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NOTE

From:	Commission services
To:	Permanent Representatives Committee/Council
Subject:	Digital taxation in the international context - Letter by Commissioner Moscovici - Issues Paper on the reform of international corporate taxation: "Business taxation 21"

Delegations will find attached the Commission paper with regard to the digital taxation in the international context.

PIERRE MOSCOVICI
MEMBRE DE LA COMMISSION EUROPEENNE

Brussels, 6th May 2019

Dear Minister,

As I have announced at the informal ECOFIN on 6 April, I would propose to continue the discussion about Member States' views on the current international tax reform debate at the G20 and the OECD. To this end, I have prepared a note which summarizes the main challenges for the EU. This text can serve as a basis for discussion ahead of the G20 Finance Ministers meeting of June in Fukuoka where the OECD will report progress on reforming international corporate taxation towards a consensus-based solution by 2020 will be discussed.

It is essential for the European Union that any global agreement on international corporate tax reform also fits the particular needs and situations of Member States and the EU as a whole. This means shaping a solution that both respects EU single market rules and benefits the single market. It is equally important to arrive at a solution that provides stability and tax certainty for businesses, reduces the risk of double taxation and is not overly complex to implement.

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The Commission stands ready to support Member States in their efforts to ensure that the EU engages in a coordinated manner in order to impact the international discussions in a meaningful way, in line with common EU interests and requirements.

I hope the attached note may contribute usefully to our discussion at the ECOFIN on 17 May 2019 on Digital taxation in the international context. This is why I take the liberty to copy all EU Finance ministers for a good preparation.

Yours sincerely,



Pierre Moscovici

Encl.

Annex I to Document:

Issues Paper on the reform of international corporate taxation: “Business taxation 21”

Copies: EU Finance Ministers



EUROPEAN COMMISSION

DIRECTORATE GENERAL

TAXATION AND CUSTOMS UNION

Direct taxation, tax coordination, economic analysis and evaluation

Brussels, 30 April 2019

Issues Paper on the reform of international corporate taxation:

“Business taxation 21”

(Commission Services Non-Paper)

1. INTRODUCTION

The international corporate tax system is in urgent need of reform. This system is no longer fit for the economy of the 21st century, which is increasingly globalised and digitalised. Although significant progress has been made at EU and international level to tackle base erosion and profit shifting (BEPS), existing rules fail to align with the new business models and the new realities of value creation and still leave scope for aggressive tax planning. Moreover, they are often overly complex for businesses operating across borders.

This has implications not only for revenue raising but also for the economy more widely. The current international tax system distorts investment location and magnitude. It undermines the level playing field between businesses by putting domestic businesses at disadvantage and making them less able to thrive and innovate in an international environment. Pressure to reduce corporate tax rates may also reduce the revenues to finance the necessary provision of public goods. Moreover, it creates a shift of the tax burden towards less mobile tax bases, such as labour or consumption, with consequences in terms of inequalities and fair burden sharing.

These are global challenges that require a global response. Policy responses cannot be managed uniquely within national borders. Given the spillovers of tax policy, national tax sovereignty is de facto limited and constrained by the actions of other countries. There is a growing awareness of the need to act together and work is ongoing at OECD/G20 level for a long-term comprehensive solution, addressing both the challenges of taxation in the digitalised economy and broader issues related to the allocation of taxing rights and tax competition.

Reaching a global agreement is urgent. Inaction will lead to further fragmentation, distortions and misalignments as jurisdictions introduce alternative and competing solutions to the same problems.

It is essential for the European Union that any global agreement also fits the particular needs and situations of Member States and the EU as a whole. This means shaping a solution that both respects EU single market rules and benefits the single market. It is equally important to arrive at a solution that provides stability and tax certainty for businesses, reduces the risk of double taxation and is not overly complex to implement.

