EU sexy tax policy

Large Corporate

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Louise Harvey, Hans Hack and Luc Cade review the latest developments in EU tax policy debates – is it at last becoming sexy?

Key Points

Tax policy has leapt up the EU political agenda The EU has shifted its focus to mitigating avoidance, fraud and evasion The Commission would like to create a ‘one-stop-shop’ to cut red tape for EU companies

The European Council, in its statement of conclusions to the 14–15 March 2013 meetings, clearly identified the driver behind current tax policy: ‘In the context of challenging fiscal consolidation it is important to ensure that everybody pays their share of taxes’.

Historically, tax policy at EU-level has not been one of the most dynamic policy areas; partly due to the required unanimity voting system for member states and partly due to the European Parliament only fulfilling an advisory role, making it unable to exert its influence in other areas. Moreover, key member states, not least the UK, often supported by Ireland, have in the past been adamant in refusing any EU competence in tax issues which they have jealously guarded. Is this about to change?

Recent statements by George Osborne and David Cameron and the joint statement with France and Germany at the G20 in Moscow suggest that there is a shift in approach from the UK towards a coherent EU tax policy. Could it be that the UK recognises it needs EU support at a political level to push through the changes it wants? After all, in managing some high-profile tax issues, cross-border cooperation is the key.

Tax policy is now high on the EU political agenda, possibly becoming the new 'sexy' topic for finance ministers. At the G20 meeting in February, ministers from France, Germany and the UK issued a joint statement calling for a clampdown on tax avoidance by multinationals, in effect setting EU policy on this controversial issue. As European economies struggle to escape the economic crisis and remain crippled by burgeoning public debt, governments are becoming more creative trying to find solutions, preferably without impeding growth. Their attention has now focused on tax matters which increasingly has domestic public support.

In an internal market, tax policy is inherently a *cross-border* issue. The European Commission, European Parliament and European Council are preparing to work on a range of issues, including changes to the VAT system to forcing through the financial transaction tax (FTT), at least in a critical core of 11 member states. The European institutions are trying to design tax regulation that will enhance and reinforce the single market; a challenging task considering member states continue to insist key tax features remain national prerogatives.

The need for European governments to efficiently maximise tax revenues has led the EU to focus on mitigating avoidance, fraud and evasion. David Cameron illustrated this in his 2013 Davos speech, referring to the difference between evasion, which is illegal, and aggressive tax planning, which is legal, stating that some forms of tax avoidance 'raise ethical issues and it is time to call for more responsibility and that governments act accordingly'.

The December 2012 Commission action plan sets out three key issues to be tackled and seeks to provide a clear definition and a common set of criteria to identify tax havens.
First is the endorsement of a strong EU stance against third countries not complying with EU tax standards – which goes beyond current international measures. Using common criteria, member states are encouraged to identify these countries and place them on national blacklists.

Second, aggressive tax planning is trying to prevent individuals or companies taking advantage of loopholes to either substantially reduce or obviate the need to pay any tax. The proposal is for a common general anti-abuse rule, under which member states could ignore any artificial arrangement carried out for tax avoidance purposes and instead allow taxation on the basis of actual economic substance.

Third, special provisions will be sought to trace money flows or extend the code of conduct to include special tax regimes for high net-worth individuals. The action plan has even received full backing from the European Parliament; with MEP Mojca Kleva Kekuš's report on the topic pushing for a clear definition of a tax haven, together with the creation of a European blacklist. Exactly how this definition is drafted will be fundamental to the impact of the proposal.

The European Commission has launched consultations in 2013 on two methods to fight tax evasion and fraud. First, it established a web portal for EU tax identification numbers (TINs) in order to publish country-by-country descriptions of tax structures, provide useful information and an online check module to verify the TIN of an individual.

Second, the establishment of the European taxpayers code which will list best practice for dealings between tax authority and taxpayer, will eventually lead to better transparency.

The agreements with the US relating to the Foreign Account Tax Compliance Act (FATCA) have created new opportunities for the EU to reach similar outcomes with countries that have special banking structures such as Switzerland, Lichtenstein and Austria. The EU's tax commissioner, Algirdas Semeta, has stated: 'Switzerland should logically have to offer similar treatment to the 27.' This has been symbolised by increased European Commission activity focused on improving the Savings Directive which, in conjunction with changes to the Interest and Royalties Directive, have passed the scrutiny of the European Parliament and are now in the hands of the European Council, despite Austria and Luxemburg maintaining their vetoes.

