Recent international trends in corporate taxation : more competition or more convergence ?

B. Coppens
R. Schoonackers
L. Van Meensel
S. Van Parys

Introduction

The international corporate taxation environment is rapidly changing. In recent times, a number of countries have lowered their tax rates or plan to do so. In addition, there have been moves to combat the erosion of the tax base and tax-motivated profit shifting.

In that context, a reform of the Belgian corporate tax system was conducted in December 2017, leading to abandonment of the strategy of tax niches based on preferential regimes, combined with relatively high nominal tax rates. The Bank published a study on the budgetary and macroeconomic aspects of the corporation tax reform in Belgium on 6 December 2017.

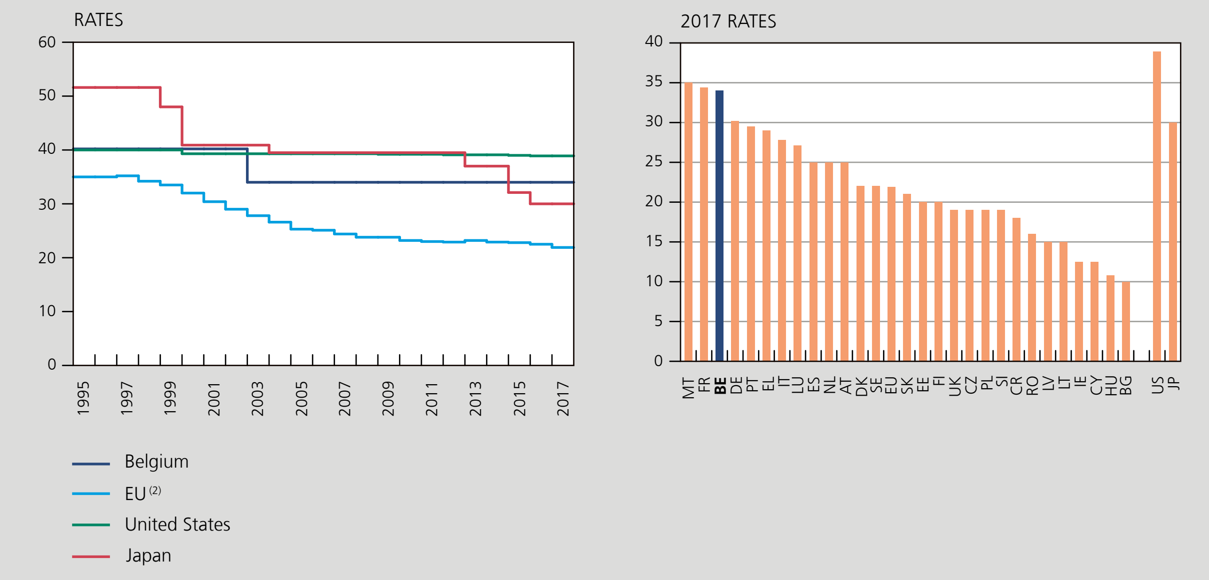
This article presents a brief description of that reform and a detailed analysis of the international corporate taxation environment. Section 1 describes changes in corporate tax rates and revenues. Section 2 examines the most important lessons to be drawn from the economic literature on the subject. Section 3 sets out the measures taken at international level to combat profit shifting and other practices which are eroding the tax base, in order to prevent corporate tax avoidance. Section 4 outlines the reforms to corporate tax regimes in Belgium, in the other EU Member States and in the United States. Section 5 puts forward a number of policy recommendations. Finally, the article ends with the main conclusions.

1. Corporate taxation from an international perspective

1.1 Rates

The downward trend in corporate tax rates in Europe is undeniable, as the average nominal tax rate in the EU has fallen steadily, declining from 35 % in 1995 to 21.9 % in 2017.

CHART 1 NOMINAL CORPORATE TAX RATES [1]: DOWNWARD TREND AND SIGNIFICANT DEVIATIONS



Source: EC.
(1) These are the highest statutory tax rates, including any local or regional taxes on corporate profits.
(2) Unweighted average.

The downward trend in tax rates was most evident during the period preceding the economic and financial crisis. In the EU, the nominal average rate of corporate income tax dropped from 32 % in 2000 to 23.8 % in 2008. After that, it stabilised overall at around that level, as some countries increased their rates while others cut them.

Lately, it seems that rates have begun falling again. In 2016, Denmark and Spain cut their respective nominal rates to 22 % and 25 %. In 2017, the rate dropped to 24 % in Italy, 27.1 % in Luxembourg, 21 % in Slovakia, and 18 % in Croatia, while in Hungary it was halved to 10.8 %. Furthermore, the rate continued to fall in the UK, dropping to 19 % in 2017, compared to 30 % ten years previously.

There is every reason to expect the downward trend in nominal tax rates to persist in the years ahead in many European countries. Apart from Belgium, reforms are planned in the Netherlands, France and Luxembourg. These reforms are discussed in section 4.

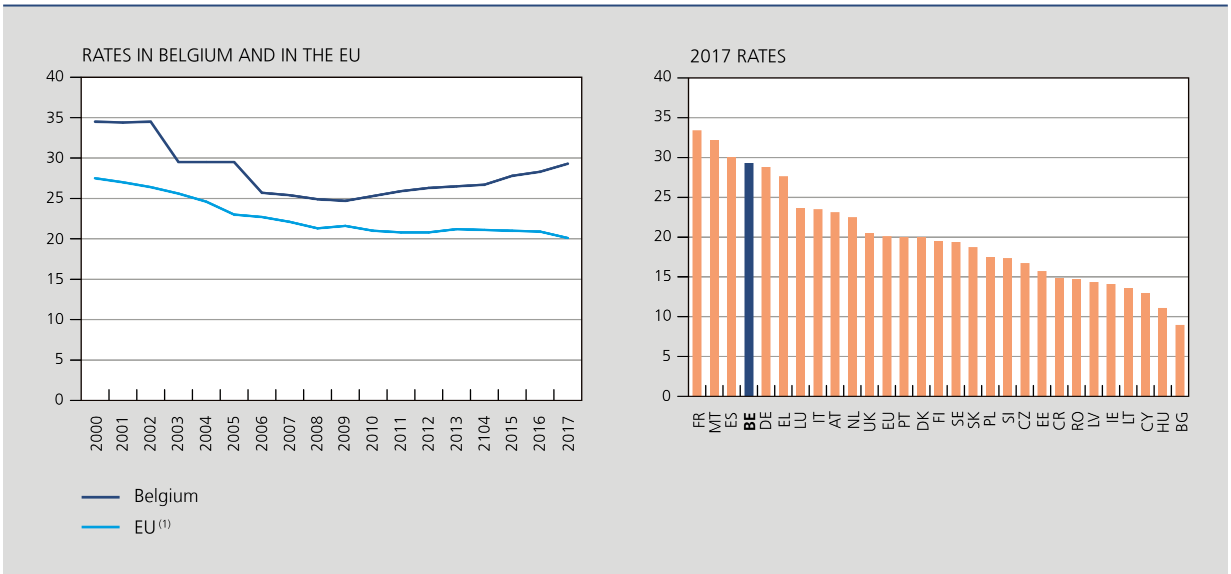
There are wide variations in the maximum nominal rates of corporate income tax between the EU Member States. Malta has the highest nominal rate of tax on corporate profits, at 35 %. At the other extreme are Ireland, Cyprus, Hungary and Bulgaria. This last country charges a nominal rate of barely 10 %. In Belgium, the nominal rate was 33.99 % in 2017, the third highest tax rate in the EU, after Malta and France. In that same year, the unweighted EU average was 21.9 %, as already stated.

Compared to the United States and Japan, nominal corporate income tax rates in Europe are low. In 2017, the nominal rate in the United States stood at 38.9 % while in Japan it was 30 %. Both apply a system of imputation, i.e. multinational companies are taxed in their country on the whole of their profits, wherever they were made. However, companies can obtain a tax credit for taxes paid in other countries.

Nevertheless, a list of the highest nominal rates in various countries provides only a partial picture of the real tax burden on companies, because the corporate tax charged may vary greatly from one country to another depending on tax breaks, depreciation methods or the existence of preferential regimes. The real rates of tax calculated on the basis of tax legislation therefore provide a more accurate picture of the effective tax burden.

The real tax burden on companies is lower than the nominal tax rate in almost all EU countries. In Belgium, for example, the difference between the nominal tax rate and the average effective rate came to almost 5 percentage points in 2017, as the Belgian government's policy combined a relatively high nominal tax rate with a fairly small tax base.

CHART 2 AVERAGE EFFECTIVE CORPORATE INCOME TAX RATES
(in % of the tax base before tax breaks)



Source: ZEW.
(1) Unweighted average.

1.2 Corporate income tax revenues

The decline in nominal rates of corporate income tax, sometimes likened to a "race to the bottom", is due to the lack of a coordinated European policy, which has led some Member States to design strategies aimed at attracting international investment or capital by manipulating nominal tax rates, the tax base or exemption rules.

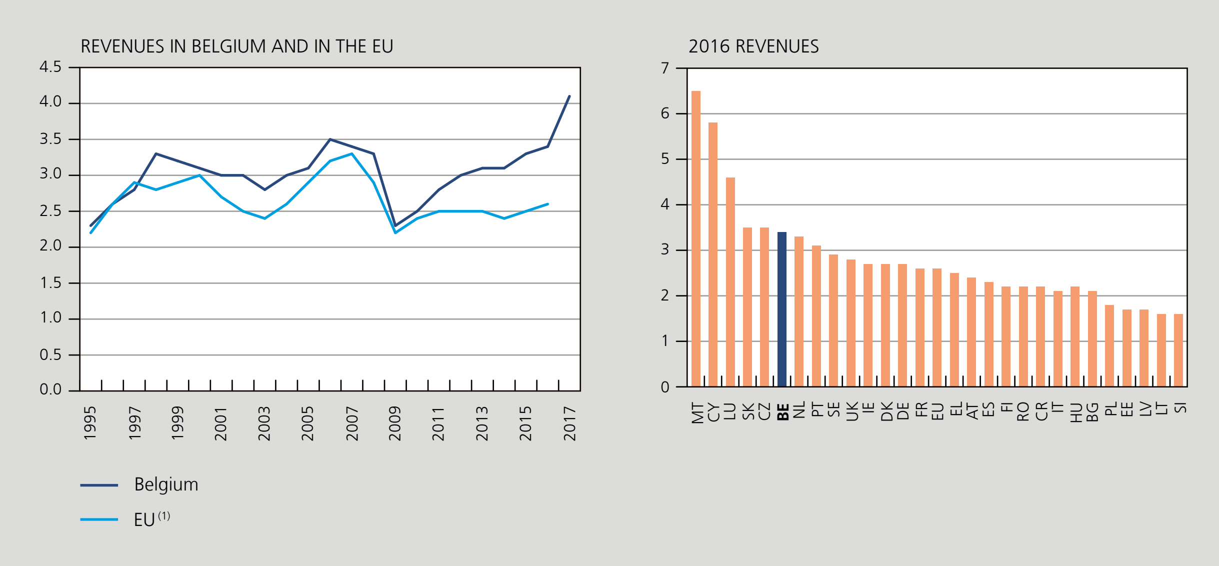
Although almost all European countries have, to a large extent, cut their nominal corporate tax rates in recent decades, the real consequences of those reductions need to be qualified.

For instance, despite this decline in nominal rates, the average corporate tax yield as a ratio of GDP has not fallen in the EU. On the contrary, these tax revenues, which naturally depend on the economic situation, increased from 2.2 % of GDP in 1995 to 2.6 % in 2016. In Belgium, the rise was even more marked, since the figure increased from 2.3 % of GDP in 1995 to 3.4 % in 2016. In 2017, corporate tax revenues actually reached a historically high level of 4 % of GDP.

This shows the considerable expansion of the tax base over that period. However, on the basis of the available data on the net operating surplus, it cannot be said that this expansion accounts on its own for the rise in corporate tax revenues. This suggests that the nominal rate reductions were also accompanied by enlargement of the basis used to calculate the tax. In practice, this means that compensatory measures were taken, such as the abolition of certain tax breaks or preferential regimes granting tax concessions. The fact that the lower tax rates have not led to any significant fall in corporate tax revenues is also due partly to the greater number of conversions into companies (1), a higher proportion of income from

(1) For members of the professions and other self-employed persons, conversion to a company means pursuing their occupation via a company. That often enables them to reduce – perfectly legally – the tax charged on their activities.

