall taxpayer morale, fairness must be a cornerstone in our tax framework. Tax avoidance undermines the social contract between citizens and their governments and attacks public confidence in the corporate sector. Ordinary citizens, who had previously shown very little interest in company taxation, now have increasingly strong views. Citizens expect justice in taxation, notably through companies paying their share of tax. As public policy makers, we have a duty to deliver on these expectations.

For all of these reasons, the Commission is pursuing a comprehensive agenda of tax reforms, to make corporate taxation in Europe fairer, more effective and more growth friendly.

Increasing tax transparency

The first step in this agenda sought to boost tax transparency, as the bedrock for any further tax reforms. At the Commission, we launched this work in 2015 with the Tax Transparency Package and have gone much further since. New transparency provisions have been agreed for tax rulings, spelling the end to the hidden sweetheart deals that have caused much public outcry.

The new EU rules, which enter into force in January 2017, go beyond any similar measures agreed at international level. Member states must systematically share pre-defined information with each other on all of their cross-border tax rulings and pricing arrangements, including those made in the previous five years. The Commission will have access to data on these exchanges, and will be quick to act if there are any lapses. We have also extended the automatic exchange of information to multinationals' tax related activities. In line with BEPS, member states' tax authorities will share country by country reports on key information related to groups with a turnover of €750m or more. To ensure a level playing field, the new rules cover all multinationals – European or otherwise – that are active in the EU. This will give authorities crucial information to better target their tax audits and identify aggressive tax planning schemes.

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In a similar vein, we proposed in July that tax authorities should have access to national anti-money laundering information, particularly on beneficial ownership and due diligence data. As with the other transparency measures, this proposal looks set to be adopted in record time, with member states aiming for agreement before the end of this year.

A slightly more contentious, but equally necessary, proposal was that for public country by country reporting by multinationals, which the Commission presented in April. We want any group with a turnover of more than €750m and a presence in the EU to publish a specified set of tax related data online. They should provide a separate report for every member state in which they are active, and an aggregated report for their activities outside the EU. However, if any of the countries in which the group is active is listed by the EU for tax reasons, a separate report will have to be provided for that jurisdiction. This is part of our new offensive against external base erosion threats.

Public country by country reporting may not be entirely necessary for the work of our tax administrations; however, it will provide citizens with the oversight of companies' tax practices that they demand, and help to restore public confidence in both our tax systems and corporate sector. Moreover, it will reinforce the level playing field for all companies in the single market. Many are already publishing their tax information on a voluntary basis and these binding EU rules will put them on an even footing with their less transparent counterparts. The proposal is now in the hands of EU member states and the European Parliament, which will hopefully soon agree to make it EU law.

Despite all this progress, our work on tax transparency is not over yet. For 2017, we have our sights set on securing greater transparency on beneficial ownership and better oversight of the facilitators and enablers of tax avoidance. The Panama papers revelations confirmed that these are areas which urgently need to be addressed, and the Commission has lost no time in examining solutions. Our work will take full account of international developments on these issues, but will not be strictly bound by them if we believe there is a need to go further.

Pursuing effective taxation

This alignment to international norms, with EU added value, has also been a feature of our work for more effective corporate taxation – the second leg of our fair tax campaign. Effective taxation has become a core focus of EU corporate tax policy over the past few years, as we seek to ensure that companies are taxed where they make their profits.

As with tax transparency, the speed of progress made in reaching this goal has surpassed expectations. In July, member states agreed on the major Anti-Tax Avoidance Directive, which pins down common anti-abuse measures against prevalent types of profit shifting. This binding legislation has the major benefit of allowing member states to fulfil important BEPS commitments in a swift, consistent and coherent manner. In addition, it provides them with the reassurance that the same anti-abuse measures will be applied in the same way throughout the EU. This removes the risk of loopholes, mismatches and legal clashes, and will prevent a potential 'weakest link' from disrupting the anti-avoidance defences of the entire single market.

We will build further on these anti-abuse rules over the coming weeks, with provisions on hybrid mismatches in relation to third countries. In parallel, work is also advancing in other 'soft law' forums to reinforce effective taxation in the EU. For example, in 2015, member states committed to apply the modified nexus approach to their patent box regimes. The Commission is now working with the Code of Conduct Group to monitor the implementation of this commitment to better align tax incentives to the underlying economic activity.

