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**COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN  
PARLIAMENT AND THE COUNCIL**

**Business Taxation for the 21st Century**

## **1. EU Tax Policy framework**

### **1.1 Context**

The context for EU business taxation policy has changed radically in the past year. The coronavirus has deeply affected societies and economies in Europe and globally. The public health challenge turned into the most drastic economic crisis in the EU's history with deep social impacts and rising inequalities.

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 pre-existing trends towards **digitalisation**, with increasing numbers of people and businesses making purchases, working, interacting and doing business online. These trends have major impacts on existing tax bases and require reflection on the shape of efficient, sustainable and fair tax frameworks in the future, including through consideration of the overall tax mix (see Box 1).

Moreover, there is now consensus that the fundamental concepts of tax residence and source on which the international tax system has been based for the last century are outdated. Business practices now regularly involve carrying out activity in a state without maintaining a physical presence, a situation that the current rules are unfit to cope with, while the digitalisation of the economy has also led to new opportunities to manipulate the existing principles through tax planning schemes.

In response, governments have increasingly engaged in adopting a patchwork of anti-tax avoidance and evasion measures. While these have been successful in addressing specific problems, they have introduced even further complexity. Triggered by multiple tax scandals, rigorous enforcement of State aid rules, and the need to finance public expenditure after the financial crisis, discussions on the reform of the international corporate tax framework accelerated in the early 2010s, leading to the Base Erosion and Profit Shifting (BEPS) project<sup>1</sup>, led by the OECD and G20. This process delivered its initial set of outcomes in 2015, which were implemented in the EU, including through the Anti-Tax Avoidance Directives<sup>2</sup>. International discussions are now progressing towards a global solution to reform the outdated international corporate tax system, with action on the reallocation of taxing rights and minimum effective taxation. The substance of these discussions will influence the shape of the EU business tax agenda going forward, regardless of whether a concrete global agreement is reached.

At the same time, international partners, like the US, have already announced plans to shape their business tax agenda for the coming years, going beyond or building on the international discussions. These actions recognise that revenue is needed to finance public investment in

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<sup>1</sup> This project now brings together 139 jurisdictions around the globe.

<sup>2</sup> Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market, OJ L 193, 19.7.2016, p. 1.

order to build back better and to support and sustain an inclusive economic recovery. Other countries, such as the UK, have also announced measures on corporate taxation post-COVID-19.

In this context, the EU needs 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**.

## 1.2 EU Tax Policy Agenda

**EU action on business taxation must be embedded in a comprehensive EU tax agenda.**

At its heart is the need for a balanced tax revenue mix, and a tax system guided by the principles of fairness, efficiency and simplicity.

The following priorities will be vital in achieving this vision:

(i) Enabling fair and sustainable growth

The EU's tax agenda contribute to the overall objective of enabling fair and sustainable growth by supporting wider EU policies such as the European Green Deal<sup>3</sup>, the Commission's digital agenda, the New Industrial Strategy for Europe<sup>4</sup> and the Capital Markets Union<sup>5</sup>. It should also contribute to supporting an inclusive recovery in line with the principles of the European Pillar of Social Rights.

A tax system that supports the green transition will be a vital tool to achieve the objectives of the European Green Deal. Tax measures will have to go hand in hand with other environmental pricing instruments as well as regulatory measures, while taking distributional impacts into due account to ensure a just transition.

At EU level, the forthcoming proposal to reform the Energy Taxation Directive<sup>6</sup> will be a critical step forward in this regard. Its revision will complement other initiatives in the 'Fit for 55' package, by rationalising the system of minimum rates and removing outdated exemptions and reduced rates. As part of the same package, the Commission will propose new and reformed pricing mechanisms to support EU climate objectives, notably a Carbon Border Adjustment Mechanism (CBAM), and a proposal for a revised EU Emissions Trading System (ETS). At national level, the Member States should step up their efforts in putting a price on externalities<sup>7</sup> with due regard to any adverse social impacts, and in phasing out harmful subsidies, including as part of broader tax reforms.<sup>8</sup>

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<sup>3</sup> COM(2019) 640 final.

<sup>4</sup> COM(2020) 102 final.

<sup>5</sup> See, for instance, COM(2020) 590 final.

<sup>6</sup> Council Directive 2003/96/EC of 27 October 2003 restructuring the Community framework for the taxation of energy products and electricity, OJ L 283, 31.10.2003, p. 51.

<sup>7</sup> Art. 191(2) of the TFEU calls for pricing the negative externalities of polluting or other damaging activities, while the Annual Sustainable Growth Strategy 2021 encourages Member States to include in their Recovery and

In the Digital Decade Communication<sup>9</sup>, the Commission set out the EU's targets in the digital transition until 2030. Taxation needs to facilitate this transition, by providing an environment where digital businesses can thrive. At the same time, the tax framework needs to be adapted to better match the realities of a digitalised economy. This also entails the digitalisation of tax administration.