CHART 3 CORPORATE INCOME TAX REVENUES
(in % of GDP)



Sources: EC, NBB.
(1) Weighted average.

capital and a decline in interest rates which has reduced the allowances for interest charges. That information could also indicate that tougher and more successful action is being taken against tax avoidance and tax evasion.

Finally, it seems that some relatively small European countries with low tax rates still obtain quite substantial revenues from corporate taxation. That applies, for example, to Cyprus and Ireland, and appears to demonstrate that those countries are managing to attract tax bases by charging low rates.

2. The optimum corporate income tax from a theoretical point of view

The optimal tax theory examines the impact of taxes on the social welfare of an economy, resulting from both the scale of economic activity and its distribution among households. In that regard, the analysis makes no sense unless the tax system is considered as a whole, since individual taxes such as corporation tax can only be assessed in the light of other taxation. That theory does not say anything about the desired level of taxation and takes the proportion of public expenditure funded by taxes as given. Apart from theoretical considerations, when devising the optimum tax regime it is also necessary to take account of practical constraints, such as how the taxes are administered, from the point of view of both the government and the taxpayer. This section discusses corporate income taxation from a theoretical viewpoint, first in the context of a closed economy and then in an open economy.

2.1 Corporate income tax in a closed economy

In a closed economy, capital and profits cannot cross borders and it is therefore not so easy to avoid the tax due on them. In that context, in order to understand the welfare implications of a tax on capital incomes, it is necessary to examine the impact on both economic efficiency (the scale of economic activity) and on redistribution.

At first glance, taxing capital incomes is not optimal from the point of view of efficiency. Such a tax in fact penalises future consumption as opposed to current consumption and therefore disrupts the intertemporal neutrality of consumer choice. This results in sub-optimal savings and consequently a reduction in investment. Simple exogenous and endogenous growth models show that a tax on capital incomes leads to lower investment and a reduced capital stock, and hence slower economic activity and growth.

However, more sophisticated theoretical models reveal that taxing capital may make sense after all from the point of view of efficiency. First, taxing the pure economic rent proves optimal. This is the return in excess of the minimum that investors expect on the financial markets, taking account of a risk-free yield and a risk premium. While this minimum return should preferably be exempt, taxing the excess return does not result in distortion of consumption or investment decisions, because a higher return is a sign of market power, as in the case of monopolies, or location advantages, and is not the reward for economic effort. Partial taxation of the total capital return, which is much simpler to administer than a tax on the pure economic rent, may be seen as an approximation of a tax on the pure economic rent.

Next, a tax on capital incomes may be desirable to offset other distortions, such as those resulting from the taxation of labour incomes. The latter may reduce the return on investment in human capital (education, training), especially if it is progressive. Imposing a tax on capital incomes, too, means less disruption of consumer decisions to save or invest in training. Another argument for taxing capital incomes, and consequently discouraging future consumption, is that, on average, the preference for leisure increases – or the labour supply becomes smaller – with age. Insofar as consumption and leisure are complementary, a tax on consumption means an implicit tax on leisure, and it reduces the distortion of the choice between leisure and (taxed) labour. The taxation of capital incomes, which discourages future consumption, thus permits an implicit tax on leisure at a more advanced age, or an implicit subsidy for the labour of older persons.

A tax on capital incomes may also be advocated from the point of view of redistribution. A tax on labour incomes is in principle the most appropriate redistribution method because those incomes are an accepted approximation of the ability to earn money. However, capital incomes may also be an indication of that ability, as some people are more capable than others of increasing the return on their investments. A tax on capital therefore leads to a redistribution from those with greater earning capability to those with less capability. Levelling out differences in initial wealth may be another reason for taxing capital incomes, but is only desirable if the inheritance tax on unintentional inheritances does not yield the expected results.

Although there are clearly reasons for taxing capital incomes, the question is whether, in a closed economy, that tax should preferably be levied on the company or on the shareholder, via personal income tax. Corporate taxation ensures that the tax cannot be avoided by systematically postponing the payment of profits. It can therefore be viewed as a withholding tax on personal income and an administratively effective way of ensuring that shareholders pay taxes on the profits. Another advantage of corporate taxation is that profits derived from capital are taxed in the same way, regardless of the form in which they are paid out (dividends or capital gains) and the shareholders' place of residence.

Considering that a corporate tax is desirable, box 1 discusses the best way of designing such a tax.

Box 1 – What would the optimum corporate income tax look like?

This box discusses the best way of designing a corporate tax, taking account of both theoretical and administrative considerations. It looks at both the ratio between the corporate tax rate and other tax rates, and at the composition of the tax base.

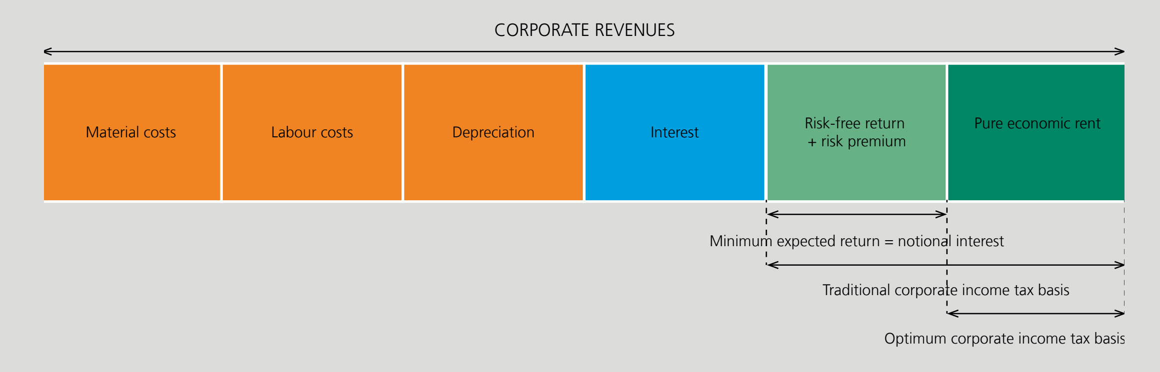
From an administrative point of view, it is arguable that rates of tax on capital incomes should be aligned with rates charged on labour incomes, as it is almost impossible to achieve a fair breakdown between labour and capital incomes within a company. If the overall tax burden on capital incomes is lower – i.e. taking account of both corporate tax and personal income tax – that is an incentive, particularly for self-employed persons, to replace labour incomes with capital incomes by forming a company. Moreover, labour incomes are also subject to social security contributions. Empirical studies (e.g. Goolsbee, 2004) have shown that the proportion of businesses operating in the form of companies increases considerably as the corporate tax rate declines. De Mooij and Nicodème (2008) demonstrate that this helps to explain why corporate income tax revenues did not diminish in the EU between 1997 and 2003, despite the reduction in tax rates.

The principle of tax capacity is also invoked to justify an equal tax on capital incomes and labour incomes. It postulates that each euro of income should be taxed at the same rate, whatever its origin. However, this legal philosophy principle does not necessarily correspond to the principle of maximising social welfare, used in economic analysis, not even as regards redistribution. The two principles only coincide in this respect if labour and capital incomes are equally good ways of measuring earning power.

In regard to corporate taxation, in a closed economy, it is desirable for all companies to be taxed in the same way, to minimise the distortion of the allocation of resources between firms. It would only be possible to advocate lower taxes on small firms than on large ones if a defect in the market caused serious under-investment in small firms. On the one hand, positive externalities are sometimes attributed to small firms, such as job creation and innovation; on the other hand, they are said to be penalised by information asymmetry, so that investors cannot accurately assess the risk. However, there is not enough empirical evidence of this. These market shortcomings would only prevent a small group of dynamic start-ups – which often do not yet generate any profits – from investing in the optimum way. Tax incentives specifically targeting small firms would thus fail to achieve their objective. Moreover, incentives based on firm size may hamper firms' growth or lead to unnecessary hiving-off of activities. The fact that small firms incur higher administrative costs than large firms in paying their taxes is another argument in favour of granting them concessions. However, in that case, administrative simplification is more efficient than applying lower rates.

The optimum basis for charging corporate income tax corresponds to the pure economic rent. That is defined as the difference between the income from an activity and the total expenses, including the opportunity cost, of another investment presenting a similar risk. In most corporate income tax regimes, only the interest due on borrowings is deductible as an expense, while the opportunity cost of equity finance is not. That cost is the sum of the risk-free return on an investment and a risk premium; it can therefore only be determined by approximation. A system of notional interest deduction tries to take maximum account of the opportunity cost of equity. In the ideal regime, expenses which cannot be taken into account for a given year because the tax base is negative can be carried forward to another year. The tax system thus encourages entrepreneurs to take risks, and that is important for innovation.

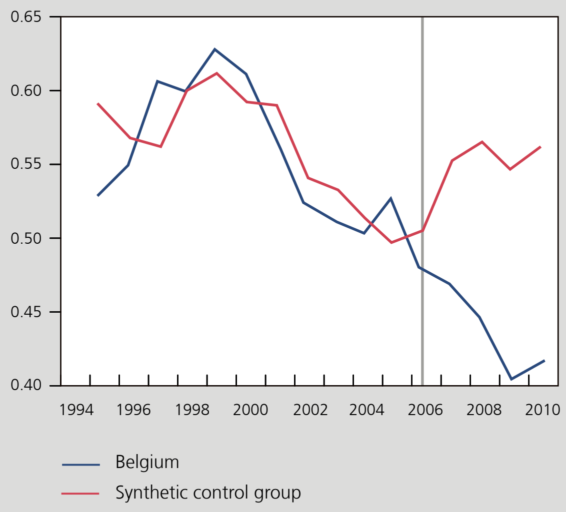
PURE ECONOMIC RENT



A tax on the pure economic rent is considered ideal because it does not distort the producer's decision on the quantity produced and the price charged. It is a way of reducing to zero the marginal effective tax rate – i.e. that rate of tax on the return that exceeds the minimum return necessary to attract capital on the financial markets – which determines the firm's decision on whether or not to proceed with additional investment. Simulations using general equilibrium models, such as those by De Mooij and Devereux (2009) and by the EC (EC, 2016e), demonstrate that the fiscally neutral introduction of a tax regime with notional interest deduction in fact leads to higher investment and stronger activity growth than a system with lower nominal tax rates but no notional interest deduction. However, the empirical evidence is less clear-cut.

If costs relating to equity capital are treated less favourably than borrowing costs, as in most corporate income tax systems, that also distorts the method of funding businesses. The debt ratios of both financial and non-financial corporations are then higher than they would be without that tax bias. Empirical studies show that corporate debt ratios thus display a positive correlation with corporate tax rates. In Belgium, the introduction of the notional interest allowance with effect from the 2007 tax year strengthened the capital situation and reduced the debt ratio of non-financial corporations. Following the introduction of this system, the debt ratio of those companies is more than 10 percentage points lower than that of a synthetic control group not granted the allowance (Hebous and Ruf, 2017). A similar, if slightly less marked, difference was seen in the case of financial corporations (Schepens, 2016).

IMPACT OF THE NOTIONAL INTEREST DEDUCTION ON THE DEBT RATIOS OF NON-FINANCIAL CORPORATIONS IN BELGIUM
(in %)



Source: Hebous and Ruf (2017).

In addition, the tax base can be adjusted to allow for quite significant externalities which are not sufficiently taken into account by the free market.

Corporate expenditure on research and development generates significant positive externalities and leads to innovation. As a result, existing products and processes are replaced by new and better ones. It is therefore a driver of long-term productivity growth. If a firm decides to spend on research and development, it ignores the fact that, ultimately, others may also benefit from the increased productivity via the transfer of knowledge. In the absence of additional incentives, research and development expenditure would be lower than desirable from the point of view of an economy's social welfare. That is why it is a good idea to provide grants or tax incentives for such expenditure.

There are substantial negative externalities associated with pollution and congestion. Ideally, incentives which increase them, such as tax concessions for company cars, should be avoided wherever possible.

Finally, all companies in a country should be subject to the same tax system and there should be no preferential regimes, so that competition conditions are the same for all firms, whether domestic or foreign.

2.2 Corporate income tax in an open economy

In an international environment, capital is mobile. Businesses can change their location, multinationals can operate in more than one country and shift their profits, and shareholders of the same company can live in different countries. Globalisation and economic integration are accentuating capital mobility. However, the taxation of capital incomes is still an essentially national competence. In an international context, countries may resort to taxes based on the source of the income or the place of residence.

