Tax – is Europe leading by example? January 2016

As Europe slowly pulled itself out of the economic and financial crisis, European governments' attention turned to focus, inter alia, on the need to conserve resources to boost Member States' budgets and address perceived inequalities in the single market. Within this context - and driven by public and NGO concern - the spotlight turned on those Member States that sought to attract investment from multinational corporations by offering them so-called sweetheart deals which offered companies preferential tax arrangements.

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In November 2014 Lux Leaks, which identified more than 340 companies deemed to have pursued aggressive and unfair tax planning practices fanned attention on the issue and catapulted the extent of tax avoidance in Europe to public attention. This provided the impetus for the European Commission to review its policy and start implementing changes. Since 2014 the Commission has focussed its attention on fighting tax avoidance and aggressive tax planning - both internally (via State Aid cases on tax rulings and actions set in the 2015 Plan for Fair and Efficient Corporate Taxation in the EU) and internationally supporting the OECD Base Erosion and Profit Shifting (OECD BEPS) initiative which was launched in 2013.

In the EU, the official State Aid investigations are being actively pursued and three decisions have already been taken against Member States' tax rulings practices by the Competition Commissioner, Margrethe Vestager. This is only the tip of the iceberg. Mrs Vestager has instructed her team to carry out a structured analysis of all EU Member States' tax rulings practices between 2010 and 2013, which will be used as a template for further investigations and legislative change.

Coupled with this, the European Parliament began to take interest in the matter. Whilst the Parliament has no authority in tax, it is able to keep the European Commission and the Council accountable for progress. In 2015 it created an ad hoc committee on tax (TAXE1 and 2) to focus on aggressive tax planning. The Parliament took the Lux Leaks' scandal as a starting point for its inquiry report on the negative impact of aggressive tax planning on public finances. These committees have been instrumental in maintaining pressure on the Commission, calling Margrethe Vestager, Commissioner for Competition, to appear before the Committee and give evidence on the State Aid cases concerning selective tax rulings. In November 2015 the European Parliament, after many failed attempts, managed to summon 11 multinational companies to a public hearing on their tax practices.

> *Tax rulings that artificially reduce a company's tax burden are not in line with EU state aid rules*
>
> *Margrethe Vestager, Commissioner for Competition*

What is in the anti tax avoidance package?

Against this backdrop, the European Commission published proposals for an anti tax avoidance package on 28 January 2016. This is predicated on the final OECD BEPS measures and seeks to transpose part of those agreed principles into EU law. The Commission has proposed-

(i) **An amendment to the Directive on Mandatory Exchange of Tax Information**. This proposal follows the OECD standard for country-by-country transfer pricing reporting. Under these new rules Multinational Enterprise (MNE) groups (with at least 750 000 000 Euros revenue) will need to report to tax authorities on a country-by-country basis providing information about revenue, profit before tax, tax paid and accrued, the number of employees, the stated capital, the retained earnings and tangible assets for each jurisdiction where the MNE does business. Under the proposal, such information will be automatically exchanged between concerned Member States' tax authorities. Obligatory country-by-country reporting to tax authorities will bring visibility to Member States to get better understanding of taxes paid across a group in different jurisdictions and, arguably, grounds to initiate tax audits.
The proposal for public Country-by-Country reporting (CBCR) as requested by the European Parliament for companies in other sectors than banks and extractive industries (which already have such obligation) is still under investigation. The Commission is expected to issue an impact assessment on such public reporting and a legislative initiative in Spring 2016.

(ii) **Draft Directive laying down Rules on Anti-tax Avoidance** which sets principle-based rules and leaves the implementation for Member States. These new requirements could potentially impact the way multinationals structure their business and result in changes to their tax planning and taxes paid. The anti-tax avoidance directive implements certain OECD BEPS measures on -

- **Deductibility of interest** - the aim is to limit the amount of interest the taxpayer is entitled to deduct each year. The EU proposes to set the rate for deductibility at the top of the scale recommended by the OECD (10 to 30%). If this proposal is implemented, multinational companies may face an increase in debt financing costs. Financial undertakings are temporarily excluded from the application of this article (until an agreement is reached at international level).
- **exit taxation** - to prevent assets being moved out of a tax residence to a lower jurisdiction without paying appropriate tax.
- **a switch-over clause** - to discourage companies from shifting profits out of high tax jurisdictions without sufficient business justification. The threshold of 'low taxation' is set at 40 percent of the average of statutory corporate tax rates in the Union.
- **a general anti-abuse rule** - taking account of the rapid evolution in tax planning. This rule would allow tax authorities to capture abusive practices despite the absence of a specific anti-avoidance rule.
- **controlled foreign company (CFC) rules** - moving profits from highly taxed jurisdictions to low tax countries where a subsidiary is established to reduce overall tax liability for the group.
- **hybrid mismatches** - disparities in the treatment of corporates in cross-border situations (e.g. deductions in two jurisdictions).

