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TOGETHER EU COUNTRIES CAN SECURE TAX SOVEREIGNTY[1]

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SUMMARY *EU member states are formally sovereign in determining their tax bases and rates. In the EU, tax decisions are made in unanimity, but the countries lose between 533-1000 billion euros annually in tax revenue due to legal and illegal tax evasion and complicated tax rules. No single country is able to stop the tax evasion alone, however together EU countries have a possibility to ensure real sovereignty on taxation. The obstacles are reinforced by globalization, where cross-border cash flows and trade are increasing. In addition, digitization means companies are not necessarily physically present where they have their turnover. Cases such as Panama Papers and LuxLeaks have understandably prompted the general public and political anger. In the corporate tax area, rising tax competition has led to a decrease in taxation both in the EU and in the rest of the world. This highlights how the old national tax systems are not equipped to handle the new reality. There is a need of far greater coordination and common rules, if countries are to secure their taxation sovereignty in the future.*

Many Danes want the EU to do something about tax havens, but they are at the same time reluctant to transfer sovereignty to the EU. However, this is a fake trade-off, since it is only by pooling our sovereignty with other countries that we actually have an opportunity to address the challenges of cross-border cash flows and trade

[1] This paper is an in-house translation done by Louise Pierrel Mikkelsen of the Danish original article: http://thinkeuropa.dk/politik/sammen-kan-eu-lande-sikre-suveraenitet-paa-skatteomraadet

MAIN CONCLUSSIONS:

- Globalization is increasingly challenging national tax systems, which are not designed to handle the way cash flows and trade circulate today - especially in large multinational companies operating across national borders.
- Developments can in worst case scenarios deprive national states of the opportunity to tax companies, etc., in the way politicians and citizens want. This means that countries lose tax sovereignty.
- The sovereignty of countries is also challenged when some countries offer tax rates at a few percent to attract big companies e.g. similar to what happened with Apple in Ireland.
- Over the last 15 years, the average corporate taxation in EU countries has decreased by around 4 percentage points. Without common rules in the area, this race to the bottom will in all probability continue.
- The extensive tax evasion in EU countries, including due to difference in national rules, is estimated to result in lost tax revenues in the order of between 533 to 1000 billion. € per year.
- Many Danes see tax havens as one of the challenges the EU should prioritize highest. On the other hand, a large majority of Danes do not wish to transfer competence to the EU in this area. This however is a prerequisite for doing something about the problems.
- Through the EU, Denmark and other member countries have the opportunity to pool their sovereignty and thus establish a tax system in line with the political and, ultimately, popular wish to do so. This applies not only within the EU, but also in regard to third countries where the EU can use its economic and trade-power to put pressure on other countries to tighten the rules.
- Despite the reluctance of some member states, the EU has succeeded in implementing several initiatives in the tax area, for example. elimination of bank secrecy and automatic exchange of information between authorities.
- In addition, the Commission has several initiatives on its way, such as; against money laundering, terrorist financing and tax evasion as well as mandatory automatic reporting from tax advisors. The EU is also cooperating with the OECD and puts pressure on the other OECD countries to achieve results.
- However, there will be a need for more comprehensive reforms and initiatives, if the countries are to seriously ensure their tax sovereignty. This applies, inter alia, to areas like VAT, corporation tax, financial taxation and climate and energy taxation

The EU must, according to the Danes, highly prioritize the fight against tax-havens. This is shown in a representative opinion-poll that YouGov made for the Think Tank EUROPA earlier this year.[2] Here the fight against tax havens lands on a third place on what the EU should prioritize - only surpassed by migration and security. In 2016, an opinion-poll from Eurobarometer showed that about 75% of the Danes wish that the EU does more to fight tax evasion.[3]

At the same time, there is political reluctance from the Danes to give the EU more competence in tax matters, and the Danes generally oppose transferring more competence to the EU. Eurobarometer's poll from this year shows that 59 per cent of Danes oppose giving more EU competence, which is significantly more than the average for the whole of the EU, where there is actually a small positive majority.[4]

The reasons the EU can make Denmark more sovereign in the tax area:

√ Through the EU, Denmark gets more influence on the design of and proceeds from a number of taxes such as corporation tax, capital tax, environmental and energy taxes.

√ In the EU we can influence the other member countries. The EU is also a guarantor that the rules adopted jointly are enforced.

