Aggressive corporate tax planning under scrutiny

Multinational companies (MNCs) can use aggressive tax planning methods in order to reach very low effective tax rates. Amplified public and political attention to aggressive corporate tax planning practises has increased pressure to change the existing situation. Scrutiny of existing practices to find solutions is a generally recognised policy priority of the European Parliament (EP).

Corporate aggressive tax planning and tax avoidance in the spotlight

Journalists' work on multinational companies' tax deals (Luxleaks) published in November 2014, contributed to raising reacting to aggressive tax planning to the top of the EU agenda. It revealed policies, practices and measures of tax jurisdictions and taxpayers aimed at achieving significant reductions of MNCs' tax bills. 'Tax avoidance' generally remains within the limits of the law, in contrast to 'tax evasion' and 'fraud', which are both illegal. Corporate tax avoidance uses loopholes and mismatches between different countries' tax systems, and profits-and-losses shifting via aggressive tax planning, with a view to reducing a company's tax bill as a result of the reduction of their taxable revenues (collectively referred to as 'base erosion and profit-shifting techniques', or BEPS).

The nature of the problem is global and cross-border. Companies participating in the global economy (MNCs) can use tax-planning techniques relating to the structure (via transfer pricing and profit shifting) or location and pattern of investment decisions (on which tax deals can have an impact). The result can be a substantial reduction of tax liabilities, and a tax situation disconnected from actual activity (as is the case with letterbox companies). The empirical assessments of the magnitude of annual revenue losses due to aggressive corporate-tax-planning in the EU range from €50-70 billion (sum of lost profit-shifting only) to €160-190 billion (adding individualised tax arrangements of major multinationals, and inefficiencies in collection).

Special committee: scrutinising harmful tax practices

In the wake of the Luxleaks revelations, on 12 February 2015 the EP set up, on a temporary basis, a special committee on tax rulings (and other measures similar in nature or effect) with the mandate 'to examine practice in the application of EU state aid and taxation law in relation to tax rulings and other measures similar in nature or effect issued by Member States, if such practice appears to be the act of a Member State or the Commission'. The 'harmful tax practices' to be scrutinised aim at 'attracting non-resident firms or transactions at the expense of other tax jurisdictions and/or measures aimed at privileging only some companies, thus distorting competition' – including tax rulings, which appear to be the tip of the iceberg.

The Committee's work was based on requests for information and hearings of institutions, Member States and MNCs as well as hearings of experts and representatives of civil society (the list of persons met and answers provided are attached to the Committee's report). However, not all provided substantiated answers to the questions and requests for information, or participated in the Committee meetings they were invited to, thus hindering the Committee's work. The report prepared by the special committee on tax rulings (co-rapporteurs: Elisa Ferreira, S&D, Portugal and Michael Theurer, ALDE, Germany) was finalised at committee level after eight months of work focused on determining recommendations for achieving fair and transparent corporate taxation in Europe.

EU state aid provisions and tax rulings

A tax ruling is a statement provided by the competent tax authorities to a taxpayer, before a specific transaction takes place, regarding the future tax treatment of such transactions, thus providing the taxpayer concerned with legal certainty. A specific type of advance tax ruling, the advance pricing agreement (APA), relates to 'transfer prices' between two related parties within a company (at arm’s length compared to the

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transfer prices with an unrelated party). When they concern MNCs' cross-border transactions, tax rulings granted by one Member States can affect others' tax bases, since current exchange of information arrangements between Member States – not including pending amendments – have proved ineffective. Another effect of tax rulings is that they may confer a competitive advantage on the beneficiary companies compared to other companies, such as SMEs which face a comparatively higher tax burden**.**

Tax benefits granted by a public authority conferring a selective advantage to a company, which distorts or threatens to distort competition and affects trade between Member States, may constitute state aid incompatible with the internal market (unless covered by state aid exceptions and exemptions). EU state aid provisions require mandatory Member State notification to the Commission prior to the adoption of measures likely to constitute illegal state aid, and monitoring by the Commission. EU state aid enforcement can be an instrument to address tax-base erosion. As pointed out by Commissioner Margrethe Vestager after recent Commission decisions on tax advantages, 'more transparency is crucial since achieving fair tax competition can only be won with a smart combination of legislative action and competition enforcement'.

Report of the Special Committee

The report scrutinises 'harmful tax practices' (which can include in tax rulings) and their impact in the EU and third countries. It stresses the observed 'paradox that free competition between Member States in tax matters in an uncoordinated tax framework within the EU, with a blatant lack of cooperation has resulted in distortions of competition and disconnections between where value is created and where profits are taxed'.

Problems identified relate to the movement from double taxation to double non-taxation, the use by MCNs of regulatory mismatches to minimise taxes, Member States' use of taxation to attract foreign direct investment, the level playing field between MCNs and national corporations, the uneven implementation of tax laws and the lack of transparency (and whistle-blower protection), with the resulting effects: the corporate tax base erosion revenue losses, revenue losses in the EU and in developing countries (negative spill overs).

Recommendations derive from the principle that MCNs should pay their taxes where they make their profits, to stop the unfair situation where public income is lost, and citizens and other firms pay for the lost taxes Fairness can only be ensured by restoring the link between taxation and real economic activities. The setting of an agreed framework to end incentives for aggressive tax planning can be based on several tools.

Tools to achieve this are, in particular: increased transparency through systematic sharing of rulings and tax information likely to have an impact on other Member States (providing tax authorities with sufficient resources), informing the Commission and public country-by-country reporting (CBCR) by MNCs (on profits made, taxes paid and subsidies received);

- ending preferential regimes and national tax system mismatches, agreeing on how transactions are valued within the same company (transfer prices) and clearly defining 'economic substance';

- a compulsory EU wide common consolidated corporate tax base (CCCTB), which should be introduced as soon as possible, would provide a comprehensive response to corporate tax base issues. It is a better solution than a two-step launch, limited to a common corporate tax base. This approach will require that consolidation be realised within a concrete and short deadline;

- providing a framework for tax-related state aid and a definition of appropriate transfer pricing (guidelines) in the framework of the state aid modernisation initiative, handling investigations and rendering recovery of illegal state aid an effective deterrent against illegal tax-related state aid;

- reforming the Code of conduct on business taxation to increase transparency, accountability and the involvement of the EP and national parliaments;

- incorporating the fight against tax avoidance in other policies and in business behaviour not only for MNCs, banks and financial service providers, but also tax advisors who could be liable to sanctions and incompatibility in case of conflict of interest (due to their role in designing aggressive tax-planning schemes);

- finally, whistle-blowers making tax revelations in the public interest should be better protected.

The report **concludes** that state aid provisions have not always been complied with, in respect of tax rulings which have not been shared, and calls for actions to remedy the situation. The Special Committee's findings will serve EP work on taxation, namely the report on 'Bringing transparency, coordination and convergence to EU corporate tax policies' prepared by the Economic and Monetary Affairs committee.