If the tax is based on source, the country taxes the income generated by investments made within its borders, regardless of the investor's domicile. That applies to corporate income tax and personal income tax exemption for shareholders receiving incomes from abroad. A source-based tax may be justified to compensate for the advantages that the country offers to the business generating the income. The drawback is that it determines decisions on where to invest. In contrast, a tax based on the place of residence applies to all the income that a country's residents receive, regardless of the country where the activity generating the income takes place. That applies to personal income tax, for which a tax credit is granted in respect of taxes paid in another country. This principle may be justified by the principle of tax capacity, and has the advantage that the tax does not influence the choice of location for the activity. Nevertheless, it does require a substantial international exchange of data on investors' capital incomes.

Countries decide for themselves how to organise their tax on capital incomes. In practice, they use both corporate income tax, which is levied on business profits, and personal income tax on dividends and interest, with or without a tax credit or exemption for income derived from investments abroad. This approach creates various problems. First, the random use of multiple systems may lead to double taxation or failure to tax certain incomes. To remedy that, countries conclude agreements to prevent double taxation. Second, businesses exploit the differences between countries' tax regimes in order to reduce the effective taxation of their incomes. That behaviour is most obvious in the case of source-based corporate income tax, as the activities and profits are transferred to the countries charging the lowest taxes. Countries then become embroiled in a game of strategy aimed at attracting the biggest possible tax base : this is known as international tax competition. Third, the multiplicity of tax systems gives rise to significant administrative expense and compliance costs for firms operating internationally. It also prevents the offsetting of losses and profits within multinationals.

2.2.1 International tax competition in the case of corporate income taxation

The combination of international capital mobility and national corporate income tax distorts behaviour. On the one hand, it influences firms in their choice of location for investing in production. On the other hand, multinationals shift their profits.

Standard theoretical models show that – all other things being equal – firms locate their activities where the average effective corporate tax rate (i.e. the rate that takes account of the nominal rate and rules on the tax base) is lowest.

They therefore do their best to take advantage of the differences in corporate taxation between countries. Conversely, countries adopt a strategic position aimed at attracting the maximum investment by adjusting their tax rates. The advantage lies not only in increased revenues, but also in the fact that a larger capital stock enhances productivity. However, countries that do so disregard the resulting negative externality for other countries, which is reflected in capital outflows. As individual countries take no account of this detrimental spillover effect, international tax competition gives rise to sub-optimal corporate tax rates, and hence to insufficient public expenditure in all countries. This process is sometimes referred to as a "race to the bottom". In that situation, countries may benefit from a coordinated increase in their tax rates.

However, according to sophisticated models, that does not mean that rates must be the same in all countries. Capital is less elastic in relation to tax rates in larger countries, enabling them to apply higher rates. At global level, an increase in the tax burden on capital, which will be more marked if the rate is increased in a bigger country, in fact leads to a lower equilibrium return after tax, cutting the cost of capital and therefore partially offsetting the expense resulting from the rate increase. However, Bucovetsky (2009) shows that a country has to be very small in order to gain no advantage from the coordination of tax rates. It is also evident from the literature on economic geography that, in economic clusters such as the centre or "core" of Europe, firms benefit from agglomeration rents owing to the low transport costs and positive spillover effects due to the proximity of other economic players. Governments can tax these rents without risking a capital outflow. However, that does not rule out tax competition altogether. For instance, firms will still relocate if the taxes are too high in comparison with peripheral countries. In addition, core countries can also interact. Other factors which reduce capital mobility and therefore attenuate competition between countries are advantages specifically connected with the location, such as the availability of certain commodities, infrastructures or skilled labour, and the preference for investing in one's own country because of advantages in terms of information.

As well as moving the location of investment in production, multinationals can exploit differences between tax systems by shifting their profits to the countries with the lowest nominal corporate tax rates. Although the tax due results directly from investment, firms have access to devices for separating the two. Theoretical models which take account of the mobility of profits without the relocation of the physical capital produce results similar to those in which the physical capital is mobile. Here, too, the equilibrium rate is lower for small countries, as a lower tax rate causes them to lose relatively less revenue from their small tax base while securing them quite significant gains via the taxable profits that they attract from the rest of the world. The application of a uniform tax rate in two competing countries will harm the small country, but a minimum rate will promote the welfare of both countries. The difference in relation to physical capital competition models is that the relevant rate here is the nominal rate, and not the effective tax rate ; in fact, profit shifting has no impact on the treatment relating to the tax base.

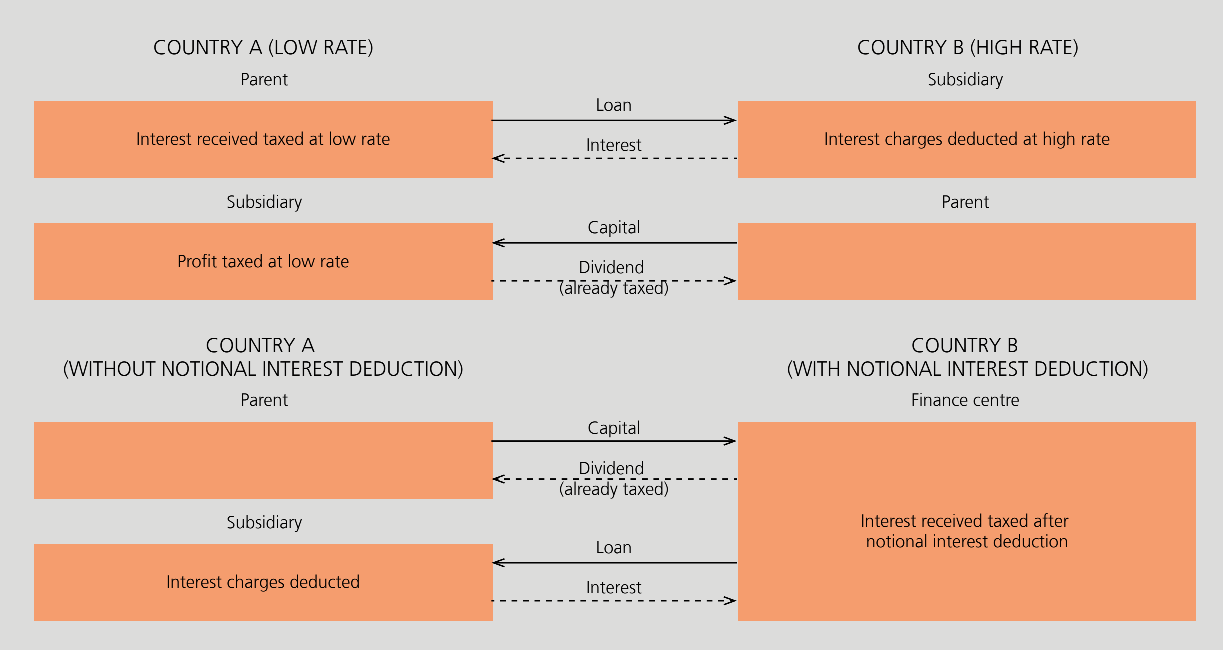
Multinationals have various ways of shifting their profits. These techniques can be roughly divided into two categories, namely manipulation of transfer prices and modification of the funding structure.

On the one hand, the transfer price represents a cost for the firm receiving a particular product, service or right, which reduces its profit, while on the other hand it constitutes income for the firm supplying that product, service or right, which increases its profit. It is in the interests of multinationals to manipulate transfer prices so as to increase the profits of firms based in countries charging a low rate of tax, and to reduce the profits of those located in countries where the tax rate is high. In the case of everyday goods and services, it is possible to check whether the transfer price conforms to the market prices charged between unrelated companies. However, for some goods and services, particularly intangible ones such as brand names and property rights, there is no market. Multinationals manage to avoid tax by locating the property rights in a country charging a low corporate tax rate or applying a favourable regime to income from intellectual property, regardless of whether the activities pursued in that country contributed to the acquisition of the intellectual property, and artificially inflating the dues paid by establishments located in countries with a high tax rate. It is also possible for multinationals to allocate their overheads in a favourable way.

Adapting the corporate funding structure may also be a way of avoiding tax. In that case, it exploits the fact that, in most corporate tax systems, interest on borrowings can be deducted from taxable profits, unlike the opportunity cost of capital (notional interest). It is then advantageous to finance subsidiaries in other countries with borrowings if they are located in a country that charges a relatively high rate of tax, and to use equity capital if they are located in a country where the tax rate is fairly low. In that context, the crucial point is that the dividend paid within the group of companies is presumed to be taxed in the country of the company which is paying it. That is the case in most countries, and notably in Belgium with the deduction of dividends received (RDT/DBI).

If a country also has a system allowing the deduction of notional interest on the capital, the scope for tax avoidance is even greater. Multinationals can optimise their taxes by establishing finance centres endowed with extremely high capital, whose main activity consists in granting loans to other establishments in the same group. That enables them to reduce their tax bill while benefiting from the deduction of notional interest in the country operating that regime, and the deduction of borrowing costs in the countries where the other establishments are located.

CHART 4 PROFIT SHIFTING BY MODIFICATION OF THE FUNDING STRUCTURE



2.2.2 How to avoid the negative effects of international tax competition ?

Opinions are apparently divided on whether it is necessary to harmonise tax systems or coordinate corporate taxation in order to combat the distortions of behaviour caused by international tax competition, or whether a high degree of tax competition is desirable.

Apart from the externalities that appear between countries autonomously deciding their taxation policy, there are other distortions specific to the centralised or decentralised character of decision-making which must likewise be taken into account when assessing the taxation policy of different countries. Unlike the usual tax competition models, "public choice" theory assumes that policy-makers maximise their own objectives rather than the welfare of the population. Decision-makers who are not benevolent could choose to increase tax revenues as much as possible rather than welfare. Tax rates would then be higher than desirable. In that case, international tax competition could lead to lower tax revenues. However, it is hard to say whether that would result in the optimum level of taxation from a welfare point of view.

According to the fiscal federalism theory, the combination of government revenue and expenditure should ideally reflect the population's preferences as far as possible, with the national legislative authorities in principle being better informed than the supranational legislative authorities. The "second-generation" theory of fiscal federalism focuses on the information asymmetries between politicians and the population. In that regard, decentralised decision-making would increase the responsibility of the decision-makers. According to the "yardstick competition" model, in the absence of better information the voters base their view on the results obtained in other jurisdictions to assess their government's policy, and that increases their government's responsibility and encourages it to work more efficiently. That theory is primarily relevant in the case of local jurisdictions with few differences of language and culture, where much more information is exchanged than between countries. However, the fiscal federalism theory also states that if the policy has significant spillover effects on other jurisdictions, it is preferable for decisions to be coordinated. That is particularly true in the case of capital taxation, where these effects are considerable in view of the increasing international mobility of capital and profits, as explained in detail above.

In view of the substantial spillover effects, which have also been clearly demonstrated empirically, close international coordination of corporate taxation seems advisable, in terms of both the tax base and the rate charged.

As regards the tax base, what is needed is harmonisation that limits the scope for profit shifting, making the tax base correspond to the economic rent – in accordance with the principles set out in box 1 – and taking consistent account of the positive externalities of investment in research and development. Profit shifting can be limited by attributing the profits to the countries where the activity generating them is located. That can be done by using formulas which take various factors into consideration, as in the EC proposal for a common consolidated corporate tax base (CCCTB) (see section 3). Countries can also conclude agreements on transfer prices and limit the scope for adjusting the funding structure for tax planning purposes, as is done in the OECD (again, see section 3). Agreements on the tax treatment of intellectual property rights and tax incentives for expenditure on research and development can reduce profit shifting and promote innovation. Finally, the harmonised introduction of a notional interest deduction scheme including rules to prevent abuse and a system of consolidating profits and losses within groups of companies would help to minimise the influence of corporate tax on entrepreneurs' investment decisions.

It would also be a good idea to coordinate corporate tax rates to some degree, in the form of a minimum rate. It is less effective to harmonise the tax base if the rates are not harmonised : the distortion relating to decisions on where to invest in production still exists and could even increase.

Harmonisation and coordination measures should preferably involve as many countries as possible. The impact often can only be favourable to them all if they all actually collaborate. That is what makes these initiatives intrinsically fragile.

A more fundamental reform would consist in switching from a system of taxation based on source to taxation based on residence. Disappearance of the tax based on source would also eliminate the scope for exploiting tax differences between countries. However, such a reform would entail technical problems, as it could drive firms to postpone the repatriation of profits to shareholders. It would also require a substantial international exchange of data on the capital incomes of investors. In recent years, some significant steps have been taken in that direction, such as the abolition of banking secrecy.