√ If Denmark goes on its own and adopts stricter tax rules than those in other EU countries, it could hurt our competitiveness and Danish companies, which in turn can cause a loss in tax revenue.

√ The EU is the most important institution to ensure a robust tax system. Partly due to of the binding nature of the cooperation, partly as a result of the political momentum created in this area, especially after the financial crisis.

√ The single market and half a billion consumers constitute an economic weight that can push third countries to increase efforts in the area - e.g. in the OECD and when negotiating trade agreements.

√ EU regulation has led to measures that increase the possibility of reducing tax evasion of individuals and multinational companies.

√ Proposals for a change in VAT and corporation tax in the EU will reduce tax evasion and thus increase each country's sovereignty, in the ability to set their tax bases and tax rates.

[2] "Danes will pay more to the EU - if selected areas are prioritized", paper in Danish, Think Tank EUROPA, 2018 "Danskerne vil godt betale mere til EU – hvis udvalgte områder prioriteres" http://thinkeuropa.dk/politik/danskerne-vil-godt-betale-mere-til-eu-hvis-udvalgteomraader-prioriteres.

[3] Special Eurobarometer of the European Parliament, June 2016, http://www.europarl.europa.eu/external/html/eurobarometer-062016/default_en.htm#taxfraud.

[4] Standard Eurobarometer, June 2018 (Question. 18.6.)

This confirms what Think Tank EUROPA has also documented; that the Danes reluctance to transfer sovereignty to the EU is relatively strong. [5] But the tax area is actually a good example of Denmark gaining sovereignty - and not losing - sovereignty by sharing it with the other EU countries

Absolute tax sovereignty is an illusion

Tax has traditionally been a holy cow for the national state. The ability to determine, how much and who to be taxed is central to the duties and self-understanding of the national state. But as a result of globalization and the ever-increasing trade and free movement of capital between countries, nationals tax systems are exposed to increased pressure. This applies especially to multinational companies that have the possibility to coerce individual countries to give them tax benefits that are unreasonable, from citizens or other countries viewpoint.

The problem is that it may be beneficial fora country to offer large companies big tax benefits, but if all countries act in this way it undermines the states opportunity to raise taxes from businesses. This is for example the essence of the case of Apple's activities in Ireland, where the European Commission with Competition Commissioner Margrethe Vestager at the helm, has instructed Apple to repay the Irish state up to $ 100 billion because the company, according to the Commission, has been given a distortive tax advantage by the Irish state.

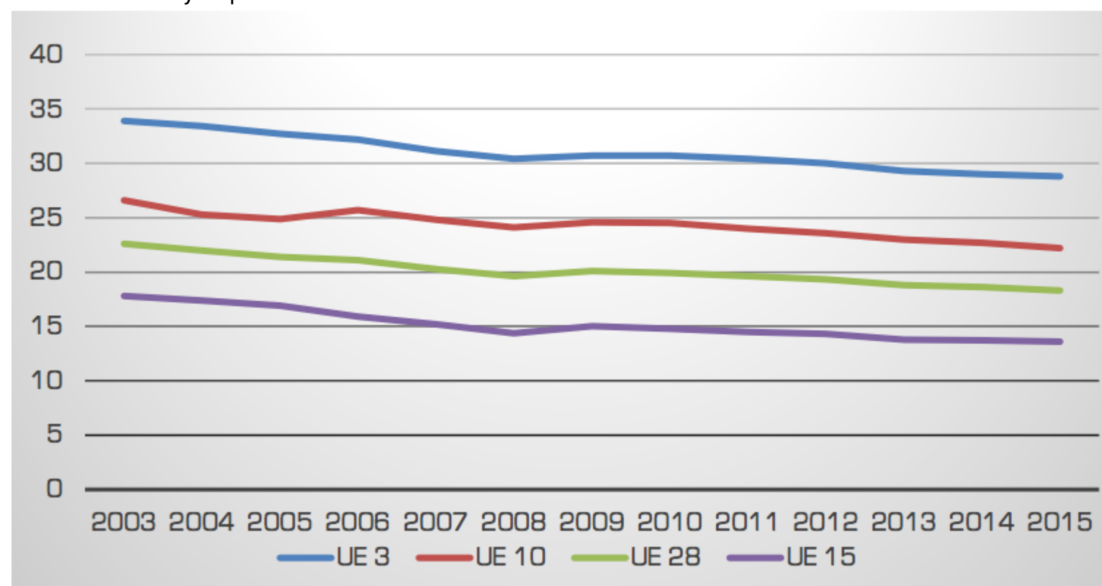
At the same time, digitalization means that globalization and internationalization are strengthened. It enables business operations based on data and sales of knowledge without physical presence. This complicates the nation state's ability to collect tax revenues, creating gray areas that can be exploited for tax evasion. It should be emphasized that corporate tax planning is not necessarily illegal, but that a number of major tax cases such as LuxLeaks and PanamaPapers have made it clear that the current national tax systems, are not able to ensure fair taxation. The cases have caused great dissatisfaction amongst the people of Europe and politically. These developments mean that absolute national tax sovereignty is increasingly an illusion. We are – similar to a wide range of other cross-border areas such as environment, climate, crime and trade - dependent on other countries acting fairly and complying with common rules.

