Media briefing: An analysis of the European Commission's Anti-Tax Avoidance Package

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Quotes for use in the media by Tove Maria Ryding, Tax Justice Coordinator at the European Network on Debt and Development (Eurodad):

Country by country reporting
"*While we're seeing a rapidly growing demand for multinational corporations to report to the public what they really pay in taxes, the European Commission presents a package on how to introduce secret reporting. That clearly misses the point. While tax administrations can benefit from better information about what multinational corporations actually pay in taxes, it's problematic that citizens, journalists and parliamentarians are still left in the dark*".

The package overall
"*To fix the tax system, the EU needs to give the public access to information about what large corporations are really paying in taxes, they need to start treating multinational corporations as one entity instead of as a group of many independent entities, and they need to abolish harmful tax competition between governments. The OECD BEPS guidelines failed to deliver these things and therefore implementing BEPS will not be sufficient to fix our tax system*."

Impacts of the package
"Some of the measures included in this package can actually result in more harmful tax competition by rewarding EU Member States with low corporate tax levels. We fear that multinational corporations might end up paying even less in taxes if EU Member States engage in a race to the bottom on corporate tax levels. Therefore, it's very worrying that the European Commission has not performed an impact assessment on this proposal, which is otherwise normal practice in the EU".

Non-cooperative jurisdictions:
"The Commission is suggesting that it continues blacklisting countries the EU considers non-cooperative on tax issues. However, all of the EU's own Member States will still be exempt from this blacklist. Keeping in mind that several EU countries are widely recognised as tax havens, this is a hypocritical approach. It is time the EU stopped this mud-slinging and instead cleaned up its own backyard. The first step would be to let the public know what multinational corporations are really paying in taxes."

Analysis of the package

1. Proposal for a directive amending the Directive 2011/16/EU on mandatory automatic exchange of information in the field of taxation

Country by country reporting.
Background: There is growing attention and support for letting the public know what multinational corporations pay in tax (public country by country reporting). The latest support comes from Commissioner Vestager, who just announced her personal support to such a measure. At the same time, EU's regulation on public country by country reporting for the financial sector has come into effect and shown that public country by country reporting is a good transparency tool without undesired side effects.

Commission’s proposal: Despite this growing support for public country by country reporting, the Commission’s proposition is to implement the OECD BEPS proposal to introduce secret country by country reporting, which only tax administrations are allowed to see. The Commission also sticks to the OECD’s proposal about only applying the reporting requirements to businesses with a revenue of a minimum of €750 million, while recognising the fact that 85-90% of the world’s multinational corporations will then not have to report. On a positive note, the package says: “*This proposal does not preclude that the Commission decides in the future to propose imposing public disclosure obligations on companies”.* We welcome this because public country by country reporting is a very crucial missing link in the Commission’s current tax effort. We certainly hope to see the European Commission come out in support of public country by country reporting soon.

2. Proposal for a Directive laying down rules against tax avoidance

Controlled foreign company (CFC) legislation.
Background: CFC rules can be an important and effective tool to reduce tax avoidance, if designed correctly. However, if designed wrongly, they can increase the incentives for governments to lower their tax rates for multinational corporations. This can create a “race to the bottom” among governments.
The general idea behind CFC rules is to prevent multinational corporations from shifting their profits from the home-country of the parent company to low-tax jurisdictions by ensuring that the government in the home-country can tax profits located outside of its jurisdiction if they are located in a low-tax jurisdiction. However, a number of perverse incentives can arise if CFC rules are designed wrongly. In particular, the definition of “low-tax jurisdiction” is important. If the definition is based on a clear limit for minimum effective taxation, the rule can be effective. However, if the limit is defined as a percentage of the home-country of the parent company, the rules can create a perverse incentive for that country to lower its taxation of multinational corporations (because the companies can get a double benefit: They will pay less tax in the home-country and at the same time it will become easier to circumvent the CFC rules because the limit defining a “low tax jurisdiction” drops when the tax rate in the home-country drops).
Commission’s proposal: In its proposal, the European Commission proposes to define “low tax jurisdiction” as any country outside of the EU that has an effective corporate tax rate below 40% of the effective corporate tax rate of the Member State where the multinational corporation is located. This can create a perverse incentive for EU Member States to lower their corporate tax rate in order to offer multinational corporations opportunities for circumventing the CFC rules.

