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UPDATE CHAPETER 9: SINGLE MARKET AND COMPETITION
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STATE AID AND TAX AVOIDANCE

For many years now, multinational companies have been in the news for all the wrong reasons. Big companies like Google or Apple managed to keep their tax liabilities at an often astonishingly low level. For example, in 2014, Amazon reported sales of 9.1 billion Euro in the UK. But the company paid corporation tax only on 20 million Euro of profits (which amounts to 0.2 per cent of its annual turnover). Non-governmental organisations such as the London-based Taxpayers' Alliance reported widely on this disproportionally low figure and soon the recently appointed EU bureaucracy and in particular the Danish Competition Commissioner Margrethe Vestager started to investigate.

Tax avoidance is susprisingly simple in the EU. Taking advantage of the Single Market's free movement, a multinational company merely has to negotiate a preferential tax rate with an EU member state in return for establishing its European headquarters there. Once a company makes sales in another EU country it 'buys' the product or service from headquarters at retail (or near retail) prices. In the end, the vast majority of the company's profits are accounted for at headquarters where only a substantially reduced tax base applies. While this might be morally questionable, the procedure is not illegal, with the result that a whole industry has sprung up to support such creative tax measures.

The tiny duchy of Luxembourg was the unquestionable leader in enticing big multi nationals to its shores. The country's economy was previously dominated by steel; an industry which ever since the 1960s was in a state of perennial decline. It was the current president of the European Commission, Jean Claude Juncker who as the country's prime minister from 1995 to 2013 diversified the economy and pursued an aggressive tax policy with spectacular success. In 2003, Amazon created a European hub, followed a year later by AOL and Microsoft. Others like Ikea, Fedex, GlaxoSmithKline, Accenture, Disney or Pepsi soon followed. In October 2014, just weeks before Juncker's reign as Commission President started, the outgoing Competition Commissioner Joaquin Almunia opened an investigation into Amazon over illegal state aid. To coincide with Juncker's arrival in Brussels, a number of documents were anonymously leaked to the international media in mid-November 2014, followed by another batch a month later. The embarrassment for Juncker was plain to see. Tasked with invigorating the European project, he had to fend off allegations over establishing a morally questionable tax policy which ultimately lured big business away from Luxembourg's European partners.

But the country's creativity was not confined to big multi-nationals. For years, shoppers from the neighbouring EU members Belgium, France and Germany enjoyed low duties on alcohol, cigarettes and petrol. A recently built 'Freeport' located right next to the country's international airport invites global investors to store gold, diamonds, wine or art in a discretely anonymous and tax free fashion. Foundations and those eager to reduce inheritance duties also have long appreciated Luxembourg's ultra-low tax rates and light regulation.

But Luxembourg is not alone. Other EU members too, including the Netherlands or Ireland established tax havens, but in contrast to the duchy which refuses to disclose vital information and is intent on pursuing the case through the EU courts, at least these countries are co-operating with the Commission in these state aid investigations. The UK as well through its off-shore Channel Islands (which in a bizarre fashion are non-EU territories) have been a magnet for a global financial elite for many decades.

Tax havens are of course not limited to the EU. The economic rationale of entire countries such as the Cayman Islands rests on this tax model. While relative tax receipts (i.e. the percentage charged on a company's profits) might be ridiculously low, the absolute monies paid by a big multinational player will certainly be enough to fund a smaller country. Big companies in return continue to defend this low tax practise, claiming that they are responsible for generating jobs in addition to investment in infrastructure, education and research. Lastly, by creating high value (and high salary) jobs, the company's employees also have a positive impact through more affluent consumption patterns and of course income tax payments. In short, very low corporation taxes are justified by an increase in income tax revenue (paid for by the employees).

Tax avoidance across the globe is now rampant, due in large parts to indifference by the EU and the Bush administration in the run-up to the financial crash of 2008. The G20 summit in 2009 did promise action but secrecy on behalf of tax haven governments and clever accounting practises continue to this day. The solution is obvious for the EU: A European tax harmonisation complemented by an international agreement is needed. Alas, the current political climate, dominated by the debt crises in the Eurozone and the Brexit negotiations pushed a tax reform to the back of the agenda.

The consequences for the European project however are not pretty. Luxembourg and other tax havens turned themselves into honey pots for multinationals. Low relative tax revenues but high absolute tax income turned Luxembourg into the richest EU country by far with GDP per capita averaging 110,000 US dollars (which is nearly three times as much as UK levels). This successful, yet aggressive and secretive approach simply means that the country lives at the expense of others given the loss of tax revenues encountered by its EU partners. Ultimately, countries like Luxembourg contribute to the erosion of politics where public service and the welfare state, faced with dwindling financial resources continue to be compromised.

This regulatory race to the bottom whereby EU countries are trying to outperform each other in order to attract big business is a highly questionable consequences of the free movement. But the EU is gearing up for action. Single Market Commissioner Pierre Moscovici (France) has for many years proposed the establishment of a Common Consolidated Tax Base. The CCTB would stipulate a common set of rules where company profits would be registered, and would disallow the consolidation of profits in just one member state. First proposed in 2011 and subject to unanimity voting, the proposal was once again rejected by the UK in 2015. With Britain on its way out, Moscovici is eager to relaunch the initiative, and if successful would offer a promising sign that indeed the EU could become a better political entity without its former partner.

But the Commission's attempt to create an even playing field across the EU has just taken on a much different dimension. In September 2016, Vestager ordered Apple to pay back 13 billion Euro in unpaid taxes, arguing that the saved tax money amounted to illegal state aid. In 2014, Apple paid the astonishing rate of 0.005% tax on its profits. In a deal dating back to 1991, the US giant had never paid more than one per cent in corporation taxes, whereas the usual tax rate for other businesses in Ireland is 12.5%. But successive Irish governments were quite happy with the arrangement, given the infrastructure boost and the establishment of over 5,000 jobs at the company's headquarters in Cork. It therefore came as little surprise that the Irish government really does not want the money for fear of antagonising its most high profile economic player. Apple's CEO Tim Cook branded the Commission's ruling as 'maddening', and indeed it might seem questionable whether Vestager acted within her authority to impose such a large fee for an arrangement that dates back so many years. Not surprisingly, both the Irish government and Apple decided to appeal, with a final verdict however not expected for many years to come.

Irrespective of the outcome in the Apple case, it is nonetheless noteworthy and indeed timely that the Commission is tackling a major irregularity of the Single Market that is unfair to European citizens who in a time of economic stagnation witness big corporations contributing less than their presumed share. Moreover, the fact that member states are competing over multinationals by means of lower rates and lighter regulations can also hardly be described as acting in the spirit of European solidarity.