



EUROPEAN SEMESTER THEMATIC FACTSHEET

CURBING AGGRESSIVE TAX PLANNING

1. INTRODUCTION

Aggressive tax planning (ATP) consists in taxpayers' reducing their tax liability through arrangements that may be legal but are in contradiction with the intent of the law. ATP includes exploiting loopholes in a tax system and mismatches between tax systems. It may also lead to double non taxation or double deductions.

The fight against ATP is essential to secure tax revenues for public investment, education, healthcare and welfare, to ensure fair burden-sharing and preserve tax morale of taxpayers and finally to avoid distortion of competition between firms.

The EU has taken several steps to fight ATP, including adoption of the Anti-Tax Avoidance Directive (ATAD) and the ATAD 2 which provides for measures to tackle hybrid mismatches¹ in relation to non-EU countries.

To boost tax transparency, the Council adopted the Commission's proposal for an automatic exchange of information on tax rulings which is beginning in the second half of 2017. The Council also adopted the Commission's proposal for the automatic exchange of information on country-by-country reports about multinational enterprises (MNEs). This automatic exchange will start in 2018. In June 2017,

¹ Hybrid mismatch arrangements exploit differences in the tax treatment of an entity or an instrument under the laws of two or more jurisdictions to achieve double non-taxation.

the Commission adopted a proposal for rules on the mandatory disclosure of aggressive tax planning schemes by intermediaries. Recently, through the Code of Conduct², a series of patent box regimes³ have been repealed or amended. A listing of non-cooperative tax jurisdictions outside the EU should be finalised in December 2017. Finally, the Common Consolidated Corporate Tax Base⁴, relaunched in 2016 by the Commission, would offer a comprehensive solution to the issue of profit shifting, but it remains under negotiation.

Despite these achievements, governments are still losing substantial amounts of revenue due to cross-border ATP. Furthermore, the cross-border nature of tax avoidance and the integration of the Member States' economies call for a coordinated approach in applying existing rules.

² The Code of Conduct for business taxation was designed in 1997 to detect harmful tax measures which unduly affect the location of business activity in the Union. The Code is not a legally binding instrument but it clearly does have political force. By adopting this Code, the Member States have undertaken to refrain from introducing any new harmful tax measures and amend any laws or practices that are deemed to be harmful in respect of the principles of the Code.

³ A patent box is a special tax regime for intellectual property revenues.

⁴ The Common Consolidated Corporate Tax Base (CCCTB) is a single set of rules to calculate companies' taxable profits in the EU.

2. TAX POLICY CHALLENGES FACING MEMBER STATES

2.1. Economic consequences of ATP

2.1.1. Loss of tax revenues

Tax avoidance costs billions of euros every year. In the EU, it has been estimated that the revenue losses from profit shifting within the EU amounts to about EUR 50-70 billion⁵. This is equivalent to 17% of corporate income tax (CIT) revenues (in 2013) and 0.4% of GDP (on the lower bound). Governments of countries whose tax base is eroded are forced to raise revenue from other taxes to avoid having less revenue for growth-enhancing reforms and for redistribution.

ATP practices in one territory have spill-over effects in other territories. Profits shifted to or through one Member State means tax base loss for another Member State. For the Union as a whole, there is a clear loss of tax revenues, even if individually some Member States may see their tax revenues increased thanks to a tax base inflated by profit shifting.

2.1.2. Lack of a level playing field

ATP also distorts the level playing field between companies that manage to avoid paying their fair share of taxes and other companies that do not have access to the same cross-border tax planning possibilities (**mostly domestic and/or smaller firms**). Studies indicate that multinational enterprises in high-tax countries pay around 30% less tax than comparable domestic firms⁶.

A recent study shows that companies engaging in aggressive tax planning benefit from a potentially significant reduction in effective taxation to the detriment of society⁷. Multinational enterprises that engage in tax planning benefit from a competitive cost advantage

that can allow them to gain market shares and raise entry barriers to the detriment of other firms. There is evidence of a link between tax planning and higher mark-ups and increased industry concentration⁸. This may lead to inefficiently high consumer prices.

