



DIRECTORATE-GENERAL FOR INTERNAL POLICIES

POLICY DEPARTMENT
ECONOMIC AND SCIENTIFIC POLICY **A**



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International Taxation and Tax Rulings: Policy Issues at Challenging Times

Compilation of Notes for the Special Committee on Tax Ruling (TAXE2) 2016



DIRECTORATE GENERAL FOR INTERNAL POLICIES
POLICY DEPARTMENT A: ECONOMIC AND SCIENTIFIC POLICY

International Taxation and Tax Rulings: Policy Issues at Challenging Times

COMPI LATION OF NOTES

Abstract

Reforming international taxation is a complex and difficult matter that will be the subject of continual discussion and negotiation for years to come. Since most major players are willing to settle for incremental change toward a better system, the world should be able to do better than now when it comes to taxing international income flows relatively fairly and efficiently. Given the complexity of the issues at stake, expert views are likely to provide great real value added. In this vein, and at the request of the Special Committee of the European Parliament on Tax Rulings (TAXE2), this compilation of three papers by people from academia specialized in International Taxation, Tax Rulings and State Aid has been prepared by the Policy Department A.

This document was requested by the European Parliament's TAXE Special Committee.

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CONTENTS

INTRODUCTION	4
1. ARE WE MOVING IN THE RIGHT DIRECTION? PUBLIC DISCLOSURE OF TAX INFORMATION & OTHER EC/EP PROPOSALS TO REDUCE AGGRESSIVE TAX PLANNING by John VELLA	5
2. THE FUTURE OF TAX RULINGS IN THE EU: EVALUATION, CONFRONTATION AND RECOMMENDATIONS by Elly VAN DE VELDE	23
3. EU STATE AID LAW AND NATIONAL TAX RULINGS by Raymond LUJA	41

INTRODUCTION

- The reform of international taxation - how national tax systems interact with each other and in the EU Single Market context - is an issue that is always technically complex, often economically significant, and sometimes politically explosive. The revelation of controversial corporate tax avoidance schemes (i.a. the Lux-leaks in 2014, and in 2016 the Panama papers) has spurred the discussion. Major changes are currently underway under the aegis of the OECD and the European Commission. The relevant European Parliament committees have been very instrumental in this process, including by two resolutions¹ on i) tax rulings and ii) transparency, coordination and convergence to corporate tax policies. Expectations are very high, but no one yet knows how effectively they might be implemented. Instead of speculating about such matters, this compilation of three briefings presents the expert views of three key people from academia.
- In a first briefing, Professor John Vella (University of Oxford, Saïd Business School) sheds some light on what is currently discussed and agreed upon in this area. He argues that some proposals might increase real economic distortions and it is unclear whether others will make much difference. He therefore argues that more radical reform is required and pleads for considering other options with more active properties than for example the currently tabled country-by-country reporting.
- In a second briefing, Professor Elly Van de Velde (Hasselt and Antwerp Universities) sets out in which direction the future of tax rulings in the EU is evolving. She thereby draws the attention to a few topics that are likely to be relevant for policy discussions regarding the coordination and cooperation on tax rulings, in particular emphasising and encouraging the need for enhancing tax compliance of potential applicants of tax rulings by inscribing cooperative compliance (as described by the OECD in 2013) in the national jurisdictions of all EU Member States.
- In a third and last briefing, Professor Raymond Luja (Maastricht University) focuses on the approach of the ongoing state aid review of tax rulings by the European Commission. He very much stresses that the rules ought to be made sufficiently clear, and pleads therefore for adopting a methodology that would allow the EU Member States receiving recovered amounts back to bear the burden of foreign tax credits as third countries (EU or non-EU) might otherwise have to offer due to recovery of taxes. Indeed, it is not impossible that EU's trading partners may use its state aid regime against it and that the outcome of the TTIP negotiations may be of relevance to future state aid recovery proceedings.

¹ Reports by Theurer-Ferreira (Special Committee on Tax Rulings) and the Dodds-Niedermayer (Committee on Economic and Monetary Affairs).



DIRECTORATE GENERAL FOR INTERNAL POLICIES
POLICY DEPARTMENT A: ECONOMIC AND SCIENTIFIC POLICY

Are We Moving in the Right Direction? Public Disclosure of Tax Information & Other EC/EP Proposals to Reduce Aggressive Tax Planning

John VELLA

IN-DEPTH ANALYSIS

CONTENTS

EXECUTIVE SUMMARY	7
1. INTRODUCTION	8
2. BRIEF COMMENTS ON SOME PROPOSALS MADE BY THE EUROPEAN PARLIAMENT AND THE EUROPEAN COMMISSION AND	10
2.1 Proposals that ought to affect current aggressive tax planning practices	10
2.2 Other proposals made by the European Parliament	10
2.3 Recommendations designed to align taxing rights with economic activity	12
2.4 Public country-by-country reporting	13
2.4.1 Benefits	13
2.4.2 Limitations	13
2.4.3 Dangers	13
3. ARE WE HEADING IN THE RIGHT DIRECTION?	15
3.1 General conclusions	15
3.1.1 Fundamental structure out-dated	15
3.1.2 Structure undermined by tax competition amongst states	15
3.2 More radical reform	17
3.2.1 Other reform options	17
4. CONCLUSION	19
REFERENCES	20

EXECUTIVE SUMMARY

- The first part of this note looks briefly at some of the proposals put forward by the European Parliament and the European Commission in the field of tax reform.
- It argues that some proposals should affect current aggressive tax planning practices. However, some proposals might increase real economic distortions and it is unclear whether others will make much difference.
- The second part argues that more radical reform is required. It considers in particular the reform proposal in corporate taxation put forward by the European Commission and European Parliament with the Common Consolidated Corporate Tax Base (CCCTB). The proposal has some clear benefits. In particular, it would remove transfer pricing issues amongst participating states. However, other options with more attractive properties should also be considered, such as a residual profit split system and a destination based cash-flow tax system. The third part concludes.

1. INTRODUCTION

The past few months have seen numerous developments in international tax reform. On 5 October 2015 the OECD published the Final Reports for the seminal Base Erosion Profit Shifting (BEPS) project.

Significant developments also took place at an EU level, including: the European Parliament Resolutions of 25 November¹ and 16 December 2015,² the adoption of a Directive on automatic information exchange of tax rulings on 8 December 2015,³ and the publication by the European Commission of its Anti-Tax Avoidance Package on 28 January 2016⁴ and of a Public Tax Transparency Proposal on 12 April 2016.⁵ During this period the European Commission also issued a number of important State Aid decisions which appear to have important implications for international taxation.⁶

Developments also took place at a domestic level as states took the first steps in implementing the BEPS recommendations. The UK, for example, introduced country-by-country reporting through Finance Act 2015, introduced legislation to deal with hybrid mismatch arrangements and the patent box regime through Finance Bill 2016, and announced its intention to introduce interest limitation rules.⁷

Furthermore, other developments are planned for the near future, including the completion of some open issues in the BEPS Action Plan⁸ and the re-launch of the Common Consolidated Corporate Tax Base (CCCTB) by the European Commission before the end of 2016.

The pace of these developments and their extensive scope has been overwhelming and there is a real danger of losing sight of the ultimate goal at hand. This note thus seeks to step back, take stock of these developments and assess the general direction of travel. In other words, it offers a personal assessment of whether the reforms being proposed will lead to an international tax system fit for the twenty-first century.

The note proceeds as follows. The first part looks briefly at some of the proposals put forward by the European Parliament and the European Commission.

¹ European Parliament resolution of 25 November 2015 on "Tax rulings and other measures similar in nature or effect" (TAXE Resolution).

² European Parliament resolution of 16 December 2015 on "Bringing transparency, coordination and convergence to Corporate Tax policies in the Union" (ECON Resolution).

³ Council Directive (EU) 2015/2376 of 8 December 2015 amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation [2015] OJ L 332

⁴ Chapeau Communication: "Anti-Tax Avoidance Package: Next steps towards delivering effective taxation and greater tax transparency in the EU" [COM(2016) 23 final]; "Proposal for a Council Directive laying down rules against tax avoidance practices that directly affect the functioning of the internal market" [COM/2016/026 final]; "Proposal for a Council Directive amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation" [COM(2016) 25 final]; Commission Recommendation on Tax Treaties [C(2016) 271 final]; and Communication from the Commission to the European Parliament and the Council on an External Strategy for Effective Taxation [COM(2016) 24 final].

⁵ "Proposal for a Directive of the European Parliament and of the Council amending Directive 2013/34/EU as regards disclosure of income tax information by certain undertakings and branches" [COM(2016) 198 final]

⁶ See for example, "Commission decides selective tax advantages for Fiat in Luxembourg and Starbucks in the Netherlands are illegal under EU state aid rules", European Commission Press release 21 October 2015.

⁷ See HM Treasury, Business Tax Road Map, March 2016.

⁸ E.g. the application of the limitation of interest deductibility rules under Action 4 to banks and insurance companies, OECD (2015); Limiting Base Erosion Involving Interest Deductions and other Financial Instruments, Final Report, OECD/G20 Base Erosion and Profit Shifting Project, (Paris, OECD), pp. 75-76.

It argues that some proposals should affect current aggressive tax planning practices,⁹ however some proposals might increase real economic distortions and it is unclear whether others will make much difference. The second part argues that more radical reform is required. It then considers the radical reform proposal put forward by the European Commission and European Parliament and argues that other options with more attractive properties should also be considered. The third part concludes.

⁹ The term “aggressive tax planning” has no fixed meaning and can mean different things to different people. This briefing paper will not enter the debate as to the meaning of this term or the usefulness of such labels. See Devereux, Freedman and Vella (2012) for a discussion of some of these issues, particularly in a UK context. This briefing paper is largely focused on base erosion and profit shifting, which can be deemed to be a subset of aggressive tax planning. It could be argued that labelling certain forms of base erosion and profit shifting as aggressive tax planning is misleading, for example when the erosion of a state’s tax base is knowingly facilitated by the law of that very state. Base erosion and profit shifting has been described in the following terms: “BEPS relates chiefly to instances where the interaction of different tax rules leads to double non- taxation or less than single taxation. It also relates to arrangements that achieve no or low taxation by shifting profits away from the jurisdictions where the activities creating those profits take place. No or low taxation is not per se a cause of concern, but it becomes so when it is associated with practices that artificially segregate taxable income from the activities that generate it. In other words what creates tax policy concerns is that, due to gaps in the interaction of different tax systems, and in some cases because of the application of bilateral tax treaties, income from cross-border activities may go untaxed anywhere, or be only unduly lowly taxed.” OECD (2013 b) p. 10.

2. BRIEF COMMENTS ON SOME PROPOSALS MADE BY THE EUROPEAN PARLIAMENT AND THE EUROPEAN COMMISSION AND

Given the volume and extensive scope of these proposals, this note offers only brief and general comments on a select number of proposals. The proposal for public country-by-country reporting is considered at greater length because of the particular public and political interest in this proposal at the time of writing.

2.1 Proposals that ought to affect current aggressive tax planning practices

The European Commission, backed by the European Parliament, has proposed a number of measures which ought to affect current aggressive tax planning practices. If adopted, and depending on how they are adopted, these proposals ought to close or narrow a number of aggressive tax planning opportunities. These proposals include: the Anti-Tax Avoidance Directive (for example through the proposed interest limitation, anti-hybrid and controlled foreign company [CFC] rules) and the Recommendation on Tax Treaties (for example through its recommendation that Member States to implement the new Article 5 of the OECD Model Tax Convention as proposed in the BEPS Final Report for Action 7).

2.2 Other proposals made by the European Parliament

The numerous recommendations made by the European Parliament in its TAXE and ECON Resolutions include a number of proposals which ought to be helpful in combatting current aggressive tax planning practices but also in operating the international tax regime. These include, but are not limited to, the proposals for a harmonised methodology to estimate the corporate tax gap, a disclosure of tax avoidance schemes regime,¹⁰ improving coordination on tax controls, improving cross border taxation dispute resolutions and providing guidance on the State Aid regime as it relates to tax.

The European Parliament's recommendation to strengthen tax administrations¹¹ has not attracted the same level of attention as other recommendations, but, to this author's mind, it deserves particular praise. Put simply, a perfect tax system would still not produce the desired results if it is not administered by well resourced and knowledgeable tax administrations. For this reason, a recommendation to strengthen tax administrations is as critical as recommendations to improve the substantive and procedural aspects of the international tax regime.

