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# Unpacking Complexity Unfolding Opportunity

The Future of Multi-National  
Corporate Taxation in the EU



**SheppardMullin**



# Content

## Introduction

### Framing the discussion

- EU Member States still enjoy tax sovereignty
- Commission's concerns
- The notion of 'fairness' and 'fair contribution'
- Who started this? Are US companies targeted?

### Towards a level playing field?

- Settling the diplomatic row: to tax or not to tax
- Between budgetary constraints and a predictable investment climate
- The Commission's Action Plan for Fair and Efficient Corporate Taxation

### Using an EU "antitrust" tool (*State aid*) to attack "aggressive" Tax Rulings

- Notion of EU State aid control and the specific powers of the Commission
- Precedents at EU level
- Current decisions and pending investigations
- Recovery obligation on the Member States
- Will the EU Courts uphold the Commission's approach?

# Why?





# Framing the discussion





# Competence

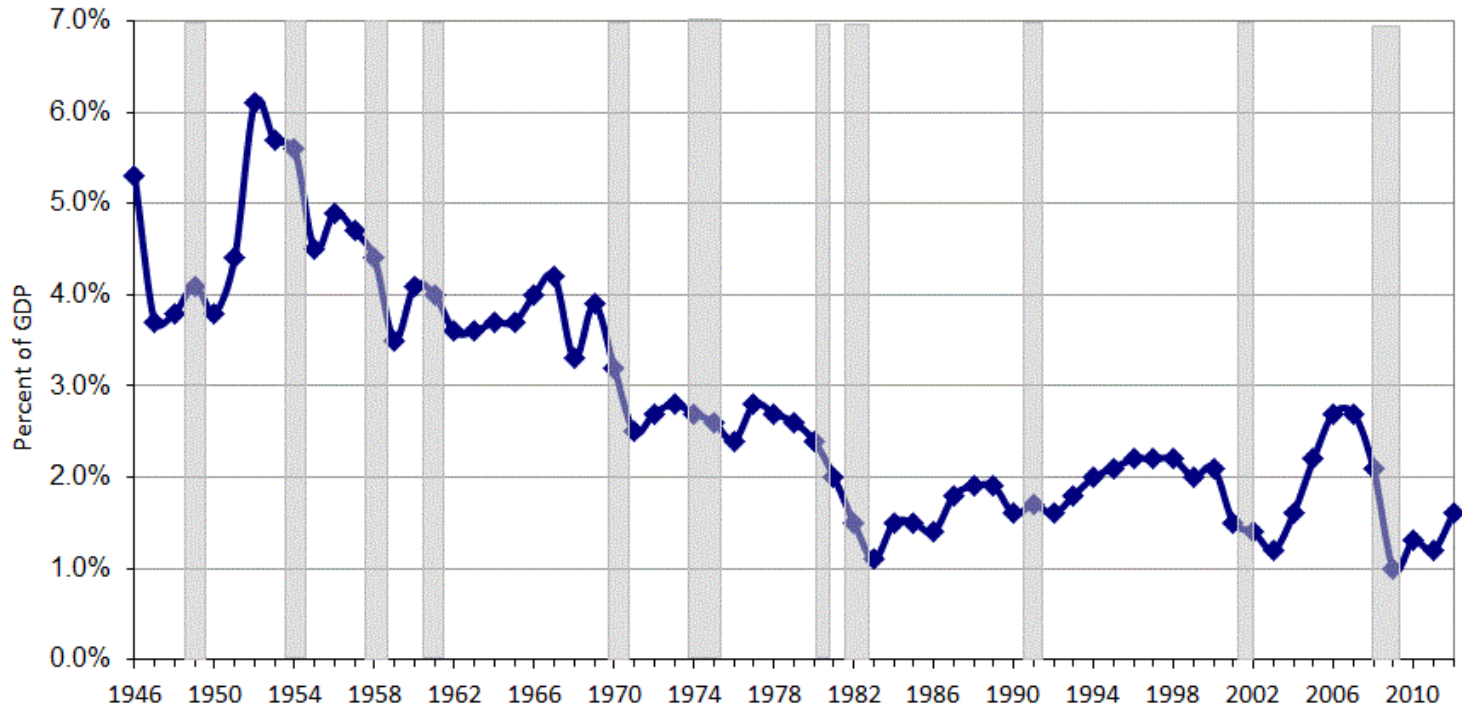
- EU is a customs union
- But limited progress on tax harmonization
  - EU Member States still enjoy much tax sovereignty
  - Unanimity of Member States (Council) required
  - Corporate taxation not harmonized
    - Divergent rules on allocation of revenue, costs and profits
    - Difference taxation bases, rates
- Compare with indirect taxation
  - Harmonized excise duties and VAT
- EU internal market rules on tax discrimination on foreign products between Member States



