
On 17 June 2015, the European Commission (the Commission) published its Action Plan for fair and efficient corporate taxation in the European Union. The authors discuss the Action Plan and place the Action Plan into the landscape of ongoing developments in the international tax realm. Critical comments are offered with regard to the merits and limits of the actions proposed by the Commission in the Action Plan.

1. Introduction

On 17 June 2015, the European Commission (the Commission) published its Action Plan for fair and efficient corporate taxation in the European Union. In this article, the authors discuss the Action Plan and place the Action Plan into the landscape of ongoing developments in the international tax realm. This article furthermore takes a critical view of the merits and limits of the actions proposed by the Commission in this Action Plan.

2. Placing the Action Plan into a Broader Perspective: The Battle against Harmful Tax Competition and Base Erosion

The proposal published by the Commission is only one of the (recent) steps taken at the EU level to reform the EU direct tax landscape. Besides the other actions taken at the EU level, the Action Plan also links in with the base erosion and profit shifting (BEPS) project of the OECD which has been initiated at the request of the G20. The common driver for all of these initiatives is the conclusion that the current international tax system is no longer adapted to the current business reality, and therefore needs reform.

The current international tax system was developed after World War I, at a time when enterprises were run in a rather decentralized and parochial way, with a value chain located typically in one location or country. With business starting to expand and grow internationally, rules were necessary to ensure that these businesses were not faced with double taxation when crossing borders. Double taxation was and is the major fiscal obstacle to international trade.

As businesses became more mobile and international, countries started to increase the attractiveness for investors in order to support long-term investments in the country. The corporate tax system has been one of the pillars on which countries have built an attractive and investment-friendly environment.

In 1997, the concern grew that countries may go too far on the tax side to attract investors, and that this behaviour of Member States could result in harmful tax competition for the internal EU market. As a result, initiative was taken at the EU level to reduce harmful tax competition and to establish the EU Code of Conduct Group for business taxation. This informal group with representatives of the different Member States mapped the tax systems in Europe and identified the regimes that were considered as harmful. On this basis, Member States agreed to abolish a number of special tax regimes and features. In addition, countries committed to refrain from introducing new harmful tax regimes.

Today, more than 15 years after the establishment of the Code of Conduct Group, the Commission has concluded that the Code of Conduct Group has made a significant contribution, but that the limit of what the current Code of Conduct Group can achieve has been reached. New initiatives are needed to address tax competition in the internal EU market going forward. The Action Plan is the response of the Commission to this challenge.

3. Why Did the Commission Publish the Action Plan Now?

With the OECD actively pursuing the BEPS initiative and local countries already adopting a wide range of different “BEPS inspired” tax measures, one could wonder why the Commission initiated their Action Plan on top of that. Would it not have been better to first wait for the initiatives taken by the OECD under the BEPS project?

The starting point to answer this question is that the Commission seems to believe that there is a genuine problem of base erosion and profit shifting in the European Union that is resulting in a significant loss of revenue for the Member States. It is sometimes mentioned that the total loss of tax revenue would amount to more than EUR 1 trillion. Although there are question marks to be placed next to this estimate, it is clear that the Commission has a clear intent to tackle BEPS in the European Union.

The Commission supports the OECD BEPS initiative, but wants to take action itself and also notes that there are EU-specific elements to take into consideration when developing measures to tackle BEPS, such as the application of the fundamental freedoms. As a result of these EU-spe-
pecific elements, not all solutions developed by the OECD BEPS initiative can be implemented directly in the European Union. Consequently, the Commission seeks to build on the BEPS initiative in order to realize measures that are tailored to the EU market.

The Commission does not aim to reinvent the wheel and will use the outcome of the OECD BEPS initiative as a basis for the development of specific EU measures. This approach can be illustrated, for instance, by the actions taken by the Commission as regards R&D incentives. The Commission has currently put on hold the ongoing State aid investigation into R&D incentives in Europe, with an aim to first wait for the outcome of the work done by the OECD in this regard.

There is a clear political commitment supporting this Action Plan. President Juncker has formally included the objective to combat base erosion in the Commission’s political guidelines and explicitly formulated the objective of the Commission to increase the fairness of the EU internal market. In order to realize this, Mr Juncker envisages combating tax avoidance and ensuring that companies pay tax where they generate profits. It is in light of this stated objective that the Commission already published its report on the Tax Transparency Package in March 2015. This package aims to increase the transparency in the ruling practice of Member States. The Action Plan forms a next step by the Commission to achieve the situation in which companies are taxed where the (value adding) activities actually take place.