This recommendation is also particular timely. There is, in fact, some concern that the certain aspects of the recent political and public debate on the tax activities of Multinational Companies (MNCs) has undermined rather than led to the strengthening of tax administrations. At various points in the debate, the competence and even integrity of some tax administrations were called into question, whether explicitly or implicitly. This was done, for example, in the context of debates around the need for public disclosure of tax information. The suggestion made or implied by some being that public disclosure is required because tax administrations are not capable or cannot be trusted to properly perform their duties to collect the tax due under the law. There have been cases which could justify such concerns, however, this sweeping and undifferentiating rhetoric can be dangerous.

¹⁰ For a discussion on the UK experience with such a regime see M P Devereux, J Freedman and J Vella, "The Disclosure of Tax Avoidance Scheme Regime" [Report commissioned by the UK National Audit Office] (2012)

¹¹ TAXE Resolution, para. 170.

Tax administrations have a difficult job. They deal with hard issues of fact and law. Indeed, they have to administer increasingly complex and uncertain tax legislation. They can be understaffed, under-resourced and working under multiple sources of pressure. With this background in mind, the suggestion that tax administrations are incompetent or even unwilling to collect the right amount of tax from MNCs, and the public pillorying which at times accompanied it, could have a negative impact on the tax administration's ability to recruit and retain the services of good tax officials. This is particularly the case given the difference between their wages and those of their counterparts in the private sector in many jurisdictions.

Over the past few years, steps have been taken in some jurisdictions to move away from a confrontational to a more open and cooperative relationship between tax authorities and large businesses.¹² There are good reasons for this approach,¹³ although, of course, appropriate safeguards must be in place to ensure that the system is not abused and is producing the desired results. If a cooperative approach between a tax administration and large business is misunderstood as being a sign that the tax administration is being "soft" on business, and if the tax administration is criticised on this basis there is a danger that the work done over the past years is undermined and a return is made to the confrontational relationships of the past. The administration of any tax system, and not only ones employing the co-operative compliance model, requires judgement and some discretion to be exercised. As a result of this undifferentiating criticism, tax officials might be reluctant to take decisions which are sensible, in line with the law and for the ultimate benefit of the fisc. This could lead to a growing backlog of tax disputes with all the problems that brings.¹⁴

Finally, and critically, this undifferentiating rhetoric helps to foster and to reinforce a belief amongst the public that tax administrations are not competent or lack integrity. This can be extremely harmful to a tax system. Public confidence in tax administrations is indispensable for the correct functioning of tax systems. Allowing a belief to grow that MNC pay a lower amount of tax than one would expect because of the incompetence or lack of integrity of tax administrations, rather than because of the well known flaws in the tax system can be extremely harmful. This is not to say that all tax administrations are beyond reproach at all times. Some might act without integrity and all tax administrations will get some things wrong. However, this should be dealt with by ensuring that internal and external checks are in place to pick up mistakes and even irregular conduct. *Ad hoc* or regular external reviews by public bodies should be considered for these purposes.

For these reasons, caution is advised in the rhetoric used in this debate. Also, the European Parliament's call for the need to strengthen tax administrations is particularly commendable and welcome at this delicate point in time. All efforts should be made to ensure that tax administrations are properly funded and have the necessary training and expertise. This is a *sine qua non* in the fight against aggressive tax planning.

¹² This model was "significantly influenced" by the work of academics such as Ian Ayres, John Braithwaite and Valerie Braithwaite in regulatory and psychological theory. See for example V. Braithwaite (ed), "Taxing Democracy: Understanding Tax Avoidance and Evasion", (Ashgate Publishing, 2003); V. Braithwaite, "Responsive Regulation and Taxation" (2007), Law and Policy. For more information on the UK experience see J Freedman, G Loomer and J Vella, "Corporate Tax Risk and Tax Avoidance: New Approaches", (2009) *British Tax Review*, 74.

¹³ See OECD, "Co-operative Compliance: A Framework. From Enhanced Relationship to Co-operative Compliance", 2013.

¹⁴ Concerns of this taking place in a UK context were documented in J Freedman, F Ng and J Vella, "HMRC's relationship with large business", (2014) Oxford University Centre for Business Taxation Report, pp. 76-82.

2.3 Recommendations designed to align taxing rights with economic activity

The guiding principle adopted by the OECD in the BEPS process is that “profits are taxed where economic activities generating the profits are performed and where value is created.”¹⁵ In fact the BEPS Action Plan is meant to “provide countries with domestic and international instruments that will better align rights to tax with economic activity.”¹⁶ The European Parliament and the European Commission have adopted this guiding principle. The ECON Resolution explains, for example, that “the overall principle of corporate taxation in the Union should be that taxes are paid in the countries where a company’s actual economic activity and value creation take place.”¹⁷ Some of the proposals emanating from the BEPS process and backed by the European Parliament, such as those relating to Action 5 (harmful tax practices) and Actions 8, 9 and 10 (transfer pricing) are clear attempts at giving effect to this principle.

This principle has intuitive appeal, however, it merits very careful consideration.¹⁸ For a start, it constitutes a departure from the current regime. Put simply, the international tax system does not currently allocate taxing rights to countries according to where ‘economic activity’ takes place. Indeed, when passive income is paid across borders, it will be taxed in the recipient’s country of residence solely by virtue of the recipient’s residence in that country. No economic activity in the country of residence is required. This change thus overlays a new and completely different principle onto the existing structure. The introduction of such a principle thus warrants more careful consideration. Furthermore, as the basic structure is being kept in place and the principle overlaid on top of it, the international tax regime following the adoption of these recommendations will be even less coherent. In some situations, taxing rights will be aligned with ‘economic activity’, but in others it will not be, depending on perceived instances of abuse.

From a conceptual perspective, a system that seeks to align taxing rights over income with the “economic activity” which created it is questionable because it is not at all clear where such economic activity actually takes place. Numerous factors contribute to the creation of income, including finance, research and development, head office functions, manufacturing, marketing and sales. In the context of a MNC, these factors might be spread over a number of countries thus making it impossible to pinpoint where the relevant “economic activities” which created the income took place.

From a practical perspective, solutions that rely on this principle are likely to create real economic distortions. For example, following the modified nexus approach proposed under Action 5 of the BEPS Action Plan, companies will have to undertake their R&D activities in the jurisdiction offering a patent box regime if they are to fully enjoy the preferential rates offered by the regime.¹⁹ This will mean that if the benefits outweigh the costs, multinationals will move real activity to benefit in full from such regimes. The revised transfer pricing rules will similarly require MNC to move real activities to low-tax jurisdictions to achieve their desired tax outcomes. This is problematic because real economic distortions are being created where there were none. Ideally MNCs would locate their real activities on the basis of economic (and not tax) considerations.

¹⁵ OECD (2014), “Explanatory Statement”, OECD/G20 Base Erosion and Profit Shifting Project, p. 4.

¹⁶ OECD (2013), “Action Plan on Base Erosion and Profit Shifting”, p. 11.

¹⁷ ECON Resolution, p. 8.

¹⁸ M. P. Devereux and J. Vella (2014), “Are we heading towards a corporate tax system fit for the 21st century?” *Fiscal Studies*, Vol 35. No. 4, 449, pp. 463-438.

¹⁹ This is also specifically recommended in the ECON Resolution, Recommendation B3.

2.4 Public country-by-country reporting

At the time of writing, the proposal for public country-by-country reporting is attracting considerable attention. This proposal has some clear benefits but also dangers and limitations.

2.4.1 Benefits

This proposal should allow an informed reader to obtain a better general picture of the tax affairs of particular MNCs. However, there are significant limitations to this given the relatively high-level information included in this disclosure. Also, one can gain a better general understanding of the involvement of specific states in MNC tax planning. These could both help attain one of the proposal's objectives: to "promote a better informed debate on potential shortcomings in tax laws."²⁰ This proposal will also provide new data which will certainly be of help to researchers in this area.

2.4.2 Limitations

One danger is that disclosed figures can be sensationalized or misunderstood, thus increasing the heat and lowering the quality of the public and political debate. Unfortunately, when such figures enter the debate they are very hard to dislodge. This was Vodafone's experience in the UK.²¹ A magazine article claimed that Vodafone reached a settlement with the UK tax authorities (Her Majesty's Revenue and Customs – 'HMRC') for £1.25 billion, when the true tax liability was £6 billion. HMRC issued a statement explaining that the figure of £6 billion was an "urban myth", but this did not stop protesters from targeting Vodafone's stores.

A second danger is that certain tax administrations might use this information to demand more tax than is due under the law from MNCs subject to these requirements.

2.4.3 Dangers

The information will certainly not be sufficient for the public to determine whether a company paid the right amount of tax due under the law. Indeed, this is not the proposal's objective. Its "main objective" is "to ensure that companies that have activities in the European Union pay their fair share of tax here"²² The concept of a "fair share of tax" as used in this context is problematic.²³ Fairness has a critical role to play in the formulation of tax policy and law. Once the law is set and a taxpayer is deemed to comply with it – a matter ultimately to be decided by the courts – one can argue that the law allows for results which fall short of expectations and thus should be changed. However, expecting and even taking action to ensure that taxpayers pay their "fair share of tax" rather than the tax due under the law is problematic for many reasons. For a start, it is in tension with the rule of law. Furthermore, fairness is a vague and ultimately subjective concept and so it is not at all clear what a requirement to pay a "fair share of tax" actually means in practice. Even if a MNC committed to pay a "fair share of tax" it would necessarily satisfy some people's concept of a fair share but not that of many others.

²⁰ "Proposal for a Directive of the European Parliament and of the Council mending Directive 2013/34/EU as regards disclosure of income tax information by certain undertakings and branches", [COM(2016) 198 final].

²¹ Andrew Godall, "Vodafone: HMRC statement fails to halt protests", *Tax Journal*, 1 November 2010.

²² European Commission, "Introducing public country-by-country reporting for multinational enterprises - Questions & Answers", 12 April 2016

²³ For a discussion on this point in a UK context see, M P Devereux, J Freedman and J Vella, 'Tax Avoidance' This paper can be found at: http://www.sbs.ox.ac.uk/sites/default/files/Business_Taxation/Docs/Publications/Reports/TA_3_12_12.pdf

The problematic concept of a “fair share of tax” is at the heart of the misguided proposal by the European Parliament to have a “Fair Taxpayer Label”.²⁴ Apart from the difficulty in determining where this new line based on fairness should be drawn, the question also arises here as to who should adjudicate whether this line has been breached.

The proposal for country-by-country reporting has other objectives. The first is that “public scrutiny can help to ensure that profits are effectively taxed where they are generated. Public scrutiny can reinforce public trust and strengthen companies' corporate social responsibility by contributing to the welfare through paying taxes in the country where they are active.” However, the notion of ensuring that profits are effectively taxed where they are generated is also problematic as discussed above. To take one important example, at times the tax system does *not* require profits to be taxed where they are generated.

More prosaically, it is unclear whether the reputational mechanism at the heart of this proposal will be effective. For this mechanism to work consumers and investors should change their consumption or investment behaviour in response to concerns about their tax affairs. It is not clear that they will, or more precisely, whether a number sufficient to make a difference will. Furthermore, even if such reputational mechanisms did work they would apply differentially across sectors. In particular, they can be expected to be even less effective in sectors which are not consumer facing.

This proposal thus employs some questionable concepts and it is not clear whether the reputational mechanism at its heart will work. This is not to say that it will not be useful in some cases or might not make some difference, however it is not the panacea some have held it out to be. The debate on making tax information public should not distract from the fact that the best long-term solution to the problem at hand is to undertake effective reform of the tax system.

²⁴ ECON Resolution, Recommendation A.2.

3. ARE WE HEADING IN THE RIGHT DIRECTION?

3.1 General conclusions

Some of the proposals discussed thus far should affect current aggressive tax planning, however the effect of some other proposals is less clear and others might create real economic distortions. Certainly, the reform proposals discussed thus far do not satisfactorily address the two major flaws afflicting the international tax regime.²⁵

3.1.1 Fundamental structure out-dated

The international tax regime treats different parts of a MNC as independent entities and relies on a number of critical distinctions such as those between residence and source, and between active and passive income. This fundamental structure dates back to the 1920s and is out-dated and not fit for purpose. The proposals discussed thus far improve some existing rules and add some new ones, however, they leave this fundamental structure in place. Issues which afflict the current system, such as those stemming from the manipulation of intra-group transactions, will thus persist after the introduction of these proposed changes.

