EUROPEAN COMMISSION

Brussels, 20.03.2017
C(2017) 1579 final

Dear President,

The Commission would like to thank the Seanad Éireann for its Reasoned Opinion on the proposals for Council Directives on a Common Consolidated Corporate Tax Base {COM(2016) 683 final} and a Common Corporate Tax Base {COM(2016) 685 final}.

The Commission would like to make some general remarks on the political context of these proposals and their compliance with the principle of subsidiarity before addressing the specific points raised in the Opinion in detail.

In the explanatory memorandum that accompanies each of the two proposals for a Common Consolidated Corporate Tax Base and a Common Corporate Tax Base, the Commission set out its arguments on why the objectives of these proposals cannot sufficiently be achieved through initiatives undertaken by each Member State on an individual basis. The Commission also explained how Union-wide action could more effectively tackle distortions of a cross-border nature that result from the interaction of national tax systems.

The objectives sought to be achieved through the Common (Consolidated) Coporate Tax Base system essentially aim to tackle problems that reach beyond a single Member State and, therefore, require a common approach. The Common (Consolidated) Corporate Tax Base responds to the needs for increased growth and job creation in the internal market and also for countering aggressive tax planning. In the Commission's considered view, these challenges do not have a domestic focus but arise in a cross-border framework. It is namely the interaction between different tax systems that generates opportunities for abuse or facilitates taking advantage of mismatches arising from different national corporate tax rules.

The Common (Consolidated) Corporate Tax Base proposals would harmonise the corporate tax base, which is a prerequisite for rectifying identified distortions in the internal market, but Member States would remain free to decide which tax rate to apply to the share of the base that they are allocated through the formula.

Senator Denis O'DONOVAN
President of the Seanad Éireann
Houses of the Oireachtas
Leinster House
Kildare Street
IRL – DUBLIN 2

The Commission would also like to recall that Article 115 of the Treaty on the Functioning of the European Union provides the legal base for the Union to act in this area, in line with the principles of subsidiarity and proportionality.

In response to the more technical comments in the Reasoned Opinion, the Commission would like to refer the Seanad Éireann to the attached annex.

The Commission hopes that the clarifications provided in this letter address the issues raised by the Seanad Éireann and looks forward to continuing our political dialogue in the future.

Yours faithfully,

Frans Timmermans
First Vice-President

Pierre Moscovici
Member of the Commission

ANNEX

The Commission has carefully considered each of the issues raised by the Seanad Éireann in its Reasoned Opinion and is pleased to offer the following clarifications.

Methodology of the impact assessment

The Seanad Éireann questions the methodology used by the Commission in calculating a net decline in corporate tax receipts for Ireland equal to 1.4% of the gross domestic product. The Seanad Éireann criticises the absence of a detailed analysis of national information and also holds the view that data is missing on sales by destination. In this context, it is also points out that although growth in the internal market as a whole is set to increase by up to 1.2%, there is no assessment of the impact on individual Member States.

The subsidiarity check under Article 115 of the Treaty on the Functioning of the European Union primarily focusses on determining the necessity for enacting a certain envisaged measure at the level of the EU, instead of nationally, in order to ensure that the envisaged objective can be fulfilled. This does not necessarily include taking into account very detailed national information pertaining to each Member State. This being said, the impact assessment and the three external studies that have been published alongside with it also provide extensive country-specific results.

Even though the Seanad Éireann does not further specify the grounds on which its criticism of the methodology used by the Commission is based, it should be pointed out that assessing the impacts of a cross-border corporate tax system where more than one jurisdiction is involved is an inherently complex exercise. In fact, this can mainly be done through a model which brings together national data originating in disparate corporate tax systems. Although the modelling exercise that has been undertaken is state-of-the-art, it is clear that there are inherent limits in all such models. Notably, they cannot incorporate all elements of a proposal, including some of the important revenue-raising features, such as the absence of intellectual property box regimes in the common tax base or the impact of eliminating the possibility to reduce taxes through debt shifting. In addition to the work of the Commission, national Ministries of Finance may also use the models and tax return data at their disposal to complement the analysis provided in the impact assessment.