In an EU context, following the disclosure of agreements taxpayers concluded in Luxembourg, the European Parliament set up a Special Committee on Tax Rulings, which published its first draft report in July 2015. In the report, strong support is given to the work of the Commission, among other things with regard to the Action plan. This political support will be important for the Commission. Direct taxation is, in principle, not an area where there is a clear political commitment supporting this proposal is to be realized under a step-by-step approach for the CCCTB (first a CCTB (common corporate tax base), with additional measures to overcome the difference with a CCCTB, and ultimately the CCCTB). Under the Commission’s proposal, the CCCTB should become mandatory. As regards timing, the Commission itself has set the deadline to finalize a proposal for the implementation of the CCCTB in 2016.

4. What Does the Commission Want To Do as Regards the Content of the Action Plan?

In the Action Plan, the Commission asserts five key actions to be taken in coming years to realize a more fair and efficient tax system in the European Union:

- a relaunch of the proposal for a common consolidated corporate tax base (CCCTB). This part of the proposal relates to a relaunch of the initial proposal to introduce a CCCTB in Europe. The political support for this proposal is to be realized under a step-by-step process:

- ensure effective taxation where profits are generated. While awaiting the realization of the CCCTB, the Commission will take a number of other initiatives to increase the consistency of the European tax systems. The Commission itself has set a 12-month timeframe to achieve consensus at the level of the Council for, for example, an amended permanent establishment definition in the European Union or strengthened CFC rules. It is also under this topic that the Commission would like to revive the Code of Conduct Group and realize an amendment of the Interest and Royalties Directive. The Commission furthermore actively supports the implementation of the BEPS actions around transfer pricing;

- create a competitive and growth-friendly corporate tax environment for the European Union. In addition to the measures that aim to tax income where it is realized, the Commission would also propose two concrete measures that increase the effectiveness of the European tax scene, namely (i) allow cross-border tax loss relief and (ii) strengthen the mechanism for dispute resolution. The aim of these measures is – before the realization of the CCCTB – already to take action to increase the competitiveness of the European tax system as a whole. International loss pooling will be included in the 2016 proposal regarding a CCCTB. A proposal to strengthen the dispute resolution mechanisms in Europe would be finalized in 2016 as well;

- increase tax transparency. An important first step in view of an increased transparency in Europe was already taken in March 2015 with the publication of the proposal for an automatic exchange of tax rulings. In the beginning of October, the European Council reached a political consensus on a directive aimed at improving transparency by requiring EU Member States to automatically exchange information on cross border rulings. In addition, the Commission would like to carry out additional work on so-called ‘non-cooperative countries’ and the launch of a public consultation on country-by-country (CbC) reporting in Europe; and

- increase coordination and cooperation between Member States. Greater coordination is felt to be necessary between Member States, and the Commission aims to promote such increased cooperation.

The Commission has explicitly excluded the harmonization of tax rates in the different countries from the Action Plan.

This is clearly an ambitious plan, also with regard to timing, as most of the actions would need to be taken between now and 2016. The fact that this plan is ambitious can be seen
by looking at some obstacles that the Commission will face when realizing this plan.

5. What Are the Main Obstacles That the Commission Should Endeavour To Overcome?

Before discussing each of the proposed actions in more detail, one should consider that the Commission will be faced with a number of legal obstacles to realize its Action Plan. In due time, the Commission will have to consider how to deal with these.

The Treaty on the Functioning of the European Union provides for a strict legal framework to realize harmonization in the European Union for direct taxes. Based on article 115 of the TFEU, fiscal measures are to be realized through unanimous agreement at the level of the European Council. Member States have a sovereign authority to organize their own corporate tax systems. This means that most of the actions proposed by the Commission will require a unanimous decision at the level of the European Council. The authors believe that the most significant challenge for the Commission may be to develop a political consensus around the proposed measures. That such political consensus may not be straightforward is illustrated by the fact that only a minority of Member States appear to be currently in support of a mandatory CCCTB. If the Council approves this, there could be a group of Member States (at least nine) that may opt for closer cooperation on certain areas. A discussion of the details of this alternative is beyond the scope of this article.