2.1.3. Lack of fairness and impact on taxpayer morale

ATP by big multinationals also has a negative impact on general taxpayer morale. Those who abide by their obligations and pay their taxes perceive ATP as a breach of the social contract. Awareness of unfair practices may encourage other taxpayers to stop complying with their own tax obligations. Recent scandals have led to public discontent over the issue of tax avoidance. Furthermore, the loss of revenues due to ATP may have an impact on social spending, such as access to quality education, healthcare or welfare services, and on redistribution. This in turn exacerbates inequalities and may fuel further social discontent.

2.2. Main ATP channels

ATP occurs through three main channels: (i) **debt shifting**, where internal debt is used to artificially shift profit from a high tax to a low tax jurisdiction; (ii) **strategic location of intellectual property rights and intangibles assets**, where highly mobile intangibles assets are artificially relocated in low-tax jurisdictions, and (iii) **(mis)use of transfer pricing**, where tax bases of low tax jurisdictions are artificially inflated at the expense of the tax base of high tax jurisdiction⁹. On top of these main structures, multinational enterprises may take advantage of bilateral tax treaty provisions to minimise taxes and the repatriation cost of dividends (treaty shopping).

⁵ See Dover R., B. Ferrett B., D. Gravino, E. Jones and S. Merler (2015).

⁶ See Egger, P., W. Eggert and H. Winner (2010).

⁷ See Center for European Economic Research, ZEW (2016).

⁸ See OECD (2015), p. 181.

⁹ For a better understanding of the way MNEs structure their tax avoidance schemes, see Ramboll Management Consulting and Corit Advisory (2015).

2.3. Main ATP indicators

2.3.1. Legal indicators of ATP

ATP indicators can be derived from certain tax rules or from their absence:

Lack of anti-abuse rules

This set of indicators refers to the lack of rules aimed at countering tax avoidance. **Examples of anti-abuse rules are: interest limitation and thin capitalisation rules and controlled foreign companies rules.** Interest limitation and thin capitalisation rules aim at discouraging artificial debt arrangements designed to minimise taxes, and controlled foreign companies (CFC) rules aim at deterring profit shifting to a low or no-tax country. It is worth noting that the Anti-Tax Avoidance Directive, adopted by the Council in July 2016 with entry into force in 2019, albeit with some exceptions, provides for interest limitation rules and CFC rules for all EU countries.

Passive indicators

This set of indicators refers to tax rules which do not by themselves promote or prompt any ATP structure, but which are necessary for an ATP structure to work. **One relevant example would be withholding taxes.** The absence of withholding taxes generally aims at preventing double taxation. However, it may also make aggressive tax planning easier under certain circumstances. The existence of withholding taxes prevents shifting profits tax-free toward non-EU country jurisdictions, and therefore discourages or impedes aggressive tax planning, even though it can lead to double taxation or burdensome requirements to avoid it.

Active indicators

Some tax regimes can by themselves encourage or facilitate aggressive tax planning structures. Tax rules need to be assessed on a case-by-case basis in order to draw a conclusion on their link with ATP practices. Such assessment requires a detailed analysis of the actual design and application of a tax rule, taking into account to what extent the tax rules

are safeguarded, e.g. through anti-abuse provisions.

2.3.2. Economic indicators of ATP

There are a number of economic indicators that may be used to detect evidence of ATP practices. For example, countries that are used in ATP structures generally have (abnormally) high financial flows. It is therefore relevant to see whether there is a possible disconnection between financial and real economic activities. Indicators such as total foreign direct investments¹⁰ (FDIs), FDIs held by special purpose entities and specific financial income flows, such as dividends, interest and/or royalty flows, expressed as a share of GDP, are relevant.

