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IN THIS ISSUE

This month's focus: Danny O'Connell, Associate Director at Kreab, takes a look at the recent publication of the reports and work programme by the OECD on international digital taxation.

Financial Transaction Tax (FTT): group of 10 presented with potential solution to "mutualisation" issue.

New European Parliament gears up for next 5 years & top jobs in Commission start to take shape – how will taxation be addressed?

International Digital Tax Negotiations: OECD Releases Progress Reports & Work Programme

by Danny O'Connell, Associate Director at Kreab

The leaders of the G20 group of countries met in Japan at the end of June to discuss outstanding issues such as global trade and security. On the occasion of the meeting, the Organisation for Economic Cooperation and Development (OECD) released three reports on international taxation which were approved by the G20 just beforehand.

These were: (i) OECD Secretary-General Report to G20 Finance Ministers and Central Bank Governors, (ii) Programme of Work to Develop a Consensus Solution to the Tax Challenges Arising from the Digitalisation of the Economy, and (iii) IMF/OECD Progress Report on Tax Certainty.

The three reports provide both a stock-take of where the international discussions have got to so far, as well setting out a clear path ahead for continuing that work. Reflecting the importance which global leaders place on finding common digital tax rules, the overall joint communique issued on Saturday 29 June at the end of the summit pledged to "redouble our efforts for a consensus-based solution with a final report by 2020."

The contents of the reports provide an interesting insight as to the politics behind the negotiations, as well as a good indication as to the type of content any final standard is likely to contain.

The Secretary-General Report lays out that the public, in many countries, have yet to be convinced that changes are real and that justice has been restored in the international tax system. In stark terms, it explains that agreeing on a sustainable and workable solution will demand political engagement and compromise.

The heart of the content of the ongoing work was contained in the Programme of Work document. This outlines the skeleton of the rules that G20 leaders hope will make up the final standard. This is comprised of two interlocking pillars.

Under pillar one (the revised nexus and profit allocation rules), three proposals have been articulated to develop a solution on how taxing rights on income generated from cross-border activities in the digital age should be allocated among countries – namely, (i) the "user participation" proposal, (ii) the "marketing intangibles" proposal, and (iii) the "significant economic presence" proposal.

Positively, the report points out that the existing commonalities suggest that there is sufficient scope to establish a programme of work considering together some key design features of a consensus-based solution under pillar one.

Then under pillar two (the global anti-base erosion proposal) concerning the right of other jurisdictions to apply the rules where income is taxed at an effective rate below a minimum rate, the members of the Inclusive Framework have agreed a programme of work that contains exploration of (i) an inclusion rule, (ii) a switch over rule, (iii) an undertaxed payment rule, and (iv) a subject to tax rule.

While the contents of the Work Programme have clearly undergone a lot of consideration and contain quite advanced policy proposals, this impression of progress must be balanced against the clear words of caution expressed elsewhere in the programme. Notably, it says that finding a solution in 2020 (the official timetable) is "extremely ambitious given the need to revisit fundamental aspects of the international tax system."

There is also a clear underlying message from these reports which is that the problems identified – and by extension the solutions needed – are inherently political in nature. As we have seen with other tax files, the technical experts can exhaust their resources but what is needed is political will.

In terms of next steps, by January 2020 the outlines of the architecture including determination of the nature of, and the interaction between, both pillars should be finalised. By end-2020, the final report should containing the agreed standard should be complete.

FTT: Group of 10 Puts Concrete Solution on Table

Sceptics of the Financial Transaction Tax (FTT) process have been pointing out for quite some time that the group of 10 would be unable to reach agreement as they could not even agree among themselves on drafting for a legal text and solutions on revenue.

In the last couple of months however, several factors have shifted and now the landscape looks markedly different. First there was a new legal text. Then Germany declared at the May ECOFIN that they were nearing agreement and would have one by autumn. Now, the group of 10 have put forward detailed solution on how to answer the mutualisation issue, i.e. to compensate smaller Member States for the cost of implementing the tax (as they would receive relatively little revenue under the new narrow scope due to their small capital markets).