2. CREATING AN EU BUSINESS TAX ENVIRONMENT FIT FOR THE 21ST CENTURY

The current international tax environment results in domestic tax policies and rules that are often aimed at short-term tax collection rather than paving the way for long-term economic growth, jobs and social fairness. These latter considerations should be the objectives of an EU business taxation environment fit for the 21st century: “**Business Taxation 21**”. To this aim, we need to achieve three complementary policy objectives:

1. **Designing a proper allocation of taxing rights** in line with current business models (where enterprises can operate in markets without a significant physical presence there) and with the new realities of value creation (where user data and user contributions play a fundamental role).
2. **Putting a floor to tax competition and limiting profit-shifting** opportunities in particular for highly mobile income, such as income related to intangibles.
3. **Securing a simple and stable business environment and avoiding distortions and double taxation** within the single market.

In recent years, the EU has tabled several legislative proposals moving in these three directions.

With the **Anti-Tax Avoidance Directive (ATAD)**, the amendments of the **Directive on Administrative Cooperation (DAC)** and the **EU list of non-cooperative tax jurisdictions**, the EU has achieved significant outcomes in recent years in the fight against tax avoidance. Rules such as controlled foreign company (CFC) provisions, exit tax rules, interest limitations rules and provisions to tackle hybrid mismatches included in ATAD are efficient tools to ensure a minimum level of protection against tax avoidance. In addition, the **tax dispute resolution mechanism**¹ provides taxpayers with much more legal certainty when it comes to interpretation of tax treaties or double taxation problems.

However, despite progress at EU level on targeted deliverables, it has not been possible to find EU level agreement on more structural reforms of the corporate tax system. The Commission's proposals on the Common Consolidated Corporate Tax Base (CCCTB) and on the Significant Digital Presence provided solutions for a proper allocation of taxing rights. Moreover, the Commission has also opened a discussion on minimum effective taxation with a proposal for amendment of the **Interest and Royalty Directive** to ensure that the exemption is disallowed if the interest or the royalties are not taxed at all. However, no consensus has been reached so far on the best way to tackle in a comprehensive manner the many challenges we are facing.

3. OPPORTUNITIES FOR THE EU IN THE GLOBAL DEBATE

The EU must seize the opportunity created by ongoing discussions at global level to modernise the corporate tax framework in its best interest. The discussions revolve around two groups of policy proposals, which are aligned with the Commission's agenda for a modern, efficient, and fair tax system. Political momentum and a more cohesive support as regards the need to take forward reforms of corporate taxation is growing at international level and would greatly benefit from a contribution from an EU perspective.

¹ Council Directive (EU) 2017/1852 of 10 October 2017 on tax dispute resolution mechanisms in the European Union, OJ L 265, 14.10.2017, p. 1–14

The group of proposals revolving around the first pillar presented by the OECD, namely the user participation, marketing intangibles and significant economic presence proposals,² **offer an opportunity to realign taxing rights with value creation, including in the digital economy.** These proposals, which build on existing profit allocation and permanent establishment rules and therefore fit with the logic of the existing international tax framework, would enable the value created by European users to be properly acknowledged and to secure a tax base. Moreover, these proposals would further eliminate certain opportunities for aggressive tax planning, in particular in relation to highly mobile income. However, they would only partially address the challenges posed by tax competition, or prevent a race to the bottom.

The second pillar on setting a minimum effective taxation can effectively curb tax avoidance and dampen tax competition. By effectively fighting aggressive tax planning, it could increase corporate tax revenues in the EU,³ reduce distortions of competition between domestic and international firms and preserving social cohesion.⁴ By setting up a floor, minimum taxation would also reduce pressure to engage in unfair tax competition,⁵ thereby focussing investment choices on economic efficiency rather than pure tax considerations and restoring the governments' ability to regain sovereignty on their policy mix.

A comprehensive reform including both proposals -“Business Taxation 21”- would bear EU benefits provided their design takes into account the following elements:

1. **The impact on revenues of reallocation of taxing rights and minimum taxation:** Both a reallocation of taxing rights towards market jurisdictions and a minimum effective taxation would imply reallocation between EU Member States and third countries, as well as within the EU. Understanding better the impact this has on individual Member States' tax revenues would help scoping and designing the proposals in the best interest of all Member States.
2. **The compatibility with EU law:** The introduction of minimum corporate effective taxation needs to be designed with thorough consideration for EU law compatibility purposes, with a careful analysis of the different legal options – in particular the fundamental freedoms laid down in the TFEU.
3. **The consequence on compliance costs:** Any reform bears the risk of further complexity but also creates opportunities for simplification. There is likely to be a tension between

