CONTRIBUTIONS OF PLATAFORMA PYMES TO THE PUBLIC INFORMATION ON THE DRAFT LAW AMENDING CORPORATION TAX IN RELATION TO HYBRID ASYMMETRIES

December 15, 2020

The OECD published on 9/10/2019 a proposal to ensure that multinational companies, mainly oligopolies with excessive rents, including digital ones, pay their taxes in the locations where they provide services and make profits, avoiding the abuse of **"transfer pricing"** between parent and subsidiary in a country that applies low corporate taxation based on **tax rulings** signed with the subsidiary.
Furthermore, the Commission of Experts for the Reform of the Spanish Tax System, created by the Spanish Government at the time, established four objectives for any reform of Corporate Tax:

1. Recomposition of the Taxable Bases, affected by exemptions and deductions
2. To achieve a more balanced financing of the company's assets than that induced by the current system, stimulating the increase of own resources and the reduction of indebtedness.
3. Preventing profits from abroad from being subject to minimum taxation in Spain or in the country of origin.
4. Compensate for previous reforms with significant reductions in nominal rates.

For their part, international economic organisations have been recommending four lines of action for this same reform:

1. Reconsideration of deductions - which significantly reduce effective taxation - causing SMEs, even with a lower rate, to bear a higher effective rate than large companies.
2. Evaluation of the R&D deduction, the efficiency of which does not seem to justify its tax cost
3. Reconsider the existence of progressive rates, which can create disincentives to business growth.
4. Adoption of additional measures to reduce the bias of the tax in favour of indebtedness. Since interest paid to third parties is deductible from the Taxable Bases, aggressive tax planning leads to over-indebtedness in order to reduce it. In this respect, in 2012, the deductibility of net interest expenses was limited, as a temporary measure, with a period of 18 years to recover the net interest expense not deducted.

The Commission of Experts for the Reform of the Spanish Tax System, following indications from international economic organisations, studied several alternatives to correct the bias towards indebtedness:

a) Allowance Corporate Equity (ACE): consists of discounting the opportunity cost of equity from the accounting results. The Commission points out, as a negative aspect of the ACE, the putting at risk of budgetary consolidation, as it would lead to a reduction in the collection of the corporate taxes.
b) Maintenance of the current model, reducing, as Portugal did, from 18 to 5 years the

period for recovering non-deducted costs. This possibility does not convince the Commission that it is inefficient to limit excessive indebtedness.

c) Elimination of the current limitation on the temporary deductibility of expenses, with no recovery of financial expenses not deducted.

d) A formula linking the tax deductibility of net financial expenses to a balanced level of indebtedness driven solely by tax reasons; at present Spanish companies finance their total assets through own and external resources in a proportion of 35/65, reaching, according to the Commission, a ratio of 50/50 (60/40 in the view of the IMF). This system eliminates the deduction of the net financial expenses corresponding to the debt exceeding a maximum level which, following a pattern of gradual decrease towards the balance between sources of financing, is established each year for the debt in relation to the total assets.

In October 2016, the European Commission presented a proposal to amend the Common Consolidated Corporate Tax Base (CCCTB), introducing the Allowance for Growth and Investment (AGI), which will allow a corporate tax deduction for companies that retain profits or increase capital, applying a risk interest rate of 2.7% per annum for 10 years to the retention of profits or the increase in capital.

This modification of the CCCTB following the launch of the NGEU reconstruction funds has become even more important as the agreement has been established that these funds, which will involve the issue of debt by the EU for the first time, will be accompanied by the structuring of new revenues to enable the repayment of this debt, and the CCCTB has been identified among these new revenues to be developed.

In addition, there are other fiscal guidelines set out by both the European Commission and the International Monetary Fund, which the Plataforma Pymes shares, based on

1. Growth-friendly tax policies in Member States and better tax coordination in the EU, issued on 23 November 2011 (com 2011 815 final).
2. Specific papers 119/2012 on possible reforms of property taxes: criteria for favourable policies, published in October 2012.
3. 2013 targets of the Annual Growth Survey towards fair and competitive tax systems issued on 28 November 2012.

