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Savings Tax, Administrative Cooperation & Co.

Exchange of tax information taking root

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Not only the dynamics and the number of international initiatives to improve tax collection and cooperation in respect of cross-border (investment) income but also the public interest in these issues have rarely been as pronounced as they are today. This is partly due to the persistently high levels of sovereign debt, which is why the EU member states in particular need to rely on an abundance of tax revenues. This is also partly due to the fact that the United States, with its adoption of the FATCA legislation and the subsequent negotiations on its worldwide application, has forced the issue since mid-2012.

In related debates and numerous initiatives it is important to distinguish between two phenomena: the fight against (illegal) tax evasion (especially regarding investment income) on the one hand and legal, so-called "aggressive" tax planning via profit shifting on the other. From the standpoint of the tax authorities, the two avoidance phenomena are the same in terms of their impact, since they ultimately lead to lower tax revenues and also call the uniformity and fairness of the tax regime into question. When choosing suitable countermeasures, however, it is necessary to differentiate between the two concepts.

Efforts to establish the automatic exchange of information for tax purposes as the European and/or international standard are relatively advanced. At the EU level, two proposals have been tabled to extend the scope of the Savings Tax Directive and of the Administrative Cooperation Directive. Their aim is to establish the automatic exchange of information for a multitude of income types by 2015. These include not only interest income but also dividends, capital gains and all other types of income with respect to the assets held in a financial account. The directives are to be adopted by the end of 2013 and the exchanges of information are to start at the beginning of 2015. Basically, the odds of this happening are not bad; the starting date is very ambitious, though. The attempt to achieve harmonisation and simplification of the international procedures on the broadest basis possible, instead of a patchwork of bilateral agreements, is to be welcomed.

So-called "aggressive" tax planning, which enables the de facto tax exemption of profits, cannot be addressed by means of an expanded exchange of information. To do so would require extensive intervention in the tax systems along with cross-border taxation procedures. Differences in taxation systems between countries as well as the outdated basic concept of national taxation systems and of the principles of international taxation make it virtually impossible for the authorities to adequately capture today's highly integrated value chains and new business models and technologies. The OECD has launched proposals to address these issues. The EU member states have resolved to support the measures proposed. The broadest possible involvement of many countries is the prerequisite for bringing about effective changes.

Multitude of initiatives to foster international collaboration on tax issues

The dynamics and the number of international initiatives to improve tax collection and cooperation in respect of cross-border (investment) income as well as the broad public interest in these issues have rarely been as pronounced as they are today. This is partly due to the still smouldering financial crisis in Europe, which has resulted in countries there urgently needing to rely on revenue inflows. This is also partly due to the fact that the United States, with its adoption of the FATCA legislation and the subsequent negotiations on its worldwide application, has forced the issue since mid-2012.

The large number of initiatives is not confined to the EU, but instead incorporates many other countries – even above and beyond the OECD members. This makes it more difficult to obtain an overview – especially since there is sometimes a considerable overlap between the initiatives. The following provides an outline of the various initiatives and the timeline for their implementation. The collaboration on tax issues[1] currently being discussed at all levels is largely related to direct taxes. The current overview concentrates on this aspect, accordingly.[2]

Which exchange of information? 1

In discussions on the exchange of tax information a differentiation is made between the so-called exchange of information on request (EIoR) and the more comprehensive variant known as the automatic exchange of information (AEI).*

So far, the first variant has been the established standard in bilateral agreements. In the EIoR framework, tax officials have to at least suspect someone of tax evasion to be able to launch a request for information from foreign tax authorities. Moreover, other specifics must be stated, such as the suspect's name and financial institution. Furthermore, for a long time the customary rule was that a country only had to provide information if no national laws argued against such action. It was not until relatively recently that this prerequisite was dropped as the standard in the new OECD Model Tax Convention.

As part of an automatic exchange of information standardised information on non-resident taxpayers is delivered to the authorities in their country of residence. Unlike with an anonymous withholding tax at the source (such as Germany's final withholding tax on investment income), non-resident taxpayers can no longer rely on anonymity vis-à-vis their country of residence. The scope of the information delivered, e.g. only interest income and/or dividends or account balances and assets, depends on the respective agreement. The US tax legislation FATCA, for instance, is much more extensive in scope than the existing EU Savings Tax Directive.