Meanwhile, EU state aid work is also making a vital contribution to ensuring fair and effective taxation throughout Europe. The Commission has shown it is ready to act decisively against any ruling or regime which breaches EU competition rules. Selective advantages, which allow certain companies to pay little or no tax and distort healthy competition, are clearly forbidden. Recent Commission decisions in this area have received much attention, perhaps because of the high profile companies involved. However, in many ways these tax related state aid cases are neither new nor unique. They build on a long history of state aid investigations in tax matters. As in all other policy areas, they draw on solidly agreed EU rules to safeguard a fair and competitive environment for businesses in the single market.

Of course, the pursuit of fair and effective taxation cannot stop at the borders of our single market. Tax avoidance is a global problem, which thrives on global loopholes, lapses in good governance structures and harmful tax competition. Therefore, the Commission is intent on ensuring that our international partners take the same dedicated approach to reforming corporate taxation and fighting abuse as we have taken in the EU.

In January, we launched a new External Strategy for Effective Taxation, to address external tax avoidance risks. This strategy is primarily focused on working in close cooperation with our international partners for higher levels of tax good governance worldwide. We want to use every tool at our disposal to achieve this, from trade agreements to EU funds. We pay particular attention to developing countries, to help them secure their own tax bases and prevent them from becoming new weak points in the international tax framework. The aim is to have developed and developing countries working as true partners for fairer taxation and to raise collectively the bar of tax good governance worldwide.

However, where attempts at a cooperative approach with third countries fail, we will also have a new EU instrument at our disposal. A common EU list of non-cooperative jurisdictions will be published in 2017, to tackle those countries which refuse to play fair. The first steps in the process to compile this list have already been taken. In September, the Commission published a scoreboard of all third countries, analysing their risk of facilitating tax avoidance. With the help of this scoreboard, member states should decide which jurisdictions they wish to examine in more detail and should launch a screening and dialogue phase with these countries in the new year. The EU list will be objective, fair and aligned to international standards. It will provide certainty, clarity and coherence to both businesses and our international partners on what the EU expects when it comes to tax good governance. It will be an open and transparent process, where we fully engage with the third countries in question, seeking solutions to avoid the last resort option of listing. We are working very closely with the OECD on this issue too, to ensure that our parallel workstreams on tax good governance are mutually reinforcing.

Meeting the needs of businesses

At this stage, it is worth emphasising that the fight against corporate tax avoidance is as much about creating a more growth friendly, business friendly single market, as it is about delivering fairness for our taxpayers. 'Anti-avoidance' should never be considered to be 'anti-business'; in fact, the opposite is true. A clear, coordinated and stable EU approach to corporate taxation is far preferable to companies and investors than a mix of different national policies.

Businesses seek simplicity, certainty and a level playing field when it comes to taxation, and a coordinated EU approach is crucial to achieve this. When member states take a common approach to implementing BEPS, and replace 28 national frameworks with a single EU one, life is much easier for businesses. When we enshrine new anti-abuse provisions in EU law, to avoid a medley of unilateral national approaches, businesses enjoy greater tax certainty. Finally, when we require all companies, large and small, to pay their fair share of tax where they make their profits, we re-establish the level playing field for companies throughout the EU. Added to these advantages, tackling tax avoidance increases member states' revenues for public investment and allows them to re-channel their tax policies in a more growth friendly direction. All of this is good for businesses in the single market and for our collective growth and competitiveness in Europe.

Working for a common consolidated corporate tax base

Of course, the holy grail in the corporate tax world is a single, simple, cost effective tax system that applies across borders and has fairness at the very heart of its design. Our response to this challenge is the common consolidated corporate tax base (CCCTB), which the Commission will relaunch in the coming weeks. The Commission originally proposed the CCCTB back in 2011, and the idea still enjoys strong support amongst businesses and stakeholders. However, the sheer magnitude of the CCCTB as proposed was too much for member states to agree in one go, and negotiations stalled as a result.

For this reason, the Commission will propose a more pragmatic two-step approach to the CCCTB this time around. Member states will be invited first to agree on the common base, before negotiating consolidation. Staggering the CCCTB in this way will make it more manageable to negotiate and will help to pin down a compromise much more quickly. This is important, because we need quick agreement on the CCCTB. It provides a holistic response to all of the major challenges in corporate taxation today and solid solutions to some of the EU's most pressing needs.

On one hand, the CCCTB will create the simpler, more stable and more cost effective environment in the EU that businesses and investors are calling for. It will complete the single market from a tax perspective, making it a more attractive and competitive place to do business. Companies will enjoy a single rulebook for calculating their taxable profits throughout the EU, a 'one stop shop' system for filing their tax returns and the possibility to offset their cross-border losses.