The Plataforma Pymes considers that any proposal in this field must be framed within a context that respects fiscal neutrality and takes into account public budgetary restrictions and their processes of fiscal consolidation, especially in an economic context of economic depression, derived from the explanation that Sars-Cov-2 has made of the economic shamefulness of advanced economies, including that of Spain, The ECB is the only institution in the euro area that has been able to achieve this objective. The ECB has also been involved in the development of the euro area's financial markets, which have been covered since 2014 by a disastrous monetary policy of balance sheet expansion and low interest rates, including negative deposit facilities, by central banks, including the ECB, with the sole aim of avoiding debt deflation by trying to inflate various assets without responding to economic fundamentals, including residential property.

Therefore, any increase in the taxation of multinational companies - oligopolies with excessive income - is meaningless if in return a decrease in corporate taxation of SMEs, including those in the residential real estate sector, is not sought. One of the most effective ways of achieving the latter would be to reduce taxation on the undistributed profits of SMEs.

The improvement in the taxation of undistributed profits of SMEs would contribute, at a time of historical difficulties in accessing bank financing, to perfecting their non-bank financing through own resources. This is particularly important given the worsening of financing conditions brought about by the approval of the Basel III rules, which penalise bank financing for SMEs as opposed to oligopolies with excessive income, which have external credit rating, and which would have been aggravated by the economic depression that would have been explained by the Sars-Cov-2

For the Plataforma Pymes, the 2019 OECD proposal should have incorporated measures regarding the corporate taxes, aimed at making the tax base coincide with the accounting result, thus increasing the total collection of the tax.

The reduction of corporate taxation for SMEs can be achieved through the introduction of Allowance Corporate Equity, following the proposed model of modification of the European Commission's Common Consolidated Corporate Tax Base through its Allowance for Growth and Investment, which allows a deduction of corporate taxes to those companies that retain profits or increase capital.

The approach of the Committee of Experts to the inadequacy of the inclusion of the Allowance Corporate Equity, obvious the difficulties of access of small enterprises to bank financing. An exceptional action of non-bank financing through own resources could consist in the introduction of an Allowance Corporate Equity so that undistributed profits capitalised as reserves, regardless of their use, would have an effective rate on accounting profit of 3.5%, comparable to that enjoyed by oligopolies with excessive income on corporate tax.

Many EU Member States have yet to transpose, including Spain, the ATA Anti-circumvention Directive, which provides for the establishment of a general anti-abuse rule, a new international tax transparency regime, the treatment of so-called hybrid asymmetries, the limitation of interest deductibility and the regulation of so-called exit taxation, often favoured by the application of tax rulings by EU Member States to subsidiaries of oligopoly parents with excessive income established in their territory, while the parent would be located in another EU Member State with standardised corporate taxation and not exceptionally by the application of special regimes regulated by tax rulings agreed between the Member State and the subsidiary.

The preliminary draft now in public information would be in line with the above-mentioned Directive.

In connection with this transposition, it should be recalled that the European Union has introduced the Controlled Foreign Company (CFC) rule. Through this mechanism, multinational companies/oligopolies with excessive revenues which seek to divert profits from the parent company in a high tax country to a low tax subsidiary in order to reduce the tax liabilities of the group, may be counterbalanced by Member States through the CFC, provided that taxation is lower by 40%. This will make it possible to incorporate a specific anti-abuse clause in the event that the profits distributed by the subsidiary are a deductible expense for that subsidiary at source, as well as a general anti-abuse clause for schemes that only seek a tax advantage.

However, the draft now in public information, should be more ambitious and under the

principle of tax neutrality and taking advantage of the higher collection in the Corporate Tax that the application of an anti-abuse standard in the treatment of hybrid asymmetries would generate, regulate ,in the framework of the CCCTB and AGI therein contemplated, an improvement in the tax treatment of undistributed profits of SMEs, including those in the residential real estate sector, that would contribute to the improvement of their non- bank financing in a historical situation of economic depression jumpstarted by the Black Swan outbreak of virus and as a formula to compensate for the difficulties that SMEs will have in accessing bank financing as a result of the growth in the cost of credit of financial institutions due to the increase in their Non-Performing Loans (NPL) ratio, which would even be leading the Single Banking Supervisor, given the seriousness of this NPL ratio, to assess the creation of a bad bank at the euro area level.

Furthermore, the tax framework proposed, contributes in a context of virus outbreak to split the damages suffered by the non-essential activities, mainly developed by SME and self-employed owing to the compulsory stop of their activities as Non-Pharmaceutical Interventions to hold back the spread of the virus, among the essential activities, rolled out, largely, by oligopolies that they don´t suffer this stop due to their condition as essential.