*For more on this and what follows see also Rixen, Thomas (2013), p. 68ff.

Existing and planned regimes for the exchange of information and for withholding taxes 2

EU:

- Administrative Cooperation Directive (2011) plus Implementing Regulation
- Directive concerning mutual assistance for the recovery of claims (2010) plus Implementing Regulation
- Extension of scope of Administrative Cooperation Directive to include investment income (automatic exchange of information (2013) from 2015)
- Savings Tax Directive (2003)
- Proposal to extend Directive on taxation of savings income in form of interest payments (2008) plus two reports on functioning of the directive

US:

- FATCA Model Agreement with five large EU countries and bilateral agreements between the US and other countries around the world

OECD:

- Model Tax Convention on income and on capital
- BEPS Action Plan

(Automatic) Exchange of information – good things come to those who wait, don't they?

Many industrial countries have wished for a transition to the automatic exchange of information for quite a long time. In the 1990s it was finally announced as a concrete (long-term) target not only in the framework of the "OECD Model Tax Convention" but also in the run-up to the negotiations on the EU Savings Tax Directive. The EU Savings Tax Directive represented the first case of multilateral cooperation in this field. Hitherto, agreements on the exchange of information had largely been contracted as part of a Double Taxation Agreement (DTA) or Tax Information Exchange Agreement (TIEA), and thus on a bilateral basis.

[1] This includes information exchanges in the battle against tax evasion as well as a joint drive to address so-called aggressive tax planning/avoidance.

[2] Indirect or consumption taxes are already largely harmonised at the EU level. Nonetheless, there is widespread tax evasion in the case of cross-border transactions in many countries – this applies to value-added tax (VAT) in particular. For this reason, measures to combat tax evasion were also discussed with reference to VAT (e.g. extension of the reverse-charge system) at the European Council summit on May 22, 2013. See European Council, EUCO 75/13.

However, in this case the information exchange was often only based on a formal request.[3]

Proposal to extend Administrative Cooperation Directive by year-end

No automatic exchange of information on basis of Administrative Cooperation Directive before 2015

At the European level, the Administrative Cooperation Directive on the Recovery of Tax Claims (2010) as well as the revised Administrative Cooperation Directive (2011), in force since January 1, 2013, cover further elements of cross-border collaboration on tax matters.[4] A major component of the Administrative Cooperation Directive is the exchange of information, whereby the automatic exchange of information[5] does not come into effect until 2015 and then only for certain categories of (investment) income.

With the new proposal of June 12, 2013[6] for a Council Directive amending Directive 2011/16/EU, the Commission is now acting on both the Action Plan unveiled in December 2012 as well as on the ECOFIN recommendations and, in particular, the European Council's May 2013 calls for action.[7] On the basis of the proposed amendment there are to be – starting from 2015 – in addition to the regulations of the 2011 Administrative Cooperation Directive also automatic exchanges of information on dividends, capital gains, any other income generated with respect to the assets held in a financial account, any amount with respect to which the financial institution is the obligor or debtor, and account balances[8].

Administrative Cooperation Directive 2011 — 3

The purpose of this directive is enhanced administrative cooperation between the member states via increased provision of information. Direct contacts are to be established partly via central liaison offices (in Germany: the Bundeszentralamt für Steuern or Federal Central Tax Office). However, the exchange of information is also possible at the local level. Moreover, the directive also enables civil service officials to be deployed in cross-border operations.

Generally, member states shall make information available and deliver data for taxation matters and related criminal proceedings to the extent that these are "relevant" for enforcement. The Administrative Cooperation Directive guarantees (as also set out in the legislation transposing the Directive into German law) that a member state cannot reject an enquiry if the information is available at a bank or other financial institute or held somewhere in a fiduciary capacity (this means banking secrecy can, in principle, no longer be maintained). Equally, the fact that income is not subject to taxation in one member state is not a valid reason to refuse disclosure.

The directive applies to all types of tax except: value added tax and customs duties as well as all direct taxes and mandatory social security contributions for which cooperation has already been arranged via other European legislation (this refers, for example, to the Savings Tax Directive). The directive enhances the mechanisms for the exchange of information by introducing, for example, deadlines and standard forms for the exchange of information on request and for spontaneous exchanges as well as standard electronic formats for the automatic exchange of information. Furthermore, it contains a most-favoured nation clause.