[5] ”Sovereign Denmark”, report in Danish, Think Tank EUROPE, 2017
“Suveræne Danmark” http://thinkeuropa.dk/vaerdier/suveraene-danmark.

1000 billion euros in lost tax revenue

Tax avoidance and tax evasion are major issues worldwide. They have been around for decades and are associated with crime and money laundering of criminal money, with rising taxes, complicated tax systems and with weak public administrations and corruption.

Figure 1. High tax evasion and major disparities in the EU
Black economy in per cent. of GDP



Note: UE3 is the three newest member states in the EU, UE10 is the ten central and eastern European countries, UE15 is the 15 old EU countries and EU28 is the whole EU.
Source: An analysis of the shadow Economist in the EU countries, Clipa and Tudose, CES Working Paper, Vol. VIII, No. 2, 2017.

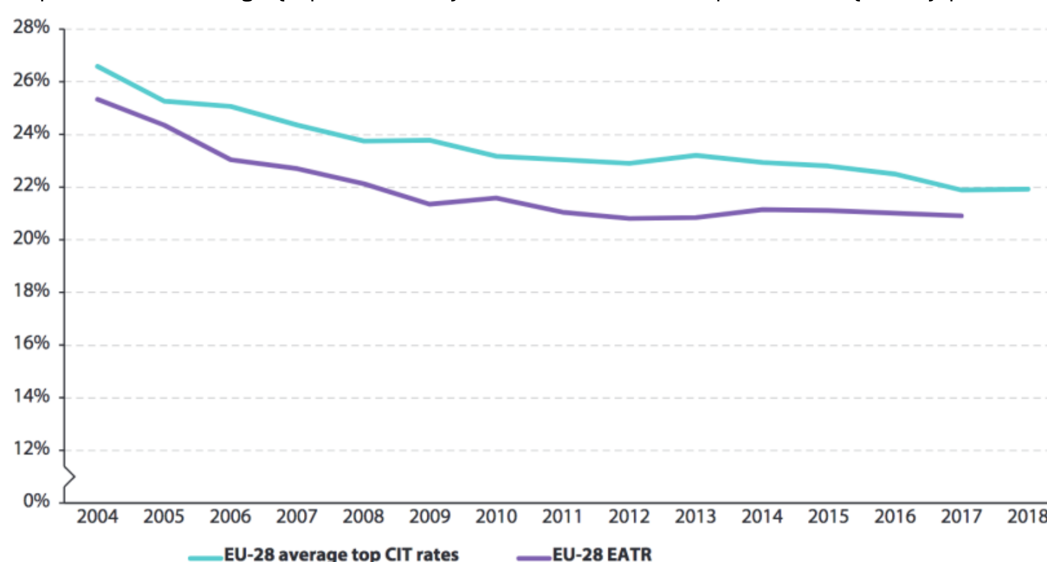
It is extremely difficult to accurately quantify the extent of tax evasion. Figure 1 shows that despite a decrease over the last 13 years, the extent of tax evasion is still very large. And there are big differences between the EU countries. It is estimated that the EU countries yearly miss between 533 and 1,000 billion. euro in lost tax revenues due to complicated VAT systems and companies and individuals who exploit differences in corporate taxation systems for tax planning and tax evasion.[6]

Greater trade and free movement of capital between OECD countries, including EU countries, increase the risk of distorting tax competition on corporation tax and

[6] "Towards a fair and more common tax in the EU, paper in Danish, Think Tank EUROPA, October 2017, "På vej mod en fair og mere fælles skat i EU" http://thinkeuropa.dk/oekonomi/paa-vej-mod-en-mere-fair-og-faelles-skat-i-eu.

charges. Differences in tax systems between EU countries and between EU countries and the rest of the world - especially the OECD - lead to increased costs for companies as a result of complicated sets of rules; particularly of VAT, and increased risk of tax evasion in general.[7] According to the OECD, the tax competition between rich countries is reinforced. Eight OECD countries have lowered corporate tax in 2017 with an average decrease of 2.7 per cent., and also among the EU countries there has been a decline in corporate tax rates and effective taxation.[8] See Figure 2.