A third reform option, put forward for long-term consideration, would be to replace the current system of taxation based on source or residence with a system of taxes based on destination. This system would tax corporate profits in the place where the products are sold. It would be very similar to a VAT system, the main difference being that labour costs would be deducted from the tax base so that only the profits would be taxed. Such a system would not influence decisions on the location of firms and would offer far less scope for profit shifting. Like a tax based on the place of residence, however, a tax based on destination would abolish the principle of remuneration of the producer country, specific to taxation based on source.

3. Recent international cooperation initiatives concerning corporate taxation [1]

The aim of coordination and cooperation in regard to corporate tax is nothing new. This section reviews developments in that sphere before discussing a number of recent European initiatives on that subject.

3.1 Review of initiatives

Like other direct taxes, corporate taxation is an autonomous competence of the EU Member States, though they have to respect the rules of the Single Market, such as the restrictions on state aid. Since the EEC was founded, there have been

(1) On the basis of the information available when the text was finalised on 19 September 2018.

numerous initiatives aimed at harmonising corporate tax. Despite the many proposals, there has been no harmonisation at EU level [1].

In view of the Member States' reluctance to harmonise corporate tax, the EC has adopted a pragmatic position over the years, opting for a two-pronged approach. In the long term, it works on measures to achieve a harmonised tax base for companies operating across borders in the EU, and in the short term it focuses on targeted measures which remove certain tax barriers for multinationals and prevent any harmful tax competition. For example, there have been measures to avoid double taxation (directive on relations between parent companies and subsidiaries, directive on mergers), a list of harmful tax regimes (leading to abolition of the coordination centres in Belgium), and the Joint Transfer Pricing Forum, which advises the EC on transfer pricing issues. In 2001, the Commission had tabled a new proposal for a common consolidated corporate tax base (CCCTB). This method should enable international companies to calculate their tax base at group level before apportioning it according to a formula between the Member States, which would apply their own tax rates. In 2011, after ten years of work, this initiative led to a draft Directive on which the Member States have yet to agree.

In the wake of the economic and financial crisis and various revelations about tax avoidance and tax evasion, the need to step up the coordination of corporate taxation has returned to the forefront in recent years. By means of aggressive tax planning, some companies in fact manage to shift profits to countries where they pay little or no tax, or to erode the tax base.

In 2013, in view of the keen interest in the issue of tax base erosion and profit shifting, and thanks to the political will to address these problems, the OECD succeeded – with the support of the G20 – in launching its Base Erosion and Profit Shifting (BEPS) project. In a time span of two years, no fewer than 13 reports were produced, culminating in a set of recommendations, new international rules and good practices which should ensure that profits are taxed at the place where the value added is actually created. Annex 2 to this article lists the 15 action points in the BEPS project. Although the components of the BEPS action plan are not legally binding, they have been largely approved by the OECD members and by the G20, and by a number of developing countries and other players (including the IMF and the World Bank). Those countries are therefore expected to take the necessary steps to solve the problem of base erosion and profit shifting, and to implement the OECD recommendations in that sphere.

In that context, various new initiatives have also been adopted at the European level in recent years in order to create a fair tax system with particular emphasis on the taxing of profits. They largely take account of the conclusions of the work on the BEPS project by the OECD and the G20, to which the EC also made an active contribution. The member states considered it important to coordinate the implementation of the BEPS action plan in the EU, in order to ensure that the operation of the single market is not additionally distorted by divergences in the interpretation and application of these recommendations on the part of the Member States.

A number of European measures discussed below should in the short run provide a solution to the problems of tax avoidance and tax evasion. By relaunching its CCCTB proposal, the EC is also working on a long-term solution which should tackle the roots of the problem of base erosion and profit shifting (BEPS) and ensure that profits are taxed where they are generated.

3.2 Examination of preferential regimes

In recent years, a number of preferential tax schemes applied by the Member States have been examined in connection with fair corporate taxation. The Code of Conduct Group on Business Taxation is a key instrument here. It establishes a code of conduct which comprises an overview of harmful tax measures and is intended to create fair competition in the corporate taxation sphere. Member States adopting this code undertake to abolish or reform tax measures considered harmful (*rollback*) and not to introduce them in the future (*standstill*).

(1) The Neumark Committee (1962) and the Van den Tempel Report (1970) both advocated the harmonisation of corporation tax rates. This last report eventually led in 1975 to a proposal for a Directive on the harmonisation of the corporation tax rate by alignment of the rates within a range of 45-55 %. However, the European Parliament considered that an agreement on harmonisation of the tax base was needed first. In 1988, the EC submitted a proposal for harmonisation of the tax base, but it was rejected by a number of Member States. In 1992, a new harmonisation proposal was launched by the Ruding Report, recommending a minimum standard for the tax base and minimum and maximum rates of corporation tax (30 % and 40 % respectively). These proposals also failed.

At the request of the Ecofin Council, this Code of Conduct Group has, in recent years, analysed the Member States' preferential tax schemes for income derived from intellectual property (*patent boxes*), while the EC, via its competition policy, and more specifically by examining illegal state aid, checks whether the Member States' tax rulings – i.e. the agreements between the tax authorities and certain firms on the way in which corporation tax law is applied – conform to the rules on state aid.

*Favourable tax treatment of income derived from intellectual property (*patent boxes*)*

In the wake of the OECD/G20 BEPS project, the Code of Conduct Group decided, following examination, that the Member States' "patent boxes", or in other words tax regimes creating a tax advantage for income derived from intellectual property, need to be modified to conform to the (adapted) Nexus approach. That decision was endorsed by the Ecofin Council in December 2014.

According to the Nexus approach, an advantageous tax regime for income from intellectual property can only apply if the activities aimed at acquiring intellectual property are actually conducted by the entity concerned. To judge whether the entity actually carried out sufficient activities, the expenditure on research and development (R&D) is used as an approximation. In practice, the tax advantage has to depend on the Nexus fraction, which corresponds to the ratio between the amount spent on R&D by the company itself (or expenditure outsourced to an unrelated company) and the total amount that has been spent on developing or buying the intellectual property.

After examination by the Code of Conduct Group on Business Taxation, it emerged that none of the patent box regimes in force in the Member States conformed to the Nexus approach. The Code of Conduct Group therefore established that the legislation of the Member States on the tax treatment of income from intellectual property needed to be brought into line with the Nexus approach by 30 June 2016. At the request of the Ecofin Council, the Code of Conduct Group verifies whether the Member States have actually adapted their patent boxes to the new Nexus approach. In the case of Belgium, both the Code of Conduct Group and the OECD consider that the new system of deducting income from innovation (replacing the tax deduction for income from patents) is not harmful.

Examination of tax rulings

Since 2014, the EC has demanded information on Member States' tax rulings and examined whether those advance rulings constitute unlawful State aid. In some cases, the EC has decided to open a formal inquiry into the granting of unlawful state aid; it did so, for instance, in regard to the excess profit rulings in Belgium. At the beginning of 2016, the EC judged that, in some cases, these rulings resulted in a considerable advantage for multinationals, constituting illegal state aid. That resulted in abolition of this system in Belgium and the EC's demand that the state aid wrongly granted to the companies concerned must be reclaimed. The state aid granted by way of excess profit rulings was repaid to the Belgian state in 2016 and 2017. Similarly, some tax rulings of other Member States, such as Ireland, Luxembourg and the Netherlands, were deemed by the EC to constitute illegal State aid. Formal inquiries are still ongoing against the Netherlands, Luxembourg and the United Kingdom.

3.3 Increased tax transparency

The EC hopes that increased tax transparency will discourage the Member States, multinationals and other players from continuing to use certain (harmful) tax strategies, or will make them more cautious in the development of new tax strategies and measures. To achieve that, there have been important initiatives in recent years which have helped to enhance tax transparency.

In December 2015, the Ecofin Council adopted a Directive obliging the Member States, from 1 January 2017 onwards, to ensure the systematic and automatic exchange of data on advance tax rulings in cross-border cases and on prior agreements on transfer pricing. This does not only concern new or amended advance rulings on these subjects, but also all rulings passed in that sphere in the five years preceding the entry into force of the directive. Apart from the other Member States, the EC must also be informed of these advance tax rulings. This Directive forms part of a package of tax transparency measures that the EC presented in March 2015.

It should be noted that the Directive does not ban advance tax rulings: it aims to ensure that other Member States are notified of a Member State's tax rulings, via the compulsory exchange of information, and are therefore able to respond.

Previously, Member States were often unaware of this type of advance rulings : the Member State implementing the advance tax rulings could decide for itself whether or not to inform other Member States.

Multinationals also need to demonstrate greater transparency. In May 2016, a Directive was adopted obliging multinationals with a consolidated group revenue of € 750 million or more, and established in the EU or conducting business there (via EU-based entities), to submit a report for each country with effect from 2017, disclosing certain information each year for each tax jurisdiction in which it operates. This country-by-country reporting supplements the master file which contains information on the group's global activities, intra-group operations and transfer pricing policy, and the local file containing data on transactions with other group entities effected by the entity or entities located in a Member State, and the prices charged. In addition, this directive requires the Member State in which the group has to submit its country-by-country reports – generally the Member State in which the group's parent company is located – to exchange automatically the data contained in the country-by-country reporting with all Member States in which the group has an entity or permanent establishment, so that those countries have a complete picture of the group. The greater transparency demanded of multinationals is in line with the recommendations of the OECD / G20 BEPS project as regards the documentation of transfer prices.

The Ecofin Council and the European Parliament are currently examining a proposal for introducing public country-by-country reporting for multinationals active in the EU. These undertakings will then have to disclose certain information, such as where they make profits or losses, their turnover, the activities that they pursue, how many people they employ, but also where they pay tax and how much they pay [1].

In May 2018, the Ecofin Council also approved a draft Directive which will oblige tax advisers and other intermediaries, namely anyone offering tax advice, such as accountants, lawyers, banks, etc., to disclose the complex cross-border tax structures that they set up or recommend, which may lead to aggressive tax strategies. The disclosure obligation imposed by the directive will ensure that Member States are informed at an early stage of the tax planning strategies to be implemented. Member States will thus be able to take action in good time, i.e. even before these strategies are implemented, e.g. by amending their legislation. They will also be able to target their checks specifically on set-ups which could lead to aggressive tax planning. In addition, the Directive will oblige Member States to exchange automatically with one another the information that they receive in this way, so that all Member States know about the tax planning strategies that concern them. Furthermore, this Directive forms part of the OECD / G20 BEPS action plan, in which action point n° 12 provides for mandatory disclosure by intermediaries.

3.4 Anti Tax Avoidance Directive (ATAD) [2]

At the end of January 2016 the EC launched a package of measures to combat tax avoidance (*Anti Tax Avoidance Package*). The ATAD formed a crucial part of the package.

This Directive, adopted by the Ecofin Council on 12 July 2016, should in principle be transposed into national law by 31 December 2018 and enter into force on 1 January 2019 [3]. The aim of the ATAD is to implement a number of crucial measures to combat tax avoidance in order to provide protection against aggressive tax planning. It thus responds to the calls from various players, such as the European Parliament. Some of the measures in the ATAD also ensure that a legal framework will be created for the coordinated implementation of a number of BEPS recommendations in the Member States. In that regard, the ATAD sometimes actually goes beyond the provisions of the OECD / G20 final reports. Moreover, the ATAD aims at a common minimum level of protection against tax avoidance : Member States themselves are free to aim at a higher level of protection when transposing the directive into national law, e.g. by defining stricter threshold values.

The ATAD contains five measures which should help to ensure that profits are taxed where they are actually generated.

(1) According to the draft Directive as introduced by the EC, in regard to activities conducted in the EU, groups with a consolidated net turnover of over € 750 million have to publish the information demanded for each Member State where they operate, while in the case of activities outside the EU, aggregate reporting should be sufficient in principle, except for activities conducted with "non-cooperative" jurisdictions.

(2) Directive 2016 / 1164 laying down rules against tax avoidance practices that directly affect the functioning of the internal market.

(3) Except for exit taxation, which has to be transposed by 31 December 2019, for implementation with effect from 1 January 2020. In regard to limiting the deduction of interest, a transitional period is possible so long as the national regulations on this subject are just as effective as the rules in the Directive, until such time as a minimum standard is agreed in the OECD. However, the transitional period must end on 31 December 2023.