From 2015 an automatic exchange of information is to be provided for five categories of income and capital: income from employment, director's fees (sic), life insurance products not covered by the Union's other legal instruments, pensions, and ownership of and income from immovable property.

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3 In March 2012, the European Council called for concrete measures to be developed to combat tax fraud. These led to the Action Plan put forward by the Commission in December 2012. See COM(2012) 8805 final and COM(2012) 8806 final.

4 See Box 3 as well as the Administrative Cooperation Directive (2011) and the Council Directive concerning mutual assistance for the recovery of claims related to taxes (2010), in force since 2012, plus the respective implementing regulations.

5 In Germany, the provisions of the Administrative Cooperation Directive were only recently transposed into national law when the Bundesrat, or second chamber of parliament, gave its consent to the "Gesetz zur Amtshilferichtlinie sowie zur Änderung steuerlicher Vorschriften" (June 7, 2013, BR-Drs. 477/13).

6 See COM(2013) 348 final.

7 See IP/13/530, COM(2012) 8805 final and European Council (2013).

8 Verbatim: "The competent authority of each Member State shall, by automatic exchange, communicate to the competent authority of any other Member State, information regarding taxable periods as from 1 January 2014 concerning the following items which are paid, secured or held by a financial institution for the direct or indirect benefit of a beneficial owner who is a natural person resident in that other Member State." See COM(2013) 348. Explanatory memorandum and Article I.

What is FATCA? 4

America's Foreign Account Tax Compliance Act (FATCA) was passed in 2010. It is being implemented in stages and is designed to prevent tax evasion by US citizens. Facing the threat of sanctions – such as a 30% withholding tax – financial intermediaries such as banks are being compelled to divulge information about accounts held by US citizens. This includes – in contrast to the existing EU Savings Tax Directive – not only information about interest income, but also dividends, rents, royalties and disposal proceeds, and in some cases also legal persons. Over the long term even information about all payments pertaining to products that generate interest income or dividends from US sources is to be passed on and logged – even if it relates only indirectly to US sources. In the course of bilateral negotiations about implementation the US has signed a series of treaties and framework agreements which, besides simplifying matters for financial institutions, primarily provide for reciprocal commitments on exchanging information (these are referred to as Intergovernmental Agreements, or IGA for short). This is also part of the agreement signed between Germany and the US on the basis of which the US tax authorities provide information about interest and dividend income collected by US financial institutions.

The way FATCA functions can be illustrated by looking at a dividend that is to be paid by a US company into the account of a non-US investor. If this investor's account is held with a non-US bank, the paying agent (in most cases a US bank or broker) must check whether the non-US bank has signed an agreement with the US tax administration (IRS) or whether there is a bilateral agreement (IGA) in place between the US and the country of domicile of the non-US bank. If this is not the case, the paying agent is required to withhold a 30% tax at the source. Otherwise, no tax needs to be withheld. All the same, the non-US bank – as a so-called Foreign Financial Institution (FFI) – is obliged to report the requested data and information on the account and the account holder to the IRS or the authority named in the IGA (in Germany's case, to the Federal Central Tax Office).

See also: Campano, Fred & Zipfel, Frank (2013).

In the existing directive this option is not provided for until the revision of the legislation after 2017. Unlike the rules on the exchange of information already to be found in the existing directive, the amendment calls for mandatory delivery of information on the newly proposed elements.[9]

The proposal for a Council Directive amending the current Directive on Administrative Cooperation simultaneously adopts other elements of the exchange of information as these emerge upon implementation of the US's FATCA and as they are (to be) applied between the member state administrations and the US authorities.[10] In April 2013, France, Germany, the United Kingdom, Italy and Spain had additionally announced plans for a "pilot multilateral exchange facility" for the automatic exchange of information on the basis of the FATCA model.[11] With the adoption of the amended Administrative Cooperation Directive, the countries' main demands would, fundamentally, have been incorporated and, in principle, made redundant. In fact, the extended Administrative Cooperation Directive would in principle then even represent an EU-wide framework for the required automatic exchange of information.[12] However, given the "most-favoured nation" clause in Article 19 of the existing Administrative Cooperation Directive, the content of bilateral agreements in connection with FATCA would also have repercussions on all member states even without the proposed amendment. The reason is that any information that a member state makes available to the US in the FATCA framework cannot be held back from another member state.

