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Letter of Germany, France and Italy to Commissioner Pierre Moscovici on BEPS within the EU and the Answer of Pierre Moscovici

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The German, French and Italian finance ministers, in a letter to the Commissioner for Taxation and Customs, Pierre Moscovici, as of November 2014 (Financial Times, December 1, 2014), have urged the European Commission to curb aggressive tax planning, base erosion and profit shifting (BEPS) in the EU, mainly caused by the lack of tax harmonization in the EU. They suggest a comprehensive BEPS-Directive to be adopted by the 28 Member States before end 2015. The Directive shall include rules on transparency, changes to the Interest-Royalties and the Parent-Subsidiary Directives, a general anti-abuse provision and common rules for Patent Box provisions.

This letter does not come as a surprise after the Commission's announcement to check tax rulings of several EU member countries under state aid conditions and after the release of documents on tax rulings provided for by Luxembourg.

In addition, during the ongoing OECD's work on BEPS, certainty emerged, that the combination of the EU-freedoms and EU-Directives on direct taxation and otherwise non-harmonized direct taxation has a considerable negative impact on the common tax income of EU-member states. Considering the main BEPS goal of securing the taxation of mobile income, that can be shifted between states much more easily than immobile income, it becomes apparent, that there is a huge BEPS-problem within the EU:

? Besides tax rulings possibilities, which may reduce the tax burden of corporations, it is obvious, that the combination of domestic tax provisions of some EU member states and the above mentioned Directives causes serious damage in the EU: Mobile income, such as royalties, dividends and interests, generated within the EU, may pass and leave the EU without any taxation.
? It is also obvious that there is an ongoing but somewhat hidden race to the bottom of corporate tax rates within the EU. Ten EU member states have introduced preferential tax rates for royalties income (so called Patent Boxes), already. The maximum effective tax rates for royalties income are: Belgium (6,8%), France (15%), United Kingdom (10%), Luxembourg (5,72%), Malta (0%), The Netherlands (5%), Portugal (11,5%), Spain (10%), Hungary (9,5%), Cyprus (0%).

Whereas there may be a short tax advantage for those EU member states that provide for tax exemptions and for preferential tax rates, because they are attracting the tax base of other countries, the EU as a common market loses considerable tax income in the long run.

Thus, there is dire need for action, which may have induced the three finance ministers to make suggestions for curbing the mentioned problems:

? The introduction of better transparency rules to prevent further harmful tax rulings;
? Changes to the Interest-Royalties and the Parent-Subsidiary Directives to prevent the tax-free flow of dividend-, royalties- and interest- income;
? Firm rules for Patent Box provisions to prevent profit shifting of royalties-income.

However, the prospects of the three ministers are quite clear and poor: While their suggestions may be taken into consideration by the EU-Commission for the preparation of an EU Directive, such a Directive has to be adopted unanimously by all 28 member states.

Pierre Moscovici, in his answer to the ministers (Agence Europe, Brussels, 3.12.2014), takes an entirely different approach. He reminds them of the EU's ongoing work on the Common Consolidated Corporate Tax Base (CCCTB), which, in his view, would address their key issues. In fact, the CCCTB may be seen as a big step into the direction of corporate tax harmonization. The CCCTB would even go further than the proposals of the ministers in the sense that intangible assets, currently considered as both, the profit driver of international corporations and also very prone for profit shifting, would not at all be taken into account as a distribution factor for the allocation of the common tax base of groups. The CCCTB in other words just ignores intangible assets. This deviation from the current common economic understanding about intangible assets is one of the reasons why EU member states do not come to an agreement on the introduction of the CCCTB. They consider the proposed allocation key arbitrary. They also criticize the CCCTB to be introduced by EU member states, only, so that cross border trans¬actions would be dealt with by two complicated systems: the CCCTB in the EU and beyond the EU the arm´s length standard, which is the worldwide accepted principle (included in 3.000 Double Tax Treaties) to calculate business profits.

However, the introduction of a common EU-tax base without consolidation, a CCTB, would address the minister's issues: It would prevent the issuance of harmful tax rulings and also the non-taxation of mobile income. The creation of different income types to be taxed at different rates would be impossible and thus would prevent EU member states from the introduction of domestic Patent Boxes. While it would be a big step forward into the direction of harmonization of corporate taxes, it would not change the international consensus on intangibles as value drivers and would keep the arm´s length standard.

On corporation taxes, realistically, there does not seem to be another solution than the CCTB to prevent the eradication of corporation taxes in the EU. Otherwise, the EU may end up without taxing companies at all and charging EU citizens with the lion share of taxes via wage taxes and VAT. The EU-Commission as well as at least three EU mem¬ber states seem to be willing to go into that direction. For the future of Europe's corporation tax income, the three EU member states and the EU Commission should concentrate on this project so that all other EU member states join this movement.

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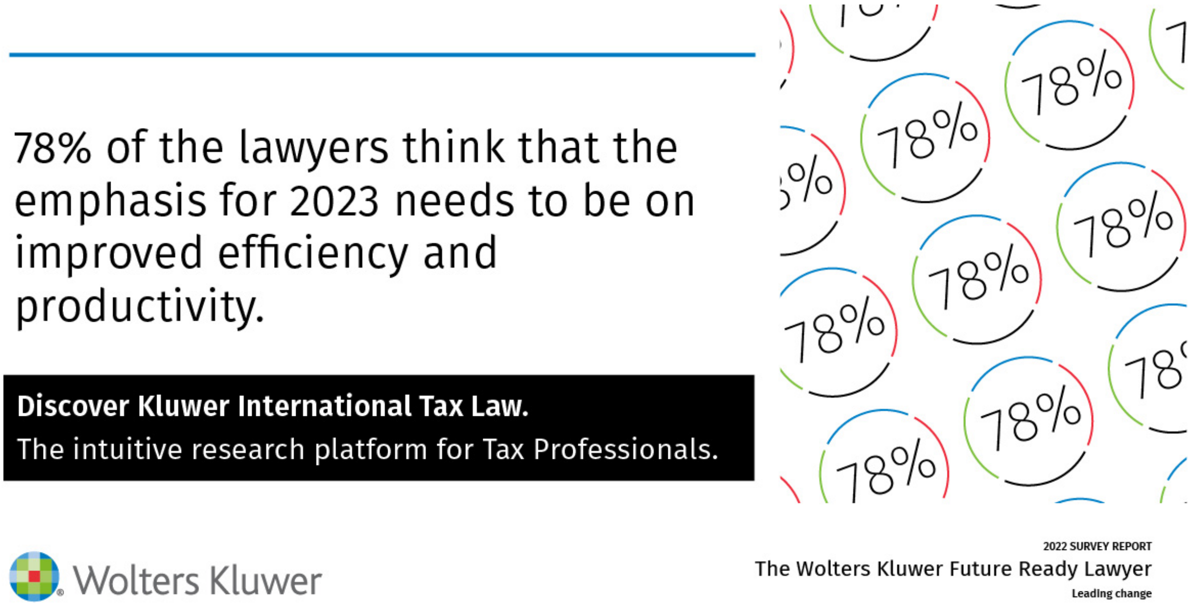

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