3.4.1 Limiting the deductibility of interest charges

The tax base may be eroded by means of excessive interest payments. For example, some multinationals arrange for group entities based in a Member State imposing high taxes on profits to record substantial interest charges via intra-group loans, so as to ensure a large tax allowance and thus to limit the tax base, while the group entity granting these loans – which therefore receives the interest income – is located in a country which charges little or no tax on profits. In order to combat such abuse, the ATAD restricts the deductibility of interest charges.

The possibility of deducting from the tax base the positive difference – also known as additional borrowing cost or net interest – between deductible borrowing costs (interest charges on all forms of debt and economically comparable costs) and the taxable interest income is limited by the ATAD to a maximum of 30 % of the gross operating surplus (EBITDA). However, the EBITDA is defined for tax purposes as excluding tax-exempt income. The ATAD specifies that Member States may include some exceptions to the rule in their legislation. For instance, deduction of net interest may still be permissible up to € 3 million, or Member States may authorise autonomous entities to continue deducting the whole of their net interest since the risk of erosion of the tax base by excessive interest arises mainly in related undertakings (notably by the use of intra-group loans).

3.4.2 Exit tax

The tax base may also be eroded by placing certain assets or the tax domicile outside the jurisdiction of a Member State so that the latter can no longer tax some corporate profits. An exit tax means that Member States can nevertheless still tax the profits on transferred assets at the time of exit if these profits were generated in their territory, even if they have not yet been realised. The purpose of this measure is to ensure that profits are taxed where the economic activity actually takes place. The ATAD envisages four specific situations in which the taxpayer is liable for exit tax. That is the case, for example, if assets are transferred from the head office to a permanent establishment (or vice versa) located in another Member State or in a third country, or where the tax domicile is switched to another Member State or third country. The transfer of assets between a parent company and a subsidiary is beyond the scope of the ATAD (1).

3.4.3 Rule on controlled foreign companies (CFCs)

Some multinationals transfer their profits from their parent company to a controlled foreign company in order to take advantage of a low or zero rate of corporate tax. However, under certain conditions the CFC rule allows those profits to be taxed in the Member State of the parent company by adding them back into its tax base.

Under the ATAD, an entity or permanent establishment whose profits are not taxed in the Member State of the parent company is a controlled foreign company (CFC) of the taxpayer if the latter, directly or indirectly, holds more than 50 % of the capital or voting rights, or is entitled to receive more than 50 % of the profits, and if the controlled foreign company pays "little" tax. That is the case if the effective corporate tax paid by the CFC in another country is less than the difference between the corporate tax that it would have paid in the Member State of the taxpayer and the corporate tax actually paid, or in other words, if the latter is less than half the tax rate in the taxpayer's Member State.

If these two conditions are met, some of the CFC's income can be added to the taxpayer's tax base.

3.4.4 Conflicts arising from hybrid mismatches

Hybrid mismatches are situations in which financial entities or instruments are classified differently in the respective national laws of two countries (or in tax treaties). These mismatches are abused for the purpose of aggressive tax planning techniques, so that some elements avoid tax.

The ATAD offers a solution for a number of classification differences arising from hybrid mismatches. In the case of double deduction, i.e. where costs are deducted from the tax base in both Member States, the deduction is granted

(1) The transfer of assets between a parent company and a subsidiary, i.e. two entities with their own legal personality, can in fact be considered a legal transfer of ownership (sale) so that the transfer pricing rules apply. The transfer of assets to a permanent establishment, which can be defined in simplified terms as a foreign establishment (e.g. a factory or branch) of the parent company, without its own legal personality but subject to tax on its activities in another country, is not always considered a legal transfer of ownership having income as its counterpart.

only in the Member State of origin of the payment. Where a particular element is deducted from the tax base in one Member State without being added to the tax base in another Member State, the Member State where the deduction is made must reject it.

The original ATAD, which only provides a solution for hybrid mismatches between two Member States, has now been revised. The ATAD II was adopted in May 2017 and has to be transposed by the Member States by 31 December 2019. The ATAD II extends the rules on hybrid mismatches to non-EU countries and its definition of conflicts arising from hybrid mismatches is broader than in the original ATAD.

3.4.5 General anti-abuse clause

This clause can be deemed to supplement the specific anti-abuse measures and acts as a safety net for cases where certain artificial tax structures designed to avoid tax nevertheless fall outside the scope of the specific anti-abuse measures. This clause enables the Member States to stop such abuse resulting from structures of that type by disregarding them when calculating corporate tax. The ATAD defines an artificial structure as one which has no commercial motivation and does not reflect economic reality.

3.5 Other measures aimed at fairer and more effective corporate taxation in the EU

Apart from the ATAD, examination of preferential regimes and increased tax transparency, the EU has taken a number of other measures in recent years to make corporate taxation fairer and more effective.

3.5.1 Common external strategy – list of non-cooperative jurisdictions for tax purposes

A key component of the common external strategy is the establishment at EU level of a list of third countries which can be considered non-cooperative jurisdictions (or tax havens). The EU list aims to encourage a good tax policy in those countries and thus find a solution to the impact that certain tax strategies of those countries have on tax bases in the EU.

At present, there are two lists of non-cooperative jurisdictions, namely a greylist and a blacklist. Countries or jurisdictions on the blacklist do not fulfil one or more of the EU's good tax policy criteria (1) and are not sufficiently committed to resolving the problems identified or refuse to cooperate. Countries or jurisdictions on the greylist do not satisfy one or more of the EU criteria, but have stated that they are prepared to amend their tax laws in order to conform to the said criteria, and can therefore be considered "cooperative".

These two lists were drawn up following an extensive screening process by the EC, the Code of Conduct Group and, ultimately, the Member States, and were published for the first time on 5 December 2017. Since then, these lists have already been updated three times as a result of new information notified and new commitments given by the jurisdictions concerned, the latest revision dating from 25 May 2018. There are currently seven countries on the blacklist: Guam, the US Virgin Islands, Namibia, Palau, Samoa, American Samoa and Trinidad and Tobago. The original blacklist published in December 2017 contained 17 countries.

For the moment, apart from the fact that blacklisted countries are formally referred to as "non-cooperative tax havens", entry on the EU blacklist seems to have rather limited impact, as the Member States have yet to agree on common sanctions, though they can take measures on their own initiative. However, the EC has linked the EU blacklist to the European Fund for Sustainable Development and the European Fund for Strategic Investments so that those resources can no longer benefit an entity in the countries concerned. The EC is also examining the possibility of linking the blacklist to other legislation.

Countries on the greylist are closely monitored by the Code of Conduct Group and must have made the required changes by a certain date. If they do not fulfil their commitments within the time allowed, these countries may be included on the blacklist. At present, there are numerous countries on the greylist (65 altogether), including Vietnam, the Hong Kong SAR, Peru, Thailand, the Maldives, Turkey, Qatar, the Cayman Islands, etc.

(1) These criteria are based on three pillars, namely tax transparency, fair and equitable tax competition, and the implementation of some of the BEPS project action points, such as the minimum standards specified by the OECD/G20.

The EU Member States are neither screened nor listed, as according to the EC (2017c), they are encouraged to introduce fairer corporate taxation, notably by the new rules on increasing transparency and the other measures concerning a fairer and more effective corporation tax, and those to combat BEPS.

3.5.2 Directive on the resolution of tax disputes

In October 2017, the Member States also reached agreement on a Directive concerning systems for resolving tax disputes arising from variations in the interpretation and application of the tax treaties, that are sometimes leading to double taxation. A key point here is that the Member States are currently subject to specific deadlines for resolving these disputes, which is helping to make the tax system fairer and more efficient. The Member States have to take the measures necessary to comply with that Directive by 30 June 2019.

3.5.3 Update of the "corporation tax" code of conduct

Work is also in progress on updating the Code of Conduct on Business Taxation. The aim is to adapt it to the complex international environment in which firms now operate. In that context, the Ecofin Council has also asked the Code of Conduct Group to clarify certain points and provide guidelines that take account of the BEPS recommendations.

The Code of Conduct Group's reports to the Ecofin Council are now also published in order to make the group more visible and transparent. In that connection, an overview of all the guidelines approved by the group since 1998 was published in February 2018.

Box 2 – Taxing the digital economy in the context of corporation tax

In recent years, the digital economy has expanded strongly, while – in some respects – corporate taxation has not been adapted to this new form of entrepreneurship. The digital economy actually has some specific features which are not taken (sufficiently) into account by the current corporate tax rules. For instance, a physical presence, at the very least a permanent establishment in the tax jurisdiction, is often a necessary condition for levying corporate tax. However, a digital business can operate perfectly well in a country without having a physical presence there. It is therefore easier for digital businesses to centralise their physical presence in a country where the rate of corporate tax is low or zero, leading to the fact that the value added is not necessarily taxed where it is created. Also, one of the main characteristics of the digital economy is that it derives its income from applying or trading intangible fixed assets, such as algorithms, patents, or user data. However, these intangible assets are often particularly difficult to value and certain elements, notably the value added created by user participation, are not always taken into account in the definition of the tax base, so that the real value added created by the digital economy is not always taxed correctly or in full. In addition, intangible assets are highly mobile, and that enhances the scope for profit shifting.

These factors are part of the reason why there is currently a significant difference between digital and traditional businesses in terms of the effective corporate tax paid. For instance, according to the EC (2018d), the effective rate of corporate tax applicable to traditional multinationals in the EU averages 23.2 %, while for digital multinationals it is only 9.5 %. However, it should be noted that the calculation of that effective rate also takes into account the fact that governments often grant certain (tax) concessions to digital businesses in order to stimulate their growth.

Fair taxation of the digital economy is therefore one of the points in the OECD/G20 BEPS action plan, and one of the items on the EC's agenda.

In March 2018, an initial interim report (OECD, 2018) was produced on this subject. It clearly indicates that opinions are still divided on how to resolve this problem: it will therefore be some time yet before an international agreement can be achieved.

Although the EC advocates a global solution to this problem, it nevertheless decided to present a phased plan, in March 2018, proposing a solution within the EU. In doing so, it hopes to provide an answer for a number of Member States which are looking for a solution, as different, unilateral initiatives could distort the internal market or cause uncertainty for businesses. It also hopes that, by taking the lead, it can encourage and steer the international debate on this issue.

In its proposal for fair taxation of the digital economy, the EC likewise resorts to its two-pronged policy. Its phased plan provides for a temporary solution which can be implemented in the short term, and modification of the corporate tax rules which should be regarded more as a long-term solution.

For the EC, the best solution is to adjust the corporate tax rules in order to introduce the concept of a "digital presence". That should enable the Member States to tax digital activities (with or without a minimum physical presence). In its proposal for a Directive, the EC therefore included the definition of a significant digital presence. Thus, a digital presence is defined as significant if, during the tax period in the Member State, revenues from providing digital services to users exceeds € 7 million, the number of digital service users exceeds 100 000, or the number of business contracts for digital services exceeds 3 000.

If a digital service provider fulfils any of these conditions, then according to the draft Directive, it has a permanent establishment in the Member State concerned (on the basis of a significant digital presence) and the firm can therefore be taxed by the Member State in question even if it not physically present. As well as adapting the corporate taxation rules in the Member States, the EC would also like to incorporate the concept of a digital presence in its CCCTB proposal.

As it will probably take some time to reach agreement on reforming the corporate income tax rules, the EC meanwhile proposes to tax a range of digital activities which are not currently taxed, as some Member States had clearly expressed their interest in that respect. The EC suggests, by way of an interim solution, levying a 3 % tax on income derived from a range of digital activities. The draft Directive aims to tax income from the publication on the digital interface of advertising specifically targeting users, the sale of user data and the provision of a digital interface enabling users to contact one another in order to exchange goods and services, for example.

This tax would only apply to firms recording global revenues exceeding € 750 million, including at least € 50 million in the EU, generated by taxable digital activities. Thus, according to the EC, these activities would be taxed pending the adjustment of the corporate taxation rules, while small start-ups would be unaffected. The tax would be levied where the digital service is used.

The Ecofin Council has not yet made a decision on these proposals.

3.6 Proposal for a common (consolidated) tax base

In October 2016, the EC presented specific plans for reviving negotiations on a common consolidated corporate tax base (CCCTB), which had stalled since 2011. As already stated, the aim of the CCCTB proposal is to harmonise the corporate tax base – it therefore does not concern the tax rates – and it has the advantage that a group will have to deal with only one tax authority for calculating its consolidated tax base in the EU, and not with the authorities of all the Member States in which it operates. The consolidation consists in incorporating in a single tax base the taxable result of the multinational group in the various Member States; that will make it possible, for example, to offset losses incurred in one Member State against profits made in another. The common consolidated tax base will then be apportioned between the various Member States by means of a formula in which labour (wage bill and number of employees), fixed assets and turnover will be given the same weighting, which should ensure that the profits are taxed where they are actually made. The Member States will then apply their tax rates to their share of the common consolidated tax base.