Proposal to extend Savings Tax Directive by year-end

A proposal to extend the scope of the Savings Tax Directive has also existed since 2008.[13] Several revisions of the directive by the Commission have shown that the existing directive functions, but has remained limited in its scope.[14] This proposal contains an extended concept of the term "interest payment" and an extended "group of beneficial owners".[15] It is the will of the EU governments that the exchange of information also be adopted by the end of 2013 on the basis of the Savings Tax Directive of 2003 and of its proposed amendment of 2008.[16] This became possible when Luxembourg and Austria, after years of rejecting the automatic exchange of information, finally changed their stance – at least in principle.[17] However, both have reserved the right to only join the automatic exchange of information once negotiations with 5 third countries[18] on the introduction of comparable measures have been successfully concluded.

9 The current directive only provides for the automatic exchange of information if the relevant data is already available in a given country. If it is not, the country's authorities are, in principle, not required to make the data available.
10 The German-US agreement on FATCA was signed on May 31, 2013. Just recently, the US starting date for FATCA was postponed once again, this time to July 2014.
11 G5 finance ministers (2013).
12 The declaration of intent is basically to be seen as a catalyst for the negotiations in the EU. The brief also calls for the extension of the scope of the Savings Tax Directive. For the framework agreement see the Model Intergovernmental Agreement for FATCA (2012).
13 See COM(2008) 727.
14 See COM(2012) 65 for the Second Review. The conclusion drawn here is that, owing especially to the widespread use of offshore locations by intermediaries and to the steady growth of new products that are tantamount to debts receivable, both the application area of the Savings Tax Directive and the agreements hammered out with third countries in this respect are too narrow in their scope. The varying interpretations of the rules of the Directive are also still said to be a source of problems.
15 See Zipfel, Frank (2009), p. 8f.
16 See European Commission (2013), MEMO/13/533.
17 For instance, Luxembourg has pledged to switch to the automatic exchange of information from 2015 on the basis of the 2003 Savings Tax Directive. See also: Communiqué Ministère des Finances Grand-Duché de Luxembourg (2013).
18 Switzerland, Liechtenstein, Monaco, Andorra and San Marino. See ECOFIN (2013).

LU, AT and CH can imagine automatic exchange of information

For this reason, the EU has launched negotiations with a mandate to introduce in one fell swoop both the automatic exchange of information on the basis of the 2003 Savings Tax Directive and also the extended automatic exchange of information on the basis of the 2008 proposal while abolishing the withholding tax on investment income. Switzerland has already indicated that it could agree in principle to the automatic exchange of information with the EU.[19] Recently, the European Commission announced that it wanted to include the proposal for a Council Directive to amend the Directive on Administrative Coordination (with the more comprehensive exchange of information) in the negotiations.[20]

Savings Tax Directive and Administrative Cooperation Directive both aiming for same target

In principle, the two directives on the exchange of information are to be regarded separately (Savings Tax and Administrative Cooperation). Ultimately, however, they boil down to the same thing – the implementation of the automatic exchange of information. The recent proposal to amend the Administrative Cooperation Directive would be suited to take up the provisions of the Savings Tax Directive to allow its long-term integration in the Administrative Cooperation Directive.

In principle, good odds of implementation ...

… but 2015 starting date very ambitious

Given the developments at the EU and OECD levels on transparency and the exchange of information it is currently still too early to tell how comprehensively the transition from a withholding tax to the exchange of information in the EU and with third countries will develop. It remains intriguing, for example, to what extent not only trusts but also other legal persons will be included and how successful countries will be in defining investment income as comprehensively as possible. However, there is much to suggest that the considerable dynamics of the situation could lead to tangible results by year-end and ultimately result in a much larger volume of information being exchanged than is foreseen at present. In this event, banking secrecy would become a thing of the past in most of the EU member states – and if negotiations were very successful also in key third countries in Europe. However, 2015 would appear to be a very ambitious target as the starting date for the extended exchange of information considering experience to date – even though the G20 endorsed that the automatic exchange of information shall be a new global tax standard.

