Briefing
Initial Appraisal of a European Commission Impact Assessment

European Parliament

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Publishing corporate tax information

Country-by-country reporting for multinational enterprise groups

Impact Assessment (SWD (2016) 117, SWD (2016) 118 (summary)) of a Commission proposal for a Directive of the European Parliament and of the Council amending Directive 2013/34/EU as regards disclosure of income tax information by certain undertakings and branches (COM (2016) 198)

Background

This briefing seeks to provide an initial analysis of the strengths and weaknesses of the European Commission's Impact Assessment (IA) accompanying the above proposal, adopted on 12 April 2016 and referred to the European Parliament's Committee on Legal Affairs (JURI; rapporteur: Evelyn Regner, S&D Group, Austria). According to this proposal, very large multinationals would be required to publicly disclose via the Internet the amount of income tax they pay as well as additional information - such as their turnover, profit before tax and number of employees - broken down by individual EU Member State and tax haven, should this be the case[1], and, as a rule, aggregated for the rest of the world. The European Parliamentary Research Service (EPRS) has produced a parallel implementation appraisal[2] in anticipation of this proposal, which provides a succinct overview of publicly available material on the implementation, application and effectiveness of EU legislation in this field. The proposal is one of a number of initiatives aimed at addressing the erosion of the Member States' tax bases and the shifting of profits to lower tax jurisdictions. It builds on an action plan developed by the Organisation for Economic Co-operation and Development (OECD) in November 2015 and endorsed by the G20. The disclosure of income tax information by multinationals to tax authorities was introduced by Council Directive (EU) 2016/881 which was unanimously adopted by the Council on 25 May 2016. For further information, please see the corresponding EPRS legislative briefing[3].

Problem definition

The IA clearly identifies the problem in need of possible EU action as 'the lack of public scrutiny on Member States and [multinational enterprises] as regards corporate income tax, due to the absence of broadly accessible information' (IA, p. 13). According to the IA, an environment of complex tax rules, fiscal secrecy and non-cooperation between Member States allows multinational enterprises to reduce the amount of their corporate income tax by adopting aggressive tax planning practices. In the current context of tight fiscal policy and budget deficits, Member State authorities are forced to fill the gaps by raising taxes on the least mobile tax bases, such as labour income. This imbalance has led to public criticism and dissatisfaction. This problem and its broader context are amply evidenced in the IA. The IA quotes an EPRS study[4], according to which aggressive corporate

[1] Tax havens are defined as third-country jurisdictions which do not respect international standards on good tax governance; the proposal envisages that a common Union list of tax havens would be drawn up by delegated acts.
[2] Publishing corporate tax information: Implementation Appraisal, PE 581.399.
[3] EU legislation in progress, Country-by-country reporting for multinational enterprise groups, PE 583.819. A legislative briefing on the proposal (COM) 2016 198 is forthcoming.
[4] Bringing transparency, coordination and convergence to corporate tax policies in the European Union, Assessment of the magnitude of aggressive corporate tax planning, PE 558.773.

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PE 581.420

tax planning leads to a loss of tax revenue to the EU estimated to be worth around 50-70 billion euro each year. For reference, the EU budget for 2016 was approximately 155 billion euro.

Objectives of the legislative proposal

The objectives of the Commission proposal are clearly defined in the IA. The *specific* objective is to increase corporate tax transparency, that is, to make information on corporate income tax accessible to the public. The broader *general* objectives are: to align the corporate income taxes multinationals pay with their actual profits (in other words, enterprises should pay taxes where they make their profits); to foster corporate responsibility in order to contribute to welfare through taxes and, finally, to achieve fairer tax competition in the EU through democratic debate. According to the Better Regulation Toolbox, objectives should be specific, measurable, achievable, relevant and time-bound ('SMART', tool No 13). The objectives set out in the IA appear to be specific, achievable and relevant, as they are concrete, realistic and is directly linked to the problem – the lack of public scrutiny. On the other hand, they do not appear to be 'related to a fixed date or precise time period to allow an evaluation of their achievement' (IA Toolbox, p. 80), as is often the case for Commission IAs. In terms of presentation, the problems addressed, their consequences and the hierarchic set of objectives have been usefully combined into a single synoptic figure, rather than being grouped into separate sections (IA, p. 13).