FDIs reflect the investments made cross border between related companies. While FDIs are not as such indicators of tax avoidance, part of these investments may be driven by tax avoidance practices. Royalty flows reflect the localisation of intellectual property and intangible assets. Other relevant indicators include corporate tax revenues as a share of GDP, bilateral import price anomalies¹¹ and treaty shopping indicators.

Corporate tax revenues as a share of GDP show that some countries are able to raise particularly high revenue from corporate tax.

Bilateral import price anomalies make it possible to detect if a good is priced too high or too low. Some countries tend to import the same intermediary

¹⁰ Foreign direct investment is the category of international investment in which an entity resident in one country (the direct investor) acquires a lasting interest in a company resident in another country (the direct investment company) including through a special purpose entity, a legal entity created to fulfil narrow, specific or temporary objectives. A direct investment enterprise is one in which a direct investor owns 10% or more of the ordinary shares or voting rights (or the equivalent for an unincorporated enterprise).

¹¹ It refers to anomalies in the average price of products subject to bilateral trade flows (between two countries).

goods at different prices, some at a cheaper price especially if they are firms in low tax countries and some at a more expensive price, especially if they are firms in high tax countries. This may be an indication of transfer mispricing and may be a sign of the erosion of the tax base in some high tax countries.

Treaty shopping indicators reflect the fact that using a combination of treaties may minimise the cost of repatriating dividends. Rather than investing directly in a host country, multinational companies funnel the investment through a third country to take advantage of treaty provisions not found between the host and the home country of the investment.

While none of the indicators provide per se an irrefutable causality towards aggressive tax planning, they may be used as part of a 'body of evidence' revealing the existence of an ATP structure.

3. POLICY LEVERS TO ADDRESS THE TAX POLICY CHALLENGES

Member States can tackle tax abuse by strengthening the legal framework and reforming national regimes that may lead to ATP, but also by increasing cooperation and transparency. Building up a culture of tax compliance is also important. This section will concentrate on the first aspect, i.e. strengthening the legal framework and reforming national regimes: by implementing strong anti-tax avoidance rules, by changing rules that may indirectly encourage ATP and by addressing national regimes that make ATP easier.

3.1. Implementing strong rules to prevent tax avoidance

As explained above, anti-abuse rules have the explicit objective of preventing ATP structures. Rapid implementation of anti-abuse rules is needed. While the ATAD will introduce five anti-abuse rules in 2019¹², the current

absence of those rules in certain Member States does not protect the EU against ATP practices today.

3.2. Changing rules that can be misused and lead to ATP

Withholding taxes towards third countries, properly put in place, could be an effective tool to counter ATP. Withholding taxes are put in place by each Member State and for each type of financial flow (interest, dividends and royalties).

3.3. Addressing national regimes that make ATP easier

The European Semester allows to address national tax practices that encourage cross-border ATP or make it easier but that are difficult to address through existing tools (such as directives or codes of conduct).

4. CROSS-EXAMINATION OF THE STATE OF PLAY

4.1. Implementing strong rules to prevent tax avoidance

The table below gives an overview of the **absence** of two types of **anti-abuse rules** across Member States: interest limitation and thin capitalisation rules. The ATAD introduces anti-abuse rules, including CFC rules and interest limitation rules. However, in the case of interest limitation rules, the Member States, with national rules equally effective, may delay implementation of the provisions on interest limitation rules in the ATAD until 2024.

¹² Some provisions will be applied at a different date.

Table 1: Overview of some anti-tax avoidance rules missing in Member States' national laws, 2017

	BE	BG	CY	EE	HR	LU	MT	NL	RO	SI	AT	CZ	IE	LV	LT	PL	SK	DE	EL	FI	HU	PT	FR	IT	SE	UK	DK	ES
Interest limitation or thin-capitalisation rules	✓	✓	✗	✗	✓	✓	✗	✓	✓	✓	✓	✓	✗	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
Controlled Foreign Companies Rules	✗	✗	✗	✗	✗	✗	✗	✓	✗	✗	✗	✗	✗	✗	✓	✓	✗	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	

Source: Ramboll Management Consulting and Corit Advisory (2015).