3.1.2 Structure undermined by tax competition amongst states

This second flaw is that this fragile structure is further undermined by competition amongst states. If achieved, coordination amongst EU Member States would help alleviate this problem. However, tax competition amongst states will continue even if these proposals are adopted. For a start, other major economies, including the United States, might not adopt similar proposals or at least not in the same form.

To be sure, the adoption of these proposals should, to some extent, make it harder for states compete as before. However, the question then arises whether competition on corporate tax rates will intensify as a result. Corporation tax rates have been on a downward trend for some time as can be seen in Figure 1.²⁶ France, Japan, Italy, UK have all recently announced reductions in their tax rates and perhaps this is a sign of things to come.

Over the years, states have also competed through the introduction of patent box regimes. As seen in Figure 2, eight G20+OECD countries will have patent boxes with rates lower than 15% by 2020. This competition on intangible corporation tax rates can also be expected to continue or even intensify.

²⁵ See Devereux and Vella above.

²⁶ Devereux, Habu, Lepoev and Maffini, "G20 Corporation Tax Ranking", Oxford University Centre for Business Taxation Policy Paper, March 2016, available at: http://www.sbs.ox.ac.uk/sites/default/files/Business_Taxation/Docs/Publications/Policy_Papers/g20-corporation-tax-ranking-2016_0.pdf

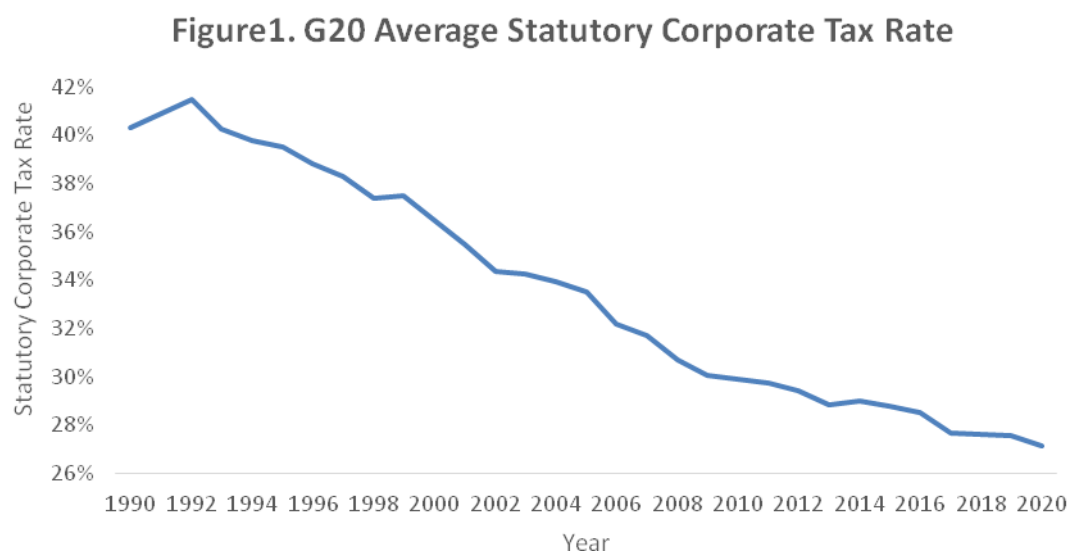


Figure 2 - Top 10 G20/ OECD countries with the lowest intangible corporation tax rate as of 2020.

Position	Country	Corporate Tax Rate on Intangibles
1	Netherlands	5.00%
2	Ireland	6.25%
3	Belgium	6.80%
4	UK	10.00%
5	Hungary	11.50%
6	China	12.50%
7	Italy	14.54%
8	France	15.50%
9	Slovenia	17.00%
10	Indonesia	18.00%

Competition through the lowering of corporate tax rates does not constitute “unfair competition” as defined in the debate on international tax reform. However, if this competition intensifies, in the long run might MNCs pay less corporation tax than they currently do? Perhaps this would be an acceptable outcome to the political class and the public at large if it is believed that MNCs are paying tax where the activities generating the income are believed to take place.

It would mean that a driving objective of these proposals is met, however some might argue that MNCs would still not be paying their “fair share of tax”.

3.2 More radical reform

The above discussion leads to the conclusion that more radical reform is required. The European Parliament and the European Commission, unlike the OECD, have put forward one such reform option: the Common Consolidated Corporate Tax Base (CCCTB). The arguments in favour and against the CCCTB are well rehearsed and so they are only discussed briefly here. This proposal has some clear benefits. In particular, it would remove transfer pricing issues amongst participating states. It is also clear that some of the criticism levelled at this proposal is unfair. For example, it has been argued that a formula based allocation does not reflect a true allocation of profits. This criticism is misguided because it assumes not only the existence of “a true allocation of profits”, but a supposition that the existing system somehow captures this true allocation, even if imperfectly. Identifying where profit is generated even conceptually is a complex, if not impossible, exercise; certainly, however, the current international tax regime does not itself allocate profits on this basis.

However, some criticism of the CCCTB does appear justified. For a start, it requires agreement on the base and on the formula – a matter of considerable political difficulty. The system will only apply amongst the Member States which introduce it, meaning that the current tax system, and all the problems it brings, would operate along side the CCCTB to deal with the rest of the world. Finally, the CCCTB retains two important negative features of the current system: it distorts real activities and allows competition on tax rates.

3.2.1 Other reform options

At the moment, the CCCTB appears to be the main, if not the only, radical reform option on the EU political table.. However, if it is agreed that radical reform is necessary to move us in the right direction, consideration ought to be given to other options too. The debate should certainly not exclude reform options which have more attractive properties.

Two further options merit particular attention: a residual profit split system and a destination based cash-flow tax system.²⁷ Both systems assign rights to tax in locations that are less mobile: the place of residence of the multinational’s customers –the “destination” location. If corporate profit were taxed only in this location, then there would be no point in moving real activity or intangible assets to low tax rate countries, since the income would be taxed elsewhere, where the customer is located.

The residual profit split system builds on the existing system and in that respect is a less radical reform option than the CCCTB. At present, cross-border transactions within companies are governed by the so-called “arm’s length pricing” standard. In principle this means that the prices at which transactions are allowed to take place for tax purposes are those that would be used by two comparable independent parties trading with each other. In practice, however, it is often difficult to find a comparable price used by independent parties, and more ad hoc methods are permitted. One is to allocate profit based on a cost-plus mark-up.

²⁷ A group of economists and lawyers chaired by Professor Michael P. Devereux (Oxford University Centre for Business Taxation) has been working on alternative reform proposals since December 2013. This research project is nearing completion and the results will be published in autumn 2016. The author is a member and secretary of the group.

Profits are allocated to country A, say, based on a mark-up agreed with the tax authority on its costs incurred in A. But a problem with this approach is that it frequently leaves a “residual” profit over and above the mark-up in each country that is not allocated. A first proposal is therefore to combine the mark-up method with allocating residual profit on the basis of the location of the customers.²⁸

A second alternative is for a “destination-based cash flow” tax on corporate profit.²⁹ The international element of such a tax borrows from the principle of VAT: exports would be zero-rated, while imports would be taxed. In effect, this creates an asymmetric tax: sales would be taxed in the country of consumption, while expenses would receive relief in the country in which they were incurred. In principle, this tax would not distort the location of production, or other investment, financial and pricing decisions of a multinational company. As a consequence of this, the tax should not be subject to competition between governments for inward investment.

²⁸ A proposal along these lines has been made by R. Avi-Yonah, K. Clausing and M. Durst (2009) “Allocating business profits for tax purposes: A proposal to adopt a formulary profit split,” *Florida Tax Review* 9,497-543.

²⁹ This has been proposed, for example, by A. Auerbach, M.P. Devereux and H. Simpson, “Taxing Corporate Income” in J. Mirrlees et al (eds.), “Dimensions of Tax Design: The Mirrlees Review”, Oxford University Press, 2010, 837-893; A. Auerbach and M.P. Devereux, “Consumption and Cash-Flow Taxes in an International Setting”, Oxford University Centre for Business Taxation Working Paper Series, WP 12/14, 2010.

4. CONCLUSION

The proposals put forward by the European Parliament and the European Commission to reform the international tax system fall into two categories. The proposals in the first category patch up the existing system, that in the second category is more radical. The above analysis suggests that reforms in the first category might make a difference to current aggressive tax planning structures, however they will not fix the major flaws of the international tax system. One particular concern is that they might even intensify competition on corporate tax rates. A long-term stable solution thus requires more radical reform. The European Parliament and the European Commission have put forward one such reform option, the CCCTB. This has clear benefits but also some well-known issues. For this reason, the search for radical reform solutions ought to be broadened to include the consideration of other options which have been the subject of academic study over the past few years.

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NOTES



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POLICY DEPARTMENT A: ECONOMIC AND SCIENTIFIC POLICY

The Future of Tax Rulings in the EU: Evaluation, Confrontation and Recommendations

Elly VAN DE VELDE

IN-DEPTH ANALYSIS

CONTENTS

EXECUTIVE SUMMARY	25
1. INTRODUCTION	26
2. EVALUATION OF EUROPEAN COMMISSION FOLLOW-UP OF TAXE 1 RESOLUTION AND ECON RESOLUTION	27
2.1 Cross-border impact of purely domestic tax rulings	27
2.2 Publication of an annual report	28
2.3 Common and legal framework	29
2.4 Clearing house	32
3. CONFRONTATION WITH BEPS ACTION 5	33
3.1 Council Directive 2015/2376 vs BEPS Action 5	33
3.1.1 Exchange of information on tax rulings	33
3.1.2 Which information needs to be exchanged with which country?	33
3.1.3 Application of the framework to rulings	34
3.1.4 Definition of ruling for purpose of exchange of information	34
3.2 Best practices: inspiration from BEPS Action 5	36
4. ENCOURAGING COOPERATIVE COMPLIANCE IN MEMBER STATES	38
5. CONCLUDING REMARKS	39

EXECUTIVE SUMMARY

- It is still unclear in what direction the future of tax rulings in the EU will evolve. However, the limitation of the scope to cross-border tax rulings in the Commission's approach is likely to be a missed opportunity as advance tax rulings and price arrangements can have (and may increasingly have) a cross-border dimension even though they relate to purely national transactions.
- The establishment of a common framework at EU level for tax rulings is the ultimate recommendation to achieve the goal of 'cooperation and coordination of advance tax rulings'. Transparency is very key in the development of an adequate EU framework, but at the same time one should assure that transparency for citizens does not conflict with the protection of tax secrecy of the assessment procedure.
- Conversely, the exchange of information requirements on both EU and OECD/G20 levels are not always compatible, which does not simplify the obligations for Member States who are part of the OECD/G20.
- Tax compliance of potential applicants of tax rulings ought to be enhanced by inscribing cooperative compliance (as described by the OECD in 2013) in the national jurisdictions of all EU Member States.

1. INTRODUCTION

The legislative evolution of tax rulings in the EU includes an interaction between the European Parliament, the European Commission and the Council. Because of this interaction, it is still unclear in what direction the future of tax rulings in the EU will evolve. This briefing paper draws the attention to a few topics that could be relevant for policy discussions regarding the coordination and cooperation on tax rulings.

Cooperation and coordination on advance tax rulings¹ is the title of one of the conclusions and recommendations of the TAXE 1 Resolution¹ (104-115). In its response to these conclusions and recommendations on tax rulings of the TAXE 1 Committee, the European Commission refers to Recommendation A4 of the Resolution of the ECON Committee² *regarding the request to complement the amended Directive 2011/16/EU so that automatic exchange of information on tax rulings be extended to all tax rulings and to a certain extent made public* (ECON Resolution A4/ TAXE 1 Resolution 107-111).

¹ "Tax rulings and other measures similar in nature or effect", European Parliament Resolution of 25 November 2015 on tax rulings and other measures similar in nature or effect 2015/2066(INI), P8_TA-PROV(2015)0408.

² "Bringing transparency, coordination and convergence to corporate tax policies", European Parliament Resolution of 16 December 2015 with recommendations to the Commission on bringing transparency, coordination and convergence to corporate tax policies in the Union (2015/2010(INL)), P8_TA-PROV(2015)0457.