The EC has learnt from previous attempts to reach agreement on the CCCTB, and has therefore opted for a new approach. Thus, it decided to phase in the CCCTB gradually. First, the Member States are to agree on a common corporate tax base (CCTB). Only in a second stage will they have to agree on a common consolidated corporate tax base (CCCTB). In the past, work on the CCCTB has shown that some points, such as consolidation, gave rise to difficult discussions which would delay progress on other aspects. In addition, a number of substantive rules and provisions included in the 2011 draft (which has since been withdrawn) were likewise revised, supplemented or deleted in order to take maximum account of the work already done for the purpose of introducing fair and efficient corporate taxation.

Taking account of the draft Directive(s) put forward by the EC, the C(C)CTB would be compulsory for all groups with consolidated revenues of over € 750 million (in the 2011 proposal, the CCCTB was still optional for all firms), while other companies could choose whether or not to apply it. It was deemed necessary to make the C(C)CTB compulsory for large firms of such a size, because these groups generally have sufficient resources to use tax avoidance strategies. In fact, the consolidation of the tax base eliminates the problem of transfer pricing, while a harmonised tax base prevents any abuse associated with variations in the law between Member States.

The EC proposal on a common tax base supplements the 2011 proposal by including various measures which are also imposed by the ATAD, so as to ensure that the C(C)CTB also conforms to these anti-abuse provisions. It should be noted that the C(C)CTB would impose harmonised rules, while the ATAD aims to provide a minimum level of protection allowing Member States to be stricter if they like. In addition, the new proposal for a common tax base pays particular attention to two deductions: the deduction for research and development (R&D) expenditure and the new deduction for growth and investment.

The proposal makes provision for a particularly large deduction for R&D expenditure, in order to offer maximum support for innovation. The new deduction for growth and investment is meant to end the inequality of tax treatment between debt financing and equity financing of investment. The deduction for growth and investment enables firms, under certain conditions, to also deduct the increase in their equity from their tax base in relation to a given base year (1), so that debt financing no longer gains a tax advantage via the deduction of interest. The C(C)CTB proposal therefore suggests introducing an incremental system for the deduction of notional interest. In that connection, it should be noted that there is also provision for making the reduction in equity subject to tax.

Up to now, no agreement has been reached in the Ecofin Council on either the Directive on a common corporate tax base (CCTB) or on the Directive concerning a common consolidated corporate tax base (CCCTB). At its plenary session on 15 March 2018, the European Parliament, which only needs to be consulted on these Directives, adopted a version of the EC's CCTB and CCCTB proposals which it had amended itself.

4. Corporate income tax reform initiatives

In the context of the international developments discussed above, it was desirable for Belgium to implement a corporation tax reform by converting the European Directives on combating tax avoidance and cutting the nominal tax rates in order to remain competitive. The reform, approved by the Belgian Parliament on 22 December 2017 (2), is discussed in section 4.1. However, Belgium is not the only country to have adopted reforms. Initiatives in other EU Member States are examined in section 4.2, while the recent major reform of corporate tax in the United States and its potential implications for the EU are analysed in section 4.3.

(1) More specifically, the notional interest deduction is calculated on the basis of the increase in the equity over the previous ten years, or – in the first nine years of implementation of the system – on the basis of the increase in the equity compared to the first year following the introduction of the system. The interest rate is equal to the rate on ten-year government bonds plus a 2 percentage point risk premium.

(2) Law of 25 December 2017 reforming corporate income tax.

4.1 Corporation tax reform in Belgium

Stimulation measures

One of the key points of the Belgian corporation tax reform is the rate reduction. The standard rate will be lowered from 33 % to 29 % in 2018 (2019 tax year), and finally cut to 25 % in 2020 (2021 tax year). The complementary crisis contribution will fall from 3 % to 2 % in 2018 (2019 tax year) and will be abolished altogether in 2020 (2021 tax year). For companies whose taxable profit does not exceed € 322 500, the progressive rate of corporation tax will disappear. In future, a reduced rate will apply to companies classed as small under Belgian law. For SMEs, the tax rate will be cut to 20 % on the first € 100 000 of the taxable profit from 2018 onwards (2019 tax year); the complementary crisis contribution will also be reduced before being finally abolished. The part of their taxable profit in excess of € 100 000 will attract the standard rate of corporation tax. This means that, for SMEs, the average tax rate will always be lower than the standard rate.

TABLE 1 REDUCTION IN NOMINAL TAX RATES
(in %)

	2018 (2019 tax year)	2020 (2021 tax year)
Normal nominal rate		
Old	33	33
New	29	25
SME rate (on the first € 100 000)	20	20
Complementary crisis contribution (surcharges (1))		
Old	3	3
New	2	0

Source: FPS Finance.
(1) Before the reform, this led to a combined nominal corporate income tax rate of 33.99 %.

A loss-offsetting system is also introduced for related companies so as to make corporation tax in Belgium more competitive. The chosen system will be one in which two companies associated in a group can conclude a mutual agreement whereby the loss recorded by one of them in the current year can be transferred to the other. This system implies that companies belonging to a group are not obliged to draw up a consolidated group tax return. Nonetheless, it is so designed that assets cannot be transferred between two companies in the same group.

The attractiveness of corporation tax in Belgium is also reinforced by increasing the allowance for definitively taxed income (DTI allowance), which will go up from 95 % to 100 %. The existing exemption from payment of payroll tax for researchers is extended to holders of a bachelor's degree.

Finally, various other, less significant, stimulation measures are proposed, such as the provisional reduction to 12.5 % in the rate of the exit tax for real estate investment vehicles, the reduction in the rate of tax on capital gains on closure of a business, standardising it at 15 %, and abolition of the 0.412 % levy on capital gains on shares in companies which are not SMEs.

Compensatory measures

In parallel with the rate reductions and other stimulation measures, a number of compensatory measures are also being adopted to enlarge the tax base so as to ensure that the corporation tax reform is neutral for the budget. In principle, the average tax burden should therefore remain unchanged.

The main compensatory measure is the reform of the notional interest deduction system. In the system applicable up to 2017, the notional interest deduction concerned the total outstanding capital. The reform will seriously restrict this system as only the increase in equity – what is known as incremental capital – will be taken into account. This system ties in with the EC proposal for introducing an incremental notional interest deduction system based on the increase in the capital over a ten-year period. However, the new system in Belgium is less extensive. For instance, its application is confined to the (average) annual increase in the capital, and the rate of notional interest is lower than proposed by the EC.

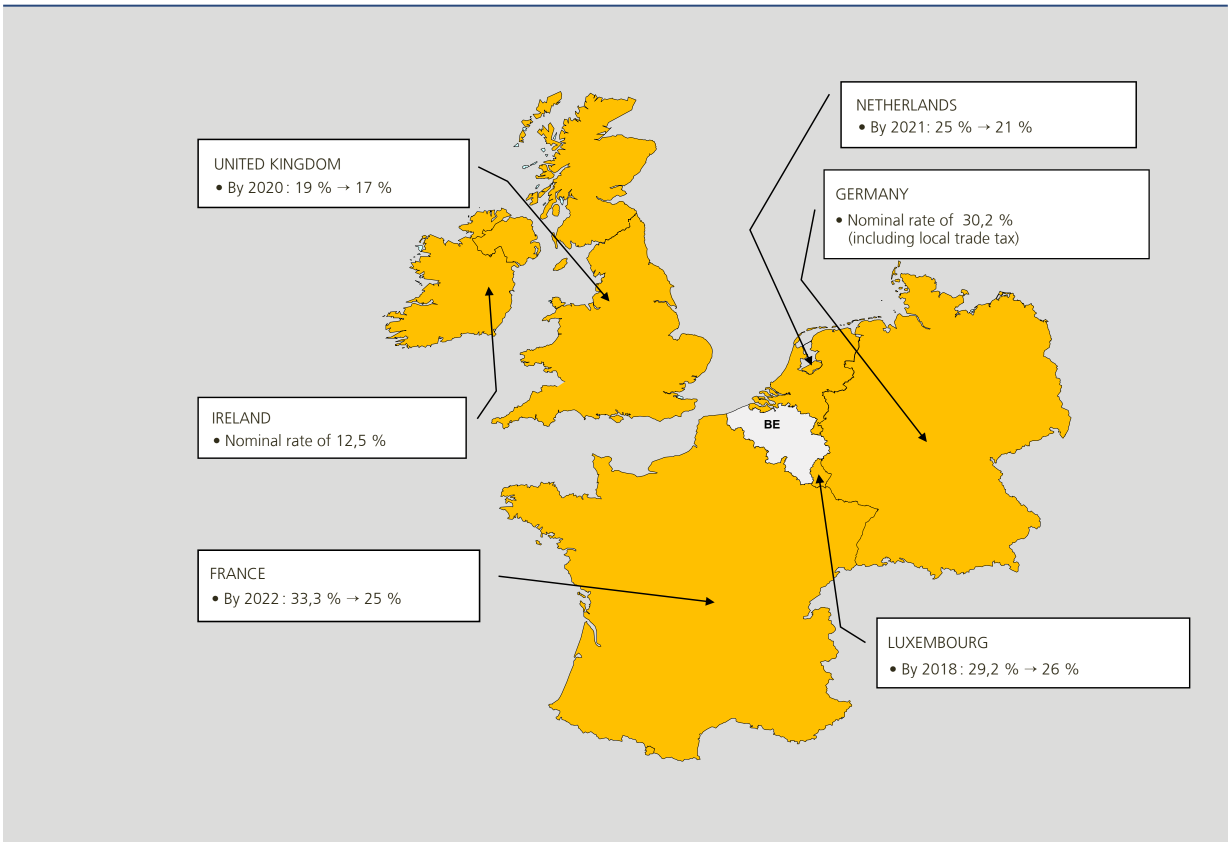
A minimum tax base was also introduced by means of a "basket" containing a number of deductible items, such as definitively taxed income carried forward, innovation income carried forward, past losses, the notional interest deduction carried forward and the new system of incremental notional interest deduction. The maximum allowance for this basket is set at € 1 million, plus 70 % of the tax base remaining after application of the investment allowance. Thus, the minimum corporation tax base is equal to 30 % of the tax base in excess of the sum of € 1 million.

Another key aspect of the reform is the transposition of the European Directives on combating tax avoidance, and in particular the ATAD. Since these Directives aim to limit the erosion of the tax base by tightening up on tax planning, they may help to fund the reform. Among other things, their transposition leads to a restriction on tax deductible borrowings, the taxation of certain income from foreign firms in the controlling domestic firm, and measures intended to combat hybrid mismatches. The exit tax, which was already applied in Belgium, is also being extended. This means that the transfer of assets from a Belgian parent company to a foreign permanent establishment will likewise be subject to this tax in the future.

Other structural measures include harmonising the exemptions for capital gains on shares with the DTI rules, discouraging conversion to a company by increasing the minimum remuneration requirement and penalising failure to respect that condition, making capital reductions taxable, increasing the rate of default interest and late payment interest, abolishing the tax allowances on additional taxes, and disallowing various costs concerning fines and car expenses.

4.2 Corporate income tax reform initiatives in other EU Member States

CHART 5 CORPORATE INCOME TAX REFORM IN OTHER EU MEMBER STATES



In order to remain competitive and attract foreign investment, various other European countries are similarly contemplating corporate income tax reforms. In addition, as the scope for transferring taxable profits and avoiding corporate income tax is becoming limited at international level, the focus is more on the difference in nominal rates between countries. That is why, among Belgium's neighbouring countries, the Netherlands, France and Luxembourg have all taken steps to cut their tax rates.

In the Netherlands, where the first € 200 000 of the taxable profit is taxed at a lower rate, it was decided – under the government agreement adopted in October 2017 – to lower both the reduced rate and the standard rate. The Dutch government has therefore opted to keep a progressive system but nevertheless plans a reform and tax reduction in stages between now and 2021.

France, too, has a progressive system of corporate taxation whereby the first € 500 000 is taxed at a lower rate. Nonetheless, with effect from the 2020 tax year, this progressive system will be abolished and all profits will be taxed at the lower rate of 28 %. During the following two years, the tax rate will be reduced further to 25 %. In addition to the corporate tax rate payable in France, there is a supplementary 3.3 % levy which will not be abolished.