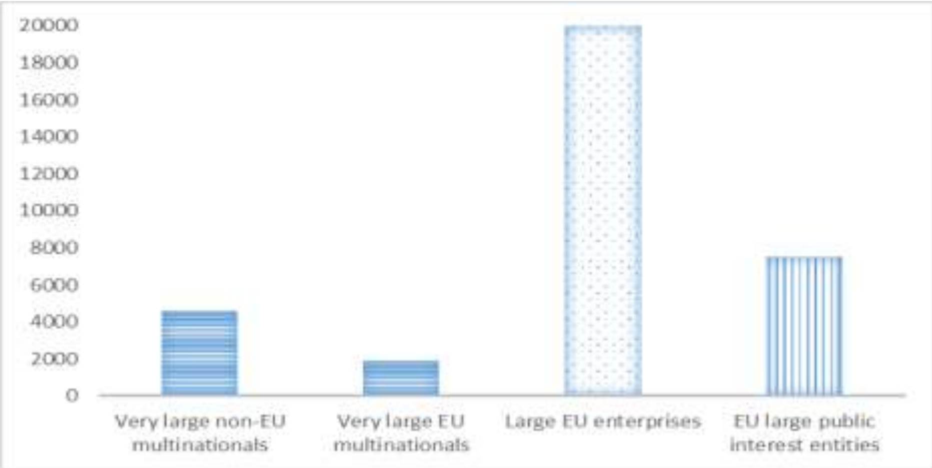
Range of options considered

The identification of the options is achieved through a two-step approach: as a first step, some preliminary issues are dealt with, narrowing down the options to a more manageable core, which is the subject of a more in-depth analysis.

The table providing an analysis of the information to be disclosed (IA, p. 21) appears to be a useful policy-making tool, as transparency regarding the criteria used to define what is to be included can contribute to an informed debate on this essential issue. This table builds on a more extensive analysis on pp. 119–124 of the IA and includes information already called for in Parliament resolutions (such as the one of 25 November 2015 on 'tax rulings and other measures similar in nature or effect'; and the resolution of 16 December on 'bringing transparency, coordination and convergence to corporate tax policies in the Union').

Apart from the question about the nature of the information to be disclosed, another preliminary issue is the type and number of companies which should fall in the scope of the initiative. In this respect, the IA expresses a preference to limiting the reporting to *'very large parent companies',* that is, companies with an annual turnover above 750 million euro - which would be consistent with the threshold for the disclosure of income tax information by multinationals to tax authorities. Throughout the document, the possibility to extend reporting to a wider number of *'large parent companies'* is analysed. This refers to the definition given in Article 3 of the Accounting Directive – amended by this proposal – which identifies large groups as those exceeding at least two of the following threshold criteria on the balance sheet of the parent company: an annual net turnover of at least 40 million euro; a balance sheet total of at least 20 million euro; and an average of at least 250 employees during the financial year. Among the additional alternatives considered is for the scope to cover '*large public-interest entities*'. Public-interest entities are defined in Article 2(1) of the Accounting Directive and include undertakings with a certain legal form, which are: a) undertakings whose transferable securities are admitted to trading on a regulated market of any Member State; b) credit institutions; c) insurance undertakings; and d) designated as public-interest entities by Member States. This option is discarded upfront. The graph below portrays the estimated number of companies involved according to the IA.

Graph 1: Estimated number of companies in the IA



Source: European Commission IA, author.

The possibility of introducing some sort of a voluntary labelling system is also analysed, but the IA considers this approach as ineffective and discards it upfront (IA, p. 24).

All options retained after this initial screening are combined into a useful matrix for a more in-depth analysis (IA, p. 29). Option 1 (the status quo) is, as of 25 May 2016, the requirement for transparency towards tax authorities introduced by Council Directive (EU) 2016/881[5].This option was originally set out in Commission proposal COM(2016) 25 of 28 January 2016, which was not accompanied by an IA. The Explanatory Memorandum of that proposal states, inter alia, that 'no impact assessment was carried out [...] in particular [as] there is an urgent demand for coordinated action in the EU on this matter of international political priority' (p. 8).

The table below provides a simplified version of the other options and sub-options.

Table 1: Focusing on public country-by-country reporting – the options and sub-options in the IA

Criteria	**Options and sub-options**		
On which operations?	2. On EU-controlled operations		3. On worldwide operations
Granularity of the reporting	A. Broken down by EU Member State and aggregated for third countries		B. Broken down by Member State and third country
Who should do it?	(a) Large EU parent companies	(b) Very large EU parent companies (annual turnover > €750 million)	Very large parent companies (annual turnover > €750 million) with a subsidiary/branch in the EU
Information covered	(i) – income tax accrued – income tax paid		(ii) – income tax accrued – income tax paid – turnover – profit before tax – number of employees

Source: European Commission IA, author.

