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NOTE

From:	Presidency
To:	The High Level Working Group on Competitiveness and Growth
Subject:	Presidency note on business environment and fiscal aspects in the upcoming Start-up and Scale-up initiative

Delegations will find in Annex a Presidency note on business environment and fiscal aspects in the upcoming Start-up and Scale-up initiative in view of the meeting of the High Level Working Group on Competitiveness and Growth on 10 November 2016.

ANNEX

Presidency note on business environment and fiscal aspects in the upcoming Start-up and Scale-up initiative

Building on the announcement in its Single Market Strategy Communication in October 2015 that: *"The Commission will launch a Start-up initiative to engage all relevant players, including entrepreneurs, Start-up communities, social partners and regional and national authorities, with the aim of improving the environment for Start-ups in Europe."*, the Commission has undertaken a number of consultations and discussions in the preparation of its new Communication called Start-up and Scale-up Initiative scheduled for the adoption for 22 November 2016. Among other things, the new Communication will address how to best interlink the number of on-going initiatives in this area to achieve the best possible results.

In the context of the HLG, the discussion on supporting European Start-ups and Scale-ups took place on 4 July 2016. The High Level Group (HLG) expressed the view that the US had a much better business climate and ecosystem for Start-ups and Scale-ups than the EU, mainly due to a single market and entrepreneurial culture. On the other hand, the EU has the potential in terms of market-size and knowledge-base, but needs to address the current market gaps in terms of deal flow and economies of scale and scope. Therefore, removing regulatory and administrative barriers and a better functioning single market should help the business climate for Start-ups and Scale-ups.

The HLG also discussed access to finance for SMEs in more details on 12 September 2016. This debate contributed to the discussion over the Competitiveness Check-up on the access to finance for Scale-ups during the last Competitiveness Council of 29 September 2016. The main finding from the Commissions´ presentation in the Council was that the major difference between the EU and the US is scaling up stage financing. This was further confirmed by the results of the stakeholders' consultation on the Start-up/Scale-up Initiative to de adopted by the Commission on 22 November 2016.

In the past decade, authorities across the EU have made major efforts to stimulate the creation of more Start-ups. In addition, EU initiatives on the Single Market, the Digital Single Market and the Capital Markets Union have tried to put in place both legislative and non-legislative framework conditions that will enable success. The result of all these efforts is that there is now no major difference between the EU and the US as regards new firm creation[1] with particular success in the ICT sector. But too often, these promising starts fizzle out rather than turning into European and global winners. Too few European Start-ups survive beyond the critical phase of 2-3 years, and fewer still grow into larger firms[2].

There is a strong perception among innovative young firms that growing beyond a certain size will be penalised as more burdensome employment, compliance costs and other rules kick in. And this is before they even consider growing cross-border. Despite all the work on improving the Single Market, it can be time consuming to get a clear picture on the regulatory and administrative rules and formalities to be fulfilled. The consultation revealed that even once Start-ups understand and fulfil all the requirements, too often they find them overly burdensome. Nearly 40% found scaling up harder than expected. There are still too many barriers in the way and these penalise Europe's potential winners most of all.

Although in the Start-up phase, EU firms do not face much greater problems in accessing finance compared to the US[3]. On the other hand, both academic evidence and the public consultation confirm that there are however substantial differences in the scaling up phase. One reason is the amount of funding available for venture capital investment. It is estimated that in 2014 , there were only around 5 billion EUR available for venture capital investment in the EU compared to more than 26 billion EUR in the US[4].

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1 OECD, (2015) Entrepreneurship at a glance, Paris

2 The percentage of firms that do not grow at all or by less than 5% is over 45% in Europe compared to 37% in the US (Bravo-Biosca, 2011, A look at business growth and contraction in Europe).

3 See for the details the ppt presentation made at the Competitiveness Council of September 29th, 2016.

4 Thomson ONE in BSG Perspectives 'The State of European Venture Capital'

Public consultation held by the Commission earlier in 2016, led to the following key findings, which were also concluded in the last discussion in the HLG on 4 July 2016:

a) Start-ups looking to Scale-up still face **too many legal, regulatory and administrative barriers,** especially cross-border;
b) There are **too few opportunities** to find and engage with potential partners in finance, business and local authorities across the EU; and
c) **Accessing finance** is harder in Europe than particularly in the US[5] for scaling-up phase.

Access to finance has emerged as the number one barrier to scaling up within the EU[6]. Therefore we would like to draw the attention of the HLG to the on-going and planned initiatives in the fiscal area of particular relevance to SMEs and Start-ups/Scale-ups. The initiatives could play an important role in two aspects, (a) in improving access to finance; and (b) further facilitating business environment.

A) Access to finance

The planned Communication on Start-ups and Scale-ups is looking at the issue of access to finance from different policy angles, however one of key questions remains how to deepen the pool of available equity financing especially for Scale-up phase. In this respect, two initiatives might be of particular concern:

<u>1) Common Consolidated Corporate Tax Base (CCCTB)</u>

The Commission adopted on 25 October 2016 a corporate tax package including two separate legislative proposals for Directives related to the Common Consolidated Corporate Tax Base (CCCTB) initiative: the first proposal lays down common rules for calculating the tax base (first step) whilst the second deals with consolidation and the allocation of revenues to eligible Member States through a formula.

