EXECUTIVE SUMMARY

Requested by the FISC Subcommittee

Removal of taxation-based obstacles and distortions in the Single Market in order to encourage cross border investment

ABSTRACT

The coexistence of 27 different national tax systems in the European Union brings about significant obstacles to cross border business activity in the European Single Market. The objective of this study is to show the context and developments in European secondary law that have led to the current situation or, at least, have not yet resolved it. In addition, perspectives are shown as to how the described obstacles to cross border investment in the Internal Market can be countered both in the short and long term, both at the fundamental and also at the procedural or administrative level.

This document was provided by the Policy Department for Economic, Scientific and Quality of Life Policies for the Subcommittee on Tax Matters (FISC).

Background

The coexistence of 27 different national tax systems in the European Union (EU) brings about significant obstacles to cross border business activity in the European Single Market. This obstacle is at odds with the economic objectives of the European Treaties and also with the ambition set out in the Lisbon Strategy of establishing the "most competitive and dynamic knowledge-based economy [...] in the world" .

The present document is the executive summary of the study on Removal of taxation-based obstacles and distortions in the Single Market in order to encourage cross border investment. The full study, which is available in English can be downloaded at: https://www.europarl.europa.eu/RegData/etudes/STUD/2022/733964/IPOL_STU(2022)733964_EN.pdf

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PE 733.964 – October 2022

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Aim

The objective of this study is to show the context and developments in European secondary law that have led to the current situation or, at least, have not yet resolved it. In addition, perspectives are to be shown as to how the described obstacles to cross border investment in the Internal Market can be countered both in the short and long term, both at the fundamental and also at the procedural or administrative level.

Key Findings

EU Member States have found it much easier to agree on curbing international tax planning than on reducing tax and administrative barriers in the Single Market. As a consequence, leeway for international tax planning has actually decreased significantly in recent years, but at the cost of a complexity explosion.

For companies active across borders in the Single Market, tax complexity today is not only caused by the sheer heterogeneity of 27 non-harmonised national tax systems in the EU but also by very high transparency and documentation requirements as well as by internationally non-aligned substance criteria that companies must meet to escape from tighter anti-avoidance legislation. Moreover, the actions agreed in the Organisation for Economic Co-operation and Development (OECD) project against base erosion and profit shifting (BEPS), which the EU has implemented at a record pace, especially through its Anti-Tax Avoidance Directive (ATAD), are inherently complex and partly overlap in their scope of application with hierarchies not always being clearly defined. Newly introduced linking rules designed to combat gaps in the taxation of income make the source country tax treatment of a cross border payment dependent on its taxation abroad, potentially over multiple layers of the multinational's group structure. The required deep look along the entire ownership chain of a company, potentially stretching across multiple countries, is costly and complex, both for the taxpayer and the local tax administration.

Low-taxed or even untaxed income has turned out to be a thorn in the European legislator's side. And quite certainly, the fight against specific forms of tax avoidance that generate untaxed, i.e. "white" income, is legitimate and can be justified on systematic grounds: Corporate profits should be taxed exactly once within the international corporation tax system. Just as double taxation of income contradicts the desired functioning of the tax system, so does zero taxation. The result of such deviations from the desired single taxation of income, in one direction or the other, is a distortion of competition in the market.

However, in seeking to ensure taxation at the "place of value creation", both the OECD and the EU go beyond this systematically grounded notion of tax aggressiveness, in some cases significantly.

While for the last ten years the fight against tax avoidance has been high on the European policy agenda, the avoidance of double taxation as well as the efficient implementation of EU law prohibiting discrimination and restriction of cross border activity have been less of a concern to the legislator. Some improvements, as in the form of the EU Dispute Settlement Directive, were certainly made. Still, many administrative procedures in cross border taxation, e.g. for the exemption or refund of withholding taxes, are lengthy and costly. Similarly, EU legal requirements and European Court of Justice (ECJ) rulings are implemented hesitantly or defensively by the Member States. Infringement procedures often turn out lengthy and inefficient, too. These deficiencies go as far as preventing taxpayers from initiating procedures that have been put in place to secure their legal rights. In essence, from the point of view of multinational companies active in the Single Market, the EU legislation implementing key impulses from the OECD BEPS project has brought about restrictions in tax-related leeway and a drastic increase in compliance costs without providing facilitation of cross border activity in return. In particular, no fundamental coherence of national taxation systems was achieved. The measures put in place address the consequences rather than the causes of tax-related frictions in the Internal Market and thus remain purely symptom-related. While the ATAD creates some convergence in the set of instruments used to restrict tax-planning leeway resulting from incoherent tax systems, its design as a mere minimum standard implies once again a considerable fragmentation of tax rules in the Internal Market. Other pressure points that matter from a business perspective, such as the question of a cross border loss-offset, have not been resolved despite decades-long discussions. Tax distortions in real investment decisions also persist - in tension with the principle of tax neutrality implied by the economic goals set out in the primary law of the European Union.