Standardised, coordinated tax system makes sense

The arrangements outlined all generally follow the same line. Unlike most of the other initiatives – such as those of the OECD and of the US's FATCA – which ultimately are based on bilateral agreements, the EU is seeking to pursue a multilateral approach.[21] Bilateral approaches, especially if they remain uncoordinated, represent a major administrative challenge to financial authorities and paying agents such as banks. A system that is as standardised and coordinated as possible to achieve a cost-efficient taxation of assets therefore makes sense. To the extent that an expanded exchange of information precludes serious competitive disadvantages for investors and companies, this helps to prevent taxation from having distorting effects on capital allocation. Harmonisation and simplification of the international procedures on the broadest basis possible, instead of a patchwork of bilateral agreements, are thus necessary.

[19] See EFD (2013).
[20] See NZZ (2013).
[21] For more on this and what follows see Heckemeyer, Jost; Spengel (2013), p. 364. Coordination includes, for example, the question of how the rules can be legally implemented and sanctioned. At the EU level there are institutions for this purpose such as the European Court of Justice. Moreover, coordination means that suitable data are made available and the necessary technical standards are created in order to guarantee an efficient exchange.

Measures taken at EU level: Existing directives and proposals for new/revised directives

Exchange of information for tax purposes				"Aggressive" tax planning
EU Savings Tax Directive 2003	Proposal to extend Directive on taxation of savings 2008	Revised Administrative Cooperation Directive 2011	Proposal to extend Administrative Cooperation Directive 2013	Proposal to amend Parent-Subsidiary Directive and additional measures
•*Adoption: 2003* • In effect: since 2005 • Multi-year transition period (Luxembourg and Austria do not exchange information but deduct 35% withholding tax; Luxembourg has announced change of procedure) • Scope of automatic exchange of information: – Interest payments on debt claims (e.g. credit balances) – Sales proceeds on debt claims* – Income from certain investment funds (UCITS), as long as over 25% of portfolio is invested in interest-bearing securities*	•*Proposal: 2008* • To be adopted by end-2013 • Scope of automatic exchange of information: – Income from all investment funds which invest in debt claims* – Income from innovative financial products that are substantially similar to debt claims* – Income from life insurance products that are substantially similar to debt claims*	• *Adoption: 2011* • In effect: since 2013 (spontaneous exchange of information and exchange of information on request) • Automatic exchange of information only from 2015: • Scope of automatic exchange of information (*provided it is available in the respective country)* – Income from employment – Director's fees – Life insurance products not covered by the Union's other legal instruments* – Pensions – Ownership of and income from immovable property	•*Proposal: June 12, 2013* • To be adopted by end-2013 • Planned to take effect in 2015 with *mandatory, automatic exchange of information* • Scope of automatic exchange of information (above and beyond 2011 Directive) – Dividends* – Capital gains* – All other types of income with respect to assets held in a financial account* – Any amount with respect to which the financial institution is the obligor or debtor* – Account balances*	•*No proposal to date* •To be tabled by end-2013 • In addition: – Tightening of code of conduct for corporate taxation – Adoption of revised Money-Laundering Directive by end-2013 (proposed in February 2013) – Introduction of corporate reporting by country – Better rules for taxation in the "digital world"

* addressed by FATCA
Source: own representation based on European Commission 2013.

Difficulties in limiting (aggressive) profit shifting and getting to grips with tax havens

When considering suitable measures, vital to differentiate between illegal tax evasion and legal tax planning

Apart from the implementation of the (automatic) exchange of information, a practice referred to as "aggressive" tax planning or profit shifting is the other predominant topic at present. From the standpoint of the tax authorities, the two tax avoidance phenomena are the same in terms of their impact. They ultimately lead to lower tax revenues, which raises particular problems in times of empty public coffers. In addition, tax avoidance also impairs the uniformity and fairness of the tax regime.[22] With regard to the choice of suitable measures to fight tax avoidance, though, it is vital to differentiate between the two levels, that is between illegal tax evasion (mainly on investment income) and many forms of legal, "aggressive" tax planning via profit shifting.[23]