2. EVALUATION OF EUROPEAN COMMISSION FOLLOW-UP OF TAXE 1 RESOLUTION AND ECON RESOLUTION ³

2.1 Cross-border impact of purely domestic tax rulings

- *The mandatory automatic exchange of rulings information already provides that not only information on rulings with clear cross-border elements but also national tax rulings given to local entities which could have a cross-border impact will be subject to exchanges. Information about purely national rulings is regarded as less relevant in the context of cross-border profit shifting. The administrative burden for Member States is another important factor (EC, Joint follow-up 16 March 2016, p. 3)*

The ECON Resolution (A4) asked for an extension of the scope of the automatic exchange of information beyond cross-border tax rulings to include all tax rulings in the corporate tax area.

The TAXE 1 Resolution (107) also highlighted the fact that not only cross-border but also national rulings can impact other Member States, and called, therefore, for an extension of the automatic exchange of information to all rulings issued by, or on behalf of, the government or the tax authority of a Member State, or any territorial or administrative subdivisions thereof, which are still active at the date of entry into force of the directive.

The European Parliament considered the limitation of the scope to cross-border tax rulings a missed opportunity⁴: advance tax rulings and price arrangements can have a cross-border dimension even though they relate to purely national transactions. That is particularly true of cascade transactions, where the advance tax ruling or price arrangement concerns the first national transactions, without taking into consideration the next (cross-border) transactions (Amendment 8, Legislative Resolution 27 October 2015 ⁵).

However, advance 'cross-border' tax rulings and advance pricing arrangements on 'cross-border' transactions are subject to the exchanges prescribed by Directive 2015/2376. But what does that mean?

In my opinion, it is regrettable that the meaning of the 'cross-border' character of advance cross-border rulings as defined in Directive 2015/2376 is not unambiguously clear. The Directive mentions 'cross-border transactions' as well as 'a transaction or series of transactions where such transactions or series of transactions have a cross-border impact'. But what does a cross-border 'impact' mean? Can 'purely domestic rulings' have a cross-border 'impact'? According to the Commission, 'purely national rulings' seem to be less relevant in the context of cross-border profit shifting.

³ European Commission, 16 March 2016, Joint follow-up to the European Parliament resolution with recommendations to the Commission on bringing transparency, coordination and convergence to corporate tax policies in the Union and the European Parliament resolution on tax rulings and other measures similar in nature or effect, adopted by the Commission on 16 March 2016, available at: <https://polcms.secure.europarl.europa.eu/cmsdata/upload/bfea5123-d400-40d2-b529-756438853db4/A8-0349-2015%20-%20A8-0317-2015.pdf>.

⁴ Mandatory exchange of tax rulings proposal: a "missed opportunity", Press Release 13 October 2015, <http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//TEXT+IM-PRESS+20151013IPR97373+0+DOC+XML+V0//EN>; Council deal on automatic exchange of tax rulings is a "missed opportunity", Press Release 27 October 2015, <http://www.europarl.europa.eu/news/en/news-room/20151022IPR98803/Council-deal-on-automatic-exchange-of-tax-rulings-is-a-%E2%80%9Cmissed-opportunity%E2%80%9D>.

⁵ Mandatory automatic exchange of information in the field of taxation, European Parliament legislative resolution of 27 October 2015 <http://www.europarl.europa.eu/sides/getDoc.do?pubRef=-//EP//TEXT+TA+P8-TA-2015-0369+0+DOC+XML+V0//EN> on the proposal for a Council directive amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation, COM(2015)0135.

Hence, does that mean that the cross-border ‘impact’ is to be understood as in Action 5 of the BEPS project ⁶ (see also below, chapter 3), i.e. rulings that in the absence of information exchange give rise to BEPS concerns?

Advance tax rulings on ‘preferential regimes’ in a non-cross-border situation seem not to be subject to exchanges described in the Directive. Would it not be logical from an internal market perspective to subject ‘purely domestic tax rulings’ to exchanges as well, *in so far as* these domestic rulings affect the trade between Member States? Would there be a cross-border impact? Indeed, a purely domestic selective tax advantage (e.g. leading to a reduction of the taxable base) that distorts or threatens to distort competition and trade between the Member States could be considered fiscal State Aid as well.

2.2 Publication of an annual report

- *The information exchanges will be made in a commonly agreed template which will ensure efficient use by tax administrations. The Commission only has the information needed to monitor the proper functioning of the Directive which will enable it to provide statistics but not to summarise the main cases* (EC, Joint follow-up 16 March 2016, p. 3-4).
- *By 2017 the Commission will, under the Directive, set up and administer a secure central directory to facilitate the exchange of information between the participating tax authorities on behalf of the Member States* (EC, Joint follow-up 16 March 2016, p. 4)

The ECON Resolution (A4) asked for a significant increase of the transparency of tax rulings at the EU level, with due consideration given to business confidentiality and trade secrets and taking into account the current best practices applicable in some Member States by publishing, on an annual basis, a report summarizing the main cases contained in the Commission’s to be created secure central directory of tax rulings and advance pricing arrangements. The information in the report must be provided in an agreed, standardized form in order to allow the public to use it effectively.

Similarly, the TAXE 1 Resolution (110) stressed that, in order to enhance transparency for citizens, the Commission should publish an annual report summarizing the main cases contained in the secure central directory, and that, in doing so, the Commission should take into account the provisions of the Mutual Assistance Directive relating to confidentiality. The European Parliament considered in Amendment 20 of the Legislative Resolution of 27 October 2015 that this annual report should include at least a description of the issues addressed in the tax ruling, a description of the criteria used to determine an advance pricing arrangement and identify the Member State(s) most likely to be affected (see also Amendment 54 of the Legislative Resolution).

The TAXE 1 Resolution (107) also strongly insisted on the key role of the Commission’s involvement in the process of data collection and analysis concerning rulings. Moreover, it is the opinion of the European Parliament that the Commission should have access to the tax rulings (TAXE 1 Resolution (104), see also Amendment 14 Legislative Resolution 27 October 2015).

According to Directive 2015/2376, Member States should exchange basic information with the competent authorities of all Member States and to the Commission. The information to be communicated includes, *inter alia*, a summary of the content of the advance cross-border ruling or advance pricing arrangement, including a description of the relevant business activities or transactions or series of transactions provided in abstract terms, without leading to the disclosure of a commercial, industrial or professional secret or of a commercial process, or of information of which the disclosure would be contrary to public

⁶ OECD (2015), Base Erosion and Profit Shifting project, <http://www.oecd.org/ctp/beps.htm>

policy. This should enable the Commission to monitor and evaluate the effective pricing arrangements at any time. The information received by the Commission should not, however, be used for any purposes. Such communication would moreover not discharge a Member State from its obligations to notify any state aid to the Commission. In a second step, Member States may request additional information, including the full text of an advance cross-border ruling or an advance pricing arrangement.

In my opinion, three aspects definitely deserve more clearance in the future of tax rulings in the EU. How does the taxpayer have to understand the role of the European Commission in the exchange of information procedure? How will the competent authorities of the Member States arrange the exchange of information of rulings issued by territorial or administrative subdivisions? What about transparency on the existence of tax rulings (practices) for taxpayers? We focus on the latter question.

According to Directive 2015/2376, rulings are any agreement, communication, or any other instrument or action with similar effects, including in the context of a tax audit and which is issued by the tax authority to a particular person or a group of persons and upon which that person is entitled to rely. From this point of view, tax rulings are not only the 'official' binding opinions issued by a tax ruling commission to the tax administrator who has to assess the taxable activity, but also the so-called 'informal deals' or 'arrangements behind the official decision' between the tax authorities and the taxpayer upon which the latter is entitled to rely. Only tax rulings that are made in advance of the transactions or in advance of the filing of a tax return covering the period in which the transaction took place are meant. However, according to the Commission's staff working document of 18 March 2015, the exchange obligation includes tax rulings given in the context of a tax audit when they also apply to future years for which tax returns have not yet been received.⁷

In my opinion, it is a good evolution that the exchange of information between Member States and with the Commission not only covers formal advance cross-border rulings or advance pricing arrangements but also informal advance agreements between the tax authorities and the taxpayers upon which the taxpayer is entitled to rely (for the binding aspect of tax rulings, see below, 2.). However, the exchange of information at the Member States' and Commissions' level does not make the taxpayers aware of the existence of a tax rulings practice in a Member State. Transparency for citizens should not conflict with the protection of tax secrecy of the assessment procedure.⁸ Therefore, as suggested in the ECON and TAXE 1 Resolutions, the publication of an annual report summarizing the main cases should be recommended. At least, the administration's general policy guidelines should be known by the taxpayers (see hereafter).

2.3 Common and legal framework

- *In 2015 the Commission initiated preliminary discussions with Member States on a potential common framework at EU level for the issuing of tax rulings including common criteria for the possible development of guidelines on the conditions and rules for the issuance of tax rulings by Member States. The discussion is ongoing and will also take further conclusions from the state aid angle into account (EC, Joint follow-up 16 March 2016, p. 4)*

⁷ Commission staff working document. Technical analysis of focus and scope of the legal proposal, accompanying the Proposal for a Council Directive amending Directive 2011/16/EU as regards exchange of information in the field of taxation, http://ec.europa.eu/taxation_customs/resources/documents/taxation/company_tax/transparency/swd_2015_6_0.pdf.

⁸ Contra: M. Lang, "Tax Rulings and State Aid Law", *British Tax Review* 2015, 394-395.

The TAXE 1 Resolution (111) called on the Commission to consider the establishment of a common framework at EU level for tax rulings, including common criteria, in particular the requirement to establish them on the basis of a comprehensive spillover analysis, including the tax rulings' effect on other countries' tax bases, with the involvement of all parties and countries concerned, their public disclosure, either fully or in simplified form, but fully respecting confidentiality requirements, the obligation to publish the criteria for granting, refusing and revoking tax rulings, equal treatment and availability to all taxpayers, '*absence of discretion*' and '*full compliance with underlying tax provisions*'.

Moreover, Amendment 41 of the Legislative Resolution of 27 October 2015 even suggested, inter alia, that the information to be communicated by a MS shall as a minimum include the criteria used to determine the advance ruling or the advance pricing arrangement, as well as the limitation in time thereof, if any, or the circumstances under which the decision can be revoked.

In my opinion, the establishment of a common framework at EU level for tax rulings is the ultimate recommendation to achieve the goal of 'cooperation and coordination of advance tax rulings' as mentioned in the TAXE 1 Resolution. It is praiseworthy that the Commission initiated discussions with Member States on a potential common framework. It is important to ensure that the Commission takes into account the complete Recommendation 111 of the TAXE 1 Resolution in this discussion, to go further than a sole enumeration of when tax rulings do not violate EU state aid rules. A real tax rulings framework should be established within the EU.

As mentioned in my paper *Overview of Existing EU and National Legislation on Topics Covered by TAXE Mandate* (2015, p. 14), the OECD Report on Harmful Tax Competition of 1998 already mentioned a recommendation with respect to tax rulings with special attention to the publication of the substantive and procedural conditions for granting, denying or revoking such decisions, to the equal treatment of taxpayers in a similar position, and to a greater transparency of countries' tax policies.

As long as a common framework is absent, amendment 51 of the Legislative Resolution of 27 October 2015 remains very important. It stipulates that Member States should notify the Commission and other Member States at an early stage about any relevant change in their tax ruling practice (application formalities, decision process, etc.).

For the establishment of a common framework on tax rulings at EU level, inspiration can be found in the overview of best practices in Action 5, Chapter 5 of the Final BEPS Report 2015 (see below, chapter 3).

Besides the establishment of a common framework at EU level for tax rulings, it must be stressed that attention should be given to the elaboration of a European Taxpayer's Code.⁹ A Taxpayer's Code can include the definition of a tax ruling, rules on the competent authorities, on the binding effect of tax rulings, on the possibility of judicial review, on the amount of fee, on the topics for tax rulings, etc. Additionally, special attention should be paid to the *legal* framework in which tax rulings are issued, in order to understand that the required '*absence of discretion*' by the tax authorities as required in the TAXE 1 Resolution is not realistic at all, not even in a correct application of tax law. However, tax authorities and taxpayers are confronted with legal limits at several levels that should be taken into account. A similar reasoning is made in the overview of best practices in Action 5, Chapter 5 of the Final BEPS Report 2015 (see below, chapter 3).