Going forward, the EU must position itself in the global competition. The US tax policy has long been characterised by a greater awareness of the realities of international tax competition, providing also carrots and not only the stick for investors. In contrast, the EU stands out globally with a high-speed strategy that almost exclusively centers on the fight against tax avoidance. The ATAD is representative for this endeavour: It is the first EU directive that does not bring any tax advantages for affected taxpayers, but only entails restrictions and costs. Meanwhile, the EU Commission keeps on pressing ahead with the implementation of the projected global minimum tax. However, it is already clear that even with the global minimum tax, the fundamental role of taxation in international location competition is unlikely to become obsolete. On the one hand, this is due to the design of the global minimum tax itself. On the other hand, competition between locations is likely to shift to other tax fields, such as the taxation of highly qualified labour or omitted tax advantages are potentially compensated for by subsidies. The latter route in particular, however, is barred to EU Member States against the background of EU state aid law. This, in turn, puts the EU in a potentially disadvantageous position compared to locations that are more flexible.

Some of the fundamental tax obstacles and distortions in the Internal Market can (only) be addressed by a substantial harmonisation of corporate taxation in the EU. The idea is to establish independent and uniform European regulations for a harmonised profit tax base and then to consolidate group profits with subsequent formula apportionment to the Member States. In 2021, the EU Commission reconfirmed this plan under the new label "Business in Europe: Framework for Income Taxation (BEFIT)". Within the framework of a Europe-wide uniform corporate tax base, the emergence of qualification conflicts in the Internal Market would be prevented, since the uniform profit determination rules would also regulate the tax treatment of shareholder distributions, the demarcation between equity and debt capital in hybrid financing instruments and the deduction of financing costs. A uniform tax base would also cover consistent rules on loss determination, which would be an important prerequisite for the further development of group taxation towards cross border loss offsetting.

If the concept of group taxation including consolidation and formulaic profit allocation is not implemented immediately, cross border loss relief could be made possible at an earlier stage of harmonisation. While this certainly would raise questions in terms of revenue implications and budget balancing between Member States, cross border loss offset would be a very strong signal for the competitiveness and attractiveness of the Single Market.

Since formula apportionment annihilates any incentive or starting point for cross border profit shifting in the Single Market, there would no longer be any need for highly complex anti-avoidance measures in the Single Market. In view of the burdensome effects of the ATAD, it seems worth considering extending the scope of application at least of the harmonisation of the tax base to all companies subject to corporate income tax and, in return, withdrawing the ATAD in the Internal Market.

The EU's immediate focus should be on the reduction of actual tax obstacles in the Internal Market. Initiatives already launched by the EU and the OECD to reduce tax compliance costs for taxpayers are therefore to be welcomed and expanded. Besides the urgent need to simplify the relief or refund procedures for withholding taxes in the Single Market, the EU must generally promote harmonised and efficient taxation procedures and the reduction of legal uncertainty in other areas as well. Against this background, it seems fundamentally positive that in the course of the most recent amendment of the Directive on Administrative Cooperation (DAC 7), a legal framework was also created for conducting joint audits between two or more Member States as of 1.1.2024. Joint audits are one aspect of the so-called OECD Tax Certainty Agenda, with the aim to improve legal certainty and application of tax law. Such efforts should be taken up and intensified. In the EU context, it also makes sense to accelerate infringement proceedings by improving the resources and staffing of the responsible bodies.

In order to avoid potential violations of EU fundamental freedoms and subsequent lengthy proceedings, a strong voluntary commitment by the Member States in the sense of a Code of Conduct to a speedy and foreseeable final implementation of European legal requirements could be an important step. In addition, an innovative idea would be for the EU states to agree, at least in principle, to give greater weight to the opening of the Internal Market in the future than has been the case to date in alternative ways of eliminating discrimination by adapting the law.

However, efforts to reduce tax complexity and the associated compliance costs are potentially counteracted by the planned further anti-avoidance measures in the course of BEPS 2.0, in particular the global minimum tax. When designing the further tax measures that will be required if BEPS 2.0 is implemented, procedural issues and the threat of complexity due to interactions with existing anti-avoidance rules should be consistently considered and remedied in order to counteract a further drastic increase in administrative and tax compliance costs as well as the further emergence of double taxation risks. Furthermore, at the latest with the implementation of BEPS 2.0, all plans for the implementation of a digital levy on the part of the EU Commission should be finally abandoned and existing unilateral digital levies in the EU Member States should be withdrawn.

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IP/A/FISC/2022-01
Print ISBN 978-92-846-9785-4 | doi: 10.2861/977991 | QA-09-22-549-EN-C
PDF ISBN 978-92-846-9786-1 | doi: 10.2861/514782 | QA-09-22-549-EN-N