



# Euro Tax Flash from KPMG's EU Tax Centre



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## **European Commission communication on Business Taxation for the 21st century**

[European Commission working programme – Fair taxation – Tax abuse – Digitalized economy – OECD – Digital levy – ATAD – CFC – BEFIT – EU list of non-cooperative jurisdictions for tax purposes](#)

On May 18, 2021, the European Commission unveiled its [Communication](#) on “Business Taxation for the 21st Century” (the Communication). The document sets out the Commission’s views on the EU’s tax policy agenda and plans for the implementation of the rules to be agreed upon at international level under the OECD’s BEPS 2.0 project. The Communication also mentions targeted solutions that go beyond the OECD agreement, in the form of five action points that are meant to support the EU’s ambition for a holistic EU business tax framework that provides for a “robust, efficient and fair tax framework that meets public financing needs, while also supporting the recovery and the green and digital transition by creating an environment conducive to fair, sustainable and job rich growth and investment.”

### **Background**

The Communication was initially announced for fall 2020 but was postponed several times, with a [public consultation](#) seeking feedback from stakeholders taking place earlier this year.

In parallel, negotiations within the OECD’s Inclusive Framework (IF) group aimed to address tax challenges arising from the digitalization of the economy have been ongoing, with the aim to reach a decision on the framework by July 2021 and adopt a formal package by October 2021. The global discussions are focused on two pillars, Pillar 1 on nexus and profit allocation and Pillar 2 on global minimum taxation - see a KPMG [TaxNewsflash](#).

## European Commission May 18 Communication

In its May 18 Communication, the Commission reiterated the need for a robust, efficient and fair tax framework that meets public financing needs, while also supporting the EU's economic recovery and the green (i.e. reducing emissions by 55 percent by 2030 and becoming climate neutral by 2050) and digital transition.

The document takes stock of upcoming tax proposals in support of the green transition – the reform of the Energy Taxation Directive, a Carbon Border Adjustment Mechanism (CBAM) and a revised EU Emissions Trading System (these last two proposals would contribute to the EU's new system of own resources financing the EU budget).

The document notes that an initial set of proposals, including the CBAM, the digital levy and the revision of the EU ETS, is expected in July 2021. The Commission reiterates its commitment to propose additional new own resources, potentially a Financial Transaction Tax and an own resource linked to the corporate sector.

With regard to the forthcoming proposal for an EU digital levy, it is noted that the levy will be independent of the expected global agreement on the international corporate tax reform and will be designed in such a way that it is compatible with WTO and other international obligations. The aim is for the digital levy to generate a new source of revenue that will support the longer-term sustainability of the EU budget and enable investments in the digital transition. The Commission also notes that once set-up, the digital levy would co-exist with the Pillar 1 agreement, as implemented in EU law. It is mentioned that this proposal will differ from the 2018 proposals for a Digital Services Tax and for a Significant Digital Presence, both of which will be withdrawn.

The Communication also sets out the Commission's plans for the implementation in the EU of the reform of the international corporate tax framework (Section 2), as well as short-term initiatives in the area of corporate taxation (Section 3), including a set of five action points for the European Commission's agenda for the next two years:

1. Legislative proposal for the publication of effective tax rates paid by large companies, based on the methodology under discussion in Pillar 2 (by 2022).
2. Legislative proposal setting out rules to neutralize the misuse of shell entities for tax purposes (referred to as "ATAD 3" in the Commission Q&A) (by Q4 2021).
3. Recommendation on the domestic treatment of losses (alongside the Communication).
4. Legislative proposal creating a Debt Equity Bias Reduction Allowance (DEBRA) (by Q1 2022).
5. Business in Europe: Framework for Income Taxation or BEFIT, moving towards a common tax rulebook and providing for fairer allocation of taxing rights between Member States (2023).

### *Implementing the global agreement on BEPS 2.0 in the EU*

The Communication provides an overview on how the global agreement expected to be reached at the level of the OECD's IF would be implemented in the EU. For consistency purposes and because not all EU Member States are OECD members or participate in the IF discussions, the Commission will issue two Directives to implement each of the two Pillars in the EU.

In the specific case of Pillar 2, it is noted that several existing and pending EU initiatives will also be impacted, as follows:

- The Anti-Tax Avoidance Directive: the Commission will explore how to accommodate the interaction between the proposed Income Inclusion Rule and the rules on controlled foreign companies (CFC) under the EU ATAD;
- The pending proposal for recasting the Interest and Royalties Directive (to make the elimination of withholding tax on cross-border interest and royalty payments conditional on the interest being subject to tax in the destination state): agreement on a minimum level of taxation is expected to pave the way for agreement on this proposal, which has been on hold since 2011 due to disagreements at Council's level;
- EU list of non-cooperative jurisdictions for tax purposes: the Commission will propose the introduction of Pillar 2 in the listing criteria used for assessing third countries.

#### *Targeted short-term initiatives*

The document acknowledges that achieving the Commission's long-term vision will take time, and that short-term initiatives are needed to address specific immediate challenges.

