Memo to the commissioner responsible for tax policy

Pascal Saint-Amans

context needs to be countered, and taxes can play a role in f nding new resources for the EU budget. Priorities include tax simpli f cation,

Promote simpli f cation

Tax policy at European Union level faces stringent legal and political limitations. This reflects the fact that taxation lies at the core of national sovereignty and consent to taxes is a core constitutional principle in all EU countries. Their tax profiles vary widely, with tax-to-GDP ratios ranging from 21 percent (Ireland) to 48 percent (France), with an EU average around 40 percent.

There is some basis for EU harmonisation of value-added taxes and excise duties (Treaty on the Functioning of the EU, Article 113), but no unambiguous basis for direct taxation such as income or wealth taxes (Article 115 TFEU provides only for an indirect basis, to "*limit distortions in the internal market*"). All tax decisions require unanimity.

Some harmonisation has been agreed in the field of indirect taxes, notably on the definition of the base, and procedures and limitations in EU countries' freedom to fix rates (for example VAT and energy taxes). But over the past decade, the tax policy debate in the EU has focussed primarily on direct taxation, particularly corporate income tax (CIT), which is most likely to distort competition within the internal market. The combination of unanimity requirements and very different member-state level tax policies has made harmonisation very difficult. Low corporate income taxes in small open economies have historically coexisted with much higher tax pressure on companies in larger economies. This is true for CIT rates (10 percent in Bulgaria, 12.5 percent in Ireland compared to 25 percent in France and Germany) but even more so for the tax base.

Unanimity requirements and different member-state tax policies have made harmonisation very difficult

Some progress was made during the 1990s and early 2000s in limiting withholding taxes on some intra-group cross-border flows within the internal market, with the Parent-Subsidiary Directive on dividends (2011/96/EU), the Interest and Royalty Directive (2003/49/EC) and the Merger Directive on taxation applicable to cross-border mergers and acquisitions (2009/133/EC). Despite calls to harmonise corporate income tax (European Commission, 1992), which later led to the Commission proposal for a common consolidated corporate tax base, no real progress was made on the legislative front until the early 2010s. Instead, beginning in the 1990s, some harmonisation was imposed by the European Court of Justice, which ruled that, while taxing non-residents differently from residents was allowed in principle, it should not constitute hidden discrimination based on nationality[1]. This improved the consistency of domestic tax regimes, but EU countries remained unable to agree on common rules.

Since the 2008 global financial crisis however, the EU has made unprecedented progress on the back of global efforts, brokered by the Organisation for Economic Co-operation and Development, to reduce tax evasion and avoidance. Since 2015, the EU has implemented eight directives on administrative cooperation between tax authorities to fight tax evasion, and two anti-tax avoidance directives (ATAD) to limit profit shifting and corporate tax avoidance. The latter involved anti-abuse measures including controlled foreign company taxes and limitations on the deduction of interest payments.

On the procedural side, the EU adopted a dispute resolution directive in 2017 (Directive (EU) 2017/1852), increasing the scope and availability of tax certainty to taxpayers in the EU. The most recent and meaningful addition to the rulebook is the has also raised some diplomatic issues. The ATAD Directives also went beyond the OECD by introducing so-called 'general anti-abuse rules' and an exit tax.

Member states have been lukewarm on the European Commission's efforts to leverage this progress. Your predecessors tabled several proposals which have either failed or are likely to fail – a 2018 proposal to establish a digital service tax, for example. In 2023, the Commission tabled a draft directive to reboot the common consolidated corporate tax base into BEFIT (Business in Europe: Framework for Income Taxation). BEFIT is stalling as member states remain reluctant to give up control in this area. Even a draft directive on transfer pricing, proposed at the same time as BEFIT[3], which would just translate agreed OECD rules into EU legislation to bridge a gap revealed in some state-aid cases, faces some challenges. It would result in EU countries transferring their international tax competence to the Commission, which they are reluctant to do. A few other proposals on fighting tax evasion and avoidance have not progressed (eg preventing the misuse of shell entities for tax purposes – UNSHELL – or securing the activity framework of enablers – SAFE). Overall, it seems clear that EU countries do not want to transfer tax competences to the Commission and the control of the EU Court of Justice.

You will have to handle the sensitive and important debate on own resources for the

Finally, you will have to handle the sensitive and important debate on 'own resources' to meet the growing demands on the EU budget. In December 2021, the Commission proposed three new own resources: 15 percent of the revenues from the EU emissions trading system (ETS); 75 percent of of the revenues from the new carbon border adjustment mechanism (CBAM), and a 15 percent share of the revenue expected from the application of the OECD agreement on the taxation of the residual profits of large multinationals (Box 1). In June 2023, in an update to the plan, the Commission proposed increasing the ETS contribution rate to 30 percent and suggested a new statistically based own resource on a proxy for corporate profits.

These proposals have failed to trigger much discussion among

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EU countries, despite a call for them "*to accelerate the negotiations*", countries may do so. Starting in 2025, EU countries will start collecting the minimum 15 percent from US companies that operate in Europe but book profits in third jurisdictions where they are taxed below 15 percent (such as Bermuda or the Cayman Islands). This is in line with rules, but a Republican majority in the US might threaten the EU with trade sanctions for doing so (not understanding that it would require an unlikely unanimity to change the EU directive).