In a paper circulated to the group of 10, France and Germany put forward that smaller countries that are expected to generate little revenue from the FTT will be guaranteed a minimum share of the tax take (guaranteed minimum revenue) of €20 million. Based on the Commission's estimates, three of the participating countries (Greece, Slovakia and Slovenia) would require a top-up to reach the guaranteed minimum revenue of €20m. These top-ups would add up to a total of €50m and would be borne by those five countries whose own FTT revenue exceeds €100m, i.e. Belgium, France, Germany, Italy and Spain.

This mutualisation question has been a sticking point as soon as the new, narrower scope was put forward at the end of 2018. Now we have a concrete proposal to address this issue. Although it will require an effective subsidy from the larger 5 Member States, it may just be politically feasible. These countries are now faced with a direct question, if you really want an FTT, are you willing to pay for it?

If the group of 10 can agree on this approach (which is a big if considering Spain's opposition to such a move) then that would seemingly only leave one major obstacle to overcome, the concern of Belgium and Slovakia (and Italy to a lesser extent) to avoid any adverse impact on pension funds.

In this light, those commentators who have been eternally sceptical of the FTT project may now begin to take a closer look at negotiations. As always with the FTT, for now we can only postulate and speculate, but one thing is for sure, policymakers have been engaging on this file for nearly 8 years now and would be very pleased with reaching the finishing line. If this proposal gains political support, agreement could take shape very quickly.

France and Germany have also re-iterated their call for other Member States to join the enhanced cooperation group of 10. In terms of next steps, the group of 10 are expected to bring discussions within the Council Working Party on Tax Questions (with representatives from all 28 Member States) from September onwards.

What Role for Tax Under New European Parliament & Commission?

The European Parliament elections at the end of May delivered a shift in the balance of power. The old grand coalition between the centre-right European People's Party (EPP) and the centre-left Socialist & Democrats (S&D) is now finished. In its place, the new Parliament is more fragmented with a shrunken centre. The big winners from the elections were the liberals and the Greens.

While we wait to see how this new set-up will operate in practice, and which working coalitions will form, it is difficult to envisage any working majority which does not have the support of the liberals. And the Greens will certainly play an enhanced role in the legislative process.

Taking a look at the previous activities of the Greens on tax, they have been very vocal and often times quite aggressive in pushing for tax transparency and for new rules aimed at curbing tax avoidance. The liberals have also championed tax transparency and a reformation of the rules, but not to the same extent as the Greens.

What practical outcomes can we expect under the new European Parliament on tax? For a start, we will likely see a push to set up a permanent parliamentary committee on tax matters, building on the previous temporary special tax committees. Such a permanent committee would only have a consultative role, given the Parliament's lack of powers on tax. Nevertheless, if the previous iterations of the special tax committees are anything to go by, it would be highly effective in keeping tax on the political agenda and building political momentum.

This question of having a new tax committee was meant to be answered during the last political term. Differences of opinion emerged between different MEPs however, even in the same group. Most MEPs favoured the creation of a permanent committee, but disagreed over whether it should be a sub-committee of the Economic and Monetary Affairs (ECON) Committee and who should have preferential access to it. There were also concerns about undermining the role of the ECON Committee.

The new European Parliament will be in waiting mode to a large extent until the new European Commission is fully installed. In terms of tax priorities for the new European Commission, all the indications suggest that they will aim to focus on 3 broad areas: (i) advancing the OECD work on both digital tax and minimum effective taxation. (ii) introducing an energy Tax, and (iii) changing the way tax legislation is adopted, including revisiting the Qualified Majority Voting (QMV) suggestion. While we wait to see the new Commissioner, we can expect the new European Parliament to continue its ambitious agenda on tax.

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