FONDATION ROBERT SCHUMAN

POLICY PAPER

European Issues
n°477
19th June 2018

Tax harmonisation, chapter 1

Alain LAMASSOURE

LONG LIVE THE SCANDALS!

Offshore leaks, Swiss leaks, LuxLeaks, Panama Papers, Paradise Papers: the tax scandals succeed each other, the topography changes from time to time, but the repercussions of outrage persist. The leaders of Europe should take advantage of this!

Because these scandals shed full light on a situation that the major international institutions have allowed to continue, either out of negligence or through a lack of political courage. The current international tax framework is totally outdated. Dating back to the mid-20th century, it is mainly based on the principle of tax residency, linked to the place where businesses are registered: thus, businesses are taxed in the State where their HQ is established. Such a framework was perfectly logical in a time when multinationals exported from their countries of origin: businesses generally operated in a single State and the production of value drew on assets and means of production that were not very mobile or were even immobile (machines, factories etc.).

Globalisation is typified however by the dissemination of the chain of value. Factors of production are much more mobile, notably with the growing preponderance of intellectual property; whole swathes of the economy are now affected by dematerialisation, giving rise to hitherto unknown types of value creation, via for example, the collation, storage and processing of digital data, the new manna; financial flows are much more complex, much freer, but also opaquer and often much more sophisticated.

Globalisation has especially led to the emergence of economic giants that can cast their nets much further than the industrialist of the past. Today's mega multinationals operate well beyond their national trading area and are surpassing tax frameworks that have remained purely national, trapped in the industrial era. They are using the loopholes in this to take advantage of the arbitrage offered by the latter. By establishing its HQ in one State, a business can virtually choose at its convenience – almost freely – its tax framework. It is of little importance that its activities take place elsewhere and that the link between the business and the State in question, is limited to the location of its HQ or its intellectual property. This link, which is often purely artificial, allows it to choose how it is taxed as it so wishes, in other words how it can avoid taxation. The OECD estimates the erosion of the global tax base at 100 to 200 billion $.

DISTORTED COMPETITION

Beyond the economic distortions, this situation has given rise to unhealthy competition between States, with some placing their corporate tax framework at the heart of their "business model". Rather than responding via reform to the malice of those who have plunged into the breaches in the crumbling system, tax authorities entered a race to see which would make the most of the situation. Hence, a toxic rivalry has grown, leading to fully-fledged, unbridled fiscal dumping.

Even within the European family, redoubling in ingenuity with their "Double Irish", patent boxes and other "Dutch Sandwiches", about six States have undermined the foundations of the principle of sincere cooperation, the keystone to European integration, which is however included in the treaties.

The present situation is therefore one of fiscal competition that disrespects the fundamental rules that apply in all other areas. For a long time, the taboo of fiscal sovereignty allowed this politically and economically untenable situation to continue.

EUROPEAN FISCAL FUEL

The wave of indignation caused by the scandals helped turn the page on European inertia.

So much has happened since we laughed at placing discussions over the fight to counter tax optimisation and even fraud on the agenda! Because Europe has totally embraced the issue, which is just as well. The European Parliament has introduced the temporary committee TAXE, responsible for investigating the practice of tax rulings. The initiative has been successful and has given rise to three new successive temporary committees. The most recent TAX3 (after TAX2 and PANA) of these was established last March and is responsible for drafting proposals in the area of fraud and tax evasion, as well as financial crime. Renewed several times this committee put forward a clear political approach: accepting tax competition, but with the implementation of the usual rules of competition, set by the Union in all areas: transparency, trust and fairness.

The acceleration in European legislative work in this area has been spectacular. The first of these initiatives, supported vigorously by Parliament, was the strengthening of cooperation between tax authorities, a vital stage before any other kind of convergence could occur. Following LuxLeaks, five amendments to the directive over the exchange of fiscal information have succeeded each other since 2014, focusing on the taxation of capital, the price of transfers and tax rulings.