(iii) External Strategy for Effective Taxation

The Commission presents to the European Parliament and the Council the latest situation in the international arena and proposes further actions for the EU.

- Given that the former Commission's recommendations were not followed by Member States, the Commission sees the need to clarify how EU applies tax good **governance criteria** in relation to third countries. For instance these criteria should be included in the bilateral and regional agreements with third countries.
- The Commission **encourages Member States to lead by example and support the OECD BEPS** initiative by 'pushing for its smooth and timely implementation' in the EU and internationally.
- The Commission notes that it will promote international country-by-country reporting and the Extractive Industries Transparency Initiative (EITI) for **greater transparency and accountability in the extractive industry.**
- The Commission insists that the '**EU tax havens black list**' is needed and urges Member States finalise the assessment process by the end of 2016.

Additionally via the Chapeau Communication the Commission informs that –

- The EU **Transfer Pricing** documentation ("EU-TPD") will be reviewed to include the latest changes in the OECD BEPS guidance. After which the Commission will monitor the implementation in Member States and will consider whether stronger rules are required to prevent manipulation.
- The Commission shall also consider introducing legislation if Member States do not implement the revised approach to **patent boxes** appropriately.

Political context and timing

Pierre Moscovici, Commissioner for Economic and Financial Affairs, Taxation and Customs, has said he wants the Council to reach agreement on these proposals by June 2016 to set an international example. However, it will be challenging for the Council to meet this timeline because legislation related to tax needs to be adopted unanimously: this means even one small Member State can completely block negotiations. Traditionally negotiations on tax matters can drag out since Member States guard their competence and sovereignty on tax matters jealously.

However, most Member States contributed to and have committed to the OECD BEPS measures, as members of the OECD, so there is unlikely to be much that is new to them. There is also political recognition that the status quo must change due to public concern. Additionally some of the anti-tax avoidance directives provisions have already been debated by the Council under ongoing negotiations of the old CCCTB proposal. Negotiations can be simplified because this proposal only sets principle-based rules and leaves implementation to Member States to conclude.

Since LuxLeaks, there is a much greater push and attention from the Commission and the European Parliament for increased transparency and fair competition on tax. The European Parliament will not allow the Council to drag its feet on these negotiations, the new six months TAXE Committee mandate granted in December 2015 gives the power to MEPs to focus on Member States and their tax planning activities even more. The expectation, therefore, is that the Council has the appetite to push to finalise the proposals as quickly as possible.

Tax rulings

The Commission calls upon Member States to set an international example by implementing the OECD BEPS recommendations as quickly as possible and expects Member States to put political pressure on third countries to do the same, so that the guidelines can be implemented smoothly on an international basis. Conversely, the Commission in some instances rejects OECD guidance on transfer pricing arrangements via the State Aid decisions on tax rulings.

These messages are controversial and leave multinationals in a quandary. If the international guidance is not aligned – how should multinational companies navigate the rules of different jurisdictions where they are doing business? Who decides in the end, for example, which method of calculating profits should be applied to multinationals – national authorities or the European Commission?

A State Aid investigation is launched when the European Commission has serious doubts that the tax treatment of a corporation is selective, grants discriminatory aid and results in an anticompetitive effect in the market. To date, the majority of the State Aid cases on Tax rulings involve big US multinational companies. In January 2016, the Commission ruled against the so called Belgian 'excess profit tax ruling system' which allowed group companies to substantially reduce their corporation tax liability in Belgium. This decision affects 35 companies, mostly European. However, it differs since the Commission does not single out a multinational company but instead condemns a national taxation scheme itself.

