Euro Tax Flash from KPMG's EU Tax Centre

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First steps after Commission Communication on Business Taxation for the 21st century

European Commission working programme – Fair taxation –Tax losses – ATAD – DEBRA

As a first set of actions following its May 18, 2021 Communication on Business Taxation for the 21st Century, on May 20, the European Commission started a consultation process for a legislative proposal setting out rules to neutralize the misuse of shell entities for tax purposes (Action 2 of the Communication). The same day, a Recommendation on the tax domestic treatment of losses (Action 3 of the Communication) was published in the Official Journal of the European Union.

Background

As previously reported (see ETF 448), the May 18 Communication outlines the Commission's views on the EU's tax policy agenda and introduces a set of action points to support the EU's ambition for a "robust, efficient and fair tax framework":

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 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).

Consultation on fighting the use of shell entities and arrangements for tax purposes

On May 20, 2021, the Commission kicked off their consultation strategy on the upcoming initiative to fight the use of shell entities for tax purposes in the EU. As stated on their website, the Commission's aim is to explore legislative options to ensure that companies and legal structures in the EU, with no or limited economic substances, would not benefit from tax advantages.

As an initial step, the Commission published the Inception Impact Assessment, which outlines their understanding of the issue and provides a preliminary assessment of the expected economic, social and administrative impact.

According to the Inception Impact Assessment, several policy options will be analyzed for the purpose of designing the legislative proposal, including:

- the current domestic anti-tax avoidance legislation and practices, including the provisions implementing EU rules (e.g. local implementation of the Anti-Tax Avoidance Directive);
- the extent to which soft law could achieve the objectives of the initiative. Under this step, both legislation already in force, e.g. Code of Conduct on Business Taxation, and the possibility of introducing new soft law instruments would be considered;
- a new legislative initiative, which would define substance requirements and "real economic activity" for tax purposes;
- options for enhanced cooperation, monitoring and enforcement of the new rules.

The document acknowledges the potential risk that multinationals would relocate shell companies to third countries, but notes on the other hand that this negative impact would be offset by the benefits of a standardized common assessment of substance for tax purposes. The Commission is of the view that the instrument would tackle the erosion of Member States' tax base, and thus increase tax revenues, and that it would improve the level playing field for companies operating within the EU Single Market.

Interested parties are asked to provide feedback and comments by June 17, 2021. The input received will be published on the Commissions' website and will be taken into account in fine tuning the initiative. In terms of next steps, a more targeted public consultation (based on a questionnaire) will be launched in the second quarter of 2021. The planned adoption by the Commission of a legislative proposal is expected for the first quarter of 2022.

Recommendation on the tax treatment of losses

On May 20, 2021, the Recommendation on the tax treatment of losses that the Commission had announced would be published alongside the Communication, was published in the Official Journal. The document, which is not legally binding, but sets out suggestions for measures

related to the tax treatment of losses that Member States – that have not done so already, could introduce to support businesses affected by the COVID-19 pandemic.

The document acknowledges the steps taken by Member States in the current complex environment to support small and medium-sized enterprises (SMEs) – e.g. deferral of tax obligations, but notes that these companies are less likely to be able to absorb or finance losses due to reduced cashflow.

Member States are advised to allow for the carry-back of 2020 and 2021 losses to at least the previous tax year, i.e. at least 2019. The carry-back period may be extended up to the previous three years, meaning that companies could offset their 2020 and 2021 against already taxed profits in 2019, 2018, and 2017. Companies should be able to claim the carry-back of losses estimated for the 2021 tax year immediately, without having to wait until the end of the year.

In order to reduce the impact on national budgets, the recommendation sets a limit of EUR 3 million per loss-making tax year. In addition, if Member States extend the carry-back of losses to the three previous years (i.e. 2019, 2018 and 2017), companies would only be eligible if they have not incurred losses in any of those years.

Member States are asked to inform the Commission about the measures implemented based on the current recommendation.

EU Tax Centre Comment

In the May 18 Communication, the Commission set an ambitious timeline both for their short term and longer term initiatives. Whilst the public consultation on the use of shell companies was kicked off just two days after its announcement, the estimated deadline for its adoption by the Commission was pushed from the second quarter of 2021 (as per the Communication) to the first quarter of 2022.

Several other initiatives are scheduled to be adopted by the Commission in 2022; further developments, such as public consultations on the other action items, can therefore be expected in the near future. It the context of the upcoming proposal on a debt equity bias reduction allowance (DEBRA), it is worth noting the Commission's annual report on taxation. The 2021 edition was also published on May 18, and it includes several high level recommendations on how the debt financing bias could be reduced. One of the options mentioned is the allowance for growth and investment (AGI) – as proposed in the CCTB draft directive (that the Commission intends to withdraw). This may be an indication that the AGI could be used a starting point in the design of the DEBRA.

For further comments on the May 18 Communication, the recent public consultation on the use of shell companies 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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