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PRESIDENCY ISSUES NOTE

Working Session III: A renewed approach for corporate taxation in the Single Market and tax challenges of the digitalization of the economy

I. Introduction

The main objective of taxation is to provide funding for public spending, support economic growth and employment, promote investment and social fairness. In the EU context, this means reducing barriers for businesses and creating an environment more open to investment and innovation, increasing the competitiveness of EU enterprises and the Single Market as a whole, while ensuring that all taxpayers pay their fair share and that taxation fulfils its function of supporting the EU's social and economic model.

While the objectives and functions of tax systems do not change, the world in which they operate changes rapidly. Due to the rapid technological development and the digitalization of economies and societies, different business models and competitive forces develop, which create opportunities as well as challenges for the sustainability and fairness of the tax environment.

There are a number of aspects of the current corporate tax system that could be adjusted to cope better with the ever-changing global economy and with international pressures, such as the unprecedented business globalization and digitalization. The measures that the EU should take need to be consistent with the ones taken at the global level and at the same time have to contribute to the competitiveness of each and every Member State as well as the EU as a whole.

The purpose of this document is to guide the discussion among Ministers on the topics related to identifying priority areas of corporate taxation where further action is needed at EU level.

II. The corporate tax system in the EU Member States and the challenges it's facing

If well designed, tax systems ensure sustainable revenues in the long-term and are considered by all taxpayers across the EU to be fair and stable. A proactive, well-considered coherent approach to shaping future tax policy in the EU Member States is likely to yield far greater results than piecemeal and reactive adjustments.

The timely implementation of coherent changes to the Member States' tax rules would make the EU a global leader in the implementation of new and modern taxation standards corresponding to the dynamic business and technologic development and globalization while providing the necessary incentives for investment and growth.

1. *Corporate taxation in an ever-changing international environment*

The EU is a useful platform through which the EU Member States could react strategically to major shifts in the international tax environment. The US and other international partners are already taking steps to adapt their corporate tax frameworks to the new status quo. The US tax reform, for example, includes elements to boost US competitiveness, as well as measures against the challenges of aggressive tax planning. Inevitably, in today's interconnected global economy, this will have an impact on other major economies, and the EU as a whole. Through the EU, Member States could therefore consider their tax policies collectively from the perspective of revenue and competitiveness needs, just as its international partners are already doing.

Ensuring that the EUs' tax systems remain competitive does not mean entering a race to the bottom. Stability and certainty for businesses, simplicity, ease of administration and a level playing field for different types of businesses all play a vital role in supporting the competitiveness of the EU economies. The national tax systems need to incentivise investment and innovation, both in their general structure and through appropriately designed tax incentives.

This challenge is unlikely to be met through a fragmented response in today's globalised, digitalised, mobile business environment. Against this background, a coherent EU approach would respond better to new and emerging challenges in taxation and to safeguard the Single Market. A coordinated tax strategy is also more effective in helping Member States to maximise the collective benefits of the new economy. The EU could also continue to support international action and multilateral solutions to address common challenges. Here too, coordination in the Council of the EU will strengthen the Union's influence in shaping the global solutions – the EU speaks most strongly when it speaks with a common voice.

2. *Ensuring a fair and efficient corporate tax system in the EU*

The EU should reflect on a fundamental level on how to review its corporate tax system to better deliver on the twin pillars of fairness and competitiveness in the long term.

The Common Consolidated Corporate Tax Base (CCCTB) proposals could help to deliver on these goals. It could indeed ensure a fair and efficient framework for taxing multinationals, while also improving the tax environment for businesses in the EU.

The Bulgarian Presidency aims to identify those parts of the proposal for a common corporate tax base (CCTB) that are needed for an evaluation of the impact on MSs' national tax revenues. This evaluation would be done in the course of 2018 by Member States who hold the data necessary for running such an exercise with the technical assistance of the Commission services.

In this context and taking into account international developments, Member States could identify the incentives that may give the greatest boost to EU competitiveness, and consider how these could be introduced at EU level. These shared tax incentives could help the EU to become a platform to formulate a tax policy that effectively responds to unfavourable external factors. The EU should not overlook the international dimension, in particular in relation to some jurisdictions outside the EU. It should pursue its dialogue with them, based on the work already started through the EU list of non-cooperative jurisdictions for tax purposes. With this regard, it is important that the commitments made by jurisdictions in the context of the EU list continue to be properly monitored by the Council. If third countries fail to deliver on their commitments, Member States could consider the possibility of taking consistent and co-ordinated action also through stronger common countermeasures.