This will drastically reduce the legal and administrative demands on companies that operate in more than one member state. Indeed, we estimate that the CCCTB will cut compliance costs by 2.5% and compliance times by 10% for cross-border companies. The cost of expanding cross-border will decrease significantly, too, which should encourage all companies, particularly SMES and start-ups, to take full advantage of the single market. Moreover, the CCCTB will remove serious tax obstacles that arise today from mismatches between member states' different corporate tax systems. Cases of double taxation, for example, will be largely eliminated for CCCTB companies, along with the costly disputes that go with them. For the few cases of double taxation that remain, the Commission will propose improved dispute resolution mechanisms in the very near future.

The CCCTB therefore ticks all the boxes when it comes to helping the single market, and each member state in it, to become more competitive, more growth friendly and more appealing to investors.

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At the same time, the CCCTB will fully support the goal of making corporate taxation fairer and more efficient in the EU. By eliminating national mismatches, transfer pricing and preferential regimes, the CCCTB will remove the main channels of aggressive tax planning and severely hamper those that seek to avoid taxation. Originally, the CCCTB was conceived as an optional system, which companies could choose to use or not. However, this approach left the door open for aggressive tax planners to opt out of the watertight CCCTB system. Therefore, in the relaunch proposal, the Commission will make the CCCTB mandatory for large multinationals. This will strengthen its potential as an anti-tax avoidance tool and ensure a level playing field for businesses. The CCCTB will also create complete transparency on the effective tax rate of each member state, thereby reducing the scope for harmful tax competition and further reinforcing fair taxation in the single market.

This combination of business friendliness and fairness means that the CCCTB will make an important contribution to the EU's wider goals of growth, jobs and investment. Moreover, in the upcoming proposal, the Commission intends to introduce new elements into the CCCTB, to further reinforce its growth promoting capacity.

First, we will address the longstanding issue of the debt-equity bias, in line with the goals of the Capital Markets Union. The current corporate tax incentives for debt over equity encourage indebtedness, discourage strong capital bases and create fragilities in the private sector. We want to rebalance this phenomenon, and will therefore introduce a new measure to encourage more equity investments and neutral financing decisions.

Second, we will use the CCCTB to promote research and development (R&D) in the EU, which is vital for growth and long term competitiveness. Investment in R&D is woefully low in the EU compared to other advanced economies, such as the USA and Japan. This problem needs to be urgently redressed, to meet its 3% GDP target for R&D investment by 2020. The relaunched CCCTB proposal will include attractive tax incentives for R&D, drawn from recent economic studies on best practices. It will reward real, innovative investment, particularly in small companies and start-ups, given their role in job creation and market changes. Unlike many national regimes that exist today, this incentive will be carefully designed to protect it against abuse by aggressive tax planners.

Respecting national sovereignty

The CCCTB offers a chance to fundamentally overhaul corporate taxation in Europe. It can be a flagship for modern, efficient and fair corporate taxation, fit for the 21st century. However, there is one area which the CCCTB will not touch, now or in the future. Tax rates remain an area of national sovereignty and member states are free to decide their own rates for companies, both inside and outside the CCCTB structures. The Commission is highly vigilant as regards the fine balance between member states' national sovereignty in tax matters and the need for EU action. This balance is further protected by the fact that EU tax rules are decided by unanimity.

At the same time, I believe that member states are gradually coming to realise that the real threat to their sovereignty does not lie in European level action. Rather, it comes from unrestrained tax competition and corporate avoidance, which erode their tax bases and destabilise their tax frameworks. It comes from mismatches between one national tax regime and another, which create legal uncertainty and administrative burdens for companies they are trying to attract. It comes from 28 uncoordinated approaches to taxation undermining the single market and all the benefits it offers.

In this respect, it can be argued that EU coordination on tax matters actually reinforces member states' sovereign rights in this area, rather than erodes it. It provides member states with a collective strength and security, which allows them to focus on tax policies that truly meet their national needs.

Coordinating on future challenges

The CCCTB and the other initiatives we are pursuing already constitute a full and ambitious agenda for EU corporate tax reform. Coupled with our yearly recommendations to member states (the so-called 'European Semester'), they will fundamentally improve corporate taxation, making it fairer, more effective and better fit for purpose in the future. However, this does not mean that our work stops here.

