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**PLATFORM FOR TAX GOOD GOVERNANCE**

**Communication on Business Taxation for the 21st Century:**

**Key messages and Next Steps**

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## 1. Context

The context for EU business taxation policy has changed radically in the past year. The public health challenges stemming from the COVID-19 pandemic turned into the most drastic economic crisis in the EU history, causing rising inequality, and deeply impacting social safety nets. The pandemic occurred against a background of ongoing major trends that are shaping our economies and societies, including population ageing, climate change, environmental degradation, globalisation and the transformation of the labour market. The pandemic has also accelerated existing trends, such as digitalisation, and highlighted problems with the current corporate tax system.

The current international corporate tax system was designed more than a century ago and is based on outdated principles of tax residence and source. Developments in globalisation and digitalisation have left these principles increasingly out of step with the economy of today and the made tax rules increasingly difficult to apply to modern business realities.

In the EU, the patchwork of national corporate tax rules creates complexities for businesses operating cross-border in the Single market and creates particular challenges for EU SMEs, start-ups and other businesses looking to grow, expand and trade cross-border. This hurts investment and growth, as well as the EU's competitiveness.

While corporate income is taxed at the national level, business models continue to become ever more international, complex and digital. This creates high compliance costs for business and risks of double taxation. At the same time, some companies exploit loopholes between tax systems through aggressive tax planning strategies. This also makes it difficult for citizens to know how much companies are actually paying in tax, which risks undermining trust in the tax system as a whole.

Thus, the EU needs a robust, efficient and fair business tax framework that supports the post-COVID-19 recovery, removes obstacles to cross-border investment and creates an environment conducive to fair and sustainable growth.

On 18 May, the Commission adopted a Communication on 'Business Taxation for the 21st Century'. This sets out both a long-term vision to provide a fair and sustainable business environment and EU tax system, and a tax agenda for the next two years, with targeted measures that promote productive investment and entrepreneurship and ensure effective taxation. This agenda complements the ongoing work on international corporate tax reform, and provides solutions to the most pressing problems for the EU in business taxation today, while also supporting the green and digital transitions. It is complementary to the Action Plan for Fair and Simple Taxation supporting the recovery strategy and the Communication on Tax Good Governance (July 2020), and forms part of

a holistic EU tax agenda focusing on enabling fair and sustainable growth and ensuring effective taxation.

## **2. Business Taxation for the 21st Century: key messages**

### **A future global agreement on international corporate taxation**

The Communication recalls the Commission's on-going commitment to the G20/OECD led discussions on international corporate tax reform, which aim to reach agreement by mid-2021. These discussions are focused on two pillars: Pillar 1 (partial reallocation of taxing rights) and Pillar 2 (minimum effective taxation) in the EU. The two pillars aim to address different but related issues linked to the increasing globalisation and digitalisation of the economy. Both pillars of the future global agreement are in line with the Commission's vision for a business taxation framework for the 21st century, and the other actions outlined in the Communication.

The Communication also sets out how the Commission would plan to implement a global agreement in the EU. Once agreed and translated into a multilateral convention, the application of Pillar 1 will be mandatory for participating countries. In order to ensure its consistent implementation in all EU Member States, the Commission will propose a Directive for the implementation of Pillar 1 in the EU. In order to ensure its consistent application within the EU and compatibility with EU law, the principal method for implementing Pillar 2 will be an EU Directive that will reflect the OECD Model Rules with the necessary adjustments. The implementation of a global agreement on minimum effective taxation will also have implications for existing and pending EU Directives and initiatives.

### **Going beyond the OECD agreement – targeted measures**

In the short term, the Communication also sets out a series of targeted initiatives to address current pressing problems in business taxation in the EU. These focus on ensuring fair and effective and taxation and enabling productive investment and entrepreneurship. These initiatives will:

- **Ensure greater public transparency on the taxes paid by businesses, by proposing that certain large companies operating in the EU should have to publish their effective tax rates.** The proposal will allow public scrutiny of actual effective tax rate paid by large multinational companies in the EU. It will be based on the methodology agreed for calculating minimum effective taxation in the global discussions.
- **Tackle the abusive use of shell companies, through new anti tax-avoidance measures.** Shell companies are legal entities and arrangements that have little or no substance and economic activity, and in some cases may be used purely for aggressive tax planning. The Commission will propose new monitoring and reporting requirements for shell companies, so that tax authorities have better oversight and can better respond to aggressive tax planning through these entities.