US counterparts have expressed concern that the Commission is taking a novel approach to tax policy and, by applying it retroactively, may be acting inconsistently with internationally accepted standards. If approved by European Courts, it may be US taxpayers that will end up shouldering the cost. In December 2015, the US congressional committees responsible for tax policy convened separate hearings that closely examined the OECD BEPS final report. Lawmakers raised some specific concerns about the recommendations, primarily burdensome rules such as Country-by-Country reporting requirements. Following the investigative hearings, the Senate Finance Committee sent a critical letter on EU State Aid cases to the US Secretary of the Treasury, Jacob Lew, in January 2016. The letter states that the European Union's State Aid investigations could lead to retroactive taxation on multinational enterprises and have an adverse impact on US-based companies and asks to consider whether corporations of the US are being subjected to discriminatory or extraterritorial taxes. The Senate Finance Committee also questions a process under which the US Government has no rights to protect US tax interests while ensuring US firms are not subject to double taxation because of EU state aid decisions.

Similar to their Senate colleagues, House lawmakers have also been critical of the OECD's BEPS project recommendations. In response to the European Commission proposed directives issued on 28 January 2016, Ways and Means Committee Chairman Kevin Brady (R-TX) said the EU's efforts would make it even harder for American companies to compete in the global market. As a call to action, Brady encouraged Congress to move forward with international tax reform – an idea that has gained some bipartisan support in recent months.

Conclusion

The new European Commission's anti-tax avoidance package is one step further in Europe's fight against tax avoidance and aggressive tax planning. The perception at both public and political levels is that the so-called "sweetheart" deals and aggressive tax planning by multinationals have cost Member States millions in unpaid taxes, unfair during a period of austerity when ordinary citizens and governments are having to tighten their belts. The European Commission and European Parliament are, therefore, intent on maintaining political pressure on Member States. It may be easier for the Council to reach unanimous agreement on the proposals since the rules proposed are principle based, leaving Member States room for manoeuvre when introducing them into their national laws. The new anti-tax avoidance rules could well, therefore, be agreed still in 2016 whilst the single EU tax haven list may take more time to be agreed.

In 2016 we can expect the European Commission to continue its State Aid investigations on Tax rulings; more decisions will emerge as well as new cases, some driven by public pressure and political pressure from the European Parliament.

Notes

[1] Lux Leaks is an investigation into Luxembourg's industry friendly tax rulings from 2002 to 2010, revealed in November 2014 by a journalistic investigation conducted by the International Consortium of Investigative Journalists.

[2] Three ongoing in-depth investigations on tax rulings which may give rise to state aid issues, concerning Apple in Ireland, Amazon and McDonalds in Luxembourg.

[3] Decisions declaring the state aid illegal under EU law: October 2015 against Starbucks in the Netherlands and Fiat Finance&Trade in Luxembourg, January 2016 against Belgian 'excess profit tax ruling system',

[4] Facebook, Google, Amazon, Coca-Cola, Mc Donald's Europe, Ikea, Philip Morris, Disney, Anheuser-Busch InBev, HSBC and Barclays

[5] Proposal for a Council Directive laying down rules against tax avoidance practices that directly affect the functioning of the internal market [Link]; Proposal for a Council Directive amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation [Link]; Communication on an External Strategy for Effective Taxation [Link]; Communication on Anti-Tax Avoidance Package [Link] and the accompanying Staff working Document [Link]; Study on Structures of Aggressive Tax Planning and Indicators [Link]; Recommendation on measures against tax-treaty abuse [Link]

[6] According to the Treaty of Functioning of the EU the Council has an exclusive competence to legislate on tax related proposals. Therefore, the legislative process follows as a special procedure under which the European Parliament has no decision power on these proposals, but can only put forward an opinion coupled with political pressure.

[7] The Directive on Common Consolidated Corporate Tax Base (CCCTB) was proposed by the Commission in 2011 to introduce a single set of rules that cross-border companies could use to calculate their taxable profits in the EU, instead of having to deal with different national systems. Given that the negotiations in the Council on the CCCTB proposal proved to be unsuccessful, the Commission decided to review the proposal and aims to issue a new version in Q4 2016.

[8] Apple, Amazon, McDonalds – investigations ongoing. Starbucks and Fiat Finance and Trade – decisions announced in October 2015

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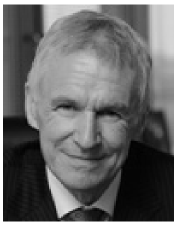

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