# Concerns

- Commission is concerned about distortion of competition within the EU internal market resulting from unfair tax advantages
- Fierce competition between Member States to attract investments
- Shifting of burden
- The OECD highlights urgency of dealing with BEPS ('base erosion & profit shifting') – Nov. 2012 request to coordinate actions
  - Not just an EU problem
- Corporate tax as a share of a country's GDP has decreased significantly over time

## Corporate Income Tax as a Percent of GDP, 1946 - 2012

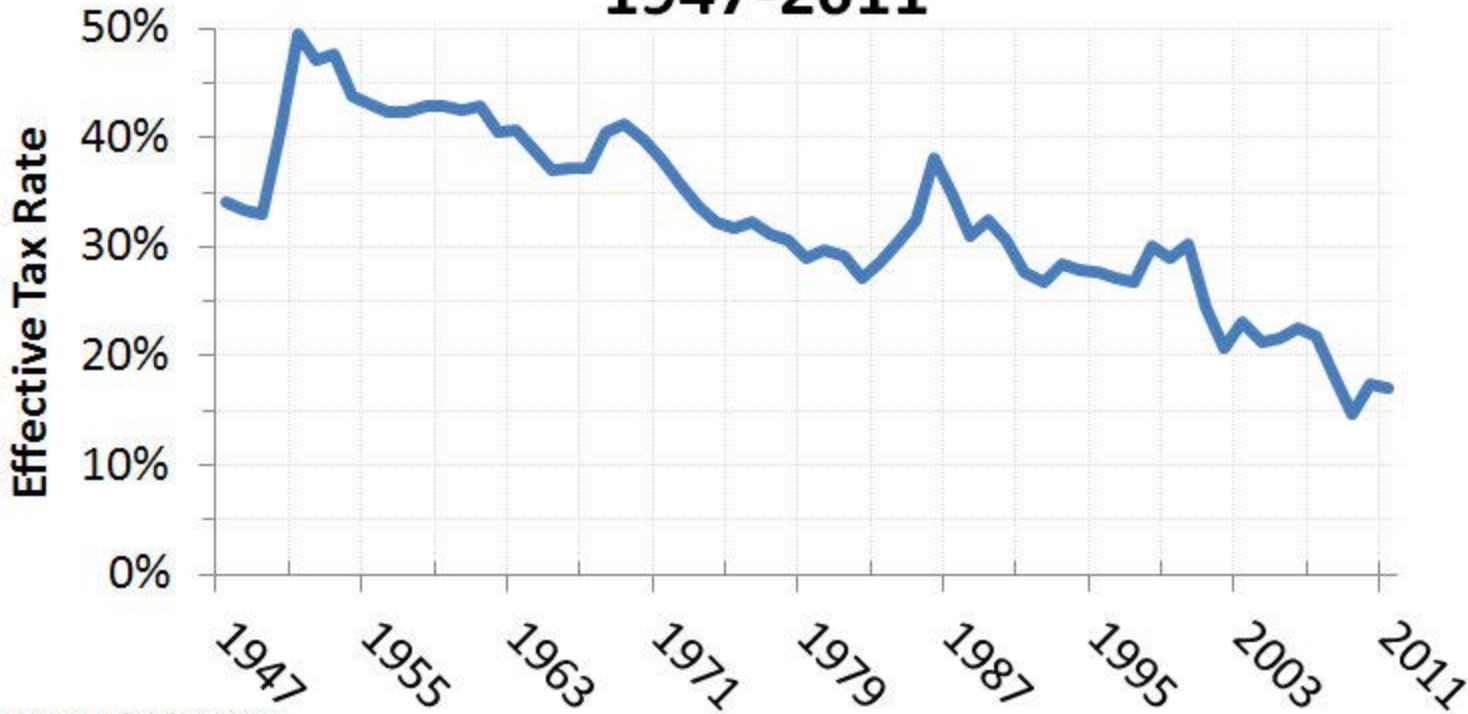


Notes: Shaded areas represent recessionary periods as recorded by the National Bureau of Economic Research. Miscellaneous taxes such as estate and gift taxes are omitted for the sake of clarity, and comprise a very small fraction of total revenues in any case.

Source: Budget of the United States Government, Historical Tables, Table 2.3

Based on Adam Carasso, "The Corporate Income Tax In the Post-War Era," Tax Facts Column, Tax Notes Magazine, March 03, 2003