In corporate sector, tax evasion likely to be negligible

Increased transparency via the exchange of information can help to curb tax evasion in particular, as it ensures that taxpayers are no longer able to hide income from the tax authorities in their country of residence. This mainly applies to natural persons and their asset income, since as a rule they have no scope for legal tax avoidance (exceptions being foundations or a change of residence, for instance). In the corporate sector (especially in the case of large multinationals), tax evasion is likely to be virtually negligible. [24] In this area, the focus is more likely to be on instances of legal tax avoidance via shifting of company and investment locations and the shaping of profits in order to minimise the tax load in certain regions.[25] From the viewpoint of the taxpayers this is not reprehensible per se, as the idea is to recognise certain differences in rates of taxation across countries and to react accordingly. Note that when jurisdictions have differing tax rates, it does not automatically mean that any of them are so-called tax havens. However, what may be a problem is drawing the line between normal tax minimisation and aggressive planning aimed de facto at reducing taxation to zero.

Exchange of information alone does not lead to appropriate division of profit between countries ...

… instead, this requires not only radical changes to the national tax systems, but also to international tax procedures

So in order for the countries to secure an appropriate share of the tax revenue (or taxable profit), harmonisation and simplification in the framework of the exchange-of-information approaches outlined alone are not conducive to achieving the desired result. This requires more extensive changes to the tax system and to the procedures of cross-border taxation. Heavily contrasting national taxation systems – even within the EU – but also the outdated basic concept of national taxation systems and of the principles of international taxation, which in many cases date from the first half of the 20th century[26], are an obstacle to simple solutions and constrain the system as a whole. On the basis of the current tax systems it has now become virtually impossible to adequately capture today's highly integrated value chains and the new business models and technologies (in which the location of economic activity differs from the jurisdiction where profits are taxed). Particular features of the "digital" economy include, for example: nearly exclusive use of intangible assets and personal data, generation of value-added in connection with free products and

22 This applies both to various types of investment (tax object) and to taxpayers. As regards the latter it should be noted that, for example, large multinational companies have far more scope for intensive tax planning than small and medium-sized enterprises, so this can lead to serious competitive distortions. However, in practice this has to be set against the fact that the frequency of tax auditing increases with the size of the company.

23 For more on this and what follows see Heckemeyer, Jost; Spengel (2013) as well as Leibrecht, Markus; Schratzenstaller, Margit (2013).

24 Ibid.

25 For details see OECD (2013A), especially chapter 4. Related instruments include hybrid models (financial instruments and legal entities), preferential regimes (e.g. Luxembourg), taxation at the source especially on deliveries of digital goods and services, tax treatment of debt financed by persons not at arm's length, captive and other insurance arrangements as wee as other intra-group financial transactions (group financing), transfer prices, abuse of formal agreements.

26 Ibid, esp. chapter 4.

substantial difficulties in establishing the country in which value is added.[27] In this context it is necessary to answer the fundamental questions of how value is added and how profits are generated in the "digital" world and how this fits with the existing concepts of source country and country of residence.

Potential alternative courses of action in the area of tax systems 5

Bilateral or multilateral measures are not always needed. This is illustrated by the currently very prominent example of US technology firms which, by skilful structuring of their European company networks, are able to channel their profits virtually tax-free from business activities in the EU (in most cases via subsidiaries in the Netherlands or Ireland) to the Caribbean.* The repatriation of their profits to the US is thus postponed indefinitely and does not attract the US's 35% tax on controlled foreign companies. This differs from the German tax regime, for example, where such tax may not be deferred and the tax authorities generally tend to take a stricter approach than many other countries (this applies to both the tax legislation and its enforcement). Via a reform of its taxation of controlled foreign companies the US could unilaterally establish the taxation of foreign profits. However, the status quo gives US companies a substantial competitive advantage outside the US. If the US government were to enable the tax-privileged repatriation of profits by means of an exception rule, this would permanently cement the competitive advantage.

One fundamental course of action might be to seek an internationally coordinated transition to a tax that is linked to the specific destination country.* In such a case, reported profits would no longer have to serve as the yardstick for economic activity, but say turnover instead. Since this would lead to a shift in the breakdown of tax revenue, though, it would ultimately raise the distribution question. The division of profits (according to a mix of earnings, wages and turnover) is a major impediment in negotiations on a common consolidated corporate tax base (CCCTB) in the EU. Therefore, the CCCTB project has still not evolved beyond the Commission proposal stage. A tax geared to the destination country principle would thus tend to be a very long-term objective. Incidentally, the OECD Action Plan rejects a division of profit on the basis of a formula, since this is not accepted by a majority of governments.