- Better support business in their recovery, with a Recommendation on the domestic treatment of losses, adopted alongside the Communication.** The Recommendation prompts Member States to allow loss carry back for businesses to at least the previous fiscal year. Loss carry back has the advantage of benefitting only the businesses that were profitable in the years before the pandemic, so it supports healthy businesses. Companies that were making a profit and paying taxes in the years prior to 2020 would be able to use losses incurred in 2020 and 2021, to offset the taxes paid between 2017 and 2019 (at a maximum). This ensures that the measure is targeted at businesses suffering as a result of the pandemic, and that public money is not spent trying to help private businesses that are failing for reasons unrelated to the crisis. Member States are also recommended limit the amount of losses to be carried back to €3 million per loss making fiscal year. Such a measure will help level the playing field and better support business during the recovery, and will particularly benefit SMEs.
- Promote corporate investment by addressing the debt-equity bias in corporate taxation.** The economic crisis following the COVID-19 pandemic has contributed to a significant increase in companies' stock of debts. The current pro-debt bias of tax rules, where businesses can deduct interests attached to a debt financing, but not the costs related to equity financing, can encourage companies to accumulate debts. This could lead to high waves of insolvency, with a negative effect for the EU as a whole. The Commission proposal will aim to redress the debt-equity bias and contribute to enhancing the equity levels of companies that may currently be financially vulnerable, including because of the COVID-19 crisis.



Figure 1 The main initiatives put forward by the Business Taxation for the XXI Century communication

## **Going beyond the OECD agreement - An EU Business taxation environment for the 21st Century**

The Commission will propose a new framework for business taxation in the EU, which will reduce administrative burdens, remove tax obstacles and foster a more business-friendly environment in the Single Market. **The “Business in Europe: Framework for Income Taxation” (or BEFIT) will provide a single corporate tax rulebook for the EU, based on a formulary apportionment and a common tax base.** It will build on progress in the global discussions, where these concepts are already present, through the use of a formula for the partial reallocation of profits under Pillar 1, and common rules for calculating the tax base for the purposes of applying Pillar 2. BEFIT will aim to cut red tape, reduce compliance costs and tax avoidance opportunities as well as supporting jobs, growth and investment in the EU. This new proposal will replace the pending proposal of a Common Consolidated Corporate Tax Base (CCCTB), which will be withdrawn.

While the principles of a common tax base and of formulary apportionment already featured in the previous CCCTB proposal, the new proposal will reflect the significant changes in the economy and in the international framework since March 2011 when the CCCTB was originally proposed. Most notably, it will build on the approach taken in the forthcoming global agreement in its proposals for the definition of the tax base. It will also feature a different apportionment formula, which will better reflect the realities of today’s economy and global developments, in particular by taking better account of digitalisation. Key considerations will include how to address the importance of intangibles in creating the value of a company and give appropriate weight to sales by destination, in order to reflect the importance of the market where a multinational group does business. The Commission will work closely with Member States in the preparation of this proposal, also taking into account the views of the European Parliament, and in consultation with the business sector and civil society groups.

### **EU tax mix on the road to 2050**

In addition to the actions outlined above, the Communication highlights the need for a wider reflection on the tax mix in the EU for the coming decades, responding to megatrends such as population ageing, climate change and digitalisation. The Commission will host a symposium in 2022 on “EU tax mix on the Road to 2050”.

### **3. Timing for initiatives announced in the Communication**

- Recommendation on the domestic treatment of losses for SMEs during the recovery – adopted alongside the Communication
- Legislative proposal to address aggressive tax-planning opportunities linked to the use of shell companies - Q4 2021
- Legislative proposal creating a Debt Equity Bias Reduction Allowance (DEBRA) - Q1 2022

- Legislative proposal for the publication of effective tax rates paid by large companies, based on the methodology under discussion in Pillar 2 of the OECD negotiations - 2022
- Legislative proposal for BEFIT (Business in Europe: Framework for Income Taxation) - 2023

#### **4. Questions for participants**

- 1. What are the views of platform members on the targeted initiatives announced as part of the Communication?*
- 2. What should be the main considerations for the Commission in the development of the BEFIT proposal?*
- 3. What do platform members see as the most important considerations for the tax mix in the EU on the road to 2050?*