# U.S. Effective Corporate Tax Rate 1947-2011

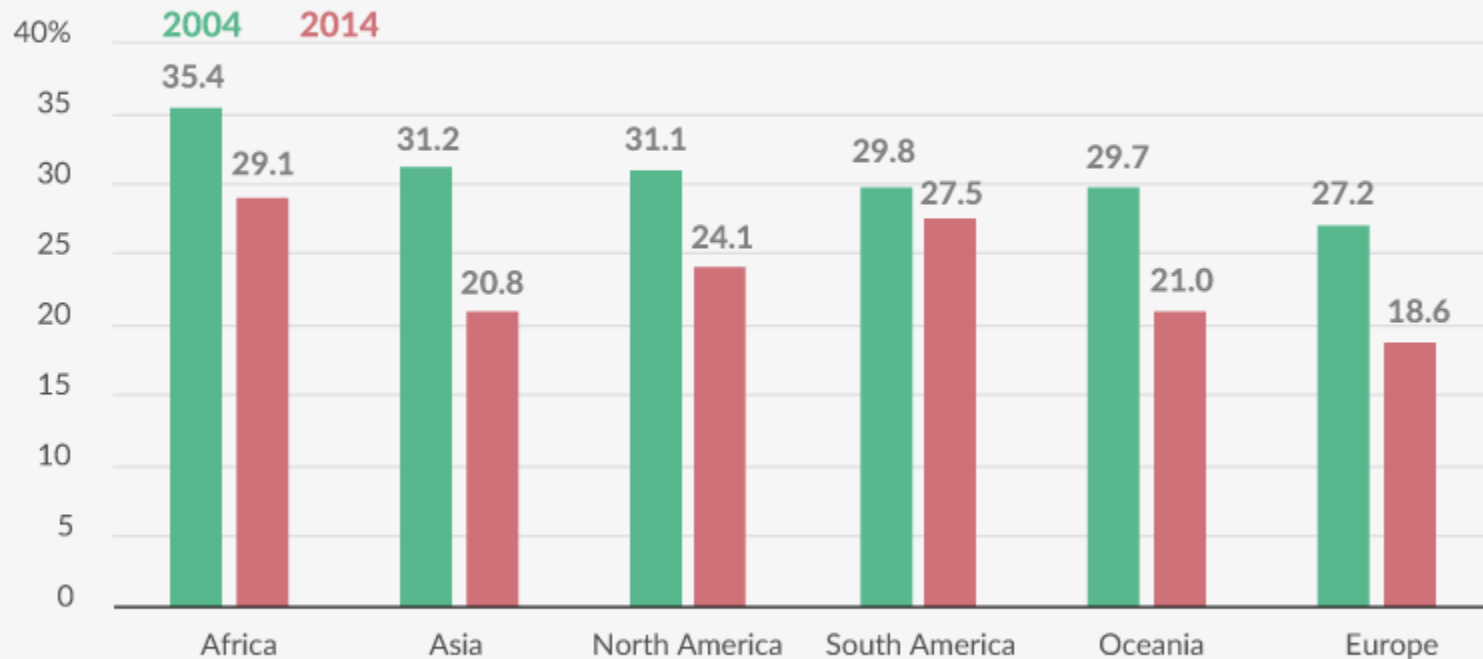


Source: Federal Reserve



## Corporate Tax Rates throughout the World Have Declined over the Past Decade

The Average Top Marginal Corporate Tax Rate by World Region, 2004 and 2014



Note: Simple averages used.

Source: Tax Foundation calculations based on data from World Bank, OECD, and KPMG.

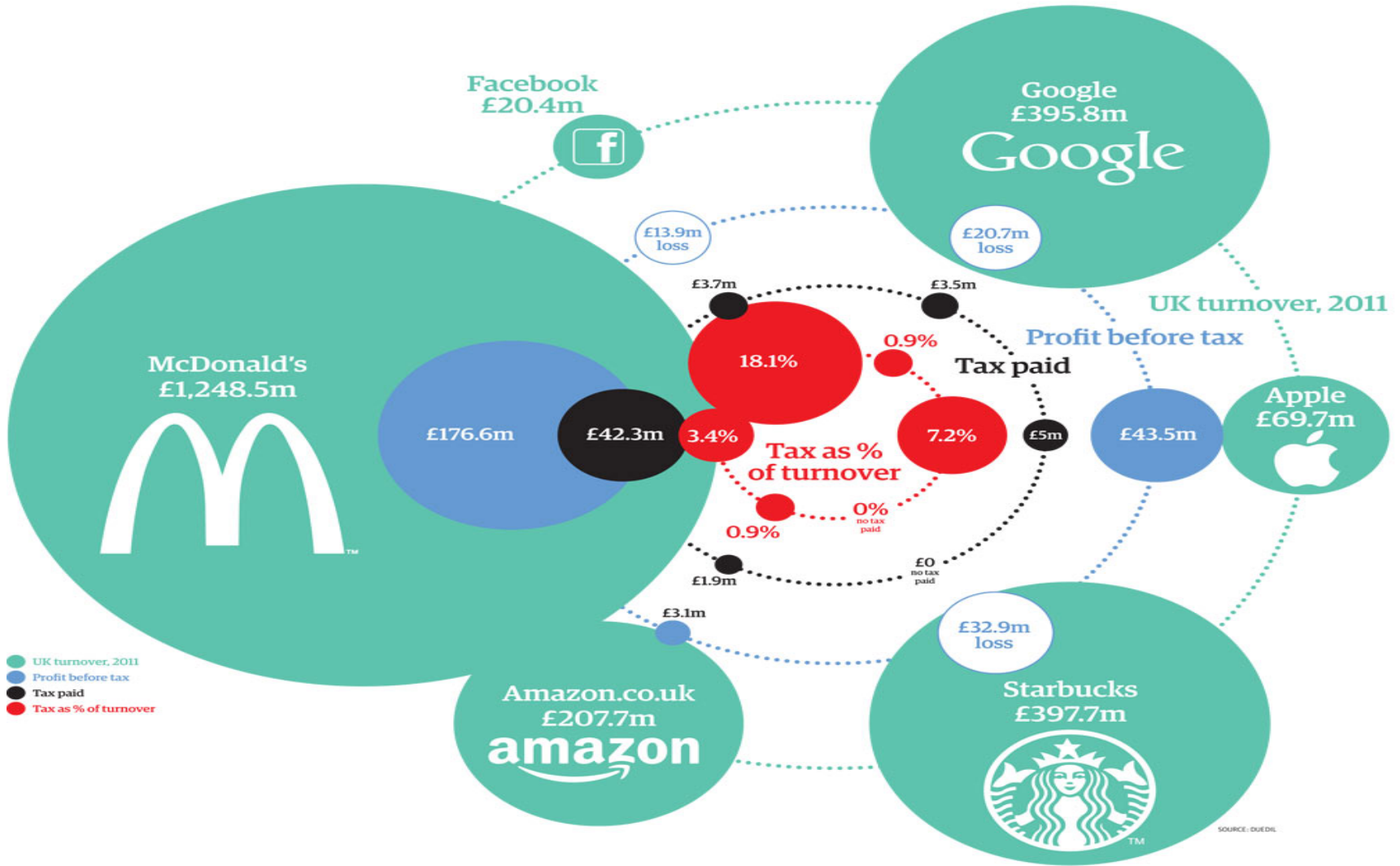
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# 'Fairness'