4.2. Changing rules that can be misused and leading to ATP

Some Member States do not have withholding taxes towards third countries that could protect their tax

system from ATP practices that use interest, dividend and/or royalty flows. However, other Member States have done so already.

Table 2: Withholding taxes in EU Member States towards third country jurisdictions, 2017

	HU	MT	CY	EE	LU	NL	IE	UK	AT	DE	FI	SE	BE	BG	CZ	DK	EL	ES	FR	HR	IT	LT	LV	PL	PT	RO	SI	SK
Royalties	✗	✗	✓	✓	✗	✗	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
Interests	✗	✗	✗	✗	✗	✗	✓	✓	✗	✗	✗	✗	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	
Dividends	✗	✗	✗	✗	✓	✓	✗	✗	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	

Source: ZEW (2016), with updates based on national reforms.

Notes:

(1) The above table focuses on the domestic withholding tax (WHT) rates, i.e. the rates that are specified in national corporate tax law. It therefore does not reflect the WHT rates specified in double tax treaties.

(2) A cross means that the Member State does not apply a withholding tax (exceeding 0%).

4.3. Addressing national regimes that make ATP easier

Some Member States took measures to adjust their patent box regimes in line with Action 5 of the Base Erosion and Profit Shifting project¹³ as endorsed by the Code of Conduct for Business Taxation.

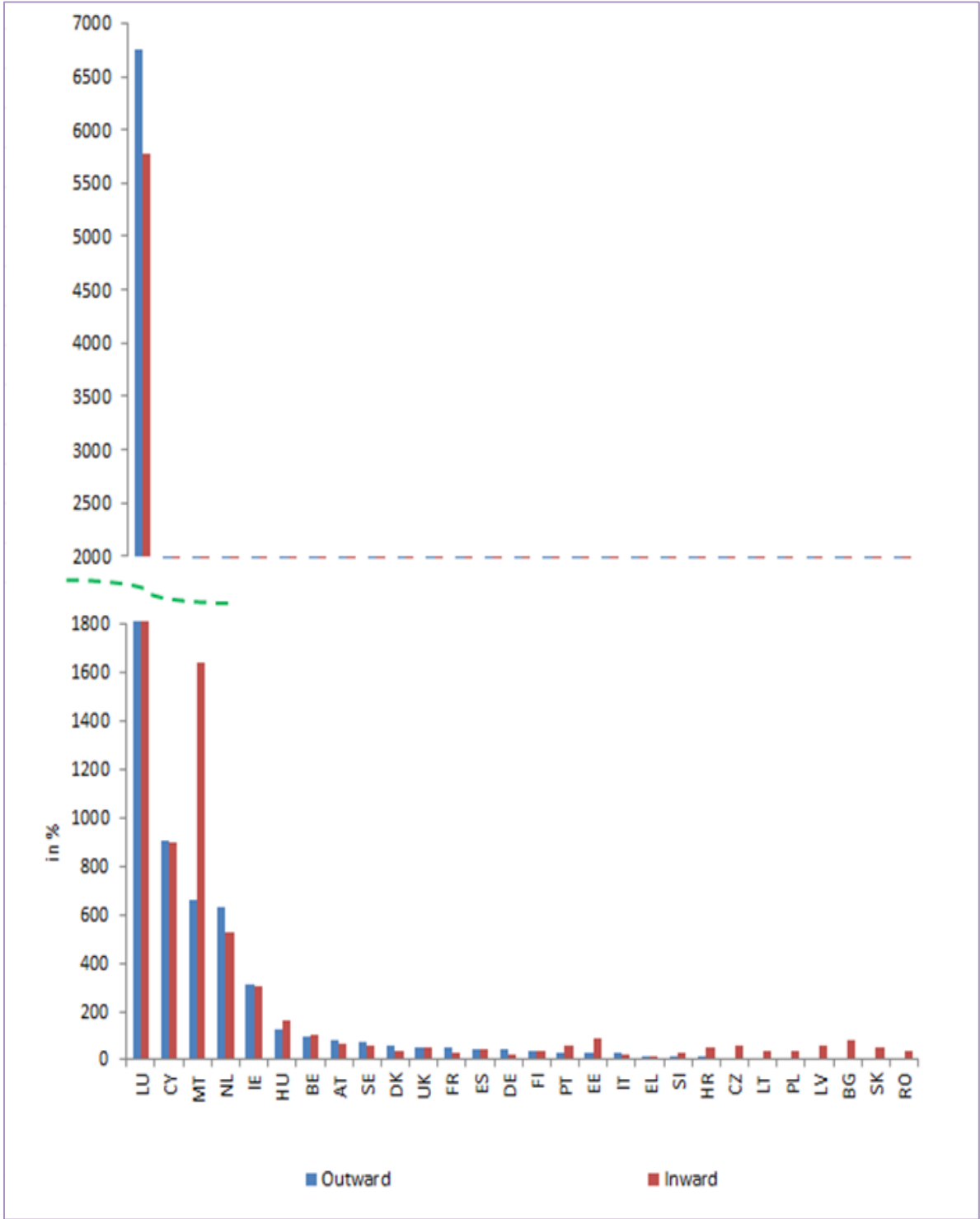
Some national regimes still need to be reviewed to prevent use of ATP by MNEs. The Ramboll 2015 study referred to earlier identifies a number of such rules and their prevalence in Member States. However, tax rules need to be assessed on a case-by-case basis before drawing any conclusion on their link with ATP practices.