The most recent one, the DAC 6 (directive on intermediaries), was adopted by the Council in record time last March. This amendment addresses the central issue of intermediaries and cross-border tax strategies. The European Parliament is now working on an issue of critical importance: that of the ultimate VAT system. For the past fifteen years Europe has lived according to a supposedly temporary system. The proposed reshaping of this should help to settle the issue for VAT fraud that costs the European economy nearly 150 billion € per year. This is a colossal figure since it is almost equal – give or take a few euro - to the Union's budget itself! The new system now being studied totally reverses the present approach, bringing an end to the so-called principle of origin, by establishing taxation in the place of the product's destination. This would bring an end to waiver recognition mechanisms on intra-community goods deliveries along the entire chain, thereby eliminating one of the main channels of VAT fraud, which is better known as "carousel fraud". During cross-border deliveries, dispatching countries will have to collate the VAT for the Destination State receiving the goods. This was unthinkable 25 years ago when the temporary system was introduced, hence this reversal constitutes a mini administrative revolution.

Finally, although progress has been made in terms of fraud, the issue of fiscal optimisation also has to be addressed: the ill effects of this are just as serious and as costly for our economies. The anti-tax evasion directives ATAD 1 and 2 have upset the apple cart in terms of aggressive tax optimisation. Fundamental rules arming Europe against practices involving third country have been introduced to prevent, for example, double taxation or artificial relocation of elements of intellectual property to States with more generous tax rules. Again, we should stress that the European Parliament revealed itself more ambitious than the Council which, in the end, watered down some measures included in the texts.

TRUE POLITICAL REVOLUTION: CCCTB

It remains that in terms of intra-European fiscal optimisation, a great deal of work still has to be done. The solution bears the acronym: CCCTB, or the common consolidated corporate tax base.

Firstly, this will involve establishing a common definition of the taxable profit that will limit national niches and other practices, thereby bringing the effective rate of taxation for some companies down to zero. Secondly, it will involve defining the conditions of Europe-wide consolidation and the redistribution of tax revenues on profits made in Europe in the jurisdictions where they are actually produced.

Hence CCCTB establishes the conditions for healthy tax competition within the Union. The Single Market, which has fallen prey to aggressive fiscal optimisation practices, that undermine its foundations, will become totally efficient again.

The CCCTB project, which has been delayed so many times before, is now enjoying the impetus of an unexpected policy, thereby enabling hope of finally redesigning the tax framework, thus returning a fair share of the fiscal cake to the States. Citizens and European SME heads, who have been appalled by the successive tax scandals that have all been similar, can no longer bear to see growing tax pressure weighing down on them, whilst there has been ever growing leniency and rulings to protect the biggest structures, which enjoy much greater financial means.

The States that lend themselves to these practices, on the other hand, can no longer assume these strategic choices from a political point of view in the face of their citizens. The courageous decision taken by Commissioner Margrethe Vestager against Ireland, is from this standpoint, particularly remarkable: by ordering the Irish tax office to recover 13 billion € in taxes from Apple that it should have received, she stressed that in reality that it was the Irish citizens who were paying the price of these political choices.

The European Parliament has suggested strengthening the CCCTB project by introducing tax on digital activities. To date, search engines and digital platforms like Google and Facebook have escaped taxation in the countries where they have no "permanent physical establishment" – factories, land or significant staff. This was the case in France and in almost all of its European partners. The European Parliament's proposal is to define "a permanent digital establishment": the fact that a business will collate and/or process personal digital data of nationals from a country to commercial ends. Once this definition has been made, the distribution of the taxable profit between the Member States will be possible according to the amount of data collated in each country.

Even the most fervent Eurosceptic would not dare to vote against this, thereby acknowledging that when the stakes affect the entire planet, Europe is the pertinent level to enforce justice and the general interest.

Alain Lamassoure

former French minister for European Affairs and minister for Budget. Member of the European Parliament, he chaired the committee on Budgets and the special Committee on Tax Rulings and Other Measures Similar in Nature or Effect.

You can read all of our publications on our site :
www.robert-schuman.eu

Publishing Director : Pascale JOANNIN

THE FONDATION ROBERT SCHUMAN, created in 1991 and acknowledged by State decree in 1992, is the main French research centre on Europe. It develops research on the European Union and its policies and promotes the content of these in France , Europe and abroad. It encourages, enriches and stimulates European debate thanks to its research, publications and the organisation of conferences. The Foundation is presided over by Mr. Jean-Dominique Giuliani