It is also important to highlight that the impact assessment of the 2016 proposals has to be read in conjunction with that of 2011[1]*. As explained in Annex V of the 2016 impact assessment, the structure of the formula apportionment has not been modified, as compared to the first proposal and so, the analysis underpinning this scheme has to be found in the impact assessment of 2011. This document includes modelling of the potential formula factors and concludes that the existing combination of factors and weights best reflects the principle that tax should be paid where value is created.*

[1] SEC(2011) 315 final.

Tax rates

The proposals do not deal with the levels at which tax rates should be set at the national level. The Common (Consolidated) Corporate Tax Base proposals harmonise the corporate tax base, which is a prerequisite for rectifying identified distortions in the internal market. Member States remain free to decide which tax rate to apply to the share of the base that they are allocated through the formula. It follows that Ireland would individually fix its rate to apply to the Common (Consolidated) Corporate Tax Base share. However, given that the common rules for the base do not draw a distinction between trading and passive income or capital gains, Member States will have to decide on a single national rate for the purpose of the Common (Consolidated) Corporate Tax Base.

Impact on national tax revenues

Regarding impacts on tax revenues, the Commission wishes to note that Member States' budgetary choices are likely to depend on a variety of factors, all possible combinations of which cannot be modelled and assessed. However, the impact on the revenues of Member States will ultimately depend on national policy choices with regard to possible adaptations of the mix of different revenue collection elements. Member States will hence have all the flexibility to control the impacts on tax revenues.

In any case, the Commission would like to clarify that, in the absence of detailed actual revenue data from national tax administrations, gathering quantitative evidence on the impacts of the Common (Consolidated) Corporate Tax Base on individual national revenues would be particularly challenging and require the use of both representative and accurate data in the quantification of the future tax charge.

Relation to the anti-tax avoidance directive

According to the Seanad Éireann, it is not clearly established that the Common (Consolidated) Corporate Tax Base brings benefits which do not exist in the recently adopted Directive against tax avoidance practices[2]*. The Commission's Action Plan of June 2015 sets the context for the Directive and the Common (Consolidated) Corporate Tax Base initiatives. The Directive only provided for immediate action to deal with urgent needs within the context of existing national tax systems. The Common (Consolidated) Corporate Tax Base will eliminate mismatches and loopholes between national systems which are exploited by tax avoiders. Transfer pricing, which accounts for around 70% of all profit-shifting, will be eliminated. Moreover, the Common (Consolidated) Corporate Tax Base sets objectives that also reach beyond anti-tax avoidance action: it is by itself a fully-fledged corporate tax system, which is designed to have a cross-border dimension and improve the functioning of the internal market. Indeed, an equally critical aspect of the Common (Consolidated) Corporate Tax Base involves its business facilitation aspect, as part of which the new scheme would be expected to promote growth and lead to job creation in the internal market.*

[2] Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market, OJ L 193, 19.7.2016, p. 1.

Parallel operation of two tax systems

The Seanad Éireann doubts whether the Common (Consolidated) Corporate Tax Base can meet the objective of reducing administrative burden, assuming that some companies which are not captured by the mandatory scope of the directive may decide to opt for applying it. Consequently, Member States will be encumbered with operating two corporate tax systems in parallel.

The Commission would like to clarify that the argument of administrative simplicity is primarily relevant to taxpayers and, in particular, to those with cross-border activity in the internal market because they will be given the opportunity to settle their tax obligations through one single corporate tax system. When it comes to administrations, it is inevitable that in the first years following the introduction of the Common (Consolidated) Corporate Tax Base, they may need additional resources but in the mid-term, administrations should be in a position to benefit from the reduction in workload related to transfer pricing compliance within the European Union.