Figure 2. Increased tax competition leads to a fall in corporate tax average
Corporate tax average (top CIT Rates) and the Effective Corporate Tax (EATR), per cent.



Source: European Commission, DG Tax and Customs, 2018, https://ec.europa.eu/taxation_customs/sites/taxation/files/taxation_trends_report_2018.pdf

There are new challenges such as increasing globalization and digitization of the single market. Digitization creates new business models with emphasis on intellectual property and data production and use. Digitization makes it possible to sell goods and services across borders in the recipient or consumer country, and to channel profits to low-tax countries. [9] A report prepared for a working party in the European Parliament in the context of an informal meeting of EU finance ministers

[7] Tax policy in the European Union: A review of issues and options, Sijbren Cnossen, CESifo WP 758, 2002; Tax policy in the EU. Issues and challenges, EPRS, Europaparlamentet, februar 2015

[8] "The corporate tax rattles down in Europe: "We need a political signal", article in Danish. Selskabsskatten rasler ned i Europa: "Vi har brug for et politisk signal", Børsen 14.september 2017, https://borsen.dk/nyheder/politik/artikel/1/351001/selskabsskatten_rasler_ned_i_europa_vi_har_brug_for_politisk_signal.html

[9] Tax policy in the EU. Issues and challenges, EPRS, Europaparlamentet, februar 2015; Discussion on corporate taxation challenges of the digital Economy, Estisk EU formandskab, 16.september 2017.

in September 2017 indicated that the countries miss out on 5.4 billion Euro (about 40 billion Dkk.) in annual tax revenue from Google and Facebook. Existing international tax rules require that tax be paid only where a company is physically present. By moving revenue and profit to low-tax countries like Ireland and Luxembourg, the report states that the two companies managed to save a billion in tax.[10]

Taxes and sovereignty are eroding

The Internal Market has brought increased trade between Denmark and the rest of the EU, increasing the prosperity of Danes by up to 100 billion Dkk. a year, according to a study prepared for the Danish Commerce and Industry Agency in March 2018. [11] The increased economic integration in the EU is reducing the economic policy influence over tax policy. Formally, the member states are sovereign on taxation, where EU Treaty requires unanimity, and thus places the power in the area in the individual member countries. No harmonization has been completed regarding personal income taxes, and harmonization in this area is not something that is being discussed.

EU decisions on taxation has largely been limited to VAT and excise duties to ensure a smooth Internal Market. For VAT and excise duties, the EU is operating with minimum rates, but there are still significant differences in e.g. VAT basis, i.e. which goods and services are to be taxed. The free movement of capital, which is the foundation of a globalized economy, seems to be the biggest challenge for tax evasion by businesses and individuals.

The possibility of easily and quickly transferring capital between countries exists not only through the EU, but also as a result of OECD cooperation. Recent years of tax-scandals and leaks show that tax systems, both internationally and nationally, are far from being able to cope with the challenges posed by a globalized economy. For a number of years, the EU Commission has been pushing for better regulation in this area, but several times member states have blocked the tightening of rules.[12] Without the political struggle in the EU, the improvements that were achieved would hardly have come to fruition. This applies, for example on the

[10] "Report: The EU has missed out on tax bills from Google and Facebook" article in Danish, "Rapport: EU er gået glip af skattemilliarder fra Google og Facebook," Berlingske Business 14. september 2017, https://www.business.dk/digital/rapport-eu-er-gaaet-glip-af-skattemilliarder-fragoogle-og-facebook.
[11] Betydning af international økonomi for handel og beskæftigelse i Danmark, rapport, Erhvervsstyrelsen, 2018, https://em.dk/nyheder/2018/03-06-int-handel.
[12] "Jeppe Kofod: EU countries must not be able to block in secret" article in Danish "Jeppe Kofod: EU-landene skal ikke kunne blokere i hemmelighed" Politikken, 16. september, 2017, https://politiken.dk/udland/art6114762/Jeppe-Kofod-EU-lande-skal-ikke-kunne-blokere-ihemmelighed.

abolition of bank secrecy in the EU and in Switzerland and better exchange of information between tax authorities.[13]

The massive amount of tax evasion puts pressure on tax systems and public welfare systems in the EU. The pressure was compounded by the economic crisis. At the same time, globalization and digitization questions the established principle in the tax system that businesses are taxed according to their physical presence. It also focuses on the dilemma of avoiding double taxation while ensuring fair taxation of all.

