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December 23, 2015

**Subject: Recommendations on the Commission Anti-Tax Avoidance Package**

Dear M. Zourek,

Over the past few years, tax scandals and the search for additional public resources by European governments have made clear the huge scale of corporate tax avoidance across the EU and beyond. For years, civil society organisations and trade unions have been denouncing the harm done to the public finances by tax avoidance in both Europe and the Global South.

When G20 leaders made a commitment to tackle corporate tax avoidance in 2013, we hoped for a global set of progressive reforms which would ensure that corporate profits would be fairly taxed in the places where they are genuinely created. The OECD's Base Erosion and Profit Shifting (BEPS) recommendations have now been endorsed by the G20 leaders.

Unfortunately, the OECD's BEPS process was heavily flawed by only including a small number of non-G20 developing countries very late in the process and its recommendations are not comprehensive and ambitious enough to effectively tackle the problem of global corporate tax avoidance. They have also failed to address some of the key concerns of developing countries, notably the division of taxing rights between source and residence countries, and will do little to curb the global problem of tax competition which is disproportionately harmful to the tax revenues of developing countries.

We now fear that uncoordinated implementation of anti BEPS measures by Member States could lead to the perpetuation of existing problems or the creation of new loopholes whilst preventing further EU wide action in BEPS related areas.

That is why we strongly support the European Commission to propose an **EU directive**, when it releases the Corporate Tax Package at the end of January 2016, which not only ensures the implementation of common anti-tax avoidance rules across the European Union but goes beyond the OECD's proposals and fill in the remaining gaps.

As the Commission has acknowledged, European tax rules have significant harmful spillover effects on developing countries and these effects are undermining the efforts of the latter to collect tax revenues which are urgently needed to invest in curbing poverty.

## Key elements of an EU BEPS directive

We would like to highlight certain measures which we believe must be part of a BEPS directive if it is to effectively tackle tax avoidance in the EU and in developing countries.

1. Full-inclusion **Controlled Foreign Companies (CFC) rules** are a crucial measure against profit-shifting into low-tax jurisdictions, meaning that such CFC rules must ensure that home countries tax all CFC income and provide credit for foreign taxes paid. CFC rules deter profit-shifting by ensuring that corporate income which is shifted into a low-tax jurisdiction can still be taxed by the home country of the corporation at its own (higher) rate. Such rules can also serve as an important backstop for the efforts of developing countries to curb tax avoidance, provided that they cover corporate income that is shifted into controlled foreign companies from third countries, not just from the parent jurisdiction of the corporation. This is a point acknowledged by the OECD (see BEPS Action Three: 2015 Final Report, page 16). However, the OECD BEPS recommendations on CFC rules are a set of best practices and do not offer a clear rule to be implemented. So we urge the Commission to propose strong European full-inclusion CFC rules which cover profit-shifting from third countries as well as from the EU. It is important to set the benchmark for defining CFC income at a high enough level to be effective. By way of illustration, we note the OECD's observation that many countries use a benchmark that CFC income is income which faces a tax rate of less than 75 per cent of that country's statutory tax rate.
2. Consultations by the OECD and the UN committee of experts on taxation have found that tax avoidance via excessive interest deductions is a particular concern for developing countries. We therefore believe that the EU can set an important global precedent by adopting rigorous **rules on the tax deductibility of interest**. We propose capping such deductions at 10 per cent of EBITDA, with the option of limiting interest deductions based on the consolidated net interest expense of the whole corporate group to third parties, apportioned to each group member according to its EBIDTA.
3. The OECD's BEPS proposals relating to **hybrid mismatches** are insufficient. To be effective, the EU needs to propose a clear, binding rule favouring the adoption of source countries' classification of entities and/or of financial instruments when a hybrid mismatch arises between two jurisdictions. Moreover, the EU should try to phase out existing hybrid mismatches as quickly as possible, including phasing out corporate structures in Member States which facilitate the construction of hybrid mismatches.
4. We are deeply concerned by the spread across Europe of **special tax regimes for intellectual property (IP)** – the so-called "Patent Boxes" and "Knowledge Boxes". These regimes have the potential to be a serious drain on public revenues from corporate taxation and we are concerned by the risk of harmful spillover effects onto the tax bases of developing countries. The OECD approach is to bring all such regimes in line with the "modified nexus" approach. This should at least remove an incentive for companies to shift IP between jurisdictions for tax purposes. However, we believe that tax breaks on IP-related income are harmful by nature and should be phased out across the EU.
5. Timely and comprehensive **analysis of the scale of corporate tax avoidance** is indispensable to successfully tackle this problem. The EU also has a role to play in coordinating and gathering data analysis as referred to in Action 11 of the OECD's BEPS project. EU leadership in this area would not only provide the EU and its Member States with better information and evidence on a phenomenon which is hard to assess, but would also

benefit other OECD countries and third countries by providing them with comparable and ready-to-use data.