It would be simpler* to focus on the exemption of interest income and royalties from withholding tax, as provided for in the Council Directive on a common system of taxation applicable to interest and royalty payments made between associated companies of different member states**. This would reduce the appeal, for example, of constructs that enable companies in the Netherlands, which are exempted from withholding tax on interest income and royalty payments, to shift profits from the Netherlands to low-tax countries (especially in the Caribbean) on a largely tax-free basis.

Moreover, the problem remains that in many countries debt financing is given preference over equity financing, which can encourage profit shifting.***

* For more on this and what follows see: Heckemeyer, Jost; Spengel, Christoph (2013). ** Council Directive on interest and royalty payments (2003).

*** See Fatica, Hemmelgarn and Nicodème (2012).

New thrusts are also being made in relation to these problems – by the OECD in particular.[28] The European Council took up the issue of the preparatory work of the OECD in this area[29] in its Conclusions of May 2013 and called for further efforts in this direction. [30] In concrete terms:

(i) it is proposed that the Parent-Subsidiary Directive be revised and the existing EU legal instruments be examined for potential vulnerability to misuse of the legislation;

(ii) moreover, the Code of Conduct should be strengthened;

(iii) furthermore, the proposal calls for rigorous action against non-cooperative third countries and for a drive to combat both tax evasion as well as money laundering. To this end, there have also been calls for the adoption before end-2013 of the revised Money-Laundering Directive of February 2013[31] put forward by the Commission, since this will facilitate the identification of the beneficial owner (especially for companies, foundations and trusts), which is also of relevance for tax purposes;

(iv) it should be determined to what extent it may be ensured that large companies and corporate groups apply a set of accounting rules that is broken down by country, and how tax procedures can be made to work more effectively in the digital world.

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27 See OECD (2013b).
28 See OECD (2013a) and OECD (2013b).
29 OECD (2013a). The starting basis is the report on these problems entitled Addressing Base Erosion and Profit Shifting, or BEPS for short.
30 For more on this matter and what follows see European Council (2013), p. 6ff.
31 See COM(2013) 45 final.

The measures outlined here are much less concrete than those for the exchange of information. So in this case the process is still very much in the early stages of development. The challenge is also much larger than that in the context of the exchange of information. Given unbroken dynamics, proposals are expected to continue coming in until end-2013, though scarcely with concrete decisions on measures.

OECD Action Plan still proposes virtually no concrete solutions, but instead details where action needs to be taken

At the summit of the G20 finance ministers in Moscow on July 20 the OECD unveiled the 15-point Action Plan already announced back in February that addresses the BEPS issue. It still contains virtually no concrete solutions or individual proposals to amend rules, but rather it shows segments (e.g. national legislation, tax agreements etc.) in which changes will have to be brought about or else which need further examination. At the same time, the Action Plan contains a timeline. Many of the measures contained are to be implemented within the next two years – but provision has been made in some cases for a significantly longer period. Explicit mention is made of the fact that the OECD would also like to include in the process G20 countries that are not OECD members as well as developing countries. Moreover, a consultation process involving representatives of companies and civil society is also to be launched.

Taxation in the "digital" world requires new rules and better collaboration

In terms of the EU it may be said that many roads lead to Rome. The Commission, the EU countries and many OECD members are currently exploiting all channels to make progress in this matter. From a political standpoint this is no doubt a sensible approach. However, there is also the risk that the numerous proposals will lead to an additional, virtually unmanageable web of rules and regulations. This needs to be avoided. At the same time, care should be taken to ensure that tightened regulations do not excessively impact those sectors of the economy that are not able to make use of the existing shifting scope. For unlike, for example, in the information technology sector, where the situs-of-property principle is virtually non-applicable, real production and operating sites do exist.