TABLE 2 CORPORATE TAX REFORM INITIATIVES IN OTHER EU MEMBER STATES

	Approved ?	Characteristics of the current system	Reform timetable
Netherlands	Approved in the Dutch government agreement of October 2017	Progressive system : € 0-200 000 : 20 % > € 200 000 : 25 %	2019 : € 0-200 000 : 19 % > € 200 000 : 24 % 2020 : € 0-200 000 : 17.5 % > € 200 000 : 22.5 % 2021 : € 0-200 000 : 16 % > € 200 000 : 21 %
France	Approved by the French parliament in December 2017	Progressive system : An earlier reform in 2016 made provision for a reduction to 28 % in 2020. In addition to the rate in force, a supplementary contribution of 3.3 % is levied.	2018 : € 0-500 000 : 28 % > € 500 000 : 33.3 % 2019 : > € 500 000 : 31 % 2020 : Abolition of the progressive system Rate of 28 % 2021 : Rate of 26,5 % 2022 : Rate of 25 %
Luxembourg	Approved by the Luxembourg parliament in December 2016	Reform already begun in 2017. The rates also include the municipal business tax and the unemployment fund contribution.	2017 : 27,1 % 2018 : 26 %
United Kingdom	Proposed reform	Reduction from 20 % to 19 % from 1 April 2017 (already decided).	2020 : 17 %

Luxembourg, which operates a dual system in which small firms and start-ups are taxed at a lower rate, had already decided in December 2016 to reduce the general rate of corporate tax to 26 % by 2018 (1). In addition, it decided to cut the lower rate still further to 22.8 % and extend its application to firms whose taxable profit does not exceed € 30 000.

The United Kingdom has reduced the rate of corporation tax from 20 % to 19 % for tax years from 1 April 2017 onwards; in addition, there is a proposal for lowering that rate to 17 % from 1 April 2020.

Finally, Germany forms an exception to these rate reductions, as there is currently no proposal for revising the rates downwards. Consequently, Germany has a high rate compared to neighbouring countries, namely 30.2 % (2).

4.3 Corporate income tax reform in the United States

Main points of the reform

At the end of 2017, the American Congress approved a radical reform of corporate tax, based on two pillars. First, on 1 January 2018, the nominal tax rate was slashed from 35 % to 21 % (3). Also, the American system of global taxation was replaced by a territorial system so that the tax rate again became a key factor determining the foreign direct investment of American companies. In a worldwide system of taxation, the profits generated by foreign establishments of American multinationals, if repatriated, were in any case subject to American corporate income tax. Nonetheless, it was possible, via a tax credit, to deduct the corporate tax already paid abroad (4). With the switch, to a territorial system, profits are in principle taxed solely in the country where the business is based. However, at the time of this switch, a transitional tax is put in place which helps to finance the reform in the short term: the repatriation of deferred earnings is then subject to a one-off tax at a rate of 15.5 % for cash and liquid assets, and 8 % for non-liquid assets.

In order to stimulate economic growth and encourage business investment, the reform also makes provision for a temporary full deduction of new investment expenditure. This deduction is applicable to the first five years of the reform and attempts to attract innovative activities by creating an appropriate climate for income from intangible assets (see box 3).

Finally, the American reform aims to discourage tax avoidance by multinationals by introducing a minimum tax on businesses established in the United States (Base Erosion Anti-Abuse Tax). This tax is calculated on the taxable profits of the firm before deduction of payments (excluding the sales of goods) to related foreign companies. The aim here is to prevent profit shifting in the form of excessive prices for transactions between related companies. The minimum tax rate was 5 % in 2018, but will rise to 10 % from 2019, and even 12.5 % from the 2026 tax year. However, it should be noted that the tax applies only to firms of a given size, namely those with a turnover of € 500 million or more, whose deduction of payments to related foreign companies exceeds a certain percentage. The inherent risk in this minimum tax is the possibility of double taxation of payments to related foreign companies, because the reform takes no account of the way in which this payment is treated in the country where the related company is based. However, double taxation may be contrary to the bilateral tax treaties concluded by the United States with other countries.

(1) This is the rate, including the unemployment fund contribution and municipal business tax, applicable to firms based in Luxembourg City.
(2) This is the rate of corporate income tax including the special rate of local business tax levied in Berlin.
(3) These are the federal tax rates. Most American states levy additional taxes.
(4) Profits retained by the foreign subsidiary, referred to as retained earnings, were not taxed in the United States until they were repatriated. Consequently, retained earnings were largely kept in the foreign establishments of American companies.

Box 3 – The American "carrot and stick" strategy for attracting income from intangible assets

The American corporate tax reform comprises a targeted strategy for attracting income from intangible assets. Two aspects of this reform are crucial here, namely the FDII (Foreign-Derived Intangible Income) rule and the GILTI (Global Intangible Low-Taxed Income) rule.

Under the FDII rule, American companies qualify for a lower tax rate of 13.125 % on the excess return on their foreign sales, including the sale of licences and leases. The excess return is defined as the global return in excess of 10 % of the value of the company's tangible assets. This rule therefore aims to ensure that American firms locate their production for export in the United States and stop that production being transferred to other countries.

Under the GILTI rule, American multinationals with a controlled foreign company deriving substantial income from intangible assets are also taxed on that income in the United States. American corporate tax therefore still includes a worldwide taxation element, namely the tax on the excess return of a foreign company controlled by an American parent. Nonetheless, when this tax is assessed, a tax credit of 80 % of taxes already paid abroad is granted. The minimum tax rate applied after deduction of the tax credit is 10.5 % and applies equally to unrepatriated profits.

However, it should be noted that the "carrot and stick" strategy adopted by the United States to attract innovative activities may not be conform to various international agreements. For instance, the BEPS agreements on patent box schemes, whereby the favourable taxation of income from intangible assets is only granted if there is a direct link with the formation of those assets, are certainly not respected. Moreover, the FDII rule could also be considered an unlawful export subsidy.

Implications for Europe

The drastic reduction in the nominal tax rate in the United States will heighten mutual tax competition with Europe, and that will be further intensified by the strategy developed in the United States to attract income from intangible assets. To remain attractive as a location for multinationals, various European countries will consider cutting their rates, encouraging a further race to the bottom.

The switch to a territorial tax regime in the United States will also exacerbate tax competition between European countries. In a system of global taxation, profits repatriated to the United States are taxed at the prevailing American rate. Conversely, in a territorial regime, the European country's rate effectively plays a decisive role in attracting American firms and investment.

Another consequence of the American reform is that tax bases in Europe will come under renewed pressure, because the American system aimed at attracting income from intangible assets will lead to the transfer to the United States of activities hitherto pursued in Europe. The potential uncertainty over the double taxation of income in the context of the minimum tax in the United States may also encourage the transfer of activities from the EU to the United States. The potential erosion of the tax bases is further amplified by the changed incentives concerning profit shifting, because – following the drastic cut in the American rate – it becomes more attractive for firms to transfer their profits to the United States.

Finally, capital flows between the United States and the EU will also be influenced. In particular, the switch to a territorial tax system will boost the repatriation of previously retained earnings, thus expanding the inflow of capital into the United States. This change of regime will also increase American foreign direct investment in Europe, with the tax rate in European countries becoming a key factor here. Foreign direct investment in the United States will increase too, as the tax cut has enhanced profitability. In general, the impact on the net inflow of foreign direct investment depends on the difference between the average effective tax rate in the United States and that in the European country concerned, with a lower effective tax rate leading to a positive net inflow.

5. Evaluation and recommendations

5.1 Evaluation of European initiatives

The initiatives taken at the instigation of the OECD and with the support of the G20 to combat the erosion of the tax base and tax-motivated profit shifting formed the basis of the ATAD, permitting the coordinated implementation of action in the EU. The measures aimed at total transparency of tax regimes, e.g. regarding advance tax rulings or prior agreements on transfer pricing, should also curb the transfer of profits to countries where little or no tax is levied. In addition, rules were passed which must be respected by preferential tax regimes applicable to income from patent rights (patent boxes). Consequently, the Belgian regime, which was highly advantageous for firms from an international point of view, was replaced by a deduction for income from innovation with effect from I July 2016. The EC considered that advance tax rulings on excess profits (excess profit rulings), which sometimes offered significant tax advantages for multinationals, were against the European rules on state aid. These initiatives, designed to combat tax avoidance, merit support because that practice is both unfair, and inefficient in macroeconomic terms.

Similarly, the EC's intention to establish a common consolidated tax base in the EU, so that profits can be consolidated in multinationals and apportioned according to a formula to the country where the activity takes place, is equally sound. The same applies to its intention to align the tax base with the economic rent, and provide a harmonised incentive for expenditure on research and development. A common corporate tax base in the EU should in any case permit administrative simplification for businesses. An effective approach to tax competition requires not only harmonisation of the tax base but also coordination of the tax rates, e.g. in the form of a minimum rate.

5.2 Evaluation of the corporate income tax reform in Belgium

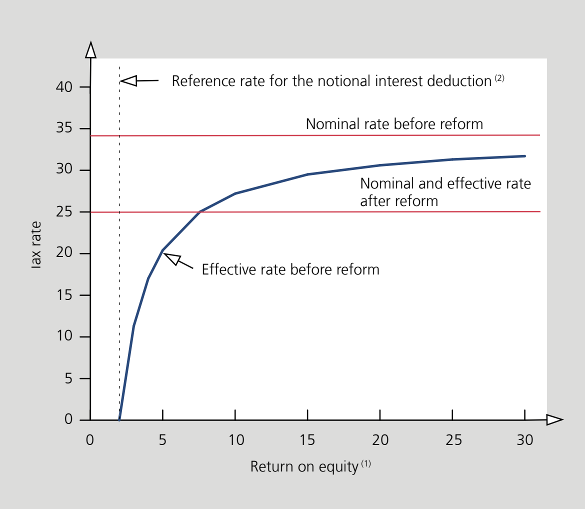
The changing international context, and particularly the international initiatives to combat erosion of the tax base and the downward trend in nominal tax rates, meant that it was necessary to reform corporation tax in Belgium. A key aspect of the Belgian reform is the transposition of the European anti-tax-avoidance Directives. At the same time, it was appropriate to reduce the nominal tax rates, as they were high from a European point of view. Only Malta and France charged higher rates, while the rates were lower in all other EU Member States. Moreover, the downward trend in these rates, which was mainly evident in the run-up to the economic and financial crisis but then more or less came to a halt, seems to have been resumed, as some Member States have recently lowered their corporate tax rate or plan to do so. Cutting the standard nominal rate of corporation tax in Belgium to 25 % will bring the rate more into line with the EU average, which is still slightly lower and arrived at 21.9 % in 2017. If the Belgian rate were to deviate too far from that of other Member States, that might compromise Belgium's attractiveness as a location for multinational undertakings' activities, which could have a detrimental impact. The reform can therefore be expected to produce positive dynamic effects overall, compared to the status quo of the corporation tax regime in Belgium.

The reform of the notional interest deduction is the main measure aimed at offsetting the budgetary impact of lowering the tax rate. The introduction of the notional interest deduction largely eliminated the tax discrimination against equity capital as opposed to borrowings, and improved the solvency of Belgian businesses. Moreover, the notional interest deduction stimulates private investment. That is why international institutions have generally expressed their approval. The EC also recognises the merit of this system, but in its proposal for a common consolidated tax base, it advocates an incremental system for the deduction of notional interest based on the increase in the capital over ten years. This would imply less scope for tax avoidance, and the budgetary impact of introducing this allowance would be relatively small, whereas the economic advantages of the system would be largely maintained. The new Belgian notional interest deduction system, which is more limited than the EC's proposal, will also drastically restrict the scope for abuse. The reform will also reduce the system's economic advantages, one being that the method of funding businesses is not distorted in favour of debt financing rather than equity financing.

The impact of the rate reduction and the reform of the notional interest deduction on the effective tax burden depends on the return on equity. For instance, firms with a low return on their equity which have secured a substantial reduction in their effective tax rate via the notional interest deduction will see their effective tax burden increase. As a result, Belgium will cease to be an attractive location for the financing centres of multinationals. Highly profitable businesses will see their tax burden decrease.