² The user participation (UK) proposal would grant greater taxing and income allocation rights to countries where an MNE's active user base is located and would be applicable only to highly digitalized businesses like advertising and platforms. The marketing intangibles (US) proposal would be applicable to all types of MNEs and would address situations where MNEs reach into a jurisdiction, either remotely or through a limited local presence, to develop a customer base and other marketing intangibles. The third approach (promoted by the G24 group of countries) would allocate profits to a significant economic presence based on a fractional apportionment method (e.g. on the basis of sales revenue).

³ Several estimates exist for the losses in the EU due to corporate tax avoidance, including an estimate of 50-70 billion EUR for 2013.

⁴ European Commission, Note for the Tax Dialogue of the Economic Policy Committee on Aggressive Tax Planning, 8 November 2018.

⁵ IMF Policy Paper (2019). Corporate Taxation in the Global Economy.

accuracy and simplicity. In order to limit compliance costs and provide legal certainty, it will be important to design solutions that are both clear and simple enough to implement for both businesses and tax administrations.

4. **The need for an inclusive approach:** The proposals will need to take careful account of the needs and requirements of different stakeholders if they are to garner widespread support and takeup. There are a wide range of interests that need to be reconciled in the best possible way.

Creating consensus on the design and moving at speed will be challenging. But the risk of non-action would be a much greater danger. The digitalisation of the economy will not cease, and there will remain a risk of a race to the bottom in corporate taxation, alongside increased opportunities for aggressive tax planning. If no international solution can be found, unilateral measures will certainly be taken. A proliferation of unilateral, uncoordinated measures would risk being less effective, open new distortions and create further burdens for businesses and costs for tax administrations.

4. WORKING METHOD AND WAYS FORWARD

Many of today's and tomorrow's challenges cannot be addressed in isolation. The EU needs a commonly shared and holistic vision for EU tax policy for the 21st century.⁶ Its absence hampers the ability to reform. Such a policy needs clear guiding principles, such as supporting the competitiveness of the EU and its Member States, promoting sustainable growth, jobs and social fairness, ensuring fair tax competition⁷ to preserve governments' sovereignty to define their tax mix. The EU needs to reflect on how to achieve this vision. Defining these political choices is a necessary step.

An additional step to guide our choices would consist of a collective effort to quantify the economic impact of the reform proposals. Any structural reform is likely to affect Member States differently. Assessing the impact of proposals cannot fall to the Commission alone and Member States need to contribute proactively to the assessment of reform proposals for their individual economy, mobilising their access to unique resources and data sources.

There is an urgency to act at EU level, because work is advancing at the global level with solutions being actively discussed and developed. Within the Inclusive Framework of the OECD and at the G20, international work is organised around a number of key milestones. Building on the June 2019 progress report to the G20, which will propose a work programme for endorsement, the OECD is committed to deliver its final report by 2020. EU action needs to be timely and the upcoming ECOFIN meetings could provide opportunities to shape a common position.

⁶ Commission Services Non-Paper on 'The Role of Taxation in Supporting Inclusive and Sustainable Economic Growth'.

⁷ See for example IMF Policy Paper (2019). Corporate Taxation in the Global Economy.

The EU can either join the debate and shape the agreement, or be an observer. The current challenges are here to stay and our international partners show a clear determination to change the status quo. **We are at a crossroads.** While Member States can contribute individually to the global discussion, their individual influence may be limited – and certainly more limited than were they to speak with one voice. An EU coordinated position would increase our leverage in shaping the reforms and make sure that EU common interests and requirements are fully reflected in the final solution.

The Commission stands ready to support Member States in their efforts to ensure that the EU engages in a coordinated manner so as to impact the international discussions in a meaningful way, in line with common EU interests and requirements.

QUESTIONS FOR DISCUSSION:

1. How would you create an EU business tax environment fit for the 21st century?
2. What are the opportunities for the EU in the global debate?
3. What should be our working methods and way forward?