A second challenge will be that Member States have concluded bilateral tax treaties with each other and third countries. Under those tax treaties, a number of principles have been agreed to allocate the right to tax certain profits. For example, most treaties refer to the authorized OECD approach to allocate profits to a permanent establishment and refer to the arm’s length principle (see article 9 of the OECD Model). Although EU law, in principle, overrides agreements reached between Member States under a tax treaty, these tax treaties may also come into play in relation to third countries. The challenge for the Commission will be to ensure that new measures in a European context are aligned with the existing tax treaty network, at least between the Member States and third countries.

The importance of the tax treaty network is seen in the context of corporate income tax transparency. The CCCTB proposals require transparency and international cooperation. However, the OECD BEPS project has not yet reached consensus around the idea of the CCCTB. The authors believe that in order to maintain legal certainty for taxpayers in the European Union, this coherence will be of the utmost importance.

6. A Detailed Look at the Proposal To Relaunch the CCCTB

The roots of the CCCTB go back to 2001, and a proposal for a directive to introduce the CCCTB was issued in 2011. On the basis of this proposal for a directive, the Commission proposed to introduce a common tax base for European companies. A single set of rules would apply to determine the tax base for European companies on the basis of one and a single tax return for Europe. In the past years, it became clear that the 2011 proposal itself would not be able to garner the necessary political support. On the basis of a questionnaire sent around in 2012 within the PwC EU Direct Tax Group network, it became clear that only about one third of the Member States were, to a certain extent, positive towards the proposal.

The proposal boils down to a formulary apportionment system, whereby profits at the European level are consolidated and “allocated” to the different Member States on the basis of an allocation key. The allocation key under the initial proposal is based on three elements, namely payroll, sales and (tangible) assets.

With this Action Plan, the Commission is now announcing that it will relaunch the initially proposed CCCTB. The new proposal would deviate from the 2011 proposal on two material points:

- the new proposal would introduce a mandatory system, as opposed to the 2011 proposal that provided for an optional system. The aim of making the system mandatory is to strengthen the ability of the CCCTB to deter profit shifting. The concern exists that by making the system optional, companies that seek aggressive tax planning, would simply opt out of the CCCTB. It is far from excluded that making the CCCTB mandatory is a policy that would risk reducing the support for the CCCTB (rather than increasing it); and
- the new proposal starts from the idea of introducing the CCCTB via a phased approach. Indeed, the idea is to first introduce a mandatory “common” European tax base and, after that, move forward towards a truly “consolidated” European tax base. The aim of such a phased approach is to foster political support for a mandatory CCCTB.

3. This conclusion is based on a questionnaire that was completed by the PwC EUDTG network, a group of experts in State aid matters and international taxes drawn from PwC network member firms in various countries.
There are numerous benefits to a CCCTB, according to the Commission, including (i) the fact that the CCCTB would reduce complexity and compliance costs (a single European tax return), (ii) that it would constitute a means to resolve profit shifting in Europe, as it would no longer be possible to artificially shift profits through transfer pricing and (iii) that the CCCTB would reduce the opportunities for (harmful) tax competition in Europe.

The authors welcome the objective of the Commission to increase transparency and reduce the complexity and compliance costs – which are growing concerns for business. However, the authors do have a number of concerns regarding this proposal for a CCCTB in light of these stated objectives:

- First, the introduction of a CCCTB may not be the magical solution to tackle profit shifting through transfer pricing – which the Commission claims it to be. This is illustrated by the fact that companies can still "manipulate" the parameters used to allocate profits, such as payroll costs. It remains necessary to, jointly with the CCCTB, improve the transfer pricing rules (which is, in fact, one of the key objectives of the OECD BEPS initiative). This is explained in more detail below, in the discussion of the link between the Action Plan and transfer pricing.

- In addition, the authors wonder whether the CCCTB and parameters used to allocate profits across Member States will result in a fair allocation of profits. Indeed, the current parameters do not consider, for example, intangible assets when allocating profits.

- In addition, the authors question whether the CCCTB would materially curb tax competition in Europe. Under the CCCTB, differences in tax rates are likely to remain, as the Commission has explicitly stated that tax rate harmonization is not part of the Action Plan. As a result of these rate differences, companies may be incentivized to consider the parameters for the CCCTB profit allocation when making investment decisions. Some of these parameters, like payroll costs, can be monitored with some flexibility by reducing headcount and assets in high-tax countries and moving these to low-tax countries – or even out of the European Union.