4.4. Overview of recent economic indicators of ATP

Here are the most recent data for some main economic indicators.

¹³ The Base Erosion and Profit Shifting (BEPS) project, led by the G20/OECD, provides for a number of action to tackle tax planning strategies that exploit gaps and mismatches in tax rules to artificially shift profits to low or no-tax locations where there is little or no economic activity.

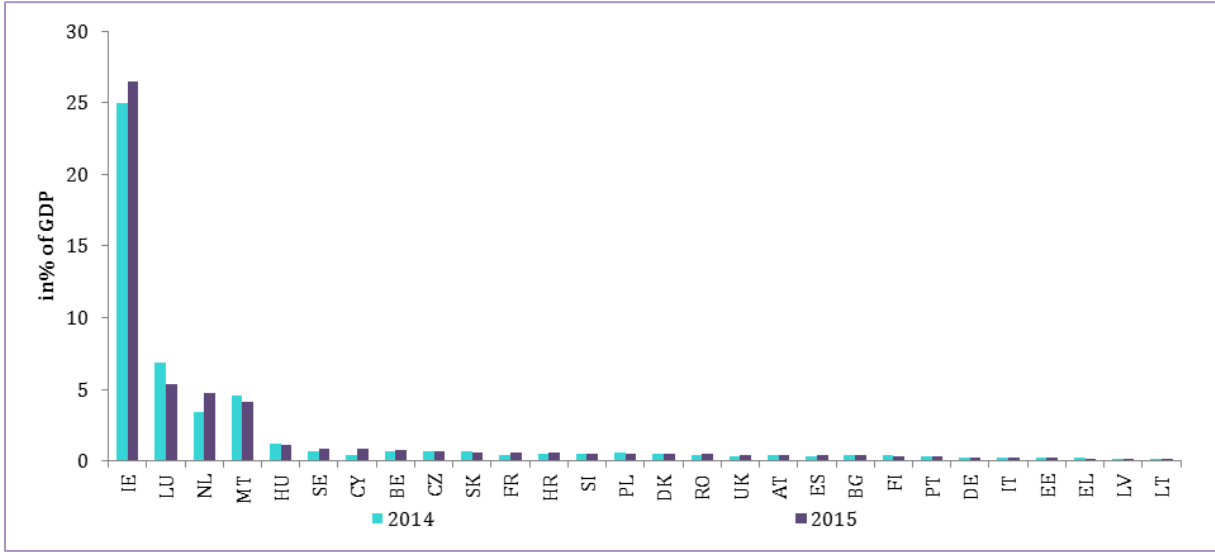
Figure 1: FDI positions as a share of GDP, 2015