Most of these options and sub-options can be combined. This means that the IA considers three main options: 1), 2) and 3); four main sub-options 2A), 2B), 3A) and 3B); as well as the additional sub-options 2(A)(a), 2(A)(b), 2(B)(a) and 2(B)(b). The possibility to provide either some basic information, as in (i), or more extensive contextual information, as in (ii) in the table above, is also analysed. Although changes can obviously be imagined, this seems to be a rather comprehensive set of options. **Option 3A(ii)** is the IA's preferred option and is greyed-out in the table above.

[5] The implementation deadline for the Member States is set at 4 June 2017. See the quoted EPRS legislative briefing.

Scope of the Impact Assessment

The IA argues that the proposal would bring about both social and economic net benefits. It addresses and expands more extensively on a wide range of **economic impacts** – mainly growth and jobs, market efficiency, level playing field and competitiveness – through a systematic qualitative analysis. These are complemented by an issue-specific risk analysis, focusing on the risk that information may be misinterpreted as well as on the risk of tax adjustments and disputes resulting in double-taxation. The impact on tax revenues is also analysed. In some instances, these main topics are usefully broken down, in some instances, into their constitutive elements. For instance, market efficiency is broken down into threshold effects, impact on cost of capital, market monitoring and organisation efficiency. Although one could consider the statements contained under these sub-sections fairly general, this level of analysis seems to be an acceptable starting point for further research.

The IA indicates clearly the working assumptions it has used and the uncertainties in the outcomes. For instance, it openly acknowledges that the overall outcome with regard to the area of growth and jobs is uncertain. It also specifies that the substantial increase in corporate income tax revenue is a working assumption and not an economic forecast. Moreover, the IA identifies the key elements – such as the shareholder structure of individual firms – which may influence how impacts would actually materialise. The tone of the analysis is balanced, carefully weighing the pros and cons.

Social and societal impacts are assessed in the IA, which states that all the options considered would contribute to some extent to increasing public trust and 'soothing societal dissatisfaction associated with the suspicion of unfair tax practices' (IA, p. 40).This is substantiated in particular by the contribution of non-governmental organisations to the public consultation, as well as by the opinion and work of media, citizens as well as some investors. According to the IA, Option 3B, which provides a break-down of information also for third countries, would have the most positive contribution to societal impacts.

As far as the **territorial dimension** of the analysis is concerned, the IA contains a wealth of relevant information at Member State level. It is worth highlighting in particular in this respect the parliamentary inquiries in the UK and France (pp. 112–114); and the findings on the possible territorial effects of a lower threshold than the one selected (turnover above 750 million euro per year). In this respect, the IA states that, as firm size varies across the EU, enterprises in Germany and the UK would be the first to be affected, whereas it would take even lower thresholds to capture firms in France and Poland, then in Italy and Spain, and finally in smaller Member States (pp. 141–143). Relevant studies about Denmark, the Netherlands and Sweden have also been taken into account (IA, p. 126).

Based on this theoretical framework, options are put on a continuum from the least to the most effective. A useful table (IA, p. 44) summarises the magnitude of the main impacts for each option considered. The retained option is the one which, according to the Commission, would provide the most societal and economic benefits in terms of increased public transparency, while minimising potential negative effects. The IA acknowledges that there would be some additional costs which it deems as 'insignificant' for very large EU multinational groups already subject to the mandatory exchange of information towards tax authorities, and 'minimal' for non-EU ones (IA, pp. 41–42). Should country-by-country reporting be extended to large multinational groups, argues the IA, each group would incur recurring costs worth, on average, 100 000 euro a year. This average may vary significantly depending on the group's structure and situation (IA, pp. 42 and 155).