Incompatibility with OECD initiatives

The Commission does not share the view that the Common (Consolidated) Corporate Tax Base proposals run counter to the initiatives undertaken by the OECD. On the contrary, the Common (Consolidated) Corporate Tax Base, once implemented, will make a major contribution to the fight against tax avoidance, in particular the erosion of corporate tax bases and profit shifting. It should therefore be seen as complementary to the OECD work in the same field. The OECD is an inter-governmental organisation which, in tax matters, makes recommendations (with the exception of the Multilateral Instrument) that States are called on to apply individually or on a bilateral basis (e.g. Double Tax Conventions). It follows that the OECD does not consider the specific features which are relevant to a single market, such as that of the EU. Without ignoring the general political context around international taxation (e.g. the recent shift of policy priorities towards anti-tax avoidance), the Commission retains the competence to propose legislation – within the limits of its Treaty-based competence – in order to ensure a better functioning of the internal market.

Having said this, the Commission can confirm that the transfer pricing principles agreed at the OECD will continue to apply to transactions with associated enterprises outside the tax consolidated group within the European Union and in third countries.

Risk of losing national expertise

The Commission does not share the view that Irish tax officials may lose their expertise in taxation. First, a large number of companies will continue to apply the national corporate tax system. In addition to this, some officials will have to be trained in administering the Common (Consolidated) Corporate Tax Base for a limited number of corporate taxpayers. This will gradually create judicial precedent and administrative expertise which will also be informed by the sharing of experiences and views with officials from other Member States.

Weakness of the formula factors

It should be recalled that the Commission, in the choice of formula factors for the Common (Consolidated) Corporate Tax Base, based its proposal on a tried and tested methodology. These three equally weighted factors (assets, labour and sales by destination) constitute the so-called 'Massachusetts formula', which the States in the USA have been using – in numerous variations – since the beginning of the twentieth century, for the purpose of charging Franchise Tax (i.e. tax on trading profits at State level). Prior to the proposal of 2011, the Commission modelled different combinations and weights of the formula factors and the results clearly demonstrated that the proposed combination of the three equally-weighted factors offers the best option. It was found that this scheme offers the fairest results and that these are the most resilient to attempts of manipulation and tax avoidance practices.

It therefore follows that the allocation of profits through a formula is likely to guarantee a more efficient way for allocating profit within an integrated group that operates in a single market, as compared to traditional transfer-pricing methodologies. This is because the factors have a direct relevance to the real economy since they relate to the key income-producing elements of a company: assets, personnel and sales.

Although intangibles are not included in the assets factor of the formula, they are not ignored. Specifically, intangibles are taken into account where this is necessary to ensure that the State(s) which contributed to the creation of those intangibles (for instance, through giving deductions for research and development) can subsequently secure a taxing right on the profits generated out of successful assets.

The Commission does not share the view of the Seanad Éireann that sales by destination unjustifiably favour countries with larger populations. Sales by destination bring the point of taxation closer to consumption and in this way, create a framework which cannot easily be manipulated simply by moving the point of production. All the destination principle does is to attach taxation where profits are earned. This is a straightforward and clear principle.

Judicial matters

The Commission respectfully considers that the Seanad Éireann is mistaken in asserting that national courts will be deprived of their role in adjudicating tax cases. Neither is it true that the intention is to bring tax matters and disputes before the Court of Justice of the European Union. In fact, the competence of the Court is defined in the Treaties. It follows that secondary legislation may assign cases to the Court only within the scope of the competence delineated in the Treaties.

The Common (Consolidated) Corporate Tax Base administrative procedures maintain the competence of the national courts of the principal tax authority both for disputes between Member States and administrative and judicial appeals between tax authorities and taxpayers.

Impacts on growth and investment

The Common (Consolidated) Corporate Tax Base has very clear benefits for businesses, which have been assessed in the impact assessment published with the proposal. Business facilitation, alongside fighting tax avoidance, is one of the main objectives of the Common (Consolidated) Corporate Tax Base. These benefits include, but are not limited to, the removal of cross-border investment obstacles, an allowance to foster research and development and an allowance for growth and investment. The Commission does not share the view that small companies will simply benefit from a narrower tax base whereas large companies would not find the system attractive. To the contrary, the Common (Consolidated) Corporate Tax Base offers attractive features for all types of companies. More generally, it will make the EU a highly attractive market to invest in, by allowing companies to benefit from a single set of solid and predictable rules, a level-playing field, and reduced costs and administration. To the extent that small companies benefit, they can opt into the system, with corresponding benefits for the economy as a whole.