The EU tax framework must be designed to contribute to a stronger Single Market for Europe's recovery, in line with the the 2020 New Industrial Strategy and its update adopted in May 2021<sup>10</sup>. It should reduce compliance costs for businesses, facilitate cross-border investment, and provide the right environment for SMEs and larger enterprises alike to thrive in a green and digital Europe.

The EU tax framework also has a key role to play in supporting the development of the Capital Markets Union (CMU)<sup>11</sup>, in particular by removing tax barriers to cross-border investment and addressing the debt bias in corporate taxation.

(ii) Ensuring effective taxation

Ensuring the effective collection of tax revenue is vital to fund quality public services, and is a precondition for a fair sharing of the tax burden between taxpayers. It also contributes to a level playing field for firms, improving EU competitiveness. Billions of Euros are lost in the EU each year to tax fraud, evasion and avoidance<sup>12</sup>. Tax provisions of individual Member States can also result in revenue losses for other EU Member States, for example, where royalties and interest payments can be paid to recipients in low or no-tax jurisdictions without taxes having been paid in the EU.

**Box 1: The EU tax mix on the road to 2050**

Tax systems will need to be modernised to better reflect ongoing and future economic and social developments. Member States' budgets rely heavily on labour taxes, including social contributions, which provide more than 50% of the overall tax revenue in the EU-27. VAT accounts for more than 15% of total tax revenue, while other tax bases, such as

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Resilience Plans structural reforms, including 'reforms of tax system, for example by shifting the tax burden from labour to taxes that are less distortive' (COM(2020) 575).

<sup>8</sup> To support this process, the Commission will adopt recommendations on how to further promote relevant instruments and incentives to better implement the polluter pays principle and thus complete the phasing out of the 'pollution for free' era, following up on the upcoming European Court of Auditors report. (COM(2021) 400).

<sup>9</sup> COM(2021) 118 final

<sup>10</sup> COM(2021) 350 final.

<sup>11</sup> COM(2020) 590 final.

<sup>12</sup> International tax evasion by individuals results in a tax revenue loss of EUR 46 billion/year for EU Member States. See ECOPA and CASE (2019) *Estimating International Tax Evasion by Individuals*, Taxation Papers 76. Moreover, it is estimated that EUR 35-70 billion is lost each year in corporate tax avoidance in the EU. See Dover, R., Ferrett, B., Gravino, D., Jones, E., & Merler, S. (2015) *Bringing transparency, coordination and convergence to corporate tax policies in the European Union*, European Parliamentary Research Service, PE 558.773; Álvarez-Martínez, M., Barrios, S., d'Andria, D., Gesualdo, M., Nicodème, G., & Pycroft, J. (2018) *How Large is the Corporate Tax Base Erosion and Profit Shifting? A General Equilibrium Approach*, CEPR Discussion Papers 12637; and Tørsløv, T., Wier, L., & Zucman, G. (2018) *The Missing Profits of Nations*, NBER Working Paper 24701.

environmental taxes (~6%), property taxes (~5%) or corporate income taxes (~7%) contribute relatively little<sup>13</sup>. Although the overall composition of tax revenue in the EU has remained relatively stable over the last two decades<sup>14</sup>, megatrends such as climate change and the digital transformation of the labour market are likely to have an impact on the future tax mix in EU Member States.

Population ageing and an increase in non-standard work may reduce the ability of labour taxation to generate the same revenues as today. Building on the Green Paper on Ageing<sup>15</sup> and the 2021 Ageing Report<sup>16</sup>, this will require us to rethink how labour is taxed and the implications for other tax bases, taking into account the need for sustainable revenues and intergenerational fairness, and to contribute to the sustainability of social protection systems. The traditionally high labour tax burden within the EU, also as compared to other advanced economies, will have to be further reduced to support competitiveness, employment and job creation post-crisis<sup>17</sup>.

At the same time, consumption tax rates are already at a historic high, as VAT rates were increased in the years following the financial crisis. Priority should be given to limiting the inefficient use of reduced VAT rates and exemptions, which often fail to deliver on their presumed policy objective.

Behavioural taxes, such as environmental and health taxes, continue to be of growing importance for EU tax policies. Well-designed environmental taxes help to support the green transition by sending the right price signals, as well as implementing the polluter pays principle<sup>18</sup>. They also generate revenue that could compensate some of the needed labour tax cuts. Similarly, health taxes, for example on tobacco or alcohol, can improve public health and save lives, while reducing the pressure on public health systems.

Finally, a future-proof tax mix will require the fair and effective taxation of capital income, both from individuals and corporations. At the same time, simplification and other measures to reduce administrative complexity will be needed. In addition, recurrent taxes on immovable property can be a relatively efficient way of raising tax revenue. However, distributional and administrative challenges related to the valuation of property need to be properly addressed.

