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Europe's Push For Tax Transparency Picks Up The Pace

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The European Commission on Thursday announced an investigation into McDonald's and its tax arrangements in Luxembourg. This is the latest in a raft of investigations launched by the commission into the tax arrangements of corporations such as Apple, Fiat, Starbucks and Amazon. However, aside from individual investigations, the European institutions have also set their sights on new legislation on tax transparency. This may be a challenge.

Europe has 28 divergent corporate tax regimes and this divergence of national rules for computing the corporate tax base has led to a perception of harmful tax competition within the European Union. Europe's policymakers have been considering ways to harmonize corporate taxation across the EU internal market since the 1960s. In the last few weeks, the Organization for Economic Cooperation and Development, the European Parliament and the European Commission have all published new material that provides an insight into their planned efforts to address tax transparency.

The commission is preparing a new legislative proposal for a Common Consolidated Corporate Tax Base (CCCTB) and ahead of this, recently initiated a specific consultation to seek stakeholder views. On Nov. 25, the European Parliament passed a resolution urging EU member states to agree on the CCCTB, mandatory country-by-country reporting by multinationals of profits and taxes, common definitions for tax terms, and more transparency and accountability. In this article, I will provide an overview of the CCCTB and other various measures being considered by the European institutions to improve tax transparency in the EU.

What is CCCTB?

Under a CCCTB regime, businesses would have to comply with just one EU system for computing their taxable income, rather than different rules in each member state in which they operate. For example, EU member state A might allow certain expenses to be tax deductible, whereas member state B might not. A common corporate tax base would mean that these rules would be the same throughout the EU, and companies only need to do their calculations based on one set of tax rules. All EU member states would apply the same rules for calculating the taxable profits of cross-border companies. This is intended to eliminate perceived tax loopholes between national systems as well as simplify the tax environment for businesses.

A previous proposal on the CCCTB was launched in 2011 but has stalled in the European Council after four years of technical discussions over tax consolidation (see original proposal here). The commission now feels that this proposal was “too ambitious to be adopted in a single step.” The commission plans to withdraw the 2011 proposal and in parallel, to propose new measures in 2016, which will follow a "two-step" strategy (see below).

European Commission Consultation on the CCCTB This Winter …

Following the general public consultation on corporate tax transparency, which closed in September 2015, see here, the commission has now initiated a specific consultation on the relaunch of the CCCTB. Stakeholders have until Jan. 8, 2016, to provide their responses (see consultation here and Q&A here). In particular, the commission is seeking stakeholder views on which criteria should determine the companies that will be subject to the rules of a mandatory CCTB/CCCTB, the "two-step" approach and whether a cross-border loss relief mechanism would help firms cope with any losses incurred due to consolidation of their tax base.

Leading to a CCCTB Directive in 2016?

Following this consultation, the commission intends to come forward with revised legislation next year. In October 2015, the commission published a road map (an inception impact assessment), which is the first step in proposing a new directive on the CCCTB (see here). This road map provides an insight into the commissions plans for the new legislation. The proposal in 2016 is likely to have the following key features:

- ***A Mandatory CCCTB:*** The commission will propose a mandatory CCCTB, at least for multinational companies in order to target aggressive tax planning.

- ***A "Two-Step" Approach:*** The original 2011 proposal will be broken into smaller, more manageable stages to make it easier for member states to agree. The commission will adopt its proposal in two steps: (1) First the commission will propose provisions for a Common Corporate Tax Base (CCTB). The common base would introduce complete transparency on the effective tax rate of each member state. (2) After this, the commission will propose measures related to consolidation (i.e. CCCTB). This has been the most difficult element in negotiations so far. Consolidation means that member states would be allowed to tax their share of the base at their own corporate tax rate. This seeks to eliminate the mismatches and loopholes between national systems, which companies are perceived to be exploiting. In addition, consolidation would remove the need for complex transfer pricing within the company group, which is currently one of the main vehicles for profit shifting. The commission is undertaking more in-depth impact assessments into each of these steps and shall soon launch a study with the European Joint Research Centre.