- Commission strives for fairness in corporate taxation
- Attacks on Member States engaging in unfair tax competition (in particular through "Advanced Pricing Agreements" - "APAs" or "Tax Rulings")
  - APAs are practices invented in the U.S.
  - Tax administration specifies by a ruling system the acceptable transfer pricing methodologies to be used in allocating items of income, deductions and other elements among taxable persons being under one and the same economic control as part of the same "undertaking" (entreprise)
- EU Competition Commissioner Vestager quotes:
  - "Fair taxation and greater transparency"
  - "All companies, big or small, multinational or not, should pay their fair share of tax"
  - "Competition of a fairer society"



Source: the data centre of The Guardian



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# Public Opinion

- “Protestors mount street-based campaign targeting Boots”, the high street chemist and pharmaceutical giant, that avoided over £1 billion in tax since it went private – The Guardian, 19 Jan 2011
- “Tax avoidance campaigners have held protests at Starbucks cafes across the UK, despite the firm's pledge to pay millions of pounds of extra corporation tax for the next two years: profit shifting and corporate restructuring.” – BBC News, 12 Dec 2012



# Who started?

- Since 1995, aggressive tax avoidance schemes have helped multinationals transfer trillions of dollars from OECD and developing countries into tax havens
- A Government Accountability Office study in the US found that, from 1998 to 2005, 55% of US companies paid no federal income taxes during at least one year in a seven-year period it studied
- An IRS report in 2009 on the US Corporate Income Tax in the 90'ies indicated that, for example, in 1998 a total of 94 corporations faced a net liability of less than half the full 35% corporate tax rate
- The US Public Interest Research Group said in 2014 that the US loses roughly \$184 billion per year due to corporations such as Pfizer, Microsoft and Citigroup using offshore tax havens to avoid paying US taxes
- Laws known as a General Anti-Avoidance Rule (GAAR) statutes which prohibit "tax aggressive" avoidance have been passed in several developed countries