[5] **European venture capital funds** are smaller on average and therefore do not have sufficient volume to help companies grow from Start-ups to mid-caps and on to global players. Between 2007 and 2012, the average size of European VC funds (at final closing) was 61 million EUR and 50% of all VC funds were smaller than 27 million EUR. In contrast, the average US VC fund in 2014 was $135 million in size . This is a particular problem for Scale-ups, as the supply of funds tends to dry up as they move to later stages of funding and financing

[6] See Staff Working Document

To facilitate the business to grow and expand cross-border within the internal market, the CCCTB proposals include the following incentives:

a) R&D super-deduction with an enhanced benefit for innovative Start-ups;
b) Debt bias: correction mechanism to ensure that equity and debt financing are treated equally from a tax point of view. The so-called Allowance for Growth and Investment (AGI) includes a 2% entrepreneurial risk premium added to the defined yield rate based on 10 year EU government bonds;
c) Cross-border loss relief, as a temporary mechanism aimed to give businesses a cash advantage until the ultimate objective of cross-border tax consolidation materializes.

It should also be noted that the existing business advantages from the consolidation of company profits under the CCCTB (Full cross border loss off-set, allowing cross-border groups to deal with one tax administration in the EU and doing away with burdensome transfer pricing formalities within the group in the EU), which were already included in the 2011 proposal, remain valid for the re-launch project.

2) On-going study of the effectiveness of tax incentives for VC and business angles.

In the context of the Capital Markets Union, the Commission is taking action to encourage best tax practices in promoting venture capital and business angel investment into Start-ups and innovative companies. A study on tax incentives for venture capital and business angels was launched in January 2016 and there was a meeting to allow Member States to exchange best practice on this issue on 5 October 2016. The second meeting will take place in spring 2017 and the final report will be finalised by mid-2017.

B) Business environment – simplification and reduction of compliance costs

Commission foresees two major fiscal policy initiatives in 2017 that aim at simplification of the current VAT regime, and thus reducing the related compliance costs, namely VAT Simplification Package for SMEs as well as a proposal for definite VAT regime. Meantime it addresses one of the elements of the current VAT regime, that is the rules for cross border B2C e-commerce (scheduled for adoption on 30 November), that are expected to have high impact on facilitation and lowering costs of cross-border activity.

3) Modernisation of current VAT rules

Commission proposal on Modernisation of current VAT rules for cross border B2C e-commerce to reduce the burden on businesses arising from different VAT regimes[7] is still to be adopted in Q4 2016. The Single Market Strategy and the Digital Single Market Strategy identified that one of the key reasons why a business would not engage in cross-border e-commerce are the complex VAT obligations as well as an inherent lack of neutrality which harms EU business. It has been estimated that the costs of complying with VAT obligations are on average 8.000 EUR annually for each Member State a business supplies to – a significant cost especially for SMEs. The current VAT system is not neutral as EU businesses are at clear disadvantage to non-EU businesses which can legitimately through the VAT exemption for small consignments and through high levels of non-compliance make VAT free supplies into the EU. Given that VAT rates can be as high as 27%, there is a substantial distortion in favour of non-EU business if VAT is not applied.

The Commission will present a proposal before the end of 2016 which will extend the current Mini One Stop Shop to goods including imports and introduce improved coordination arrangements for cross-border auditing of business who use the One Stop Shop. The proposal will also remove the VAT exemption for the importation of small consignments which will ensure that all commercial parcels entering the EU will be subject to VAT. A new intra-EU cross-border threshold targeted at SMEs and Start-ups will be introduced.

4) VAT simplification package for SMEs

The initiative forms part of the Single Market Strategy, adopted in October 2015 and of the VAT Action Plan adopted in April 2016. The overall objective is to reduce the administrative burden on small enterprises, to contribute to the creation of an environment favourable to their growth and cross-border trade, and to provide a level playing field for EU business.

7 Both the Single Market Strategy and Digital Single Market Strategy identified that one of key reasons why a business would not engage in cross-border e-commerce are the complex VAT obligations as well as an inherent lack of neutrality which harms EU business. It has been estimated that the costs of complying with VAT obligations are on average 8.000 EUR annually for each Member State a business supplies too – a significant cost especially for SMEs

The review of the SME scheme will cover both the VAT exemption and its threshold, and possible simplification measures relating to VAT obligations, such as identification, invoicing, accounting or returns. The Commission aims adopt proposal on VAT simplification package for SMEs in 2017. HLG could actively contribute to the work in progress in this context by sharing the experience of most burdensome VAT compliance requirements.

Questions for discussion/further steps:

- *Which of the recommendations in the Scale-up Manifesto*[8] *should be of attention and further discussed by the HLG?*
- *What is your SMEs' experience vis-a-vis intra-EU compliance costs? HLG members are invited to share their views on Scale-ups' experience in cross-border expansion and the internationalisation process?*

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8 www.scaleupeuropemanifesto.eu