The Communication sets out the EU's business tax agenda for the next two years, with a focus on two strategic areas:

1. Ensuring fair and effective taxation:

##### *Action 1: Proposal on disclosing effective tax rates paid by large companies*

Increasing public transparency on taxes paid is viewed by the Commission as a first step for a fairer tax system. A proposal is expected by 2022 and will require the annual publication of the effective corporate tax rate by certain large companies operating within the EU, based on the methodology agreed upon for the Pillar 2 calculations.

##### *Action 2: Proposal targeting the use of shell entities (ATAD 3)*

By the end of 2021, the Commission will also prepare a proposal targeting the use of shell companies – defined as companies with no or limited economic substance. Amongst others, the proposal is expected to include requirements for companies to disclose to the relevant tax authorities information necessary to assess the (lack) of economic substance, and rules to deny tax benefits where shell companies are used.

The Communication also notes that, in addition to the two actions above, the Commission will continue to use all tools, including the enforcement of State Aid rules, to ensure that companies pay their fair share of tax, including the enforcement of State aid rules.

2. Enabling productive investment and entrepreneurship:

##### *Action 3: Recommendation on the domestic treatment of losses*

Alongside the Communication, the Commission will adopt a Recommendation on the domestic treatment of losses. The document acknowledges the steps taken by Member States in the current complex COVID-19 environment to support small and medium enterprises (SME) (e.g.

deferral of tax obligations), but notes that SMEs are less likely to be able to absorb or finance losses due to reduced cashflow.

The Recommendation is aimed to assist companies, and SMEs in particular, to deal with the economic impact of COVID-19. Based on the [Q&A](#) published by the Commission in relation to the Communication, the Member States are recommended to allow for the carry-back of losses, to at least the previous tax year. As such, companies impacted by COVID-19 would be allowed to offset their 2020 and 2021 losses against taxed paid before the 2020 (a maximum limit of EUR 3 million per loss-making fiscal year is suggested).

At a later stage, the Commission undertakes to explore the possibility of a coordinated treatment of cross-border loss relief.

#### *Action 4: Proposal on creating a Debt Equity Bias Reduction Allowance (DEBRA)*

The document notes a pro-debt bias under the current tax framework, which allows for the corporate income tax deductibility of interest expenses related to debt financing, but doesn't provide for an equivalent deduction of costs related to equity financing. The Commission commits to make a legislative proposal, by the first quarter of 2022, to address this issue. The proposal will include anti-abuse measures to support the aim of the initiative – i.e. re-equitization of financially vulnerable companies.

#### *Long term initiative*

The Communication notes that the lack of a common corporate tax system within the EU represents a competitive disadvantage for the EU Single Market compared to third country markets. Specifically, the current corporate tax framework acts as a distortive element for investment and financing decisions and increases compliance costs for multinationals.

To address this issue, and building on the work undertaken at the level of the IF, the Commission set out an ambitious plan for a new framework for income taxation for businesses in Europe (Business in Europe: Framework for Income Taxation or BEFIT), to be proposed by 2023.

#### *Action 5: Business in Europe: Framework for Income Taxation (BEFIT)*

BEFIT will provide for common rules for determining the corporate tax base and for the allocation of profits between Member States, based on a pre-defined formula (formulary apportionment). The proposal will build on the principles agreed upon under Pillar 1 and Pillar 2, and further adapt these to ensure suitability for an extended use within the EU Single Market.

In short, BEFIT would consolidate the profits of the EU members of multinationals into a single tax base, to be subsequently allocated to Member States using a formula that will replace the current transfer pricing rules. The formula will be developed by considering issues such as giving appropriate weight to sales by destination, reflecting the importance of the market where a multinational group does business, assets (including intangibles) and labor (personnel and salaries). Once allocated, profits will be taxed using the common principles of an EU corporate tax base.

The pending Common Consolidated Corporate Tax Base (CCCTB) proposal will be withdrawn in light of this new initiative. Once implemented, BEFIT could represent a stepping stone for the

introduction of an even more ambitious initiative, i.e. the possibility of a single EU corporate tax return for a group.

## Next steps

In addition to the timelines mentioned above for the various action points and commitments made, the European Commission will also launch a broader reflection on modernization of tax systems and updates to the tax mix (labor taxes, including social contributions, currently provide more than 50% of the overall tax revenue in the EU 27) to better reflect ongoing and future economic and social developments, which should conclude in a Tax Symposium on the 'EU tax mix on the road to 2050' in 2022.

## EU Tax Centre Comment

Following the lines of the tax package introduced by the Commission on July 15, 2020 – see [ETF 433](#) – the Communication sets an ambitious timeline and agenda for the coming years. For further comments on the May 18 Communication and other updates from the EU institutions, join our “EU Tax perspectives” webcast, during which a panel of KPMG specialists will share their insights on some of the latest developments from across the EU affecting multinational groups operating in Europe. Please access the [event page](#) to register.

Should you have any queries, please do not hesitate to contact [KPMG's EU Tax Centre](#), or, as appropriate, your local KPMG tax advisor.



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