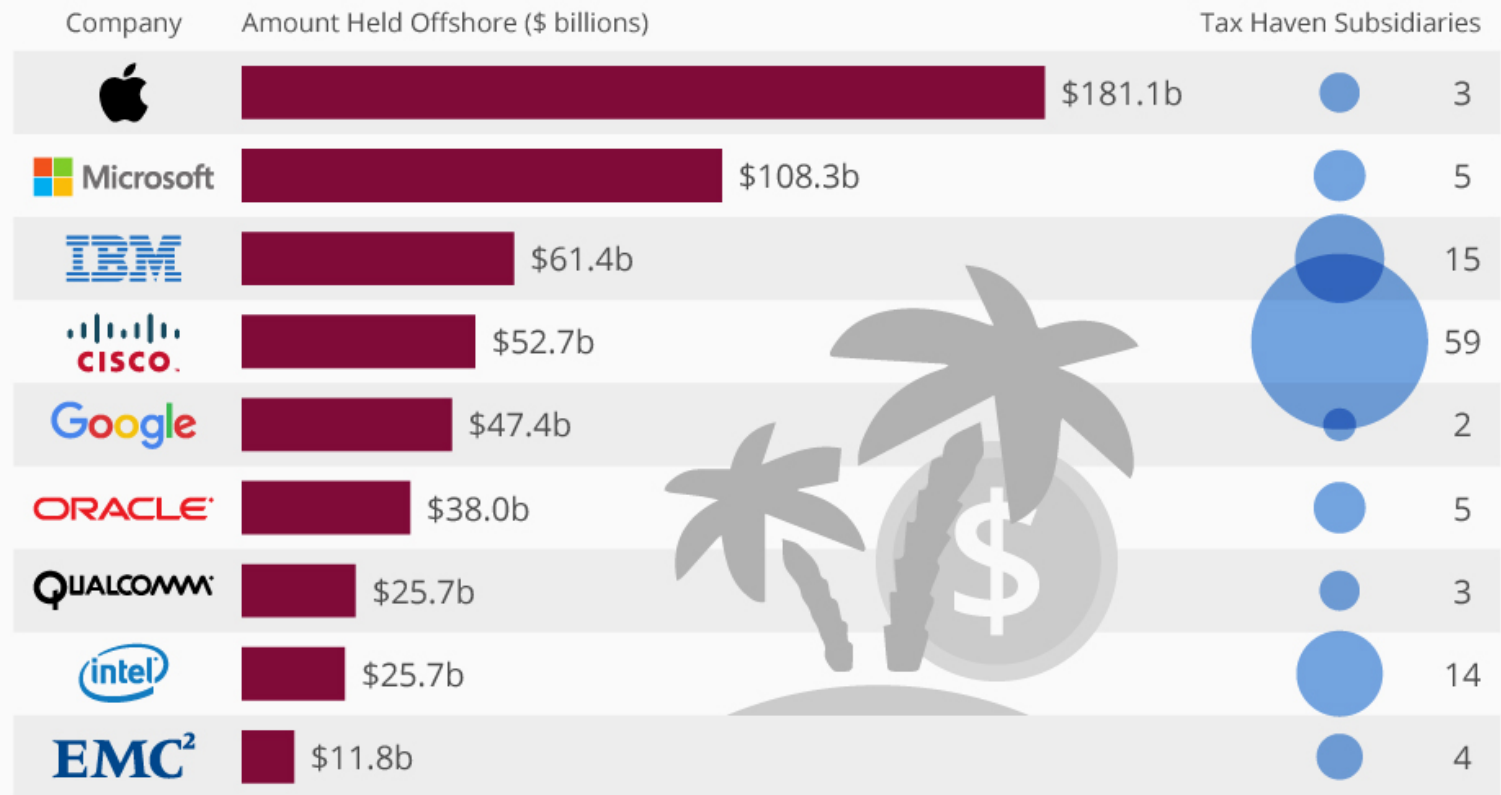


# OECD

- At forefront of efforts to improve international tax cooperation between governments to counter aggressive tax planning
  - ATP Steering Group as a centre of knowledge and expertise
- Identifies trends in international tax planning and helping governments respond quickly and effectively
- BEPS: tax planning strategies that exploit gaps in the architecture of the international tax system to artificially shift profits to places where there is little or no economic activity or taxation
  - BEPS Action Plan
    - **Action 2** on Neutralising the Effects of Hybrid Mismatch Arrangements
    - **Action 3** on Strengthening CFC rules
    - **Action 4** on Limiting Base Erosion via Interest Deductions and Other Financial Payments
    - **Action 12** on Requiring Taxpayers to Disclose their Aggressive Tax Planning Arrangements

# U.S. Tech Companies Hoard Billions in Offshore Tax Havens

Top 10 U.S. tech companies by amount held offshore in 2014



@StatistaCharts Source: Citizens for Tax Justice and U.S. PIRG Education Fund

statista

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## A reminder...

- Of course, the exhaustive 2013 investigation by the U.S. Senate's Permanent Subcommittee on Investigations (PSI) that brought Apple's tax avoidance practices to light never alleged that Apple's practices were illegal
- Apple shifted a record \$50 billion in cash offshore in 2014, and admitted paying a tax rate of just 2.2 percent on its offshore cash
  - Offshore cash and 'repatriation' issue
    - Apple: \$216bn
    - Microsoft: \$111bn

Source: FT, Nov 10, 2016



# The fire spread across the Atlantic

- A BBC Panorama documentary in 2009 exposes how the super-rich can squirrel their money away in tax havens such as Liechtenstein, Jersey and the Caymans
- The European Commission adopted an action plan in 2012 to strengthen the fight against tax fraud and tax evasion setting out over 30 measures to achieve those ends (this was relaunched in June 2015)
- In response to tax planning becoming more sophisticated the European Commission released a Recommendation on aggressive tax planning in 2012
- In January 2016, the Commission presented a Communication on an External Strategy for Effective Taxation as part of its Anti-Tax Avoidance Package: Next steps towards delivering effective taxation and greater tax transparency in the EU
- In October 2016, the European Commission relaunched the Common Consolidated Corporate Tax Base as a single set of rules to calculate companies' taxable profits in the EU