⁹ See my paper *Overview of Existing EU and National Legislation on Topics Covered by TAXE Mandate* 2015, p. 23-26), [http://www.europarl.europa.eu/RegData/etudes/STUD/2015/563451/IPOL_STU\(2015\)563451_EN.pdf](http://www.europarl.europa.eu/RegData/etudes/STUD/2015/563451/IPOL_STU(2015)563451_EN.pdf)

According to the Commission's draft notice on the notion of State aid of 2014, "*advance administrative tax rulings involve selectivity in particular where the tax authorities have 'discretion' in granting administrative rulings, the rulings are not available to undertakings in a similar legal and factual situation, the administration appears to apply a more 'favourable' 'discretionary' tax treatment compared with other taxpayers in a similar factual and legal situation, and the ruling has been issued in contradiction to the applicable tax provisions and has resulted in a lower amount of tax*"¹⁰.

But how to understand the '*absence of discretion*' and '*full compliance with underlying tax provisions*' as required in the TAXE 1 Resolution? Tax statutes are and remain the legal basis upon which taxes must be paid. In tax rulings, the tax authorities explain to the taxpayer how they will apply tax law in a concrete situation. In principle, this is admissible as long as the tax authorities, prior to applying tax law, do not interpret the law itself more flexibly or more strictly than the legislator had in mind. In interpreting the law, the principle of legality imposes the requirement of regularity: only a strict, meaning correct, interpretation of the law is allowed. In the legal framework of a concrete situation, the requirement of legality is supplemented by a legitimacy requirement. The more room for judgement the legislator allows the tax authorities, the less likely will they violate the principle of legality. The more restricted their authority, the more limited the room to manoeuvre in interpreting the law without violating the principle of legality. The observation of the principle of equality, in the case of a relatively clear law, is already guaranteed, in principle, by the correct application by the law. The observation of the principle of legality thus guarantees the equal treatment of taxpayers before the law. But when tax authorities have a wider margin of appreciation because of an unclear law ('*discretion*'), the principle of equality is imposed as a supplementary requirement of legitimacy or as a general principle of proper administration. In the application of the principle of equality, the degree of similarity plays an important role. Therefore, it is essential that the tax ruling is made sufficiently known (on an anonymized and summarised basis) so that the similarity test can be applied. However, a necessary first step to apply the principle of equality – as a limit to the administration's discretion – is to make known the administration's general policy. On the basis of the principle of equality, tax authorities are not allowed to deviate randomly from administrative (legal) policy rules. The publication of an annual report summarizing the main cases can be seen as a step towards an adequate application of the principle of equality (see above).

In the Commission's draft notice on the notion of State aid of 2016, the Commission deleted justly – after consultations – the '*discretion*'-requirement¹¹.

¹⁰ Communication from the Commission, *Draft Commission Notice on the notion of State aid pursuant to Article 107(1) TFEU*, Brussels, 2014, available at: http://ec.europa.eu/competition/consultations/2014_state_aid_notion/draft_guidance_en.pdf, n° 177. See also http://ec.europa.eu/competition/consultations/2014_state_aid_notion/index_en.html.

¹¹ Communication from the Commission, *Draft Commission Notice on the notion of State aid pursuant to Article 107(1) TFEU*, Brussels, 2016, http://ec.europa.eu/competition/state_aid/modernisation/notice_of_aid_en.pdf, n° 174. The Commission summarized that tax rulings confer a selective advantage on their addressees in particular where: "*a) the ruling misapplies national tax law and this results in a lower amount of tax; b) the ruling is not available to undertakings in a similar legal and factual situation; or c) the administration applies a more 'favourable' tax treatment compared with other taxpayers in a similar factual and legal situation. This could, for instance, be the case where the tax authority accepts a transfer pricing arrangement which is not at arm's length because the methodology endorsed by that ruling produces an outcome that departs from a reliable approximation of a market-based outcome. The same applies if the ruling allows its addressee to use alternative, more indirect methods for calculating taxable profits, for example the use of fixed margins for a cost-plus or resale-minus method for determining an appropriate transfer pricing, while more direct ones are available*".

2.4 Clearing house

- *As far as more transparency is concerned, in 2018 the Commission will review the implementation of the Directive and will evaluate its functioning in practice. In the same year, the Commission will provide a report to Member States and, if appropriate, consider further transparency requirements, e.g. the setting up of a clearing house* (EC, Joint follow-up 16 March 2016, p. 4)

The TAXE 1 Resolution (109) called on to study the conditions for setting up, in the longer term, an EU-wide clearing house system, through which tax rulings would be systematically screened by the Commission so as to increase the system's level of certainty, consistency, uniformity, and transparency, and check whether such rulings have a harmful effect on other Member States. In my opinion, these engagements can only be encouraged.

3. CONFRONTATION WITH BEPS ACTION 5

3.1 Council Directive 2015/2376 vs BEPS Action 5

The EU evolution on tax rulings can be confronted with the so-called soft law BEPS-developments. One could ask if the EU initiatives match the BEPS evolution. Could the EU draw inspiration from the final BEPS report 2015?

Council Directive 2015/2376 wants to be compatible with the OECD developments (see also Amendment 62 Legislative Resolution 27 October 2015). To what extent is that the case today? Chapter 5 of Action 5 of the Final BEPS Report 2015 deals with the *“Revamp of the work on harmful tax practices: framework for improving transparency in relation to rulings”* (Action 5, BEPS report, p. 45). According to the Forum on Harmful Tax Practices (FHTP), this work contributes to the objective of ensuring transparency while promoting increased certainty and predictability (Action 5, BEPS report, p. 45).

On the basis of a comparative analysis of both instruments¹², the requirements on both EU and OECD/G20 levels are not always compatible, which does not simplify the obligations of those Member States who are part of the OECD/G20.

3.1.1 Exchange of information on tax rulings

The BEPS project asks for a compulsory spontaneous exchange of information, whereas the EU Directive prescribes the mandatory automatic exchange of information (Action 5, BEPS report, p. 45). Only six categories of taxpayer-specific tax rulings trigger the BEPS exchange obligation, whereas the mandatory automatic exchange of information relates to advance cross-border rulings and advance pricing arrangements.

3.1.2 Which information needs to be exchanged with which country?

The BEPS plan cannot require exchange of information with all states, but must provide for rules regarding the states with which the ruling information will need to be exchanged.¹³ As a general rule, exchange of information on tax rulings for the six categories needs to take place with the countries of residence of all related parties with which the taxpayer enters into a transaction for which a ruling is granted or which gives rise to income from related parties benefiting from a preferential treatment, and the residence country of the ultimate parent company and the immediate parent company (see BEPS report, 52-53). There is a two-step process for exchanging information. Under the first step, a tax administration provides a summary and some basic information on the ruling (Action 5, BEPS report, template annex C, p. 54).

Directive 2015/2376 on the other hand, prescribes that a defined set of basic information should be accessible to all Member States (a standard form shall be adopted by the Commission before 1 January 2017). A limited amount of basic information should also be communicated to the Commission. Where necessary, a Member States may obtain additional information, including the full text of advance cross-border rulings or advance pricing arrangements from the Member States having issued such rulings or arrangements. Specific provision should be made for the establishment of a central directory, accessible to all MS and the Commission, to which Member States should upload and store information, instead of exchanging that information by secured email.

¹² See A.C. Breuer, J.P. Boer, S.C.W. Douma, “Uitwisseling van tax rulings”, *Weekblad Fiscaal Recht* 2016, 50; D. Van Stappen, W. Oepen, E. Molla, “Mandatory Automatic Exchange of Information on Tax Rulings: Political Agreement Reached in ECOFIN Council”, *International Transfer Pricing Journal* 2016, 9-14.

¹³ D. Van Stappen et al., p. 14

Hence, at both the EU and BEPS levels, there is a two-step process. To keep the administrative burden low, templates on both levels should be aligned with one another as much as possible.

3.1.3 Application of the framework to rulings

For BEPS purposes, it has been agreed that information on rulings that have been issued on or after 1 January 2010 and were still in effect as of 1 January 2014 must be exchanged (Action 5, BEPS report, p. 53). The exchange process should be completed by the end of 2016 (Action 5, BEPS report, p. 55). Future rulings will be those issued on or after 1 April 2016 (Action 5, BEPS report, p. 54). The information should be exchanged as quickly as possible and no later than three months after the date on which the ruling becomes available to the competent authority of the country that granted the ruling (Action 5, BEPS report, p. 55).

According to Directive 2015/2376, the start of the exchange obligation is 1 January 2017. Information on tax rulings granted from then onwards should be exchanged within three months following the end of the half of the calendar year in which the advance cross-border rulings or advance pricing arrangements have been issued, amended or renewed. Rulings from the five years before 1 January 2017 should be exchanged as well (before 1 January 2018). However, for rulings issued, amended or renewed between 1 January 2012 and 31 December 2013, the exchange applies only if the ruling was still valid on 1 January 2014. Rulings issued, amended or renewed between 1 January 2014 and 31 December 2016 should be still valid to fall within the scope of the exchange obligation. Rulings issued, amended or renewed before 1 April 2016 to persons with a group-wide annual net turnover of less than EUR 40.000.000 in the fiscal year preceding the date of issuance, amendment or renewal may be excluded from communication.

3.1.4 Definition of ruling for purpose of exchange of information

For BEPS purposes, rulings are *"any advice, information or undertaking provided by a tax authority to a specific taxpayer or group of taxpayers concerning their tax situation and on which they are entitled to rely"* (Action 5, BEPS report, p. 47). The report explains that this definition is broad and includes both general rulings and taxpayer-specific rulings. General rulings apply to groups or types of taxpayers or may be given in relation to a defined set of circumstances or activities, rather than applying to a specific taxpayer (Action 5, BEPS report, p. 48). However, the exchange obligation only applies to taxpayer-specific rulings (Action 5, BEPS report, p. 47).

Taxpayer-specific rulings are rulings that apply to a specific taxpayer and on which that taxpayer is entitled to rely. Such rulings can be given both pre-transaction (advance tax rulings and advance pricing arrangements) and post-transaction, in each case in response to a ruling request by the taxpayer. The report stresses (Action 5, BEPS report, p. 47) that this definition (we suppose the need for 'a ruling request') excludes any statement or agreement reached as a result of an audit carried out after the taxpayer has filed its tax return or accounts. This does not, however, exclude any ruling or agreement, on the treatment of future profits, given as a result of an audit if that ruling falls within any of the categories set out in this report (Action 5, BEPS report, p. 47).

More precisely, the exchange obligation for BEPS purposes includes six categories of taxpayer-specific rulings which in the absence of compulsory spontaneous exchange of information could give rise to BEPS concerns (Action 5, BEPS report, p. 46). According to the FHTP, ruling regimes can also be used to attract internationally mobile capital to a jurisdiction and have the potential to do this in a manner that contributes to, or constitutes, a harmful tax practice (Action 5, BEPS report, p. 46-47). Hence, the six categories are: rulings relating to preferential regimes, unilateral advance pricing arrangements or other cross-border unilateral rulings in respect of transfer pricing, cross-border rulings providing for a downward adjustment of taxable profits, permanent establishment rulings, related

party conduit rulings, and any other type of ruling agreed by the FHTP that in the absence of spontaneous information exchange gives rise to BEPS concerns (Action 5, BEPS report, p. 46).

To conclude, for the exchange obligation in BEPS context, tax rulings include six categories of formal or informal (even written or oral) binding taxpayer-specific pre- or post-transaction tax rulings at the request of the taxpayer. A ruling given as a result of a tax audit is not intended, unless it is a ruling on the treatment of future profits.

The EU Directive definition on tax rulings differs at first sight from the BEPS definition, but both definitions seem to be almost similar at second sight. The main differences are the above mentioned cross-border character of tax rulings (see above, 1.) and the condition that tax rulings for the EU exchange obligation should be made in advance of the transactions or in advance of the filing of a tax return covering the period in which the transaction took place. However, the latter condition seems to be interpreted in a similar way in the BEPS context. Real post-return tax rulings could possibly also apply to a number of previous years for which returns had already been received, which is neither the case in the EU Directive, nor in the BEPS report.