- Finally, the Action Plan suggests that differences in the CCCTB calculation methodology for specific sectors or specific activities should remain possible (e.g. different rules for the digital economy). Apart from the fact that such deviating regimes may open the door for tax competition, it should also be considered how these differences in the tax regime are to be seen within the scope of the (potentially unlawful) State aid discussion.

The authors clearly expect that the Commission will need to address, among other things, these points in order to realize a proposal that will be endorsed by all Member States. Given the importance of political support, significant work may be required to realize the introduction of the CCCTB.

7. Reach Consensus in the Next Year on a Number of Measures to Ensure Taxation Where Profits Are Generated

The analysis by the Commission shows that there are significant differences between the corporate tax systems of the Member States. Such differences do not come as a surprise, as Member States are largely sovereign to determine their corporate tax system, and may consequently take different approaches and decisions. The concern is that those differences, however, may be exploited by companies whereby certain portions of the profits are shifted and fall into a vacuum between two corporate tax systems. The objective of the Commission is to take steps to reduce the level of profit shifting and ensure that profits can be taxed where they are actually realized.

The Action Plan provides an overview of a number of topics that the Commission would like to address, namely:

- adjust the notion of permanent establishment to ensure that permanent establishment status cannot be artificially avoided;
- strengthen CFC legislation, as this would allow the picking up of income that was shifted to a low-tax jurisdiction;
- review the Interest and Royalties Directive to ensure that the directive does not result in double non-taxation;
- update the Code of Conduct Group to realign the group objective with the current economic environment;
- improve the transfer pricing framework in the European Union; and;
- ensure correct implementation of the modified nexus approach, whereby the Commission indicates that it will make a formal assessment of implementation of the modified nexus approach within 12 months.

The Action Plan does not provide a great level of detail under these actions. The plan does confirm that the Commission will consider the work done at the level of the OECD BEPS initiative (e.g. for the work on permanent establishments and transfer pricing). As discussed above, any actions taken by the Commission will need to be aligned with the OECD BEPS initiatives and the existing tax treaty network. One topic will be extremely critical for business, namely transfer pricing. A pivotal question will concern how the Commission addresses transfer pricing under the proposed actions.

8. How Does the Action Plan Link in with Transfer Pricing?

The Commission believes that the current transfer pricing system no longer works effectively, as it may be too complex and ‘easy to manipulate’. The Commission aims to work with Member States to realize a "more concrete" implementation of the OECD BEPS initiative and to work closely to increase transparency. The Action Plan does not yet provide any further guidance on what this more concrete implementation may include.
The ultimate objective of the Commission is to realize the CCCTB, as this would – in its view – remove the possibility to “manipulate” transfer prices. The authors believe that transfer pricing is unlikely to lose importance and relevance, even under the CCCTB, going forward:

- irrespective of the fact that intra-CCCTB transactions would be ignored under the CCCTB, they should still comply with the arm’s length standard in order to comply with the obligations under the tax treaties concluded by Member States. Although in an EU context, it can be argued that EU law supersedes concluded tax treaties, a CCCTB which puts aside the arm’s length standard applied in tax treaties concluded between Member States can create complex situations. In order to truly realize the objective of reducing complexity, it would be necessary to amend the tax treaties between Member States to explicitly allow a deviation from the arm’s length principle and allow the use of the allocation keys under the CCCTB to allocate profits; and

- the current allocation keys are very simple and do not take into account intangible assets, functions and risks. This means that a profit allocation on the basis of these allocation keys may, for a large number of industries and activities, derogate from an arm’s length allocation of profits. A well-known example of this is the digital economy, where profits are typically realized in locations with little payroll or (tangible) assets. In the draft report of 20 July 2015 of the Special Committee on Tax Rulings and Other Measures Similar in Nature or Effect, this is acknowledged and it is proposed to introduce industry specific allocation keys. In a European context, it may be cumbersome to apply different corporate tax rules for specific industries, as this may – under certain circumstances – qualify as unlawful State aid.