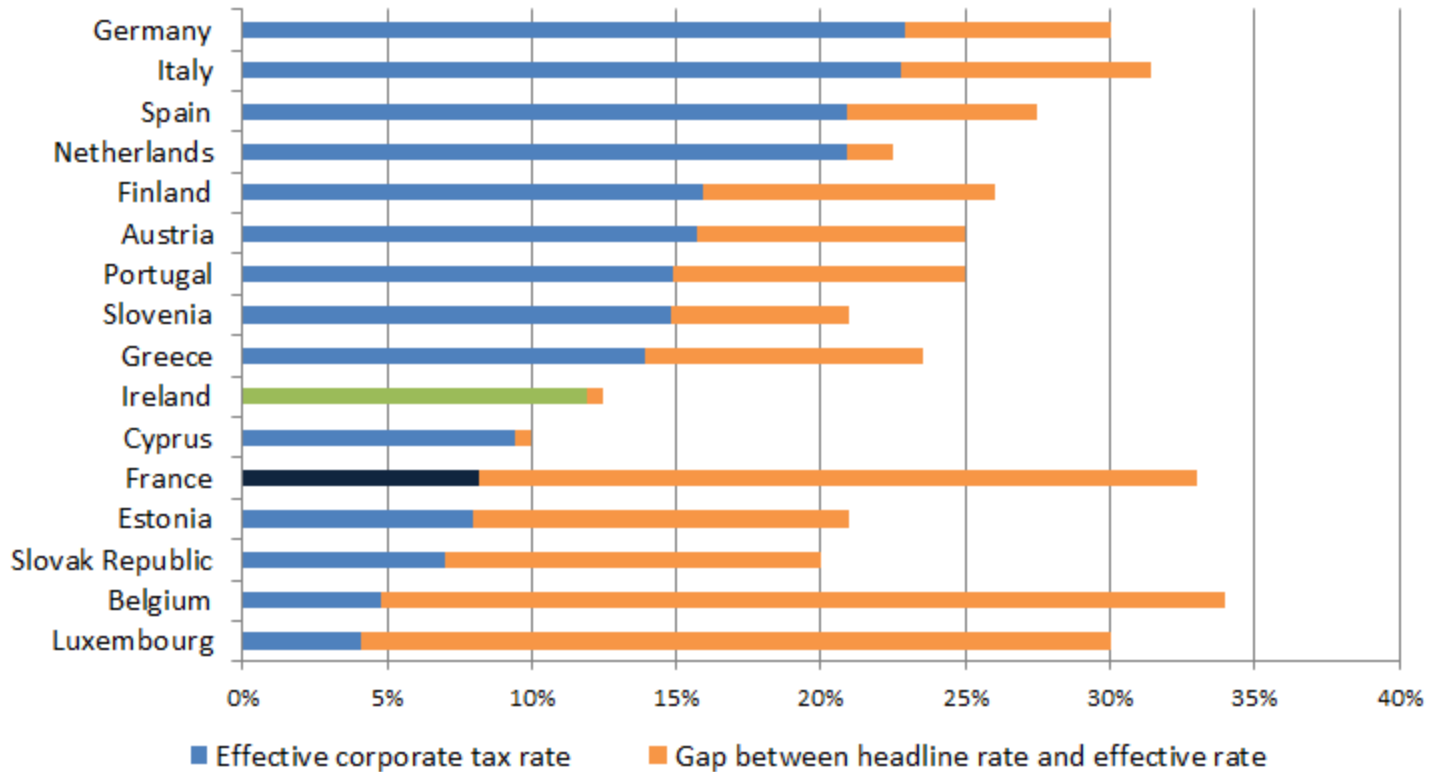
# US companies not targeted

- Robert Stack (U.S. Deputy Assistant Secretary, International Tax Affairs) questioned “basic fairness” of the ongoing investigations into billions in tax revenues that the EU believes top US companies are avoiding by striking “sweetheart” deals with certain EU countries
- State aid rules are specific to the EU and the EU has been applying them for decades
- Majority of EU cases concern EU companies
- Commission works closely with US within OECD G20
  - Fair taxation is not just Europe’s concern, it is a global issue



# Towards a level playing field?

## Effective corporate tax rates in the eurozone, 2009



Source: PwC

# EU Debt to GDP







# The EU reaction

- Good student approach: follow the OECD recommendations
- Creative approach: State aid
- Fixing approach: amend existing (ad hoc) EU tax directives
  - Tax Transparency Package
  - Anti-Tax Avoidance Package
  - External Strategy for Effective Taxation
- Long-term approach: contemplated
  - The Commission announced, on 25 October 2016, a major tax reform to overhaul the way companies are taxed in the EU
  - Common Consolidated Corporate Tax Base (CCCTB)
  - Improved mechanisms to resolve double taxation
  - Measures to tackle tax loopholes with non-EU countries