Pillar 1 is unlikely to succeed

In addition, and more importantly, Pillar 1 is unlikely to succeed. It would reallocate to market jurisdictions some of the profits of the world's largest (above €20 billion in revenues) and most profitable (above 10 percent profitability on sales) companies. A quarter of their rent (defined as exceeding 10 percent profitability) would be allocated to market jurisdictions based on a revenue key, whether or not the company has a physical presence in that jurisdiction.

Pillar 1 largely responds to the call by some EU countries to tax digital transactions in the countries where customers are located. The removal of digital services taxes in countries including France, Italy and Spain was conditional on the implementation of Pillar 1, and EU countries have agreed that without implementation of Pillar 1, a European digital services tax will be implemented. Pillar 1 requires a multilateral convention that has not yet been approved or signed. Even if it is, it is unlikely to be ratified, since this would require a two-thirds majority in the US Senate. The issue of the taxation of tech companies will therefore remain unresolved, implying tensions between the EU and US in the next five years.

Europe is perceived as an aggressive regulatory environment, including on taxation. The past decade of strengthening tax cooperation, closing loopholes, putting in place anti-abuse measures and increasing tax revenues was long overdue. However, pro-growth measures have been missing, including in VAT where an upgrade of rules – VAT in the digital age – is perceived as adding another layer of compliance cost by innovative companies.

The Commission attempts to introduce business friendly measures have not been successful. A draft directive expediting withholding tax relief has been watered down by member countries even though it would remove obstacles to financial flows within the EU[4]. Tax administrations' fears of fraud are a serious obstacle to progress that would make the EU financial market more attractive. A Commission proposal to equalise tax treatment of equity and debt has also been ignored. Moving from the current 'anti-abuse agenda' to a pro-growth agenda will hence be challenging.

Digital mobility has facilitated the emergence of 'digital nomads' for whom traditional definitions of tax jurisdiction are no longer fit for purpose

You should do this when it is more efficient than decisions at the national level. Digital mobility, particularly post-COVID-19, has facilitated the emergence of 'digital nomads' for whom traditional definitions of residence or tax jurisdiction are no longer fit for purpose. The resulting tax uncertainty for both individuals and companies (do companies have a permanent establishment in a country because some of their employees telework from there?) can be an obstacle for growth and should be addressed. The unprecedented level of income inequality between individuals also calls for action (Alstadsæter *et al*, 2023). Addressing these personal tax issues at EU level is both a challenge and an opportunity to reboot the EU tax agenda in a balanced manner.

The role of the OECD in setting the international tax agenda is being contested by large emerging and developing countries. Following a campaign by African countries, the United Nations has established an intergovernmental group to develop terms of reference for a new international tax framework. This work is likely to challenge the OECD leadership on these issues. The EU has been

4 E [illegible] M [illegible] 2024, [illegible] C [illegible] E [illegible] 14 M [illegible] 2024, [illegible] : C [illegible] (FA [illegible] E [illegible]); https://www.consilium.europa.eu/en/press/press-releases/2024/05/14/taxation-council-agrees-on-new-rules-for-withholding-tax-procedures-faster/.

outvoted on this issue at the UN and is criticised for not supporting developing countries. One of the reasons for the bitterness of frugal states and those supporting more action from the EU. On the proposals, such as on withholding tax relief (see footnote 4), should also be a priority. And in line with the implementation of the global minimum tax, a comprehensive review of the ATAD anti-abuse rules might be necessary, to avoid duplication of administrative burdens related to the global minimum tax and other anti-abuse rules, if the rules end up having the roughly the same impact.

Digital service taxes are distortive and will ultimately be passed on to consumers

Digital service taxes are distortive and will ultimately be passed on to consumers, making them a ‘European tax on the Europeans’ rather than a tax on the American tech giants. In case of a roadblock in the negotiation, a very large base and low-rate tax could be a way out, in consultation with the US.

You should explore how aviation taxation could be strengthened internationally and take the lead to establish the necessary forum on taxing carbon emissions from the shipping industry, which so far has been out of scope of any international agreement. You could also explore progressive carbon taxation as a way to increase the legitimacy and acceptance of those measures among the broader public.

This would both strengthen the EU’s capacity to raise revenue and increase coherence in the tax system. The ETS and CBAM should be revisited and enriched. Pigouvian taxes, that aim to raise revenue while penalising bad behaviour, should be explored.

This can be done by reducing the scope of countries that are assessed for compliance with OECD and EU tax transparency and anti-evasion standards. This is currently much too broad and includes countries merely because they have economic links with the EU or because they are aid recipients, even if they are not tax havens, like most African countries. The current metrics determining scope should be replaced by a risk-based approach, resulting in the removal from the assessment of most developing countries, particularly African countries. Prioritising concrete counter-measures against illicit financial flows, through a dialogue with the African Union, would help restore the relationship.

Alstadsæter, A., S. Godar, P. Nicolaides and G. Zucman (2023) *Global Tax Evasion Report 2024*, EU Tax Observatory

European Commission (1992) *Report of the Committee of independent experts on company taxation* (the Ruding Report), Publications Office of the EU