Subsidiarity / proportionality

The IA states that the added value of EU action is justified by the cross-border nature of many tax planning structures and transfer pricing arrangements, which allow multinationals to easily relocate their tax base from one jurisdiction to another within or outside the EU, and by the fact that Member States in isolation are ill-equipped to address cross-border issues (IA, p. 18). National parliaments had until 16 June 2016 to raise objections to the proposal on grounds of subsidiarity. By that date, both the Irish Houses of Oireachtas and the

Riksdag of Sweden had issued a reasoned opinion, considering the proposal not to be fully compatible with the principle of subsidiarity. The Swedish Parliament considered the list of tax havens – which was included in the proposal but was not analysed in the IA – to be in conflict with the principle of proportionality; and that Article 50 TFEU should not be the legal base, as the proposal entails a harmonisation of tax regulations. The Irish Parliament also objected to the list of tax havens and to the harmonisation of tax regulations the proposal would allegedly entail. The IA considers that both Article 50 TFEU and Article 114 TFEU concerning the functioning of the internal market may serve as the appropriate legal basis, either combined together, or as alternatives to each other. It adds that 'measures on corporate transparency on payment of taxes would have no direct effect on the taxation of companies: transparency is expected to only indirectly contribute to this overall objective' (IA, p. 19).

Considerations of proportionality constitute one of the stated reasons behind the choice of the options retained by the Commission. The IA indicates that the chosen course of action builds on the international consensus reached by the G20 in terms of scope and content, and that it should not cause disproportionate administrative burden to companies, generate further tax conflicts or pose the risk of double taxation. With public country-by-country reporting, tax authorities of a Member State or a third country may apply a tax adjustment and claim an additional share of the companies' profit. As this profit has often already been taxed elsewhere, there is a risk of double taxation. The IA states that this risk is lower within the EU, as there is a higher degree of cooperation (IA, pp. 36–-38 and 104–107).

Budgetary or public finance implications

The IA addresses the **cost impact** of the proposal for the Member States and tax authorities and assumes it to be marginal, as Member States would already be complying with the requirement for a mandatory exchange of information with tax authorities (IA, p. 42), originally set out in Commission proposal COM (2016) 25 of 28 January 2016 and currently enshrined in the recently adopted Council Directive (EU) 2016/881.

SME test / Competitiveness

The qualitative assessment of the impact on SMEs is one of the themes of the IA. Its assessment is based, *inter alia*, on the reported finding that 'in the case of high [corporate income tax] jurisdictions a cross-border company pays on average 30% less tax than a company active in only one country' (IA, p. 33). SMEs, which have less capabilities to shift profits and erode their tax base, as they have less financial means and operate in fewer jurisdictions, are the intended end beneficiaries of the initiative and should avoid administrative burden. However, the Executive Summary of the IA clarifies that, in order to cover multinational enterprises established in a third country, medium-size subsidiaries or branch would have new reporting obligations (Summary, p. 3). The proposal's impact from the point of view of EU companies' competitiveness is analysed qualitatively for each option considered (IA, p. 35) and summarised in a table (IA, p. 44). The preferred option (3A) is expected to have a marginal or neutral effect on EU companies' competitiveness, whereas option 2B(ii) is considered the most negative. This effect is related to disclosing commercially sensitive information to competitors, which are not subject to the same requirements. The IA argues that the negative impact is stronger for operations in third countries, as accounting information on subsidiaries is publicly accessible only in Europe (IA, p. 35).

Simplification and other regulatory implications

Firstly, Parliament's resolution of 16 December 2015 on 'bringing transparency, coordination and convergence to corporate tax policies in the Union' called on the Commission to introduce public country-by-country reporting for all multinationals and for all sectors. One of the recommendations made was to consider 'the proposals for full public [country-by-country reporting] outlined in the revised Shareholders' Rights Directive as voted for by the European Parliament on 8 July 2015 and the outcome of the ongoing trilogues on this Directive' (Recommendation A1). In this respect, this IA analyses some elements of this public country-by-country reporting, such as the extension of the requirement to large undertakings and public-interest entities; the country-by-country reporting at the level of third countries; and some of the information to be provided. The IA states that this type of reporting reflects an option presented in the IA (Option 2B), which, however, is not the one retained by the Commission (IA, p. 99 and p. 53, footnote 135).

Secondly, the IA suggests that, on the one hand, an exemption be introduced in the proposal to avoid double reporting for the EU banks which publish a country-by-country report on the basis of the Capital Requirements Directive (CRD IV, Directive 2013/36/EU). On the other hand, it argues that companies active in the extractive industry or the logging of primary forests, which publish a country-by-country report on the basis of the amended Accounting Directive, should be subject to both reporting obligations. One of the stated arguments for this different treatment is that there are, according to the IA, limited overlaps between the 'extractive' and the 'general' country-by-country report, whereas there are similarities in content between the 'banking and the 'general' one (see IA, pp. 135–138 for details).