# Short term fixing



# Tax Transparency Package

- Launched in March 2015 and intended to boost tax transparency
- Proposal to introduce mandatory automatic exchange of information between Member States in their tax rulings (every 3 months)- implementation by 31 December 2016
  - Problems can arise if the tax rulings facilitate or even incentivize aggressive tax planning
    - E.g. tax rulings which offer low level of taxation in one Member State can encourage companies to artificially shift profits there, leading to serious revenue losses for other Member State
- Other initiatives include:
  - Assessing possible new transparency requirements for multinationals (e.g. the public disclosure of certain tax information by multinationals)
  - Reviewing Code of Conduct on Business Taxation
  - Quantifying scale of tax evasion and avoidance



# External Strategy for Effective Taxation

- Presented by the Commission in January 2016 to protect Member States' tax bases against base erosion risks from abroad,
- Key component is a new EU listing process to deal with non-cooperative tax jurisdictions and encourage all third country jurisdictions to meet international tax good governance standards.
- The first steps in this listing process have already been taken and the common EU list should be finalized in 2017.
- Member States have endorsed the Strategy.



# Anti tax avoidance package

- Set of legislative and non-legislative initiatives.
- Aims at ensuring that all companies operating in the EU pay their taxes where profits and value are generated.
- Limit avoidance practices that directly affect the functioning of the internal market and make corporate taxation in the EU fairer, simpler more transparent and more effective
- Sets out legally binding anti-abuse measures for the entire EU in order to block some of the most prevalent forms of base erosion and profit shifting.
- Implementation by 31 December 2018.
- New Directive on country by country reporting.



# Long term fixing



# Common Consolidated Corporate Tax Base - CCCTB

- Originally proposed in 2011 – relaunched in October 2016
- Cross-border companies will benefit from a single set of rules to calculate their taxable profits in the EU.
- Companies will file a single tax return for all their EU activities through a "One-Stop-Shop" system.
- Losses in one Member State will be automatically offset against profits in another.
- Will be mandatory for the largest companies.
- Less costs, more legal certainty



# Other proposals linked to CCCTB

- Improved mechanisms to resolve double taxation.
- Will apply to companies outside the CCCTB and in cases where, for example, there are transfer pricing arrangements between a group entity within and outside the EU.
- Measures to tackle tax loopholes with non-EU countries.
- Build on to the Anti-Tax Avoidance Directive with measures to stop companies from exploiting different rules or ‘mismatches’ between the tax systems of Member States and those of non-EU countries.



**Using an EU "antitrust" tool (State aid) to  
attack 'aggressive' Tax Rulings**





# Some useful legal reminders

- EU competition law is three-fold
  - Antitrust
  - Mergers
  - State aid
- EU tax internal market harmonization limited by legislative constraints (unanimity required)
- European Commission
  - Large competition enforcement powers (with national competition authorities and national courts)
    - Subject to judicial review by EU courts
  - Only initiative powers in EU legislation



# State aid in a nutshell

## Notion of aid - Cumulative conditions

- State measure – State resources
- Advantage
- Specific companies only (selectivity)
- Likely to distort competition and affect trade between Member States

## Procedure

- State notification obligation
- Standstill obligation



# State aid control

- Unique in the world
- EU integration instrument
- European Commission
  - Exclusive powers on aid compatibility assessment
    - New aid should be notified by Member States
  - National courts
    - Control of notification obligations



# State aid and taxation

- 1998
  - Council Code of Conduct
  - Commission's Fiscal Aid Notice
- 2001-2008
  - Fiscal Aid Package
    - +60 aid proceedings against tax heavens in the Member States
- 2013-14
  - New cases against tax rulings
- 2016
  - Notice on the notion of aid
- Case law of the Court of Justice of the EU



# The issue: selectivity

- Comparison within one Member State
- Three-step analysis per EU case law
  - Reference system
  - Derogation from reference system
    - Difference between companies which are in comparable legal and factual situation
  - Justification by the logic of the tax system?
    - Avoidance of double taxation
    - Administrative manageability, etc.
- Chaotic case law
  - Various setbacks for the Commission recently



# Tax rulings and State aid

- 2000 - Umicore case
  - VAT dispute settlement
- 2012 - information on aggressive tax planning
- 2013 - EU investigations launched
- 2014-15 - *Luxleaks*, *Panama papers*
- Member States' budget constraints

# Current Tax Ruling State Aid Investigations



**United Kingdom**  
 Gibraltar corporate tax regime:  
 - 1.10.2016: Investigation

**Netherlands**



- 21.10.2015: Negative decision of the Commission with recovery
- 13.12.2015: Action for annulment by The Netherlands (T-760/15)

**Ireland**



- 11.06.2015: Investigation
- 30.08.2016: Negative decision - recovery
- 9.11.2016: Action for annulment by Ireland