Even as the EU progresses with these current reforms, new challenges are emerging which will further test the sustainability of our tax systems. New ways of consuming and producing are emerging, which do not necessarily fit with traditional approaches to taxation and will require fresh thinking. A good example is the fast growing collaborative economy which, like the digital economy, raises the question of when and how tax should be applied. On the one hand, we do not want taxation to kill innovative activity at birth; on the other hand, if such activities escape existing models of taxation, tax bases will erode as their market presence grows and traditional business models will suffer the competitive disadvantage of continued taxation.

This is just one illustration of the complexity of the corporate taxation questions we can expect over the coming years, as a direct consequence of our fast evolving mobile, digital economies. They are not easy issues to address – and some of the biggest challenges may still be unknown. However, the Commission is paying great attention to these new trends as they develop, fully convinced that – here too – closer coordination will remain the only path to effective solutions on corporate tax matters, now and in the future. ■

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Comment

Tax avoidance: problem solved or solutions just beginning?

Speed read

Is the international tax system fixed and fit for purpose or still in need of serious remedial action? Should we hold off on introducing further anti-avoidance measures until current policies have had time to work or forge ahead with fixing our broken system? How you answer these questions probably depends on how you define tax avoidance. But since there is no agreement on what counts as avoidance, should we ever expect to reach agreement on when the system is fixed?

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In the wake of the recession, a broad consensus emerged: multinationals were shifting too much profit into low tax jurisdictions, in some cases managing to avoid tax altogether, and this should be stopped. At the behest of the G20, the OECD launched the base erosion and profit shifting (BEPS) project with a view to getting agreement on how to patch up the international tax system. Two years and a mammoth amount of effort later, a set of recommendations emerged. To the surprise of many, this has led to real policy change.

Yet, revelations of companies' miniscule tax rates continue to make the news headlines. And there is little sign that the general interest in tax avoidance, or the associated public outrage, is abating. Apple is the latest, and largest, multinational to have its tax affairs aired in public, but it comes hot on the heels of stories around Google, Starbucks and others, and it won't be the last to find its tax payments in the limelight. But much of the controversy around Apple relates to a structure – the 'double Irish' – that the Irish government has already set about removing. And the state aid case being pursued by the European Commission (EC) is retrospective. Are the news stories a reflection of a past system that has now been fixed, or a sign of the future problems we must tackle?

Divergent views of tax avoidance post BEPS

One of the surprises that emerged at the 2016 IFS residential conference was the extent to which views on the current state of corporate tax avoidance are diverging.

Here's the happy picture of where we find ourselves. The BEPS process and the greater public awareness that flared up in the midst of austerity have been game changers. They have opened the doors through which governments have ushered in genuine improvements to corporate tax rules. The gaps that allowed double non-taxation have gone or are going. Changes in tax rules are making the location of taxable profits better aligned with economic substance. Moreover, shareholders and CEOs have woken up and smelt the coffee and the reputational risk associated with aggressive profit shifting arrangements. Tax is now a serious boardroom issue and companies are already preparing for a day when their accounts are open for all to see. This sanguine position is best represented by tax directors, who can see up close the changes that have occurred in recent years.

Here's the less optimistic view. The BEPS process helped in some key areas, but we still have a long way to go. Not all countries have been as proactive as the UK in ensuring that the national tax code complies with the BEPS minimum standards, and the fact that some of the action points are mere recommendations means that progress in these areas is unlikely. Multinationals continue to be able to shift profits to low tax countries and, in so doing, to erode tax bases and public trust.

This gloomier view is perhaps best captured by the EC. Within six months of the BEPS outcomes being endorsed by G20 leaders, it had launched its own action plan for EU members to go further in combating multinational avoidance. The Commission has also sought to be tougher on tax avoidance by throwing the state aid rule book at certain countries. Many international development organisations would share the gloomy view, and add that actions to date have failed to grapple with avoidance in the developing world.

These are clearly highly stylised positions, and there are many views that are less extreme. Broadly, however, they represent the directions in which different parts of the tax community are moving. This divergence of views matters. A lot. First and foremost, it has a big effect on the policy prescription.

Under the happy view, the international tax system has largely been fixed. We will continue to see the fruits of the BEPS process feed through and, if anything, should now take seriously the concern that we will get back to the days of double taxation. In this camp, a real concern is the ongoing barrage of anti-avoidance legislation that creates uncertainty around a tax code that grows ever more complex. Under the pessimistic view, though, we should crack on with more anti-avoidance measures to combat avoidance as soon as possible, and possibly move to an entirely different system.