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DÉBAT D'ORIENTATION

# UN SYSTÈME D'IMPOSITION DES SOCIÉTÉS PLUS JUSTE AU SEIN DE L'UNION EUROPÉENNE

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Note de cadrage diffusée sous l'autorité de M. DOMBROVSKIS et de M. MOSCOVICI, en accord avec M. le PRESIDENT

Destinataires : Membres de la Commission
Directeurs généraux et chefs de service

**A Fairer Corporate Tax System in the European Union**
**Five Key Areas for Action**

**Note for the College Orientation Debate on 27 May**

## Introduction

On 18 March, the Commission proposed a package of measures to create more transparency in corporate taxation in the European Union. On the same occasion, it confirmed its intention to put forward *"before the summer [...] a detailed Action Plan on corporate taxation, which will set out the Commission's views on fair and efficient corporate taxation in the EU and propose a number of ideas to achieve this objective, including ways to strengthen discussions in the Council and to re-launch the proposal for a Common Consolidated Corporate Tax Base (CCCTB)."*

## The Context

The current rules for corporate taxation no longer fit the modern context. Corporate income is taxed at national level, but the economic environment has become more globalised, mobile and digital. Business models and corporate structures have become more complex, making it easier to shift profits. This has made it more difficult to determine which country is supposed to tax a multinational company's income.

In the European Union, the main focus has for a long time been to prevent tax obstacles such as double taxation. The Parent-Subsidiary Directive and the Interest and Royalties Directives were adopted with this objective in mind. For many years, the non-binding Code of Conduct for Business Taxation has been considered an effective tool for addressing tax competition in the Single Market. However, as corporate tax planning has become more sophisticated and competitive forces between Member States have increased, the tools for ensuring fair tax competition within the EU have reached their limits.

In a context of global competition and a Single Market with 28 different tax systems, Member States have progressively lowered their corporate tax rates, in order to protect their tax bases and to attract foreign direct investment. In addition, a number of Member States offer targeted regimes or rulings that provide considerably lower rates for certain types of income or companies.

To offset the impact of lower corporate tax rates and corporate tax avoidance, some Governments have also increased the tax burden on less mobile companies and on labour. This undermines the efficiency and growth-friendliness of their tax systems. The increased tax burden on labour creates disincentives to work and to crate employment. The higher tax burden on less mobile companies raises their cost of capital and reduces their capacity to invest. Furthermore, businesses which cannot or will not engage in aggressive tax planning suffer competitive disadvantages compared to those who do. SMEs are particularly affected in this respect.

## A new Approach to Corporate Taxation

To address these problems, the Action Plan should propose a new approach to corporate taxation, to ensure that corporate taxation can be growth-friendly, fair and transparent.

This new approach must also provide the foundation for a more coherent and competitive EU approach in the global context. Internationally, the OECD is working on the Base Erosion and Profit Shifting (BEPS) project to close loopholes that facilitate avoidance, and to find solutions to today's tax challenges, including those raised by the digital economy. The EU can build on these international reforms, and it must consider how best to integrate the results of the BEPS project at EU level.

The Commission's new approach would pursue the following specific objectives:

- Re-establishing the link between taxation and where economic activity takes place;
- Ensuring that Member States can correctly value corporate activity in their jurisdiction;
- Creating a competitive and growth-friendly corporate tax environment for the EU, in line with the recommendations of the European Semester;
- Protecting the Internal Market and securing a strong EU approach to external corporate tax issues, including measures to implement OECD BEPS, to deal with non-cooperative tax jurisdictions and to increase tax transparency.

## Key Areas for Action

In order to achieve these objectives, the Action Plan would propose five key areas for action.

- **Re-launching the CCCTB** by making it mandatory while developing a staged approach for its implementation, implying in particular postponing consolidation;
- **Bringing taxation closer to where profits are generated**, in particular by considering how to ensure effective taxation of profits, including through improving the EU framework for ensuring that transactions within a cross-border group are taxed based on a comparable market price ("transfer pricing") and linking preferential regimes to where value is generated;
- **Improving the tax environment for business**, in particular by enabling businesses to offset losses from their tax payments, wherever in the EU those losses occur; and by improving existing arrangements to settle divergences between different Member States about double taxation;
- **Making further progress on tax transparency**, in particular by ensuring a more common approach to third country non-cooperative tax jurisdictions and by launching a public consultation to prepare the Impact Assessment on options for public disclosure of tax information; and
- **Improving EU coordination tools**, in particular by improving Member States' coordination on tax audits and reforming the Code of Conduct Group and Platform on Tax Good Governance.