EU tax rulings are issued to a particular person or a group of persons who is/are entitled to rely upon them. Hence, non-binding tax rulings seem to be excluded from the exchange obligation. Breuer et al. (4.3) conclude that tax rulings that violate the EU state aid rules should not be exchanged, because tax rulings *contra legem* (contra articles 107 and 108, 3 FTEU) do not bind the tax authorities. However, I suppose that the condition that the taxpayer is entitled to rely on the tax ruling is prescribed in order to exclude the so-called 'general tax rulings', but probably neither the Council nor the FHTP realized that they had excluded tax rulings *contra legem* (e.g. contra state aid rules) from the exchange obligation.

However, clearance should be brought to this point, since one could argue that non-binding tax rulings are certainly within the scope of the EU Directive on the other hand. According to point (5) of the preamble of Directive 2015/2376, *"the scope of the automatic exchange of advance cross-border rulings and advance pricing arrangements, issued, amended or renewed to a particular person or group of persons upon which that person or group of persons is entitled to rely, should cover any material form (irrespective of their binding or non-binding character and the way they are issued)"*. Moreover, the European Parliament considered in amendment 9 of the Legislative Resolution of 27 October 2015: *"in order to avoid arbitrary distinctions between tax arrangements that arise in the context of different national administrative practices, the definitions of advance rulings and advance pricing arrangements should cover tax arrangements regardless of the formal or informal manner in which they were issued, and irrespective of their binding or non-binding nature"*. Hence, Amendment 28 of the Legislative Resolution of 17 October 2015 suggested the following definition of advance ruling: *"any agreement, communication, or any other instrument or action with similar effects, including one issued in the context of a tax audit and irrespective of its formal, informal, legally binding or non-binding nature"*.

However, because of the wide range of tax rulings (agreements, communications or any other instruments or actions with similar effect), it is clear to us that Member States can try to escape from the exchange obligation of a tax ruling, arguing that the taxpayer is not entitled to rely on that tax ruling, because the tax ruling in question does not bind the tax authority. There are legally binding tax rulings, but also tax rulings that the tax authorities have to honor on the basis of the principle of legitimate expectations. This principle could have less strong binding effect than a statutory law provision.

3.2 Best practices: inspiration from BEPS Action 5

As mentioned above, the TAXE 1 Resolution called on the Commission to consider the establishment of a common framework at EU level for tax rulings. Despite the valuable intentions of the European Parliament and the European Commission, there still is little concrete action with respect to this aspect of coordination and cooperation of tax rulings in the EU. For the purpose of legal certainty and in order to be compatible with the OECD developments, inspiration for the discussion with the Member States can be found in Action 5, Chapter 5 of the (soft law) BEPS Final Report 2015 (p. 56).

The report provides a general best practices framework for the design and operation of ruling regimes. This framework intends to reinforce the transparency advancements made in the OECD framework for compulsory spontaneous exchange of information on rulings. When no distinction is made, the best practices apply to all cross-border rulings which fall within the definition of a ruling. Three topics are mentioned: the process of granting a ruling, the term of the ruling and subsequent audit/checking procedure and finally the publication and exchange of information.

(A) With respect to the process of granting a ruling, the Action 5 of BEPS prescribes that:

(a) official rules and administrative procedures for rulings should be identified in advance and published; they should include: (i) the conditions for the applicability of the ruling process; (ii) the grounds for denying a ruling; (iii) the fee structure, if applicable; (iv) the legal consequences of obtaining a ruling; (v) possible sanctions for incomplete or false information provided by a taxpayer; (vi) the conditions for revoking, cancelling or revising a ruling; and (vii) any other guidance that is deemed necessary in order to make the rules sufficiently comprehensive and clear to taxpayers and their tax advisors.

As mentioned above, special attention should be given to the legal framework in which rulings are granted, to understand how tax authorities should deal with '*discretion*'. The following best practices refer to this kind of legal framework and prescribe a realistic notion of 'administrative discretion':

(b) Tax rulings should be issued, and any administrative discretion in granting a ruling should be exercised, only within the limits of, and in accordance with, the country's relevant domestic tax law and administrative procedures, and should be limited to determining how that law and/or administrative procedures apply to one or more specific operations or transactions intended, planned or undertaken by the taxpayer. AND (c) Tax rulings should respect applicable international obligations that are incorporated into domestic tax law, for instance, obligations under relevant bilateral treaties. AND (f) Especially for tax rulings in cases where the applicable rules and administrative procedures explicitly refer to discretion or the exercise of judgement by one of the relevant officials, it is recommended that at least two officials are involved in the decision to grant a ruling or there is at least a two-level review process for the discussion.

Best practices include furthermore that tax rulings should be in writing (d), that they should only be issued by the competent government office or authority in charge of this task (e), that tax rulings should be binding on the tax authority (g). It is up to the taxpayer to apply for a ruling in writing and provide a full description of the underlying operations or transactions for which a ruling is requested (h), to provide the tax authority with information concerning the applicant and its tax advisor (i) and to check the description of the facts is sufficient and justifies the envisaged outcome of the ruling (j).

(B) With respect to the term of the ruling and subsequent audit/checking procedure, the best practices of Action 5 of BEPS only prescribe for advance pricing arrangements that they should be granted for a fixed period of time and should be subject to review before being extended (a).

For all rulings, best practices imply that the taxpayer notify the tax authority about any material changes in the facts or circumstances (b); it is up to the administration to periodically verify that the factual information remains relevant throughout the validity of the ruling (c). Finally, conditions are summed up under which rulings should be subject to revision, revocation or cancellation (d).

(C) With respect to the publication and exchange of information of tax rulings, best practices of Action 5 of BEPS make a distinction between general rulings, which should be published (on the tax administration's website) and made easily accessible to other tax administrations and taxpayers (a), and taxpayer-specific rulings, where the ruling issued falls within the scope of the OECD framework for compulsory spontaneous exchange of information on tax rulings. In the literature, authors stress that the 1998 OECD report required already the disclosure of any administrative practices, including tax rulings (A. Myszkowski, "An Evaluation of BEPS Action 5", *Tax Notes International* 2016, 369). The OECD said the recommendation is a result of compromise among transparency, administrative efficiency, reciprocity, and confidentiality of commercially sensitive information.

It may be clear that, if the EU wants to be compatible with and even wants to go further than the BEPS project, such a common framework of best practices in tax rulings is indispensable. I can only express my hope that the common framework at the EU level will be as ambitious as at the OECD/G20 level and will look further than the compatibility of tax rulings with EU state aid rules. Hopefully the common framework is not for the long term.

4. ENCOURAGING COOPERATIVE COMPLIANCE IN MEMBER STATES

*"Combatting tax evasion and avoidance requires more openness between tax authorities and greater cooperation between governments. The onus on companies to engage in tax practices that are transparent and fair must also be increased".*¹⁴

Member States should not only increase coordination and cooperation of tax rulings, but could also enhance tax compliance of potential applicants of tax rulings. The call for greater transparency in the BEPS action plan is part of a global trend of governments and wider civil society demanding increased cooperation from businesses.¹⁵ To date there still are Member States which do not participate in the worldwide evolution towards cooperative compliance, as described by the OECD in 2013 (Horizontal Monitoring is introduced in 2005 in The Netherlands, Enhanced Relationship is introduced in 2008 by the OECD).

The model works on the basis that, if taxpayers are voluntarily and fully transparent and able to provide the necessary information, tax administrations should provide early tax certainty in advance when appropriate.¹⁶ Cooperative compliance would enhance the efficiency of the audit program by encouraging an approach that is based on tax risk management.¹⁷

Perhaps it could be interesting to encourage the implementation of cooperative compliance in the national jurisdictions of the Member States.

¹⁴ E. Kokolia, T. Lazaretou, "Cross-border Rulings: Direct and Indirect Taxation", *European Taxation* March 2016, 62

¹⁵ J.L. Pemberton, A. Majdanska, "Changing the Relationship between tax administrations and taxpayers", *Tax Notes International* 2016, 249

¹⁶ J.L. Pemberton et al., 253

¹⁷ J.L. Pemberton et al., 254

5. CONCLUDING REMARKS

In this briefing I set out in which direction the future of tax rulings in the EU is evolving. I draw the attention to a few topics that are likely to be relevant for policy discussions regarding the coordination and cooperation on tax rulings and, in particular, emphasize and encourage the need for enhancing tax compliance of potential applicants of tax rulings by inscribing cooperative compliance (as described by the OECD in 2013) in the national jurisdictions of all EU Member States.

NOTES



DIRECTORATE GENERAL FOR INTERNAL POLICIES
POLICY DEPARTMENT A: ECONOMIC AND SCIENTIFIC POLICY

EU State Aid Law and National Tax Rulings: 2015-2016 Update

Raymond LUJA

IN-DEPTH ANALYSIS

CONTENTS

EXECUTIVE SUMMARY	43
1. INTRODUCTION	44
2. RECENT DECISIONS AS GUIDANCE	45
2.1 A need for a more than marginal review by the EU's Courts	45
2.2 Market information and cross-border effects of revising transfer prices	45
2.3 CUP-shopping	46
2.4 Tax Treaties	47
2.5 Recoverable amounts	48
3. THE 2017 TAX RULING DATABASE	49
4. RECOVERY IN PERSPECTIVE	50
4.1 Tax Credits and Restoring the Status Quo	50
4.2 Alternative recovery methods and anti-tax avoidance legislation	51
4.3 US-EU relations	51
4.4 Sanctions	52
5. PRIORITIZING	53
6. OTHER PENDING CASES	54
7. CONCLUDING REMARKS	55

EXECUTIVE SUMMARY

- **Recent tax ruling decisions** are a first step, but they **are not** yet **suitable to provide definite guidance** with respect to fiscal state aid and transfer pricing pending appeal. Clarity from the EU's courts is needed.
- The Commission has to prioritize its review of rulings, but its **selection criteria remain unclear**. A better understanding of those criteria would enable the European Parliament to monitor the Commission's actions more effectively. While a focus on corporate taxation rulings is understandable at the moment, other areas of taxation should not be ignored.
- **Introducing sanctions related to state aid recovery first requires the rules to be sufficiently clear**. It should be considered to **adopt a methodology that would allow the Member State receiving recovered amounts back to bear the burden of foreign tax credits** other (EU and non-EU) states might otherwise have to offer due to recovery of taxes.
- The **EU's trading partners may use its state aid regime against it**; the outcome of the TTIP negotiations may be of relevance to future state aid recovery proceedings.

1. INTRODUCTION

This briefing paper addresses a number of recent developments with respect to the ongoing state aid review of tax rulings. It is a follow-up to the 2015 Report *EU State Aid Law and National Tax Rulings*,¹ the content of which will not be repeated here.

The following issues will be addressed:

- May recent Commission decisions (already) serve as guidance? (para. 2);
- The restricted access to the new 2017 tax ruling database (para. 3);
- The role of tax credits in state aid recovery within the EU and in relation to the US as well as imposing sanctions on Member States (para. 4);
- Prioritizing the review of tax rulings (para. 5).

Para. 6 will briefly recall some noticeable pending cases. A few concluding remarks will follow in para. 7. This briefing will also provide a reflection on some of the European Parliaments recommendations regarding fiscal state aid, as reflected in the 2015 TAXE and ECON resolutions.²

¹ Report IP/A/TAXE/2015-02.

² Resolutions P8_TA-PROV(2015)0408, based on the *Ferreira/Theurer* report for the TAXE Committee, and P8_TA-PROV(2015)0457, based on the *Dodds/Niedermayer* report for the ECON Committee.

2. RECENT DECISIONS AS GUIDANCE

2.1 A need for a more than marginal review by the EU's Courts

In its 2015 Resolutions the European Parliament has called on the Commission to clarify what constitutes fiscal state aid and to issue new guidelines, in order to remove existing uncertainties and not to discourage the use of legitimate tax rulings.³ This raises the question to what extent recent Commission decisions may already provide guidance in anticipation of official guidelines. This includes, in particular, the final recovery decisions with respect to *Starbucks*, *Fiat* and the *Belgian Excess Profit Rulings* and the decision to open a formal investigation into *McDonalds*.⁴

Without going into the details of decisions currently under appeal,⁵ a number of issues have been raised that are of a general nature and that go beyond the current cases. It should be pointed out that the EU's Courts will normally restrict themselves to doing a marginal review of a Commission's decision as far as complex economic analyses are concerned. This creates a particular tension with respect to the current cases as it are the technical details of the economic analyses that are of major importance in the cases at hand and which require a level of review far more stringent than usual in order for the current decisions, if upheld, to really be able to provide guidance for future situations. Still, well drafted appeals may allow a number of general assumptions made by the Commission in respect of transfer pricing to be tested on their legal merits.