**Belgium**  
 "ONLY IN BELGIUM"

- 11.01.2016: Negative decision - Recovery
- Action for annulment by Belgium (interim relief rejected) and numerous private companies

**FIAT**

- 21.10.2015: Negative decision - Recovery
- 29.12.2015: Action for annulment by Fiat (T-755/15)
- 30.12.2015: Action for annulment by Luxembourg (T-759/15)

**Luxembourg**



- 03.12.2015: Investigation

**amazon**

- 07.04.2014: Investigation



- 19.09.2016 – Investigation

1,000 tax rulings being examined for about 700 companies



# Advantage?

- Market Economic Operator (MEO) test
  - Intra-group transactions at market price?
- OECD's arm's length principles: benchmark for MEO
  - Intra-group transaction in line with transactions between independent companies (standalone) in comparable transactions in similar circumstances
    - Traditional methods (price, resale price, mark up over costs)
    - Transactional profit method (profitability of the subsidiary)
  - Significant room for interpretation and subjectivity
- Court of Justice
  - 2006 – *Belgian Coordination Centres* case
    - Taxable income different from the one which would result from the commercial accounts of 'prudent independent operators'





# Advantage?

- Commission challenges certain methods in certain situations – creates hierarchy among methods
- Commission challenges transfer prices with no economic justification
  - Compliance with OCDE principles not sufficient
    - Advantage if:
      - No robust economic rationale / low corporate tax jurisdiction
      - Ruling for duration + 5 years
      - Multinationals vs domestic companies / standalone



# Selectivity?

- Collapse of *advantage* and *selectivity* conditions
  - Avantage : comparasion should be with "normal market conditinod" (not among treatment of other entreprises)
  - Selectivity : comparasion should be with the actual treatment of other companies in the same Member State, in a comparable situation
  - Avantage can be non selective – *MOL & Santander* cases
  - Concomitant analysis but separate (*Bovines*)
- The Commission made wrong and inconsistent choices
  - Questioning the system of rulings or some rulings?
  - Reference system: companies or multinationals?
  - Option 1: comparing multinationals with standalone companies
    - Then, the system of rulings should be put into question and the Commission did not claim that
  - Option 2: comparing multinationals with multinationals
    - Then, only some rulings may constitute aid; which ones?



# Selectivity?

- The Commission selected option 1 and has done something new in the decisions
- Main issue is the reference system
- Previous decisions / case law
  - Reference system was all multinationals (not all companies)
- Comparison under EU option will always show a difference
  - Standalone companies, SMEs do not have transfer pricing arrangements
  - Only rulings applying OECD principles would be ok



# Selectivity?

- Commission's option 1 – multinationals vs standalone companies
  - It compares selected rulings with an "ideal model", not with the normal practice of the Member State
  - For the Commission, the ideal model can only be OECD "arm's length principles"
  - However, this has nothing to do with what the Member State actually does, but with what the Commission thinks it should be doing
- State aid is not about comparing
  - what Member State does with an "ideal model" (what the State should do)
  - but with what the Member State normally does in that kind of situation



# Other conditions

- Transfer of State resources
  - State foregoes resources
- Distortion of competition
- Affect trade between Member States
  - Legal presumption if selective advantage



# U.S. Treasury's reaction

- Major implications for the U.S.
  - Aid recovery: outsized impact on U.S. companies
  - Foreign tax credits would offset the U.S. tax bills
  - Global implications for the international tax system and the G20's agenda to combat BEPS
  - Reducing tax certainty to the detriment of growth and investment.
- U.S. white paper outlining the Department's concerns with the Commission's approach.
  - New and unforeseeable by the relevant companies and EU Member States
  - Aid recovery sets a bad precedent for tax policymakers around the world
  - Undermines U.S. tax treaties and international transfer pricing guidelines already accepted broadly in the global tax community, and undermines the work done as part of the BEPS project.
- Preferred approach
  - International tax cooperation
  - Shared objective of preventing the continued erosion of the corporate tax base



# Issues in summary

- Reference system
  - Comparison with an ideal model
- OECD criteria not EU law and not the only model
- Recovery
  - Legitimate expectations and legal certainty?
    - However, recovery of unlawful and incompatible aid is a longstanding EU law principle
  - Windfall profit for the State concerned
  - Tax adjustment in other States?



# Conclusion

- US multinationals not targeted
- Multinationals targeted by a specific EU enforcement policy
  - Tax planning unit
  - Part of strategical objectives of the Commission
  - Complementary actions with legislation
- International law vs EU law
  - Not a unique issue (also in aviation, bilateral investment treaties)
- Commission acting *ultra vires*?
- State aid enforcement
  - Classic enforcement but errors of law (selectivity)?
- EU courts will clarify
  - 21 December 2016 – one ruling expected on tax aid case (Spanish fiscal aid case)



**Thank you for your attention!**

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