Most of these actions are linked to the Commission's approach to re-launch the Common Consolidated Corporate Tax Base (CCCTB) and the need to complement this re-launch with a number of short term measures to integrate the results of the BEPS project at EU level, to ensure that profits generated in the EU are taxed at the place where actual activities take place and to improve the tax environment for business.

In this context, the articulation between short and medium to long-term measures to re-launch the CCCTB as well as the question of effective taxation of profits in the European Union deserve particular attention.

**Re-launch of the CCCTB**

The Council has been discussing the current CCCTB proposal for over four years, without sufficient progress. Even those Member States who support the CCCTB in principle have so far not been able to agree on the rules on the common base or on how to apportion the consolidated tax base.

It is widely considered that the only way to re-launch the discussions is to postpone consolidation while making the common corporate tax base mandatory.

Postponing consolidation implies that until its introduction in the future, losses can be carried forward and offset against current and future profits only within the same country.

To partly compensate for this delay of consolidation, the Commission should propose the possibility for cross-border entities to offset profits and losses they make in different Member States. To ensure that one Member States does not definitely carry the burden of losses incurred in another Member State, there would be a mechanism to recapture these losses once the entity is profit-making again.

Making the common tax base mandatory would significantly increase its effectiveness as a tool to prevent profit shifting compared to the 2011 proposal, as those multinational enterprises minimising their profits through aggressive tax planning would be unlikely to opt in.

These two changes are fundamental compared to the initial Commission proposal. It is therefore considered necessary to prepare a modified proposal, supported by a proper impact assessment.

**Related short-term Actions to limit Base Erosion and Profit Shifting**

In parallel, the EU should, wherever possible, make concrete progress towards agreement on specific actions to limit base erosion and profit shifting, in line with OECD work. Relevant BEPS actions in that context include the strengthening of controlled foreign company rules, limiting base erosion through interest deductions or preventing artificial avoidance of permanent establishment. Work should also continue to improve the EU framework on transfer pricing rules and on preferential regimes such as patent boxes.

In order to maintain momentum and to capitalise on agreements in the context of the OECD BEPS project, the existing proposal should continue to be the vehicle to work on solutions for such individual issues. This approach would respond to demands to turn the broad OECD-level agreement into a more concrete common EU approach which is compatible with EU law and the Single Market. It is seen with great interest by the two next Council Presidencies.

**Effective Taxation of Profits**

The identification of measures to prevent base erosion and profit shifting due to low effective taxation is seen by a number of Member States as important to ensure a fairer corporate tax system. Other Member States note that neither the OECD BEPS nor the CCCTB proposal include specific actions to address the issue of low effective taxation and consider that clear rules ensuring activities are taxed where they take place are sufficient to limit tax avoidance strategies.

The question of effective taxation arises in the EU context in particular because EU law prevents Member States from taxing certain benefits attributed to an entity established in another Member State even if the corporate tax applied in that Member State is extremely low.

For example, under the Interest and Royalties Directive, the source Member State is prevented from levying any withholding tax on royalty payments even though in the recipient's Member State such payments fall under a special patent box regime and are taxed at an extremely low tax rate (if any).

This issue is currently debated and creates difficulty to find common ground in a number tax files, including the Interest and Royalties Directive or the extension of the Code of Conduct for Business Taxation.

Further reflection will be needed on the precise nature and scope of the issue and on the most appropriate ways to deal with it. As guardian of the treaties, initiator of EU legislation and promotor of the general interest of the Union and its Single Market, the Commission should however play an active part in this debate.

Without questioning the prerogative of Member States to apply corporate tax rates they deem appropriate, the Action Plan could therefore signal the Commission's intention to explore how to ensure effective taxation of profits, while taking into account the need for a competitive and growth-friendly corporate tax regime, and the concrete measures to achieve these objectives. This work could start for example within the framework of the Code of Conduct on Business Taxation, but the Commission should also consider how to ensure that EU corporate tax legislation aimed at preventing double taxation does not inadvertently lead to double non-taxation.

The ultimate effect of any measure linked to effective taxation should be to effectively safeguard the possibility to tax revenue generated in the Single Market and reduce the capacity of certain companies to escape taxation altogether.

## Next Steps

Following the guidance provided by the orientation debate, work will be completed at technical level. The adoption of the Action Plan is currently scheduled for 17 June. A public consultation on public disclosure of certain tax information is scheduled to be launched the same day.

## Questions

- Do you agree with the overall approach set out in this note?

- In particular, do you agree with the strategy and elements retained for a re-launch of the CCCTB, implying i) a revised Commission proposal within 18 months to make the common tax base mandatory and postpone consolidation, as well as ii) agreement on relevant BEPS issues in the short term?

- What are your views about ensuring effective taxation of profits while taking into account the need for a competitive and growth-friendly corporate tax environment?