The decision to cut the tax rates and enlarge the tax base is therefore sound, as it is a way of limiting the distortions resulting from corporation tax. The economic dynamism of the reform is reinforced by the measures to encourage investment in research and development and thus to foster innovation. Conversely, the preferential treatment of SMEs via a lower tax rate is contrary to the recommendations of the international institutions, because it could give rise to inefficiencies and conversions to company status. However, a further broadening of the tax base would have been

CHART 6 RETURN ON EQUITY AND EFFECTIVE TAX RATE



Source: NBB.
(1) This is the return on equity before tax.
(2) This is equal to the interest rate on ten-year linear bonds.

possible. By introducing the basket, which limits the amount which can be included for a given year in respect of losses carried forward and other tax-related deductions useful to large firms, the reform goes against the principle of maximising the alignment of the tax base with the economic return and the recommendation in favour of increasing the scope for carrying forward losses, unlike the measure aimed at enabling groups of companies to consolidate their profits between themselves.

Conclusions

The international context concerning corporate taxation is highly relevant in view of the mobility of capital and profits. In recent years, various measures to combat the erosion of the corporate tax base and tax-motivated profit shifting have been adopted at the instigation of the OECD and with the support of the G20. These anti-tax-avoidance initiatives merit full support.

In addition, some European countries have recently cut their rates or plan to do so. The United States also decided to reduce the tax rate as part of a radical corporate tax reform, and that, too, heightens tax competition within Europe. Thus, the downward trend in corporate tax rates, which had practically stalled after the economic and financial crisis, appears to have resumed.

In this context, the corporation tax regime in Belgium was reformed by the Law of 25 December 2017, by cutting the nominal tax rate and enlarging the tax base. If the rates charged in Belgium differ too much from those in other EU Member States, that could make Belgium much less attractive as a location for the activities of multinationals.

Further European coordination in relation to corporate taxation is desirable. The EC aims to achieve a common consolidated tax base within the EU, but agreements on minimum rates would also be a good idea.

ANNEX 1 STANDARD CORPORATE TAX RATES [1]

(in %)

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Belgium	40.2	40.2	40.2	34.0	34.0	34.0	34.0	34.0	34.0	34.0	34.0	34.0	34.0	34.0	34.0	34.0	34.0	34.0	29.6
Bulgaria	32.5	28.0	23.5	23.5	19.5	15.0	15.0	10.0	10.0	10.0	10.0	10.0	10.0	10.0	10.0	10.0	10.0	10.0	10.0
Czech Republic	31.0	31.0	31.0	31.0	28.0	26.0	24.0	24.0	21.0	20.0	19.0	19.0	19.0	19.0	19.0	19.0	19.0	19.0	19.0
Denmark	32.0	30.0	30.0	30.0	30.0	28.0	28.0	25.0	25.0	25.0	25.0	25.0	25.0	25.0	24.5	23.5	22.0	22.0	22.0
Germany	51.6	38.3	38.3	39.6	38.3	38.7	38.7	38.7	30.2	30.2	30.2	30.2	30.2	30.2	30.2	30.2	30.2	30.2	30.2
Estonia	26.0	26.0	26.0	26.0	26.0	24.0	23.0	22.0	21.0	21.0	21.0	21.0	21.0	21.0	21.0	20.0	20.0	20.0	20.0
Ierland	24.0	20.0	16.0	12.5	12.5	12.5	12.5	12.5	12.5	12.5	12.5	12.5	12.5	12.5	12.5	12.5	12.5	12.5	12.5
Greece	40.0	37.5	35.0	35.0	35.0	32.0	29.0	25.0	35.0	35.0	24.0	20.0	20.0	26.0	26.0	29.0	29.0	29.0	29.0
Spain	35.0	35.0	35.0	35.0	35.0	35.0	35.0	32.5	30.0	30.0	30.0	30.0	30.0	30.0	30.0	28.0	25.0	25.0	25.0
France	37.8	36.4	35.4	35.4	35.4	35.0	34.4	34.4	34.4	34.4	34.4	36.1	36.1	38.0	38.0	38.0	34.4	34.4	34.4
Croatia	35.0	20.0	20.0	20.0	20.0	20.0	20.0	20.0	20.0	20.0	20.0	20.0	20.0	20.0	20.0	20.0	20.0	18.0	18.0
Italy	41.3	40.3	40.3	38.3	37.3	37.3	37.3	37.3	31.4	31.4	31.4	31.4	31.3	31.3	31.3	31.3	31.3	27.8	27.8
Cyprus	29.0	28.0	28.0	10.0	10.0	10.0	10.0	10.0	10.0	10.0	10.0	10.0	10.0	12.5	12.5	12.5	12.5	12.5	12.5
Latvia	25.0	25.0	22.0	19.0	15.0	15.0	15.0	15.0	15.0	15.0	15.0	15.0	15.0	15.0	15.0	15.0	15.0	15.0	20.0
Lithuania	24.0	24.0	15.0	15.0	15.0	15.0	19.0	18.0	15.0	20.0	15.0	15.0	15.0	15.0	15.0	15.0	15.0	15.0	15.0
Luxembourg	37.5	37.5	30.4	30.4	30.4	30.4	29.6	29.6	29.6	28.6	28.6	28.8	28.8	29.2	29.2	29.2	29.2	27.1	26.0
Hungary	19.6	19.6	19.6	19.6	17.6	17.5	17.5	21.3	21.3	21.3	20.6	20.6	20.6	20.6	20.6	20.6	20.6	10.8	10.8
Malta	35.0	35.0	35.0	35.0	35.0	35.0	35.0	35.0	35.0	35.0	35.0	35.0	35.0	35.0	35.0	35.0	35.0	35.0	35.0
Netherlands	35.0	35.0	34.5	34.5	34.5	31.5	29.6	25.5	25.5	25.5	25.5	25.0	25.0	25.0	25.0	25.0	25.0	25.0	25.0
Austria	34.0	34.0	34.0	34.0	34.0	25.0	25.0	25.0	25.0	25.0	25.0	25.0	25.0	25.0	25.0	25.0	25.0	25.0	25.0
Poland	30.0	28.0	28.0	27.0	19.0	19.0	19.0	19.0	19.0	19.0	19.0	19.0	19.0	19.0	19.0	19.0	19.0	19.0	19.0
Portugal	35.2	35.2	33.0	33.0	27.5	27.5	27.5	26.5	26.5	26.5	29.0	29.0	31.5	31.5	31.5	29.5	29.5	29.5	31.5
Romania	25.0	25.0	25.0	25.0	25.0	16.0	16.0	16.0	16.0	16.0	16.0	16.0	16.0	16.0	16.0	16.0	16.0	16.0	16.0
Slovenia	25.0	25.0	25.0	25.0	25.0	25.0	25.0	23.0	22.0	21.0	20.0	20.0	18.0	17.0	17.0	17.0	17.0	19.0	19.0
Slovakia	29.0	29.0	25.0	25.0	19.0	19.0	19.0	19.0	19.0	19.0	19.0	19.0	19.0	23.0	22.0	22.0	22.0	21.0	21.0
Finland	29.0	29.0	29.0	29.0	29.0	26.0	26.0	26.0	26.0	26.0	26.0	26.0	24.5	24.5	20.0	20.0	20.0	20.0	20.0
Sweden	28.0	28.0	28.0	28.0	28.0	28.0	28.0	28.0	28.0	26.3	26.3	26.3	26.3	22.0	22.0	22.0	22.0	22.0	22.0
United Kingdom	30.0	30.0	30.0	30.0	30.0	30.0	30.0	30.0	28.0	28.0	28.0	26.0	24.0	23.0	21.0	20.0	20.0	19.0	19.0
Japan	40.9	40.9	40.9	40.9	39.5	39.5	39.5	39.5	39.5	39.5	39.5	39.5	39.5	37.0	37.0	32.1	30.0	30.0	29.7
United States	39.3	39.3	39.3	39.3	39.3	39.3	39.3	39.3	39.3	39.2	39.2	39.2	39.1	39.0	39.1	39.0	38.9	38.9	25.8
European Union [2]	32.0	30.4	29.0	27.8	26.6	25.3	25.1	24.4	23.8	23.8	23.2	23.0	22.9	23.2	22.9	22.8	22.5	21.9	21.9
Euro area [2]	33.3	32.1	30.4	28.7	27.8	26.7	26.6	25.7	25.1	25.3	24.5	24.4	24.3	25.0	24.7	24.6	24.3	24.1	24.1

Source: EC.
(1) The data reflects the highest statutory rate, including any surcharges also on local and/or regional level.
(2) Unweighted average.

Annex 2 – Overview of the action points in the BEPS project on corporate income tax (OECD/G20) and corresponding actions at European level

In the autumn of 2015, the OECD/G20 BEPS project resulted in a final report in which the OECD and G20 countries agreed on a number of action points and the corresponding recommendations. The table below gives an overview of the 15 action points and recommendations in the OECD/G20 reports and the corresponding actions taken at European level.

OECD/G20 BEPS recommendation	Initiative at European level
1. Address the tax challenges of the digital economy. Certain specific features of the digital economy in fact contribute to BEPS.	The EC launched a programme designed to ensure that the digital economy is taxed in a fair and growth-friendly way. The focus here was not only on corporate tax but also on other taxes such as VAT. In this connection, in March 2018, the EC launched two draft Directives aimed at the imposition of a fair taxation of the digital economy in the corporate income tax system.
2. Neutralise the effects of hybrid mismatches.	Directive 2017/952 (the ATAD II, which replaces Article 9 of the ATAD) is intended to provide a solution to various situations in which hybrid mismatch abuse is possible, both between Member States and with third countries.
3. Reinforce the controlled foreign company (CFC) rules.	Articles 7 and 8 of the ATAD (Directive 2016/1164) impose a CFC rule on Member States.
4. Limit base erosion by limiting deductions of interest and other financial expenses.	Article 4 of the ATAD (Directive 2016/1164) contains a measure limiting the deduction of interest charges in order to combat erosion of the tax base due to excessive interest payments.
5. Take effective action against harmful tax practices. The BEPS action plan focuses in particular on the automatic exchange of information on tax rulings and the Nexus approach for tax regimes applicable to patents (patent boxes).	*Tax rulings:* Directive 2015/2376 obliges the Member States to exchange information on tax rulings in cross-border cases and on transfer pricing agreements. *Patent boxes:* agreement in the Code of Conduct Group concerning the Nexus approach. Member States must make their patent box systems conform to the BEPS recommendation on the subject.
6. Prevent abuse of tax treaties	EC Recommendation to Member States, as part of the Anti Tax Avoidance Package, whereby they should include a general anti-abuse clause based on the principal purpose test in the tax treaties that they conclude.
7. Prevent artificial avoidance of permanent establishment status. In this regard, the definition of the permanent establishment concept used in the OECD model treaty for the avoidance of double taxation will be adapted.	In the Anti Tax Avoidance Package, the EC recommends aligning the definition of the permanent establishment concept used in tax treaties with the concept in the OECD Model Tax Convention.
8-10. Align transfer pricing outcomes with value creation. For that purpose, the existing rules were clarified and tightened. Action 8 focuses on the transfer pricing of intangible assets, Action 9 concerns the contractual allocation of the risks, and Action 10 covers other factors with a high risk of BEPS in the context of transfer pricing.	The Joint Transfer Pricing Forum is revising and updating the EU's approach to transfer pricing, taking account of the BEPS recommendations.
11. Measuring and monitoring the scale of BEPS.	The EC intends to publish studies on the subject jointly with Eurostat and the Member States. The European Parliament is also conducting research on this subject.
12. Oblige taxpayers to disclose their tax structures. This would permit the early detection of aggressive tax planning.	In May 2018, the Ecofin Council approved Directive 2018/822 which aims to impose new transparency rules on tax advisers and other players (such as banks, lawyers, etc.) who might help to devise tax avoidance strategies.
13. Review transfer pricing documentation: as well as the local file and the group file, country-by-country reporting is also required. The OECD recommendation does not specify any obligation to disclose this information.	Directive 2016/881 makes country-by-country reporting mandatory for multinationals of a certain size. A draft Directive on public country-by-country reporting is currently being considered.
14. Make tax dispute resolution mechanisms more effective: minimum rules were adopted on the prevention and speedy resolution of these disputes.	Directive 2017/1852 on tax dispute resolution mechanisms in the EU lays down specific deadlines for resolving disputes.
15. Devise a multilateral instrument to streamline the implementation of the BEPS rules, particularly in tax treaties.	The Anti Tax Avoidance Package contains an EC Recommendation on how tax treaties can be adapted to combat abuse.

Sources: Explanatory Statement of Actions 2015, Final Reports, OECD/G20 Base Erosion and Profit Shifting Project, and Commission staff working document accompanying the document "Communication from the Commission to the European Parliament and the Council – Anti Tax Avoidance Package: Next steps towards delivering effective taxation and greater tax transparency in the EU".

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