The measures listed above do not represent a complete list of all reforms which need to be adopted into EU legislation in order to deter tax avoidance, curb the race to the bottom, improve the work of tax authorities including across borders and level of public trust in tax systems both in EU Member States and in developing countries. For example, the EU also needs to address the problem of **treaty-shopping** by ensuring that all Member States, in line with the relevant BEPS recommendations, incorporate strong provisions against treaty abuse into all their tax treaties with each other and with third countries. Attention should be particularly put on countries with networks of tax treaties which make jurisdictions attractive as a conduit country for profit shifting, for example because it restricts the rights of treaty partners to impose withholding taxes, or eliminates them altogether.

This reform would be consistent with the abolition of letter box companies, a measure proposed by the European Parliament which we strongly support.

Efficient measures against BEPS would require all Member States to commit themselves to a single set of rules which will be binding under the form of a directive and which should include the elements mentioned above.

Noting that the directive proposal has not been subject to an Impact Assessment (IA), in order to ensure that European tax rules are fully consistent with the commitment to Policy Coherence for Development, we urge the Commission to carry out an a comprehensive spill-over analysis of the impact of European tax rules (at the Union and Member State level) on developing countries, covering measures which are adopted under the EU BEPS directive. It should also take into consideration measures proposed under the CCCTB and findings of the IA of the CCCTB directives.

## **EU external strategy regarding tax good governance**

Tax avoidance is a global problem. We welcome the willingness of the European Commission to set up a new external strategy and see this as an important opportunity to ensure policy coherence for development. Measures against tax avoidance within the EU should be complemented by a new EU approach to good tax governance vis-à-vis third countries, to ensure that multinationals pay their fair share of taxes everywhere.

When updating the good tax governance criteria, it is essential for the European Institutions not only to ensure that third countries do not undermine the tax bases of Member States, but also that tax practices in Member States do not undermine the tax bases of developing countries.

At the same time, the EU should acknowledge that some developing countries, including least developed countries, do not have the capacity to comply with some of the criteria and therefore exemptions should be proposed until their capacity to do so has increased.

The criteria for good tax governance should not only focus on secrecy but also include **criteria aimed at preventing corporate tax avoidance** such as:

- no substantial economic activity required to benefit from a country's tax rules;

- no corporate tax or a very low effective level of corporate taxation;
- no system to file and exchange country-by-country reports;
- prevention of automatic exchange of information for tax purposes with other governments, including developing countries;
- non-disclosure of the corporate structure of legal entities (including trusts, charities, foundations and similar entities);

We welcome the recognition that the EU has an obligation to support the fight of developing countries against tax avoidance (in line with its obligations to ensure Policy Coherence for Development as well as the Addis Ababa Action Agenda). We believe, however, that this support should go beyond capacity building for tax administration and focus on the impact of EU tax regulations and international tax agreements on developing countries, as well as matters of global tax governance.

Developing countries' contribution in international tax standard-setting should be based on full inclusion and participation on an equal footing in international fora. There is a need for an intergovernmental tax body under the auspices of the UN to ensure more long-term global coordination and inclusiveness in global standard-setting.

We also strongly support the recommendation of the TAXE Committee report that tax justice experts from developing countries be invited to join the Platform for Tax Good Governance and that they be provided with the means to do so where necessary.

**The EU has an opportunity to lead by example in the pursuit of tax justice, and to respond convincingly to public outrage against tax dodging. This requires the adoption of strong and effective legislation, which not only curbs corporate tax avoidance and the race to the bottom within the EU itself, but also addresses problems with EU tax rules which impede the efforts of developing countries to raise more of their own revenues for sustainable development.**

**We urge the European Commission to adopt into legislation and policy all the measures recommended above.**

Sincerely,



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