Relations with third countries

The IA provides relevant information regarding third countries, in both developed and developing economies, as well as tax havens. Beyond a more in-depth analysis of the situation in the USA, the IA presents evidence from a large number of non-EU countries, such as Argentina, Brazil, Canada, China, India, Japan, South Africa, Switzerland and Norway (see, for example, IA, p. 134; pp. 140–141).

Overall, the IA argues that the choices made are based *inter alia* on international considerations, such as the ones which would ensure a level playing field with third countries, and the USA in particular (IA, pp. 34–36). The OECD proposal has been considered as a basis. Moreover, it is stated that 'no major concerns are expected... on the side of third countries' and that the reporting could be seen 'as a proportionate condition to access the EU market' (IA, p. 43). The IA transparently signals that 'certain [multinational enterprises] operating in the EU without an EU branch or subsidiary, as made possible e.g. in the digital economy, may not be subject to a disclosure obligation' (IA, p. 34) – a statement which would seem to deserve a more in-depth analysis. Conversely, the impact is expected to be positive particularly for developing countries, which tend to derive a higher percentage of their revenue from corporate tax. According to some estimates quoted, developing countries lose because of base erosion more than they receive in overseas development assistance (IA, p. 44 and footnote 117).

The figures provided in the IA regarding average international tax rates do not lend themselves to straightforward conclusions. According to a University of Michigan study quoted in the IA, the overall effective tax rates of the largest US multinationals would be lower than that of the largest EU multinationals (30% in the USA vs 34% in the EU). Other sources quoted in the IA point to effective average tax rates[6] of about 20% in the EU (IA, p. 6). By way of comparison, Parliament's resolution of 16 December 2015 on 'bringing transparency, coordination and convergence to corporate tax policies in the Union' states that, as a result of tax rulings, a number of multinationals have enjoyed effective tax rates of less than 1% on the profits (Recital C). Against the backdrop of a pertinent analysis in this domain, the main weakness of the IA appears to be that it does not seem to have analysed the impact of establishing a country-by-country report for tax havens by drawing up a list of such countries (See 'Coherence between the Commission's legislative proposal and the IA' below).

Quality of data, research and analysis

This IA was prepared by the Directorate-General for Financial stability, financial services and capital markets union (DG FISMA), with the assistance of a broad steering group involving 10 additional Commission services, including the Joint Research Centre. The IA extensively refers to relevant literature, including empirical studies by academics, reports by international organisations, national parliaments and governments. The IA relies on

[6] The effective average tax rate is a measure of the present value of taxes paid expressed as a proportion of the net present value of the income stream (excluding the initial cost of the investment).

recent statistics updated for 2014–2015, which are useful for understanding the context of the proposal. These are complemented by in-house analysis. For instance, Annex U is particularly helpful for understanding the accounting aspects of profit-shifting, thanks to clear numerical examples. The IA is factual and takes into account a broad range of inputs from stakeholders holding different views. One of the strengths of the IA is that it also considers the input of civil society organisations. Research commissioned by the European Parliament's research services, policy departments and some of Parliament's political groups is quoted and taken into account. The structure of the IA is good and the presentation of the main conclusions relatively succinct. Additional analysis is structured in a user-friendly way in 21 short annexes, including the four compulsory ones that must be presented according to the Better Regulation Toolbox. The IA conveys most messages in plain language, with a list of acronyms to aid non-expert readers where necessary.

Stakeholder consultation

The extensive body of desk research and in-house analysis is complemented by findings from the consultation which is used as a second, reinforcing argument, rather than as the only line of reasoning. Parliament's resolution of 16 December 2015 on 'bringing transparency, coordination and convergence to corporate tax policies in the Union' recommended that the Commission consider the results of its consultation when proposing public country-by-country reporting. After an initial analysis, it seems that the current IA has implemented this recommendation. Annex B summarises in a clear and structured way the views of the over 400 stakeholders – firms, industry associations, NGOs, trade unions, think tanks, tax authorities, citizens and tax practitioners – who took part in the consultation. Quotes from replies of individual stakeholders are provided in the main body of the analysis. Moreover, the stakeholders who participated in ad hoc consultations are listed, and the number of participants by category seems balanced (six firms, nine industry associations, eight NGOs/trade unions/think tanks, the 28 EU tax authorities and 15 organisations representing business, civil society and tax practitioners). The IA indicates that all inputs have been carefully considered and taken into account, but openly acknowledges that, due to the wide array of opinions voiced by different stakeholders, the policy options explored may not necessarily reflect the views of all parties (IA, p. 72).