Source: European Commission (forthcoming), Eurostat

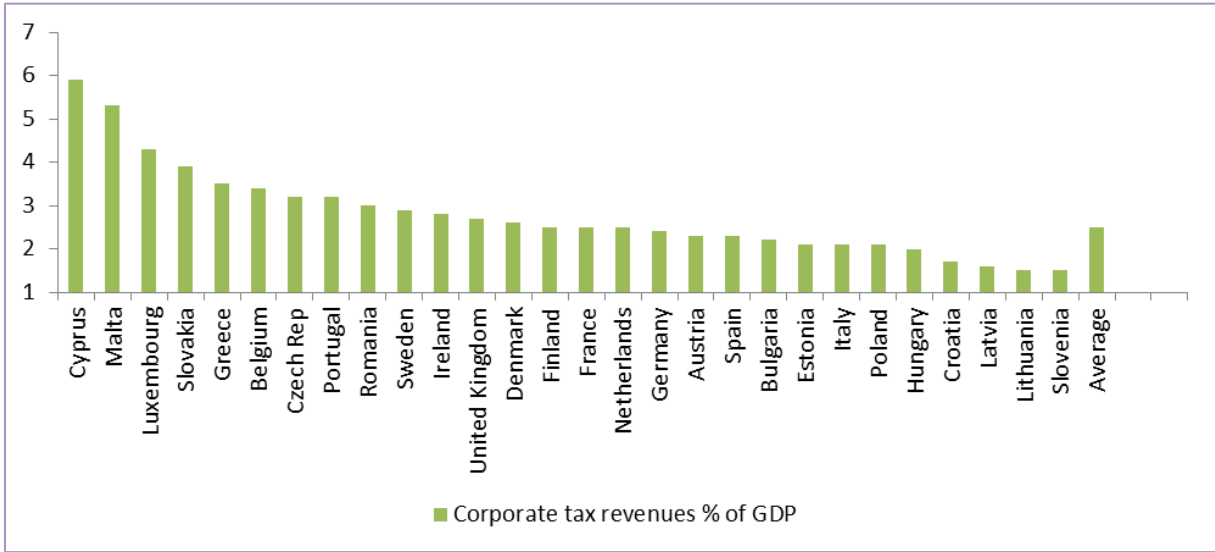
Notes: (1) Inward FDI or direct investment in the reporting economy (DIRE) refers to investment by foreigners in businesses resident in the reporting economy. Outward FDI or direct investment abroad (DIA) accounts for investment by resident entities in affiliated businesses abroad. (2) FDI stocks (or positions) indicate the value of the investment at the end of the period.

Figure 2: Charges paid (debit) for the use of Intellectual Property (IP) as a share of GDP