A large part of the problem is due to different national tax legislation as well as the challenge that some countries may find it opportune to "subvert" their tax conditions to attract large multinational companies. Nonetheless all Countries cannot subjugate each other without eroding the tax base and thus ultimately the national welfare systems. It is thus by undermining sovereignty of other countries in the tax area, that for example, Ireland, The Netherlands or Luxembourg offer multinational companies' conditions where taxation approaches zero. International cooperation and common rules are therefore the way forward, if countries are to ensure their sovereignty in the tax area in a globalized world. If EU countries stand together, they can give the national tax systems the required muscles to tax business activity and income in one consistent and fair way.

The Commission has proposed several steps to simplify the tax system across the EU to increase transparency and thus counteract tax fraud and aggressive tax planning. In addition, these actions must provide a better basis for avoiding double taxation, which is both unfair to the companies and will constitute a trade barrier in the Internal Market.

Small steps going forward

EU initiatives include amongst other things a changed VAT system, automatic exchange of tax decisions between countries and a common consolidated corporate tax base (CCCTB). They are all part of the efforts to combat tax evasion by simplifying taxation systems and reducing administrative costs. The proposal for a common VAT system is expected to reduce tax evasion with VAT, up to 40 billion euro annually, corresponding to 4 per cent of the yearly tax revenue

[13] "EU: End of banking secrecy" article in Danish "EU: Slut med bankhemmeligheden" 2017, DR 14 October 2014; Stop for EU citizens' banking secrets in Switzerland, Press release from the European Parliament, October 27, 2015.

The new EU directive on money laundering, terrorist financing and tax evasion is an even more direct approach to combating tax evasion.[14] It contains new initiatives that several NGOs and tax defenders have long argued for. This applies to central registers of who enjoys so-called beneficial ownership of companies and trusts[15], which the PanamaPapers and LuxLeaks highlighted the need of. The extensive case with Danske Bank and money laundering through an Estonian branch underlines the need for effective oversight both within the financial sector and from the authorities. In this area the EU is not yet passed the finish line.[16]

The EU has also decided that tax schemes which include characteristics that typically are found in connection with tax evasion, shall be automatically reported in detailed form to national tax authorities by corporate tax advisors no later than five days after such a scheme has been delivered. The Commission has also partnered with the OECD and G20 countries on reporting from multinational companies the tax from all the countries in which they are present - e.g. SKAT (Danish tax authority) can require information from Apple's local branch in Denmark on the company's tax situation in the United States. Finally, the Commission has delivered a temporary proposal for how it will tax multinational digital companies. These companies do not necessarily have physical presence where they have sales, which complicates taxation by traditional principles. The proposal puts pressure on the OECD and its member states to find one international solution. If not, the EU has signaled the will to go its own ways.[17]

EU state aid policy has also become important in the fight against tax evasion. Based on the LuxLeaks papers, the EU's competition commissioner Margrethe Vestager was given mandate to investigate a number of tax agreements for the purpose of deciding whether these could be regarded as hidden state aid and thus distorting competition compared to other companies in the EU. The Commission already had opened cases against Ireland (Apple), Luxembourg (Fiat) and Holland

[14] "4th Anti-Money Landering Directive" - DIRECTIVE (EU) 2015/849 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 20 May 2015.
[15] According to SKAT (Danish Tax authority) is called it in Danish "indtægtsnydelsesrettigheder", http://www.skat.dk/skat.aspx?oid=1714125
[16] " EU report reveals large gaps in money laundering control" article in Danish "EU-rapport afslører store huller i hvidvask control", Berlingske Business, 5.september, 2018.
[17] "Towards a fair and more common tax in the EU" Think Tank Europe, October 2017
"På vej mod en fair og mere fælles skat i EU"; Briefing. Common Consolidated Corporate Tax Base, Europaparlamentet, June 2018 (PE 599.395)