Monitoring and evaluation

According to the IA, monitoring would draw on information gathered primarily by the Member States, in compliance with the principle of subsidiarity and in cooperation with the Commission. An evaluation is planned and this has been mentioned in the IA. Article 48i of the proposal requires an evaluation to be submitted to the co-legislators five years after the Directive's transposition date. According to the IA, the Commission plans to carry out sample reviews of reports published on the internet and a survey of multinationals, including their management and auditors, Member States' and third countries' administrations, also drawing on data retrieved from business registers and other sources (IA, p. 54). It seems reasonable to assume that tax havens' cooperation in this respect may be limited. Moreover, further details on the indicators to be used in the ex-post evaluation would have been useful. Finally, it may be useful to add that the Accounting Directive, which would be amended by this proposal, already contains, under its Article 48, an obligation to review the chapter on 'Report on payments to governments'. This review is to be completed by 21 July 2018 and submitted to the co-legislators.

Commission Regulatory Scrutiny Board

The Regulatory Scrutiny Board met DG FISMA on 17 February 2016 and issued a positive opinion on the current IA, requesting improvements related mainly to: clarifying the relationship between the tax evasion context and tax transparency measures; further elaborating the potential option of voluntary disclosure; and strengthening the analysis of impacts, for instance for Member States and non-EU multinationals. Although the draft IA text on which these recommendations were made is not publicly available, the final IA seems to address appropriately most of the issues listed in the opinion.

Coherence between the Commission's legislative proposal and IA

The Commission's legislative proposal seems to follow the recommendations made in the IA. It should be specified that the IA refrains from taking a decisive stance on some issues, leaving this responsibility to political decision-makers. For instance, it leaves open the choice of the legal instrument to be used, which could be either a directive or a regulation (IA, p. 53). Likewise, it states that the legal base for the proposal could be Article 50 TFEU and/or Article 114 TFEU and that the exact choice would depend on the content of the proposal (IA, p. 19). This appears to be consistent with the Better Regulation Guidelines, which state that the IA 'does not need to identify a preferred option', but should only suggest it 'where appropriate' (Guidelines, p. 29). The Commission's Better Regulation Toolbox also require, with regard to the Explanatory Memorandum, that: 'If the final policy proposal deviates from the options assessed in the impact assessment, [the Explanatory Memorandum should] clarify in which way it deviates from these options and what the likely impacts would be of this change.' (Toolbox, tool No 34, p. 243). Substantive divergences are indeed transparently acknowledged, which is welcome. The Memorandum states that: 'the proposal diverges from the impact assessment in two areas: it has been refined with respect to reporting for non-EU operations, where the same level of detailed assessment applying to EU Member States will also be required for certain tax jurisdictions. Moreover, it is proposed to require the disclosure of accumulated earnings on a country-by-country basis and to seek explanations at the corporate group level where there are material discrepancies between the taxes accrued and the taxes effectively paid.' (Explanatory Memorandum, p. 5). However, the likely impacts of these changes do not appear to have been presented, as required.

Conclusions

The Commission's Better Regulation Guidelines recall that an impact assessment 'should be comprehensive, proportionate, evidence-based, open to stakeholder's view, unbiased, prepared collectively with relevant Commission services, embedded in the policy cycle, transparent and of a high quality' (Guidelines, p. 20). After an initial appraisal, it can be concluded that this IA seems to fit to a large extent this description and could be considered in many respects as an example of good practice, compared to other Commission IAs in the financial field. The Better Regulation Guidelines have been to a large extent respected. The IA seems to have considered the recommendations made in relevant Parliament resolutions, such as the one of 16 December 2015 on 'bringing transparency, coordination and convergence to corporate tax policies in the Union', although, in some cases, the Commission has drawn different conclusions. One of the weaknesses is that the IA does not appear to present the likely impacts of some changes introduced in the proposal and acknowledged in the Explanatory Memorandum, such as the EU list of tax havens. Overall, this IA appears to contribute effectively to informing the decision-making process.

This note, prepared by the Ex-Ante Impact Assessment Unit for the European Parliament's Committee on Legal Affairs (JURI), analyses whether the principal criteria laid down in the Commission's own Better Regulation Guidelines, as well as additional factors identified by the Parliament in its Impact Assessment Handbook, appear to be met by the IA. It does not attempt to deal with the substance of the proposal. It is drafted for informational and background purposes to assist the relevant parliamentary committee(s) and Members more widely in their work.

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