These are only a few examples of situations that can occur and clearly demonstrate that, also going forward, the arm’s length principle is likely to remain relevant, even under the proposed CCCTB. To the extent that the CCCTB would result in a profit allocation that is not in line with the arm’s length standard, complex situations could arise that reduce the legal certainty of undertakings and/or result in double taxation. The strict adherence of, for example, the United States to the arm’s length standard under the BEPS proceedings under Action 8 on intangibles can serve as a good illustration.

9. Measures To Increase the Competitiveness of the European Internal Market

Combined with the above-mentioned measures to avoid profit shifting and harmful tax competition in the European Union, the Commission aims to take steps to increase the competitiveness of the European Union as a whole. The Commission believes that competitiveness would automatically be realized along with the CCCTB. However, as the actual introduction of the CCCTB (via the phased approach) may take some time, intermediate measures are proposed by the Commission to already increase the competitiveness of the European internal market without delay.

In this regard, two measures are explicitly mentioned in the Action Plan:

- enable cross-border loss relief in the European Union. Under this action, the aim would be that taxpayers, in the absence of a CCCTB, would already have the possibility to set off an operating loss realized, for example, in France against operating profit realized in, for example, Germany. In order to avoid double use of losses, a recapture provision should be included. This measure will be part of the CCCTB proposal which is to be issued in 2016; and

- improve the instruments for tax dispute resolution. In the absence of a CCCTB (which, according to the Commission, would eliminate double taxation in the European Union), other solutions are needed to ensure that taxpayers in the European Union are not faced with double taxation. The conclusion is that the existing measures to avoid double taxation may be time consuming and costly, while not offering a guaranteed successful outcome. The Arbitration Convention resolves this partly for transfer pricing disputes, but an instrument with a broader scope is required. A proposal will be issued in the summer of 2016.

It should be clear that double taxation or the realization of cross-border loss relief are to be welcomed, as these measures will indeed increase the legal certainty and reduce double taxation in Europe. As rightfully mentioned in the Action Plan, double taxation remains a very significant fiscal obstacle for business, and this will only increase under the upcoming changes in the international tax landscape.

10. Increased Level of Transparency and Coordination within the European Union

The Commission has issued a proposal for mandatory exchange of tax rulings in Europe. In the meantime, in the beginning of October, the European Council has reached a political agreement on a directive that provides for a mandatory exchange of cross border rulings with an effective date of implementation of 1 January 2017. In addition, the Commission indicates other concrete areas where it will increase transparency, in addition to the measures that will be taken under the OECD BEPS initiative:

- common approach to third countries that insufficiently cooperate with the European Union. The Commission, jointly with ten Member States, has compiled a list of countries that are deemed to be non-compliant. This list will be updated regularly and will allow countries to develop specific measures to counter profit shifting to these countries. Over the next 24 months, further work will be done in this regard. The aim is to involve the EU Code of Conduct Group in this project; and

- public consultation to identify additional disclosure obligations in the framework of CbC reporting. The public consultation should be finalized in the first quarter
of 2016, allowing appropriate steps to be taken to implement additional CbC reporting obligations in the European Union.

The increased transparency will allow Member States to perform tax audits more efficiently. Greater coordination is necessary between Member States, and the Commission aims to promote such increased cooperation.

11. Conclusion

Several institutions known for "setting the rules of the game" in international taxation realize that one cannot sail on the wind of yesterday. The rules are outdated and reform is needed. These authoritative organizations sometimes give the impression of dancing every now and then on the same pavement. Indeed, against the background of the broader OECD BEPS initiative, the Commission has published its Action Plan to reform corporate taxation in the European Union. The Action Plan is a combination of measures that were already known (such as the CCCTB), as well as new measures (such as cross-border loss relief in Europe). The Action Plan confirms the ultimate aim to realize a common consolidated tax base in Europe that would eliminate a number of currently identified issues for corporate taxation in the European Union.

The main challenge for this Action Plan will be that the introduction of the CCCTB or other intermediate measures will require political consent. Such political consent may not be easy to achieve in the current economic context.

In addition, the CCCTB is unlikely to take out all existing challenges for corporate taxation. There will not be any simple solutions to combat (deemed) tax avoidance and profit shifting. The European Union will need to align and link in with the measures developed under the OECD BEPS initiative. It will be interesting to observe countries in their juggling acts to continuously preserve captive inbound investment based on their sovereign rights to design an attractive tax system while (still being seen as) "playing by the rules" in the eyes of their peers and other stakeholders.