2.2 Market information and cross-border effects of revising transfer prices

In *Starbucks* and *Fiat* the Commission availed itself of the option to gather market information from undertakings for the first time in the context of state aid. The information so gathered was then used to review transfer pricing as agreed upon in tax rulings.⁶ What is **unclear** from either case is **whether the data gathered, that was used for an ex-post review, had been accessible to either the companies involved or the national tax authorities at the time an ex-ante assessment had to be made**. This issue will have to be cleared up when the final decisions will be published.

By its very nature an advance tax ruling requires an assessment to be made on the basis of data available at the time. Even an ex-ante assessment done by the book, aimed at setting prices resembling those that would have been charged in conditions of free competition, may result in an advantage ex-post if the estimate turns out not to be spot on. Not every advantage will be selective, if the process of providing legal certainty in advance is neutral and aimed at getting to the best possible estimate.

Any system offering advance legal certainty may lead to a situation where at some point in time the addressee of a decision may have to invoke it when confronted with tax collection. For example, there may be a question of deductibility of interest for a type of loan which is ruled in favour of a taxpayer as the case law at the time was not conclusive. At a later point in time, new judgements by national courts in other cases may lead to another conclusion. The taxpayer will however be protected from undoing previous deductions because of a ruling. Here the ruling serves the purpose of providing legal certainty.

³ TAXE Resolution para. 131 / ECON Resolution C7.

⁴ European Commission Press Release IP/15/5880 (*Starbucks Manufacturing EMEA / Fiat Finance and Trade*), IP/15/6221 (*McDonalds*), IP/16/42 (*Belgian Excess Profit Rulings*).

⁵ Appeals filed by Luxembourg (T-755/15, OJ C 59/48 of 15 February 2016) and Fiat Chrysler Finance Europe (T-759/15, OJ C 59/49 of 15 February 2016) in respect of Fiat Finance and Trade, by the Netherlands in respect of Starbucks (T-760/15, OJ C 59/50 of 15 February 2016), and by Belgium in respect of the Excess Profit Rulings (T-131/16, not yet published).

⁶ For ease of reading, the term tax rulings will include advance pricing agreements.

If the ruling system is open to anyone and if the original decision was not contrary to legislation and case law at the time, then the taxpayer may be in an advantageous position without necessarily coming into the scope of state aid. This is the very essence of offering legal certainty. In contrast, rulings that clearly deviated from national law (including domestic transfer pricing rules) ex ante may well remain within that scope.

Obviously, whether the ex-ante assessment in *Starbucks* and *Fiat* was done by the book is currently the subject of an appeal at the EU's Courts and this briefing will not prejudice the outcome of those procedures. However, two general remarks should be made.

The *Starbucks* case raises the issue of **whether a Commission's analysis should focus on single elements of a ruling and scrutinize each element separately** – in *Starbucks* the Commission questioned the pricing of coffee beans as well as the payment of royalties, both intra-group – **or whether the starting point should be the final result of a ruling in terms of the taxable profit** resembling free market conditions, taking the effects of all elements together.

The *Fiat* case signals that **the one-sided focus of state aid procedures** – the presence of an advantage is to be determined vis-à-vis the normal tax system of one Member State – **might cause cross-border effects**. In *Fiat* the Commission reviewed a ruling for an entity providing intra-group financial services. It came to the conclusion that the amount of capital (equity) assigned to that entity was too low, given the functions and risks involved with the entity's activities. Furthermore, the remuneration applied to that capital was considered to be too low as well. What is unclear is which amounts were taken into account by other group members outside the Member State involved. If the amount of capital or the remuneration charged in Luxembourg had to be increased, the additional capital or remuneration should have come from other group entities (to the extent the correction proposed by the Commission would go beyond the capital or remuneration already assigned or charged in the group's accounts). This raises the question to what extent other Member States' domestic procedures may allow for a revision of past tax assessments, which might lower taxable profit abroad. (There is insufficient public data to confirm whether this is indeed the case in *Fiat*.)⁷

2.3 CUP-shopping

It follows from the *Starbucks* case that **the European Commission has a strong preference for the use of comparable uncontrolled prices (CUPs) between group companies**, which are supposed to reflect normal market prices. While the use of normal market prices indeed seems to be a logical approach towards dealing with intra-company transactions, there is a substantial risk of CUP-shopping. When companies approach tax authorities for an advance pricing agreement, they may present a selection of CUPs that suits their purpose best.

For some standardized commodities that are traded on a stock exchange, determining a CUP may seem relatively easy. (Even here we need to make adjustments to deal with, for instance, the effect of buying commodities in bulk, inventory risks or long-term contracts.) However, especially in regard to rather unique products or in respect of services, different prices may be used in different settings. In 1995, upon launching the first OECD transfer pricing guidelines, there was indeed a preference for the use of CUPs when available, but nowadays using CUPs is not necessarily the gold standard as it may allow for reduced taxation in itself. This may seem counterintuitive at first.

⁷ The final decisions have not yet been published; they are unlikely to include the level of detailed information needed to make this assessment. In respect of *Starbucks*, the Dutch government already published its summary of the decision's contents in remarkable detail. See the Cabinet's response to *Starbucks* and the annex thereto, sent to the Dutch parliament on 27 November 2015 and a response to questions from parliament dated 2 February 2016.

The current OECD transfer pricing guidelines are not perfect and there is room for improvement – as indicated in the OECD/G20 2015 BEPS reports – but the mere fact that they may allow for more than one solution to a transfer pricing dispute does not warrant the assumption that they are biased towards providing benefits to multinationals from the start.

2.4 Tax Treaties

In the context of the *McDonalds* case Commissioner Vestager stated that the “purpose of Double Taxation treaties between countries is to avoid double taxation – not to justify double non-taxation.” A statement like this is understandable given the current sentiment about tax avoidance, but it should be pointed out that it is well established practice in tax treaties that double non-taxation might be resulting from them. One of the primary functions of tax treaties is to divide taxing rights between the countries that are party to such a treaty. This can either be an exclusive assignment of taxing rights on certain income to one party, requiring the other party to exempt such income from taxation, or a shared right, requiring the other party to provide a full or partial credit for any foreign taxes already paid on certain income.

In the event business income would be exclusively assigned to one country, it may well be that double non-taxation might occur if that country would decide not to tax that income in full. ‘Loopholes’ like these are inherent to a traditional exemption system. It would be possible to make exemptions conditional upon requiring certain income to be subject to tax, or even to an acceptable minimum amount of tax, but this is not yet the standard in most treaties. Moreover, it is not self-evident that if the taxing rights are assigned to one party to the treaty, often the country of origin of certain business profits, the other party should reserve the right to reclaim a right to tax in case of low or no taxation abroad (a switch-over) as this may seriously question sovereign decision making in the first country in respect of how to tax business profits.

Tax treaties do not create a right to tax. It is the national tax law that provides the legal basis to tax. This right to tax may then be restricted by a tax treaty, depending on how the taxing rights have been divided. The *McDonalds* case indicates a shift in the Commission’s assessment practice. In the first cases selected it mainly focussed on transfer pricing, but in this case the Commission’s focus is on other types of mismatches that may lead to tax avoidance.

In the case at hand a Luxembourg entity receiving all royalties for McDonalds’ European franchising activities argued that it did not have to pay taxes as those royalties had to be attributed to its US ‘permanent establishment’, something the authorities seem to have agreed to in a ruling. The US however, did not recognise any US trade or business activity and hence did not ‘see’ a permanent establishment within its territory that it could tax. Despite rules in the tax treaty to deal with what is or what is not a permanent establishment, the relevance of the tax treaty for state aid purposes will be rather limited here. As national law is the starting point, the relevant question is whether domestic law was correctly applied when all royalties were assigned to a US-based permanent establishment (from the perspective of Luxembourg law and case law).⁸ If so, there would not have been anything to tax to begin with and the treaty would be of little to no relevance.

⁸ According to Commission press release IP/15/6221 of 3 December 2015 (*McDonalds*), this question will be addressed by the Commission.

2.5 Recoverable amounts

The press releases regarding *Starbucks*, *Fiat* and the *Belgian Excess Profit Rulings* all mention a recoverable amount of around 20 Million Euro per company affected (on average), *Starbucks* and *Fiat* possibly going up to 30 Million. These seem to be estimates that have been put in the press release, but these amounts are unlikely to have been set in stone in the actual decisions. In complex cases like these, the Member States will be asked to do the actual calculations, so the final amounts that need to be recovered may very well differ from those indicated in the press releases. (On recovery, also see para. 4 hereafter.)

3. THE 2017 TAX RULING DATABASE

In December 2015 a Directive was adopted that extended the Administrative Cooperation Directive by setting up a mandatory exchange of information of advance cross-border tax rulings and advance pricing arrangements.⁹ The Council built in certain safeguards that prevent the Commission from using this database of state aid purposes. First of all, **the Commission will not get access to the identity of the entities to which a ruling or arrangement applies nor to the summary of their contents.** It will neither get access to the criteria used to determine transfer prices, if applicable, nor will it be provided with details of the persons in other Member States that could be affected by such a ruling or arrangement.

Effectively what is left for the Commission is a list of dates, types of rulings, Member States affected and possibly amounts of transactions. Even this **data must be kept within DG TAXUD and cannot be shared with DG COMP for state aid purposes**, as it may only be used by the Commission as a means to check whether Member States do comply with their obligation to exchange relevant rulings.¹⁰ That said, nothing in the Directive will prevent a Member State from filing a complaint with the Commission if its authorities are confronted with alleged state aid granted by another Member State.

In case of tax avoidance, the mere exchange of rulings will not necessarily enable the other affected Member State to take appropriate action itself. For instance, in case of a mismatch in how Member States define debt or equity the Member State's tax authorities cannot change their own interpretation easily. For this we need non-state aid methods, like the hybrid mismatch rules proposed in the Draft Anti-Tax Avoidance Directive.¹¹

Also in case of transfer pricing, a Member State may not always be able to compensate. For instance, in case of intra-group services the contract may show a price of 10 Million Euro a year, which the seller's state considers to be an at arm's length price. Now if the state of the buyer would consider 12 Million Euro to be an at arm's length price, allowing for more deductible costs, this does not entitle the seller's state to suddenly tax the remaining 2 Million Euro as it has to assess taxable profits in accordance with its own domestic rules. Situations like these might trigger the latter state to file a complaint (if it would serve its own political agenda). So, **while the tax ruling database might reveal differences in transfer pricing it does not offer a solution to the issue by itself.**

It should be pointed out that, even if the Commission would gain full access to the tax ruling database, it is unlikely that many of the future rulings included will contain straightforward cases of state aid. Domestic rulings, where there is no cross-border effect, will be excluded from the database *en bloc*, even though rulings for domestically operating companies might be a source of state aid as well. We must also seriously consider the possibility that binding rulings ("upon which [a person] is entitled to rely"¹²) will be replaced by more informal gentlemen's agreements that, while non-enforceable, will give a sufficient degree of comfort to companies involved without this showing up in the database.

⁹ Council Directive (EU) 2015/2376 of 8 December 2015 amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation, OJ L 332/1 of 18 December 2015.

¹⁰ Articles 8(a) para. 8 and 23(a) para. 1 Directive 2011/16/EU as amended.

¹¹ Proposal COM(2016) 26 final of 28 January 2016 (ATAP Directive).

¹² See Article 3 paras. 14 (b) and 15 (b) Directive 2011/16/EU as amended.

4. RECOVERY IN PERSPECTIVE

4.1 Tax Credits and Restoring the Status Quo

The purpose of recovery of state aid is to restore the status quo, i.e. to re-establish fair market conditions as they were before state aid was granted by neutralizing the financial advantage. This process is designed to deal with the aid granted by a single Member State, such as a selective tax benefit. EU law only requires immediate and effective recovery by whatever means or process,¹³ which means that it will depend on the Member State how fiscal aid will be recovered.

If we assume that a Member State's procedural rules would require it to recover tax benefits via the tax system, recovery may result in a retroactive payment of taxes. In some situations taxes paid in one country may be credited against taxes paid in another country. This is something that lies beyond the normal scope of a state aid procedure, but it does raise several issues.