Parallel efforts should be focused on ensuring full compliance with EU Treaties, especially as far as EU freedoms and competence issues are concerned.

III. The digitalization of the economy and corporate taxation

The development of technology and the ever-widening of digitalization, both in the process of doing business and in the day-to-day activities of people, provide new opportunities for building business models and carrying out activities unlimited by the geographic location and location of business partners. Consequently, companies operating in different countries have achieved significant growth and influence, and this growth is not always fairly reflected when the tax burden is assumed. Hence the need to reconsider the international tax rules in the field of direct taxation in order to be on the one hand, fairer for the countries and on the other hand, to ensure predictability and certainty for the business.

1. *Challenges to corporate taxation arising from the digitalization of the economy*

The digitalization of the economy is characterized by an unparalleled supply of goods and services, a broad acceptance of multi-sided business models, the provision of free products and services and the difficulty in determining the country/jurisdiction in which value is created and where the taxation should take place.

This raises the fundamental question of how companies operating in a digital economy add value and generate profits, and how the digital economy refers to the concepts of “source”, “residence” or “profits for tax purposes”. At the same time, new business models can lead to a shift of basic business functions and to a different distribution of tax rights between countries which can result in low taxation or non-taxation.

Existing weaknesses put the current framework, on which the corporate taxation rules are based, at risk and taking appropriate actions can prevent the situation from deteriorating and further deepening of the problems. Inaction in this area may lead to corporate tax losses for countries or to the emergence of competing sets of international standards. The replacement of the existing consensus-based framework by unilateral measures could furthermore lead to a global tax havoc, with a massive re-emergence of double taxation.

2. *Possible responses to these challenges*

a. *Actions at EU level*

The globalization and digitalization of the economy open up huge opportunities for EU Member States, businesses and citizens. However, they also impose many challenges, including the sustainability of tax systems. In response to the European Council's calls, the Commission on 21 March made proposals for fair and effective taxation of the digital economy.

The first element of the Commission's proposals is a comprehensive solution to adapt the current corporate tax rules to profit-creation in the digital economy which is envisaged in the proposed Directive and a Commission Recommendation to Member States. If adopted by the Council, these rules would enable Member States to tax businesses with a significant digital presence in their jurisdictions, building on current corporate tax rules for the allocation of profits.

The progress on this element is also related to the work on the CCCTB proposal which could, when appropriate, be adapted to include the same principles.

The second element of the Commission's proposals is an interim tax on revenue generated by particular digital activities. This reflects the pressing need for action, which has already motivated a number of Member States to take unilateral action. The proposed digital services tax focuses on the activities where there is a large gap between the value created by user data and user participation and Member State's ability to tax it.

These two proposals are open for discussion in the Council. A strategic discussion on taxation took place on the occasion of the March European Council, with a significant number of leaders confirming the need to discuss taxation of the digital economy. The issue may also be raised at the June 2018 European Council.

The Presidency is ready to consider designing a roadmap for further work at technical level in the Council on the digital taxation package.

b. *Actions at global level – Interim Report on the Tax Challenges Arising from Digitalization, OECD*

In March 2017, the G20 Finance Ministers mandated the OECD, through the Inclusive Framework on BEPS, to deliver an interim report on the implications of digitalisation for taxation by April 2018. This interim report, Tax Challenges Arising from Digitalisation – Interim Report 2018 (hereafter the “Interim Report”) has been agreed by the more than 110 members of the Inclusive Framework and has been presented by OECD Secretary-General Angel Gurría to the G20 Finance Ministers at their meeting on 19-20 March in Buenos Aires, Argentina.

The Interim Report is built on the 2015 BEPS Action 1 Report and includes an in-depth analysis of the changes to business models and value creation arising from digitalisation, and identifies characteristics that are frequently observed in certain highly digitalised business models. It was agreed that work will continue towards a consensus-based solution, noting that at present there are divergent views on how the issue should be approached and that the Inclusive Framework would carry out this work with the goal of producing a final report in 2020, with an update to the G20 in 2019.

IV. Questions for discussion:

- Do you agree that the Member States, meeting within the Council, should work further on developing a coherent approach to corporate taxation to support the competitiveness of the Single Market, while recognizing the specific needs of all Member States?
- Should we ask our experts to examine the links between the various Commission proposals and work ongoing in the G20/OECD context in relation to digital taxation and to take this into account when organising further technical work in the Council?