The common consolidated corporate tax base (CCCTB) intends to enhance the single market by reducing tax anomalies while respecting a member state's right to its own tax system. Its principal aim is to reduce compliance and administration costs for EU businesses that have to comply with 27 member states' tax rules by harmonising the way they calculate the tax base of businesses operating in the EU. Already quoted EU companies prepare their accounts under common accounting rules, IFRS and, in 17 countries, use a common currency. It could be argued that a common tax base is a logical next step in easing the barriers to cross-border trade.

Equally, the Commission wants to create a 'one-stop-shop' allowing EU companies to deal with only one tax administration. CCCTB would eliminate the need for transfer pricing compliance costs for intra-group transfers and allow automatic cross-border relief following consolidation of tax results.

The CCCTB was conceived as being optional for companies to adopt. Member states would keep their prerogative to set their corporate tax rate at the level they saw fit. The Commission expects businesses save about €2 billion if the CCCTB were to be implemented. Although the negotiations have been going on for two years, this measure could take on increased importance due to its alignment with the EU's strategy to tackle tax efficiency and avoidance.

However, the question is whether these benefits are sufficiently important to enable the complex issues of definition and problems with differing legal structures to be overcome. Politically, member states concerned about losing tax revenues, like the UK, will need to be convinced by supporters, such as France, Spain and Italy, that CCCTB could yield significant benefits for all and should be agreed at a supranational level to overcome internal resistance.

The most harmonised tax at EU-level is VAT which, through **Directive 2006/112/EC**, is defined as the consumption of commercial activities in the supplies of goods, services, intra-EU acquisitions and imports from outside the EU. It defines the territorial scope and applied rates as well as the possibility of exemptions or derogations a member state can apply.

Fighting fraud is also the priority here; a proposal put forward in July 2012 by the Commission would give a member state the freedom to react more efficiently to VAT fraud through the establishment of a quick reaction mechanism (QRM) outside, but in parallel with, its powers of derogation. The Commission also established in 2012 a group of experts, aptly named the VAT Expert Group which, with the VAT Committee, guides and promotes the application of rules. The latter will look to promote dialogue between policymakers and stakeholders by organising the EU VAT Forum.

The most controversial topic under discussion has divided the EU into two camps: the FTT. After an initial attempt to find agreement on the introduction of the FTT between all 27 states failed, an important core of 11 have pushed forward under the leadership of France and Germany. These states have, with the European Commission, invoked the so-called enhanced cooperation procedure which allows groups of member states to move forward on a policy issue that does not have full support across the EU. The other 16 member states acquiesced to this procedure being used in January.

The basis for the negotiations is the Commission’s proposal that aims to tax all transactions in financial instruments, where at least one counter party is established in a participating member state or all transactions in financial instruments that are issued in a participating member state. The FTT will introduce a tax rate of 0.1% on shares and bonds and 0.01% on derivatives in the participating member states.

Despite only 11 member states being involved in these negotiations, unanimity, which is required in order to progress, will still be difficult to achieve. Since the 11 member states could not even agree on the text of a joint letter requesting the enhanced cooperation procedure, the prospects for agreement do not augur well. Further, a legal challenge before the European Court of Justice is highly likely as Luxembourg, and possibly Sweden and the UK, argues against it on the grounds that it would hinder the internal market and be in breach of the Treaty. The working groups between the 11 willing member states have started but it is not yet clear how long this will continue; the outlook is not positive.

French receipts from their national FTT (introduced in 2012) are reported to be much lower than expected. Additionally, liquidity in trading has dramatically reduced, especially in small listed companies. France now has doubts about the value of the measure and Italy, planning on introducing its own, could see similar results which might cause further uncertainty. In Germany, the ruling CDU/FDP coalition is no longer aligned on the issue, with the centre-right liberal FDP openly questioning the tax. However, the social democrats, the SPD, remain strong supporters, even at one stage advocating the introduction of an FTT in Cyprus as a precondition for aid.

Negotiations between the 11 are going to be tough and an agreement on this tax is unlikely in 2013, which in turn implies that the FTT would not be applied before 2015 at the earliest.

What is clear is that there is now debate about tax in the EU and radical changes could take place in the next few years, as Commissioner Semeta aptly explains: ‘For taxation, as for other policy areas, the answer to our current challenges lies in more Europe, not less.’

Consequently, FTT and initiatives on reducing tax evasion and aggressive tax planning are political symbols based on a mix of popular discontent with the financial sector, feelings of injustice and the genuine need for governments to drastically reduce their deficits.

The laudable aim of simplifying VAT rules and establishing a CCCTB run into the complexities of differing European tax systems and issues of national sovereignty.

The question in Brussels today is whether the Irish presidency, as energetic as it is, can realise its objectives in time, and if not, whether the following under-resourced Lithuanian presidency can tie up loose ends before a dramatic new dynamic in 2014 ushers in a new European Commission and European parliamentary elections. All bets are on!

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