- ***Debt Bias:*** The consultation also addresses the issue of "debt bias." In most corporate income tax systems, interest payments are tax-deductible. However there is no corresponding treatment for equity financing. This creates a so-called "debt bias,", a tendency of tax systems to favor debt over equity financing, which leads to economic distortions. The commission is examining various remedies to this in the consultation.

Interest deductibility limitation rules, controlled foreign company (CFC) legislation, General Anti-Abuse Rules (GAAR) and exit taxes will also be revised but only to the extent necessary for the improved functioning of the European Single Market.

OECD — Country-by-Country Reporting

The commission's CCCTB system includes rules that echo certain of the key action items of the OECD initiative on base erosion and profit shifting (BEPS). In 2013, the OECD launched a 15-point action plan for reform of the international tax system to tackle tax avoidance. On Oct. 5, 2015, the OECD published 15 reports addressing each of these actions, see here. We had detailed this in a previous article, see here. One particular action, BEPS Action 13 (BEPS 13), recommends that, at state level, very large multinational enterprises (turnover greater than €750 million) provide a country-by-country report (CBCR) to the relevant tax authority.

Under BEPS Action 13, countries may impose significant transfer pricing penalties when taxpayers fail to properly document cross-border related-party transactions. Action 13 is focused on revising current standards used by taxing authorities when assessing transfer pricing documentation requirements and introducing country-by-country reporting in order to increase transparency. The BEPS Action 13 report contains revised standards for transfer pricing documentation and a template for country-by-country reporting of revenues, profits, taxes paid and certain measures of economic activity.

However, OECD and G20 countries are not obliged to follow or implement the recommendations of the BEPS project, and not all EU member states are OECD members. The commission's CCCTB proposal will incorporate part of the BEPS action plan, such as updated rules on permanent establishment, so that companies are treated as having a taxable presence in a member state where they have economic activities and improved controlled foreign corporation rules, which ensure that profits parked in low- or no-tax companies are effectively taxed. The CCCTB proposals therefore provide a framework for member states to implement many of the new international tax standards being agreed through the OECD's BEPS action plan.

European Parliament (I) — Tax Transparency and Access to the Parliament

In 2014, the European Parliament established a special committee to investigate tax rulings in EU member states. On Oct. 27, the members of this committee adopted a report with recommendations for increased tax transparency in Europe, see here. On Nov. 25, the European Parliament adopted a resolution on tax rulings, see here.

The resolution urged the European Commission to introduce the CCCTB and suggested that member states should systematically share their national rulings and other tax information that has an impact on other member states (mandatory automatic exchange of information) with other member state authorities as well as the commission.

Certain multinational companies have declined invitations to appear before this European Parliament committee several times, most recently in October 2015. In response to this, MEPs threatened to restrict access to the European Parliament for lobbyists representing these companies, and some MEPs even refused to meet with those companies that have declined the invitation. Most of these companies resolved the standoff by attending the next committee hearing on Nov. 16. These moves illustrate the European Parliament's frustration with the issue of tax avoidance in the EU.

European Parliament (II) — Country-by-Country Reporting

In a parallel legislative procedure and independent of the commission work on the CCCTB, the Parliament is seeking to oblige certain large undertakings to publicly disclose country-by-country tax reports. On July 8, the European Parliament voted to amend certain parts of the commission's recommendations on the Shareholders Rights Directive (see here and our alert here). The European Commission, Council and Parliament have now entered into informal talks with member states with a view to seeking agreement on the final version of this legislation, which is expected to be adopted by late 2015 or early 2016.

Conclusion

The CCCTB is the first and major step in the commission's action plan to make the European tax system fairer (see here), but it won't be the last. We can expect further European Commission policies and European Parliament recommendations related to tax transparency in the coming year, some following from the OECD BEPS reports and others from new commission-lead initiatives. However, given the animosity of certain member states toward any suggestion of closer tax integration, it is likely that most, if not all, of the recommendations will be rejected by the European Council or watered down.

Multinational companies with a European presence should expect increased scrutiny in the future — from tax authorities, the European Parliament, the European Commission and the public. The commission's consultation process provides companies with an opportunity to provide input on these commission proposals, which will impact all companies with a European presence.

The CCCTB consultation will close on Jan. 8, 2016, with legislative proposals to follow thereafter.

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