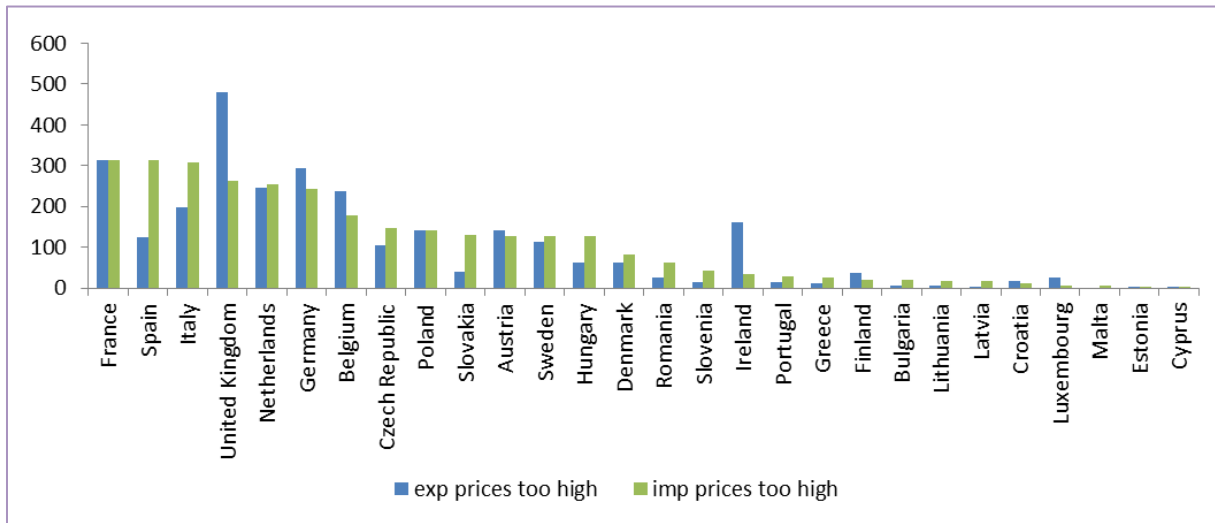
Source: European Commission (forthcoming), Eurostat

Figure 3: Corporate tax as a share of GDP, 2015



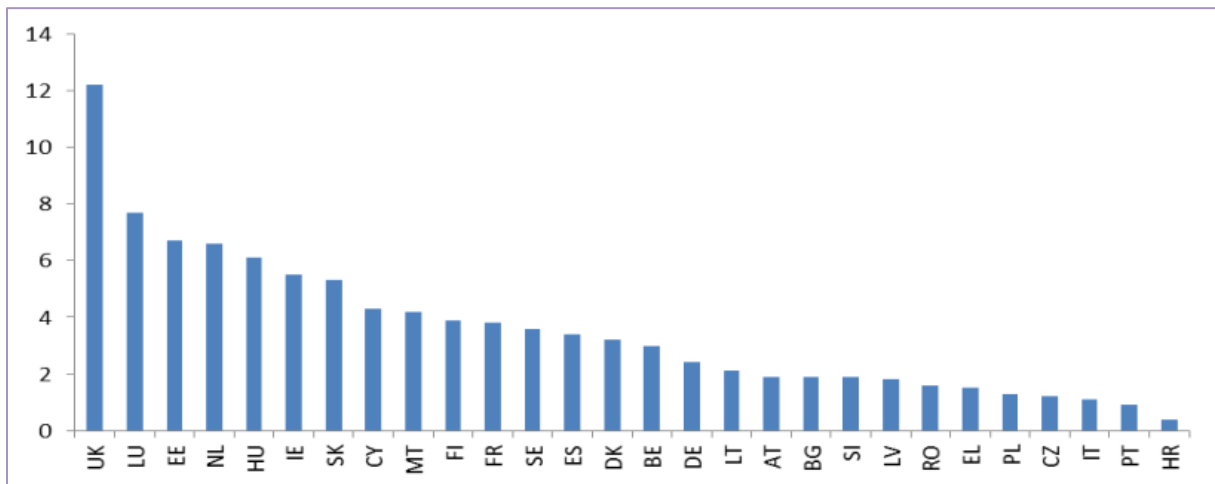
Source: European Commission (2017)

Figure 4: Bilateral price anomalies 2015



Source: IHS (forthcoming)

Figure 5: Attractiveness of treaty shopping: centrality index



Source: van't Riet and Lejour (2017), IHS (forthcoming)

Notes: Centrality index refers to the GDP-weighted percentage of tax optimal repatriation routes which include the respective country.

5. USEFUL RESOURCES

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