



Proposal 5 International issues

Radical reform of the domestic corporate tax system will do much to reverse the decline in the competitiveness of the UK corporate tax system. This is the primary concern of the task force. However, complying with a large number of different national tax systems will remain an issue for MNEs wherever they are headquartered. This means that as well as the domestic aspects of reform, there are important international factors that need to be taken into account.

These centre on the question of how national tax authorities can eliminate double taxation and reduce the administrative burden facing MNEs. There are three alternatives:

- 1 Engage in outright tax competition without regard for international efforts to either harmonise certain taxes or coordinate tax policy.
- 2 Pursue full or partial international harmonisation of corporate taxes with the aim of eliminating differentials between national tax regimes.
- 3 Retain sovereignty in key areas of tax policy, but pursue international coordination in relation to key issues facing business. These issues would be ones that cannot be addressed unilaterally.

In an integrated global economy option 1 is likely to be highly counterproductive, will damage the international reputation of the UK, and is likely to increase barriers to UK businesses wishing to operate internationally. Option 2 involves surrendering a significant degree of sovereignty over domestic corporate tax policy to an international body, and therefore runs counter to an important part of democratic accountability.

The task force considers that the government should pursue option 3. Option 3 would enable a significant reduction in cross-border compliance costs and double-taxation, whilst allowing the UK to retain national sovereignty over taxation and remain competitive in the corporate tax arena.

Tax harmonisation

EU proposals for corporate tax harmonisation

The European Commission is developing proposals for a common consolidated corporate tax base (CCCTB) for the EU. The current proposals fall short of complete harmonisation as individual member states will still have sovereignty in setting tax rates. However, as proposed, a company operating within the EU would have the option to compute its European taxable profits on a consolidated basis using a single set of tax rules. The European tax base of that company would then be allocated to different member states and taxed according to statutory rates prevailing in that country.

It is impossible to say, at this stage, whether the CCCTB will be beneficial or detrimental to business. This will, in a large part, depend on implementation by member states. But consistent with the UK's stance on fiscal sovereignty, harmonisation is not favoured as the best way of dealing with cross-border tax issues. The recent accession of new member states has strengthened the number of those supportive of national fiscal sovereignty, though it does not mean that the proposals for harmonisation have disappeared. The Commission is working on proposals for a CCCTB despite opposition from the UK and a number of other member states.

Although the matter has not yet been put to member states by way of formal proposals, if it were to be adopted by some member states it would create a new set of boundary issues for UK companies even if the UK did not sign up to the CCCTB itself. This is because some UK companies would be operating in member states that had adopted the CCCTB or would have subsidiaries based in such states.

Given the international tax, commercial and investment experience within the UK, it is recommended that the government works closely with business to ensure that any regime that might be adopted by other member states does not damage UK companies' competitiveness, and that UK needs are fully reflected in the EU deliberations on CCCTB.

The government has not been involved in the process to date, and therefore, as with other EU projects, the CCCTB may well be the worse for not being informed by the UK government's (relatively) lighter touch approach to regulation.

International coordination

International coordination of national tax systems represents a preferred approach to addressing issues facing multinational businesses. The aim of international coordination is to effectively manage the tension between retaining national sovereignty over fiscal policy and reducing the resulting distortions to free trade and the wealth-creating benefits of cross-border commerce, thereby benefiting both business and government. These issues fall within the remit of international bodies, such as the OECD and the World Trade Organization (WTO).

The advance of globalisation has magnified the importance of ensuring that barriers to cross-border trade and investment are addressed and minimised. As well as working closely with business, the government should ensure that competitiveness is improved by preventing double taxation and removing unnecessary compliance burdens. Close liaison is crucial to ensuring that UK interests are pursued fully in the relevant international forums and that the discussions fully reflect the realities of international trade, investment and competitiveness.

From a business perspective it is important to remove discrimination and double taxation in the international tax system and reduce the compliance costs associated with being subject to more than one tax system.

Bilateral double taxation treaties

The traditional method for alleviating double taxation is through a bilateral double-tax treaty. The UK's extensive double-tax treaty network already represents an important competitive advantage. The rolling programme of negotiating new treaties and re-negotiating existing treaties is therefore vitally important.

Alleviating discrimination and aligning tax systems within the EU

Within Europe, the distortions created by the operation of 27 separate corporate tax systems within what is intended to be a single market are brought into sharp focus. European law plays an important role in removing fiscal discrimination where this is contrary to the fundamental freedoms enshrined in the EU Treaty.

The UK, government and business, is firmly committed to the maintenance of national fiscal sovereignty and the retention of the unanimous voting procedure for new tax legislation. However, law and practice are not straightforward, as the UK's membership of the EU makes it subservient to EU law as interpreted by the ECJ. This means that existing and future UK tax law is open to challenge if it is thought to be contrary to EU law. Reforms may be necessary as a result of rulings made by the ECJ either in cases originated in the UK or in other member states.

However, in terms of removing fiscal discrimination, the ECJ has proved an imperfect tool. The court can only declare when rules are contrary to the EC Treaty, it cannot create or propose compliant rules.

Therefore, the European Commission has proposed a new approach to the discussion of tax issues focused on cooperation. This may prove more fruitful than politically contentious attempts at harmonisation and is likely to lead to quicker action to resolve some of the more pressing issues, such as cross-border loss relief and exit taxes, which impact on the competitiveness of UK businesses whether originating from ECJ decisions or otherwise.

Alleviating the burden of transfer pricing

Transfer pricing is likely to remain the most significant administrative burden facing multinational businesses. This is unlikely to be alleviated by alignment of domestic tax codes – indeed the burden is likely to increase as more jurisdictions enact transfer pricing legislation and associated documentation requirements. Reducing

the costs of complying with transfer pricing legislation and managing the associated risk of double taxation, depends therefore on a coordinated approach to cross-border tax administration. The work of the OECD in issuing common transfer pricing guidelines is critically important in this respect. It provides a common reference point for the consistent application of the arm's length principle and a basis for cross-border dispute resolution. The work of the EU Joint Transfer Pricing Forum in exploring how the burden of complying with transfer pricing legislation within the EU can be reduced is also welcome. The UK tax authorities should continue to take the lead in international efforts to reduce the burden of transfer pricing. This should involve:

- Streamlining the advance pricing agreement (APA) process to make it more cost-effective and available to more taxpayers. HMRC should also work with other tax administrations to standardise the APA procedure between jurisdictions. Revenue authorities generally only want to enter into APAs for complex transactions. APAs should be available for less complex transactions under a simplified process.
- Reducing instances of cross-border double taxation. This could involve simultaneous consultation or agreement with other tax authorities before a material transfer pricing adjustment is made (or at least before the tax is collected). Alternatively, mandatory arbitration (within a stated time-frame) on cross-border disputes between tax authorities would be a welcome addition to the terms of the UK's double-tax treaties.
- Exploring the potential for international standardisation of transfer pricing documentation requirements with one set of documents covering a single transaction involving two or more tax jurisdictions.
- Introducing safe harbours for routine transfer pricing issues, as is standard practice in other countries, and investigating whether there is scope for

international standardisation of safe harbours. This should give business added certainty and reduce the administrative costs to both business and HMRC. The task force does not believe that this would be contrary to the arm's length principle.

The government should participate fully in international coordination efforts, especially through the OECD and EU, as it has much valuable experience to contribute. It should, however, also consult much more widely with business on these issues because international organisations, such as the OECD, the WTO and the IMF, are one further step removed from business and the oversight of national legislatures and elected officials.

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