At present, the odds are not bad that the automatic exchange of information in tax issues could become the international standard. This applies even more since the G20 leaders decided at the G20 meeting in St. Peterburg on September 9 the automatic exchange of information to become a new global tax standard by the end of 2015.[32] Radical changes to the tax procedures to curb "aggressive" tax planning will tend to take years to implement. Given the fiscal dimension and the challenges created by new business models and technologies the countries will be compelled to intensify their collaboration in this area. Considering the many low-tax areas in Europe the EU would be well suited to play a major role in cooperation efforts, especially because agreements at the EU level immediately develop greater binding force than those at the OECD level. Nonetheless, in view of the various approaches it needs to be ensured that at least any OECD and EU measures are coordinated with one another.

From an economic viewpoint there is no ideal taxation system for a welfare-maximising division of the tax base

Finally, it must be pointed out from an economic point of view that no ideal taxation system exists at present which could lead to a welfare-maximising division of the assessment base and serve as a template.[33] This is also the reason why it is so difficult to strictly define the point at which tax shifting should be regarded as "out of proportion" or "aggressive" and thus be stopped. Ultimately, the division of the assessment base is a distribution issue.

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[32] By February 2014 the new standard (including a Model Competent Authority Agreement) shall be presented. The G20 countries also affirmed their desire to tackle the issues identified in the BEPS Action Plan.

[33] See Heckemeyer, Jost and Spengel, Christoph (2013). For further approaches that are not contained in OECD or EU plans see box 5.

OECD Action Plan, July 19, 2013 6

The OECD Action Plan addresses the problem areas highlighted in the February 2013 report

1. Address the tax challenges of the digital economy
(→ Expected output: Report identifying issues and possible actions to address them by end-2014)
2. Neutralise the effects of hybrid mismatch arrangements, i.e. if two countries take differing taxation approaches to the same issue
(→ Expected output: Proposals for changes to the Model Tax Convention and recommendations for domestic rules by end-2014)
3. Strengthen CFC rules.
(→ Expected output: Recommendations regarding the design of domestic rules by end-2015)
4. Limit base erosion via interest deductions and other financial payments
(→ Expected output: Recommendations regarding design of domestic rules and changes to the Transfer Pricing Guidelines by end-2015)
5. Counter harmful tax practices more effectively, taking into account transparency and substance
(→ Expected output: By end-2014 finalise review of member country regimes and existing identification criteria for "harmful" tax competition)
6. Prevent tax treaty abuse that can lead to double non-taxation
(→ Expected output: Changes to the Model Tax Convention by end-2014)
7. Prevent the artificial avoidance of permanent establishment (PE) status (e.g. via commissionaire arrangements).
(→ Expected output: Changes to the Model Tax Convention by end-2015)
8. Assure that transfer pricing outcomes are in line with value creation (i.e. taxation to kick in where "economic activity" takes place). Three areas in particular are to be reviewed in this respect:

   8.1 Intangibles: Among other things this will involve: adopting a broad and clearly delineated definition of intangibles, ensuring that profits associated with the transfer and use of intangibles are appropriately allocated in accordance with value creation; and updating the guidance on cost contribution arrangements

   8.2 Risks and capital: Among other things preventing BEPS by transferring risks among group members as well as preventing "excessive" allocation of capital to group members

   8.3 Other high-risk transactions: This will include clarifying the application of transfer pricing methods – in particular profit splits – in the context of global value chains; providing "protection" against common types of base eroding payments, such as management fees and head office expenses
   (→ Expected output: Changes to the Transfer Pricing Guidelines and the Model Tax Convention by end-2015)
9. Establish methodologies to collect and analyse data on BEPS and the actions to address it (e.g. also via new types of data sources on both aggregate and micro level)
(→ Expected output: Recommendations by end-2015)
10. Require taxpayers to disclose their aggressive tax planning arrangements
(→ Expected output: Recommendations by end-2015)
11. Re-examine transfer pricing documentation, e.g. by requiring that global multinationals provide all relevant governments with needed information on their global allocation of the income, economic activity and taxes paid in each country according to a common template
(→ Expected output: Recommendations for the design of national rules by end-2014)
12. Make dispute resolution mechanisms more effective (Mutual Agreement Procedures)
(→ Expected output: Changes to the Model Tax Convention by end-2015)
13. Develop a multilateral instrument designed to provide an innovative approach to international tax matters
(→ Expected output: Report identifying relevant public international law and tax issues by end-2014 and development of a multilateral instrument by end-2015)

Sources: OECD (2013b), Betriebs-Berater (2013).

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