What if the other country refuses to give a credit for the additional taxes paid? Countries that do provide credits may impose a deadline to claim a credit which may be at odds with a payment of back taxes that may cover a period of up to 10 years (and sometimes even more). In such a situation, a credit might be restricted to the amount that relates to the years for which the deadline did not yet pass. More formalistic, if tax assessments have been filed and no tax credit was claimed at the time, retroactive taxation abroad may not necessarily offer a second chance to claim a credit abroad.

Now, in order to restore the status quo we should consider the situation as it should have been. The taxpayer should have paid a higher amount to start with, but he might have been able to claim a full or partial credit abroad as well. From a state aid perspective, however, **a foreign tax credit will not be taken into account when determining the amount that is to be recovered**. So if we recover the full amount, would EU law still allow for a consideration of damages due to the missed tax credit? The answer to this is likely to be negative, although it would put the entire concept of restoring the status quo in a somewhat different perspective given the potential of overkill if we look beyond what happens in a single State.

Despite the fact that state aid recovery focusses on the advantage received within one Member State, **in the area of fiscal aid foreign tax credit entitlement may warrant a reconsideration of the current approach towards recovery** as there would be a direct link between the additional taxes to be paid after recovery and possibly missed entitlements abroad. As other (EU and non-EU) states may be at risk of facing increased credits due to recovery, the Commission might consider to compensate for this as part of the recovery process as to avoid such foreign crediting.

One could think of **setting up a methodology that would allow the Member State who contributed to the need for additional crediting to bear the 'burden'** (if one considers this term appropriate when facing a lowered windfall benefit). However, waiving an entitlement to foreign credits when calculating the net benefit to be recovered and actually determining the size of such credits (and its net present value due to timing differences) can be rather challenging not to say the least. As with sanctions (to be addressed below), such a process will be too burdensome for the Commission to carry out. But it might be something the Member States and the taxpayers themselves would be willing to engage in if allowed to, as part of the recovery calculations Member States often need to make themselves in fiscal aid cases.

¹³ Procedural Regulation 2015/1589, Article 16 para. 3, OJ L 248/9 of 24 September 2015.

It may save the taxpayers involved from the need to go through possibly problematic and lengthy foreign crediting procedures.

While other countries might have had to grant a credit to begin with if the correct amount of taxes had been paid from the start, expecting them to grant rather substantial and unexpected tax credits in response to a 10-year recovery abroad without any kind of restriction is not something that can be considered doing business as usual. An approach like the one proposed above would not fit current state aid procedure however, but it might be feasible to introduce as part of the recovery process without requiring a change of the Treaty on the Functioning of the European Union (TFEU).

4.2 Alternative recovery methods and anti-tax avoidance legislation

If Member State rules would allow for recovery of fiscal aid to take place via non-fiscal procedures, foreign crediting is rather unlikely even if – in the end – the State and the company voluntarily agree to recovery via the tax system. But more importantly, if the Commission would find that a company's taxable base should have been broader, **recovery of taxes due via other means** (civil or administrative claims not qualifying as taxes) **might trigger the application of CFC and switch-over clauses**, depending on how other governments would deal with the Commission's findings when published. In essence, a retroactive broadening of the tax base without collecting additional taxes would lower the effective tax rate. This is only of limited concern in the context of the proposed ATAP Directive, given the limited intra-EU application of its switch-over and CFC provisions.¹⁴ But, to the extent Member States may apply stricter standards the above may still become an issue in an intra-EU context.

4.3 US-EU relations

The issue of tax credits also had their impact on US-EU relations. The idea of US taxpayers "footing the bill" by allowing credits for taxes retroactively recovered abroad stirred a discussion in the US Congress which, together with the perceived singling out of US multinationals, led the US Secretary of the Treasury to forward his government's concerns to the European Commission, to which Commissioner Vestager answered.¹⁵

Without reiterating the context of the aforementioned letters here, it should be pointed out that **DG TRADE** sent a negotiating text to the US Trade Representative that **proposed**, inter alia, **to exclude potential state aid claims from the investor protection provisions of the Transatlantic Trade And Investment Partnership (TTIP) Agreement** that is currently being negotiated.¹⁶ It is not yet clear how the US responded to this particular part of the proposal.

A US refusal would open up the possibility that **recovery** of tax benefits in a situation where an EU Member State actively approached US companies to invest in their territory by offering such benefits **might lead to a conflict with investor protection safeguards**. It is too early to tell whether this will indeed be a realistic scenario, as TTIP negotiations are still ongoing.

¹⁴ Except for the application of Article 8(2), last part of the first sentence (as proposed, see note 11).

¹⁵ Letter by the Secretary of the Treasury J.J. Lew of 11 February 2016 to EC President Juncker; Letter by Commissioner M. Vestager of 29 February 2016 to Secretary Lew.

¹⁶ TTIP negotiating text - EU Proposal for Investment Protection and Resolution of Investment Disputes, Article 2 para. 4 and Annex III, 12 November 2015

4.4 Sanctions

Both the TAXE and ECON Resolutions included a recommendation to allocate recovered state aid either (i) to the Union's budget or (ii) to Member States who suffered from an erosion of their tax base.¹⁷ At present, state aid is the only part of competition law that does not include some kind of sanctioning system.¹⁸ The absence of sanctions might have to do with the fact that state aid violations per definition involve a Member State and not just companies. Either way, recovery as such is not meant to serve as a penalty even though the perception of a taxpayer may be otherwise.

Introducing a sanction on the Member State, like paying part of the amount recovered into the Union's budget, would most probably increase awareness and stimulate Member States to stick to procedure. However, as with any kind of sanction it must be clear what behaviour constitutes a violation of the rules. **Clarity is still lacking with respect to the proper application of state aid rules in some areas, such as transfer pricing. It is a precondition for introducing sizable sanctions.**

Moreover, it should be considered that state aid rules cover a large number of methods to grant aid. **Rules on sanctions should be able to be applied to all kinds of aid,** whether fiscal aid, grants, regular cash subsidies or otherwise. For this reason **the recommendation to allocate recovered aid to other Member States that may have suffered from an erosion of their tax base does not seem to fit** within the context of recovery. Moreover, it would require the Commission to extend the scope of its state aid investigation to establish the actual presence and size of tax base erosion abroad, which is hardly feasible especially in light of its workload. It would also make the recovery process too complex, which leads this author to the conclusion that this part of the recommendation should be reconsidered. (As for preventing other Member States from suffering even more from unlawful state aid, see the remarks about foreign tax credits above.)

A change in the rules of recovery in order to reroute amounts to the Union's budget would require an amendment of the TFEU. Recovery as such is based on CJEU case law and has been read into the current state aid provisions of the TFEU. Its implicit legal basis and the need to adapt the TFEU might explain why the Commission, in its response to the EP's recommendations, carefully avoided addressing this particular issue.¹⁹

¹⁷ TAXE Resolution para. 134 / ECON Resolution C7.

¹⁸ Notwithstanding the possibility for the Commission to ask the CJEU to impose periodical penalties or lump-sum payments in case of a Member State's continued non-compliance with a recovery decision.

¹⁹ Joint follow-up to the TAXE and ECON resolutions, adopted by the Commission on 16 March 2016.

5. PRIORITIZING

With Luxleaks and the EU-wide investigations into tax ruling practices of most Member States the Commission had a tremendous amount of tax rulings to process, over 1000. About 300 rulings are still under investigation. These numbers even exclude the possible fall-out of the Panama Papers, even though state aid is not expected to play a prominent role in this context.

In the 2015 Resolutions it was already recommended to **allocate additional resources to DG Comp** as to enable it to review more tax rulings.²⁰ At this point in time Member States as well as taxpayers will be served by clarity in the shortest possible timeframe. That said, this author strongly supports the Commission's preference for qualitative decisions with sound legal reasoning over speedy decisions that may be the subject of prolonged Court battles and possible revisions after annulments because of procedural or technical defects. In most cases of recovery appeals will be inevitable to get the legal clarifications we need from the Courts, but getting there in one attempt would be preferable.

The Commission will have to prioritize its work. If it would be able to single out types of (rather uniform) rulings instead of single rulings, it might be able to produce cases that give better guidance for a larger group of companies at once. Commissioner Vestager already announced her intention to focus on financing companies, for example.

With respect to checking individual tax rulings, as part of the EU-wide review process, **it has been unclear to this date which criteria the Commission applied to select rulings for an in-depth investigation** from the lists provided to it by the Member States. As these selection criteria may be important with respect to policy, a further exchange of thoughts between the European Parliament and the Commission should be considered in order to allow the parliament to monitor the Commission's activities. As the selection criteria are rather sensitive – they might help some taxpayers and their respective Member States to take action to avoid detection – a discussion *in camera* might be preferable to get the answers needed.

State aid does go beyond corporate taxation and also plays a part in respect of value added taxes (VAT) and wage taxes, albeit a less prominent one from a public relations perspective. Especially in the context of indirect taxes state aid might involve rather substantial amounts. When setting priorities it must be kept in mind that tax avoidance and selective aid are not just seen as issues limited to corporate taxation.

²⁰ TAXE Resolution para. 130 / ECON Resolution C7.

6. OTHER PENDING CASES

The European Commission filed appeals in respect of two General Court Judgements dealing with the Spanish Goodwill cases.²¹ If the CJEU would uphold those judgements, it may have a very substantial impact on current Commission policy and reduce the scope of state aid scrutiny of tax measures aimed to benefit cross-border activities of multinationals. Hearings in these cases will be held by the end of May 2016.

Final decisions in the *Apple* and *Amazon* cases are still to be expected,²² as is the Commission's decision in the *Gibraltar II* case which predates the establishment of the Commission's task force on Tax Planning Practices. In *Gibraltar II* the Commission questions a Member State's (here: an autonomous region's) ability to exempt passive income from taxation. This issue has the potential of interfering with the ongoing political process to coordinate anti-tax avoidance legislation and it might lead to an expansion of the scope of operation of state aid rules if the final decision follows the Commission's initial reasoning.²³

²¹ Cases C-20/15 P (*Autogrill España*) and C-21/15 P (*Banco Santander*), filed 20 February 2015. Court hearings have been scheduled for 31 May 2016.

²² Decision to open a formal investigation in case SA.38373 (*Apple*) of 11 June 2014 (OJ C 369/22 of 17 October 2014); Decision to open a formal investigation in case SA.38944 (*Amazon*) of 7 October 2014 (OJ C 44/13 of 6 February 2015)

²³ Decision to open a formal investigation in case SA.34914 (*Gibraltar II*) of 16 October 2013 (OJ C 348/184 of 28 November 2013). This investigation has been extended to include Gibraltar's entire tax ruling practice (Commission press release IP/14/1073 of 1 October 2014), which should in essence have been a separate investigation. It is unclear whether this extension led this case to be transferred in its entirety to the Commission's task force.

7. CONCLUDING REMARKS

This author has some reservations in respect to the EP's recommendation to let the Commission issue new guidelines on what constitutes tax-related state aid or not.²⁴ In the end this is the prerogative of the CJEU. It may indeed be useful to have guidelines like these, but only if it can be guaranteed that the Commission will not put forward its own views on unsettled issues as not to harm the procedural rights of either taxpayers or their competitors, as a notice containing such guidelines could give rise to legitimate expectations preventing recovery. There is also a serious risk of such notice contradicting or not covering past cases, which will raise issues of legal certainty of its own. As for asking the Commission to explain what 'appropriate' transfer pricing is, this may go beyond the scope of its state aid powers depending on how detailed this guidance may be.²⁵

Finally, it should be noted that **non-EU companies active from within the EU would be allowed to file a complaint with the Commission** as an interested party, which would give them some degree of protection against unlawfully granted state aid.²⁶ As the EU's state aid regime is rather unique, it is unlikely that EU companies will be offered reciprocal protection of this kind abroad.

²⁴ TAXE Resolution para. 131

²⁵ Ibid.

²⁶ The Procedural Regulation does not allow non-EU Member States to file a complaint themselves. See Article 1(h) and 24 of Regulation 2015/1589 (OJ L 248 of 24 September 2015), notwithstanding international agreements or diplomatic custom giving third countries a way to voice their concerns. (It is assumed that the foreign state itself is not engaged in an economic activity in the EU directly as to qualify as a potential competitor and hence as an interested party.)

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