European Commission agenda for business taxation in the EU - BEPS 2.0 and beyond

August 2021
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."

The document takes stock of new 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).

Implementing the global agreement on BEPS 2.0 in the EU

The Communication provides an overview on how the global agreement at the level of OECD/G20 Inclusive Framework on BEPS (IF) would be implemented in the EU. For consistency purposes and because not all EU Member States (i.e., Cyprus) are OECD members or participate in the IF discussions, the Commission initially communicated that it would issue two directives to implement each of the two Pillars in the EU.

However, in a subsequent FAQ on the Global Agreement on Corporate Taxation, the Commission notes that Pillar One will be mandatory for participating countries and will be implemented through a multilateral convention; the Commission will therefore consider whether a directive for the implementation of Pillar One will in fact be needed.

Note: (1) Communication from the Commission to the European Parliament and the Council "Business Taxation for the 21st Century"
Note that, following agreement among 133 of the 139 IF members and endorsement by the G20, the IF is set to settle the remaining issues of the two-pillar plan and to agree on the implementation plan by October 2021. In a July 1 statement, the IF committed to opening the Pillar One multilateral instrument for signature in 2022, with Amount A anticipated to take effect beginning in 2023.

Pillar Two would be brought into law in 2022 and made effective beginning in 2023. The Commission intends to follow up with the related EU proposal(s) swiftly once agreement has been reached at global level. Unanimous agreement among EU Member States would be needed in order to adopt a Pillar Two directive, meaning that a 2023 effective date for the Pillar Two rules in the EU may prove to be challenging considering that Estonia, Hungary and Ireland have not yet signed the IF statement and have expressed reservations on the level of minimum tax endorsed by the IF, while Cyprus is not part of the IF discussions and is yet to take a formal stance on the issue.

Furthermore, in the specific case of Pillar Two, it is noted that several existing and pending EU initiatives will also be impacted, such as:

- 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 Two in the listing criteria used for assessing third countries.

The Communication also sets out a number of action points in the area of corporate taxation that go beyond the OECD initiatives. These action points are discussed in more detail in the next pages.

Legislative proposal for the publication of effective tax rates paid by large companies, based on the methodology under discussion in Pillar Two (by 2022).

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 Q1 2021).

Recommendation on the domestic treatment of losses (published alongside the Communication).

Legislative proposal creating a Debt Equity Bias Reduction Allowance (DEBRA) (by Q1 2022).

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).
The EU’s new business tax agenda: ensuring sustainable growth and public revenues

18 May 2021

The world is changing. Tax should too.

A common rulebook for a better business environment in the Single Market

“Business in Europe: Framework for Income Taxation” (or BEFIT) will cut red tape, reduce compliance costs and minimise tax avoidance.

Ensuring greater public transparency

New proposal requiring certain large companies to publish their effective tax rates.

Supporting businesses to recover from COVID-19

Member States recommended to allow companies to offset their 2020 and 2021 losses against taxes they paid before 2020.

Tackling the abusive use of shell companies

New monitoring and reporting requirements for shell companies so tax authorities can better respond to aggressive tax planning.

Addressing the debt-equity bias in corporate taxation

Encouraging companies to seek finance through equity rather than debt.

On the road to 2050: Rethinking the EU tax mix

A comprehensive tax agenda, in line with global discussions, promoting fairness and supporting EU’s green and digital transitions.

Source: European Commission website Communication on Business Taxation for the 21st Century (europa.eu)
Targeted short-term initiatives

The Communication 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 Commission therefore 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 in Q1 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 Two calculations.

Action 2

Proposal targeting the use of shell entities (ATAD 3)

The Commission will also prepare a proposal targeting the use of shell companies – defined as companies with no or limited economic substance. On May 20, 2021, the Commission kicked off their consultation strategy on this initiative, with the aim 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 analysed 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.

A more targeted public consultation (based on a questionnaire) was launched on June 4, 2021 and will run until August 27, 2021.
The planned adoption by the Commission of a legislative proposal is expected for the first quarter of 2022.

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 adopted a Recommendation on the domestic treatment of losses. In its Communication, the Commission 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 cash flow.

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 published an Inception Impact Assessment, according to which the ultimate objective of the initiative is the creation of a harmonised tax environment that places debt and equity financing on equal footing across the EU. It is noted that the initiative could be designed in one of the following two ways:

- disallowing the deductibility of interest payments, or
- creating an allowance for equity by enabling the tax deductibility of notional interest for equity on:
  1. all corporate equity;
  2. new corporate equity; or
  3. financial capital (financial debt + equity) to replace the tax deduction of interests accompanied by anti-abuse provisions.

A more targeted public consultation (based on a questionnaire) was launched on July 1, 2021 and will run until October 7.

According to the consultation questionnaire the notional interest rate will be determined based on a risk-free market interest rate in order to take annual interest rates variations into account. In addition, a risk premium can be added to the risk-free rate for calculating the notional interest rate. The questionnaire also asks respondents to rate a number of anti-abuse options.

The Commission commits to make a legislative proposal, by the first quarter of 2022, to address this issue.
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 in 2023.

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 One and Pillar Two, and will 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.
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