Impacts
Commission’s proposal: The European Commission has decided not to do an impact assessment of its proposal for a Directive against tax avoidance (see page 6 in the proposal). This is problematic in general, but in particular due to the risk that the proposal can create perverse incentives for Member States to lower their tax rate for multinational corporations. A race to the bottom among Member States could lead to multinational corporations paying even less taxes than today.

Interest limitation rule.
Background: The fact that Interest payments are tax deductible has been abused by multinational corporations, who use internal lending as a way to create internal “interest payments” to shift their profits to low tax jurisdictions and avoid taxation. During the OECD BEPS negotiations, the members discussed the options of limiting deduction of interest by establishing how much the multinational corporation overall is paying in interest to third parties and applying the logic that a corporation should not have higher interest payments internally than externally. However, the OECD could not agree to this proposal. Instead, they developed a complicated method to calculate a company’s “earnings before interest, tax, depreciation and amortisation”’ (EBITDA) and recommended that

interest deductions should be limited to somewhere between 10-30% of the EBITDA. Ironically, the OECD's own consultation document on interest deductions presented data showing that such a rule would be largely ineffective. The document says (on page 50):

"Results show that for the year 2009, 69 out of 77 companies had a net interest expense to EBITDA ratio below 10 per cent, including 15 companies which had net interest income. In 2013, 75 out of 79 companies had a net interest expense to EBITDA ratio below 10 per cent, including 18 companies which had net interest income."

This data comes from a report produced by PwC. The consultation paper furthermore adds (on page 50):

"The results were confirmed through similar analysis carried out by 9 countries that participate in this work. These countries also looked at the net interest expense to EBITDA ratios for the 10 largest non-financial groups headquartered in their country. Fifty-five per cent of those groups have a ratio below 10 per cent and eighty-five per cent have a ratio below 20 per cent."

Commission's proposal: The European Commission's proposal is to go with the high end of the range suggested by the OECD's by introducing an interest deduction limit of 30% of EBITDA. In other words, the proposal is very unambitious. As mentioned above, we expect it to be largely ineffective, and thus multinational corporations are likely to continue using internal lending and borrowing as a method to shift their profits to low-tax jurisdictions.

3. Communication on an External Strategy for Effective taxation

Listing of "uncooperative" jurisdictions

Background: In June 2015, the Commission issued a list of countries considered uncooperative on tax matters. While this list did not include countries such as Switzerland and the United States, both of which have significant tax loopholes in their tax systems, it did include a number of small countries, including least developed countries such as Liberia. The list also did not include any of the EU's own Member States.[1]

Commission's communication: With a focus on the need to ensure a level playing field between the EU and other countries, the Commission proposes the development of new criteria to define which countries are being "uncooperative". However, the proposal is also to continue excluding the option of applying the same criteria and blacklisting to its own Member States. This in spite of the fact that the EU includes several countries that are considered by many to be "tax havens" (incl. The Netherlands, Ireland and Luxembourg). With this type of double standard for EU and non-EU countries, the tool will not contribute to creating a level playing field, but rather expose the EU to criticism for attempting to protect its own tax havens by blacklisting others.

4. Overall

Impacts on developing countries

Background: Civil society has highlighted the fact that EU tax policies can have significant negative impacts on developing countries (see for example the report *50 Shades of Tax Dodging*). This

[11] The full list of countries was as follows: Andorra, Liechtenstein, Guernsey, Monaco, Mauritius, Liberia, Seychelles, Brunei, Hong Kong, Maldives, Cook Islands, Nauru, Niue, Marshall Islands, Vanuatu, Anguilla, Antigua and Barbuda, Bahamas, Barbados, Belize, Bermuda, British Virgin Islands, Cayman Islands, Grenada, Montserrat, Panama, St Vincent and the Grenadines, St Kitts and Nevis, Turks and Caicos, US Virgin Islands.