(Starbucks), when Margrethe Vestager was appointed as European Commissioner for Competition.[18]

The cases have led to repayment of state aid from a number of multinational companies, digital as well as traditional, American as well as European. Most arresting is the claim of 13 billion Euro (almost 100 billion Dkk) against Apple. This money is to be transferred to Ireland. The claim is based on that Apple as a result of a tax treaty with Ireland paid less than 2 per cent. tax on its profits in the EU countries.[19] All cases have been appealed to the European Court of Justice by the companies and in the Irish case also by the state of Ireland. The court must both decide whether it was illegal state aid, and whether the repayment amount is reasonable.

It is not given that the Commission will succeed with its hard line at the Court, although there is wide political support.[20] If the Commission wins, it will of course affect a wide range of existing tax treaties, where other EU countries or competing companies will be able to file cases at the Commission thus helping to restrict these types of tax treaties. However, this is a heavy handed and uncertain way towards a more open and fair tax system, and it is still too early to decide whether the cases will help strengthen the countries' sovereignty on taxation.

Several joint initiatives needed

Specific actions to combat tax evasion, etc. are necessary. They are however, not sufficient to improve tax systems in the EU and ensure that member states can avoid an erosion of their tax base. The Commission's proposals for improving the VAT system and corporation tax should, as previously described by the Think Tank EUROPA, be more comprehensive. [21]

A future VAT system should be in addition to the destination principle, be based on a very broad and uniform basis and with as standardized rates as possible. Such a VAT can at an average standard rate of 15 per cent bring in a little more than the current 1.000 billion Euro. For high taxation countries like Denmark, a rate of 20

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[18] Mission letters to Moscovici og Vestager se Tax policy in the EU. Issues and challenges, EPRS, Europaparlamentet, februar 2015 og http://ec.europa.eu/competition/state_aid/legislation/working_paper_tax_rulings.pdf.
[19] Ibid. and : EU to hit Amazon with bill for Luxembourg back taxes, Financial Times, 3. oktober, 2017, https://www.ft.com/content/7ce5bf96-a83d-11e7-ab55-27219df83c97.
[20] Ibid. see also: "Vestagers skattekamp har gode odds", Berlingske Business, 5. oktober 2017, https://www.business.dk/oekonomi/analyse-vestagers-skattekamp-har-gode-odds.
[21] "Towards a fair and more common tax in the EU", Think Tank Europe, October 2017
"På vej mod en fair og mere fælles skat i EU"

per cent. will be required to maintain the current proceeds. A new VAT such as the Commission's proposal could reduce fraud about $ 40 billion. euro each year. [22]

The corporate tax rate could be halved by a wide consistent basis. A part of aggressive tax planning could be avoided, and a low rate and one transparent tax-basis would be attractive also for non-EU companies. [23]

The EU would be able to create a financial tax on financial companies' liabilities, subtracting equity and covered loans. Based on figures for 2016, a tax of 0.25% would bring in 37 billion Euro annually replacing national treasury taxes. The tax-income could help increase financial stability and strengthen the banking unions Resolution Fund and fulfill the political desire to exploit a tax base from the financial sector. [24]

In order to strengthen the climate agenda, the EU should agree on the establishment of a CO2-consumption tax which would affect both imported and EU-produced goods and services. Based on 2011 figures an estimated tax revenue of 1 per cent of GDP, corresponding to 132 billion euro, could be expected but the tax should be further analyzed. Until then, a common charge on gasoline and diesel would be an alternative that can reduce both CO2 emissions and pollution as well as reducing border-trade. [25] Going it alone from Denmark in this area would not have any climate significance and could damage Danish business competitiveness and earnings and thereby reduce the Danish tax base.

Denmark will undoubtedly have strong reservations, like many other EU countries, against suggestions in the indicated direction. But it is initiatives like these that seriously can reduce both tax evasion and unnecessary costs for companies. Ultimately, they will increase the sovereignty of the individual countries in the tax area, as it enables them to set their tax bases and rates accordingly after a political debate. At the same time, it will protect the countries against uncontrolled erosion of their tax revenues. On the other hand, countries will still be able to set tax rates and bases for direct taxation of individuals and property taxation nationally.

[22] Ibid.
[23] Ibid
[24] Ibid
[25] Ibid