concern has also been echoed by the European Parliament, which has proposed a spill-over analysis of the EU's tax policies, to assess the impact on developing countries. Some Member States have already conducted such spill-over analysis. For example, an analysis of the Netherlands highlighted a number of concerns, including the impacts of Dutch tax treaties with developing countries.
Commission's communication: The European Commission's communication highlights that "*[The EU] is aware of the need to remain vigilant that domestic tax policies do not have negative spill-over effects on third countries*" (page 9). However, the European Commission has not presented any proposals as to how this vigilance will be carried out, and has not taken on board the proposal to conduct a spill-over analysis.
The Commission furthermore acknowledges that EU tax treaties can have negative impacts on developing countries, but rather than suggesting concrete measures to address the issue (again, such as a spill-over analysis), the Commission intends to launch a debate with Member States on the issue and suggests that the Member States could reconsider aspects of their tax treaties with developing countries (page 9 in the Communication).
Lastly, the Commission highlights that the EU will focus on providing capacity-building and supporting international initiatives to "strengthen legislation and regulation" in developing countries. While more resources should indeed be devoted to capacity building of developing countries on tax matters, capacity building projects have at times resulted in problematic approaches, such as when representatives from EU Member States and international organisations start drafting legislation for parliamentarians and stakeholders in developing countries.

Impacts on harmful tax practices – patent boxes and tax rulings
Background: Individual EU Member States have repeatedly been criticised for using harmful tax practices to attract multinational corporations to their countries. One well-known example is the LuxLeaks scandal, which exposed Luxembourg's use of tax rulings that allowed multinational corporations to use structures in Luxembourg to avoid taxation. Another example is the Commission's State Aid cases, which have so far resulted in strong criticism from the Commission regarding harmful tax rulings in the Netherlands, Luxembourg and Belgium (the case against Ireland is still ongoing). However, while the EU has adopted new rules for secret exchange of information about tax rulings internally among the Member States, no measures have been proposed to limit the use of tax rulings. At the same time, data recently published by the European Commission shows that the number of advance pricing agreements issued by Member States to multinational corporations increased almost 50% between 2013 and 2014, and thus the problem might be bigger than previously assumed.
Another issue that has raised concerns is patent boxes, which is a type of tax incentive that grants corporations preferential tax treatment for income from intellectual property. In 2015, the European Commission published an analysis that found that "*in the majority of cases, the existence of a patent box regime incentivises multinationals to shift the location of their patents without a corresponding growth in the number of inventors or a shift of research activities. We find that the size of the tax advantage is negatively correlated with the local R&D. This suggests that the effects of patent boxes are mainly of a tax nature.*"
Patent boxes have also been a subject of intense discussion among EU Member States. In 2014, a few Member States, including UK, Luxembourg and the Netherlands, seemed isolated in their defence of patent boxes, while other countries such as Germany argued strongly against them. However, when a deal was struck between the UK and Germany, the internal discussions ceased. The deal does not entail a ban on patent boxes, but rather introduces a set of complicated guidelines for how patent boxes should be designed. In response to this, the Commission's analysis said: "*the tax-sensitivity of patent location is reduced when such specific conditionality is imposed would suggest that the nexus approach could (at least partly) inhibit the still dominant tax competition dimension of patent boxes*". However, the deal reached between the UK and Germany also introduced the rule that countries are allowed to continue with the old type of patent box regimes,

without applying the new “modified nexus approach”, until June 2016, and that these and all existing innovation box agreements will be allowed to continue unchanged until 2021. More and more EU Member States have now shown an interest in introducing these measures (see the report *50 Shades of Tax Dodging*, page 20).
Commission’s proposal: The Commission’s proposal does not include any measures to address the extensive use of tax rulings. As regards patent boxes, the Commission’s communication on an External Strategy for Effective Taxation highlights patent boxes as an area where Member States have already “*taken the first important steps”* by agreeing on how patent boxes should be designed (the above mentioned modified nexus approach). The proposal does not include any other initiatives to further address the concerns with patent boxes.

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