On the basis of these considerations, the Commission will launch a broader reflection, which should conclude in a Tax Symposium on the 'EU tax mix on the road to 2050' in 2022. This reflection will take into account the principles set out above, as well as the distributional impact of possible changes to the tax mix, including their effect on low-

<sup>13</sup> [https://ec.europa.eu/taxation\\_customs/business/economic-analysis-taxation/data-taxation\\_en](https://ec.europa.eu/taxation_customs/business/economic-analysis-taxation/data-taxation_en)

<sup>14</sup> European Commission, *Annual Review of Taxation – 2021 Edition*, forthcoming.

<sup>15</sup> COM(2021) 50 final, 27.1.2021.

<sup>16</sup> The 2021 Ageing Report. Economic & Budgetary Projections for the EU Member States (2019-2070). Institutional Paper 148. May 2021.

<sup>17</sup> Between 2012 and 2020, the average tax wedge in the EU-27 for a single person earning the average wage reduced by more than 2 percentage points.

<sup>18</sup> Art. 191(2) TFEU.

income households.

The principles outlined in this section should also apply to the system of own resources financing the EU budget. In line with the mandate from the European Council and the commitments taken in the inter-institutional agreement<sup>19</sup> accompanying the new multiannual financial framework, the Commission will also bring forward proposals for new Own Resources that will contribute to the repayments of the NextGenerationEU. After an initial set of proposals in July 2021, which will include proposals for a CBAM, a digital levy and a revision of the EU ETS, the Commission will propose additional new own resources, which could include a Financial Transaction Tax and an own resource linked to the corporate sector.

The CBAM proposal will form part of the forthcoming ‘Fit for 55 package’. It will aim to reduce the risk of carbon leakage by ensuring that the price of imports more accurately reflects their carbon content if third countries do not have similarly ambitious climate policies in place. It will also contribute to achieving climate objectives by incentivising third country producers and EU importers to adopt low carbon technologies. The CBAM will be fully compatible with WTO and other international obligations.

**Digital companies tend to pay less taxes than other companies and the taxes they pay do not always benefit the countries where their activities take place.** The digital levy will ensure a fair contribution of the digital sector to the financing of the recovery in EU and to society at large. It will be designed in such a way that it is independent of the forthcoming global agreement on international corporate tax reform and is compatible with WTO and other international obligations<sup>20</sup>. This levy will be compatible with the key policy objective of supporting and accelerating the digital transition. After its establishment, it will coexist with the implementation of an OECD agreement on sharing a fraction of the taxable base of the largest multinational enterprises, once the latter is ratified and transposed in EU law.

### 1.3 What does this mean for EU Business taxation?

Business taxation should ensure **the tax burden is fairly shared across businesses** and that **taxable revenue is fairly shared between different jurisdictions**. The **overall system should be simple**, in order to reduce compliance costs, and should facilitate investment and growth, thus reinforcing the Single Market. Despite progress in removing barriers to the Single Market in other areas, companies doing business in the EU still need to grapple with up to 27 different national tax systems. This patchwork of national tax rules creates unnecessary compliance costs **for businesses, which discourages cross-border investment in the Single Market**. This is the case both for larger businesses, but also for **SMEs, start-ups and other**

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<sup>19</sup> Interinstitutional Agreement between the European Parliament, the Council of the European Union and the European Commission on budgetary discipline, on cooperation in budgetary matters and on sound financial management, as well as on new own resources, including a roadmap towards the introduction of new own resources, OJ L 433I, 22.12.2020, p. 28–46.

<sup>20</sup> This proposal will differ from the 2018 proposals for a Digital Services Tax (COM(2018) 148 final) and for a Significant Digital Presence (COM(2018) 147 final), which will be withdrawn.

**businesses looking to grow, expand and trade cross-border**, for which the costs are proportionately greater<sup>21</sup>. It also leads to loopholes and complexities that can leave open opportunities for aggressive tax planning, hampering the level playing field. It hurts investment and growth, as well as the EU's competitiveness in comparison to other international partners. Policy choices in the area of business taxation also influence to what extent the tax system is supportive of investment. Finally, the tax system should minimise unintended distortions of business decisions, for example towards debt rather than equity financing, thus supporting sustainable and long-term corporate financing and the re-equitisation of companies that have accumulated a dangerously high level of debt, including as a result of the COVID-19 crisis.

In line with the principle of subsidiarity, EU action on business taxation should look at challenges with a clear cross-border dimension. This includes removing barriers to the smooth operation of the Single Market and to cross-border investment created by differences between national tax systems.

**Progress at EU level should be complemented by supporting national action** in areas where Member States may be best placed to judge the needs of their economy and society. This includes setting the level of the corporate income tax rate above the minimum levels to be agreed internationally (see section 2), which will remain a national competence in the EU, as well as domestic measures to improve tax administration and facilitate tax compliance. Where appropriate, it may include more targeted measures, such as well-designed and efficient tax incentives, to support wider policy goals. In these areas, the **EU can also have an agenda-shaping and information-sharing role, as well as providing financial support for national reforms and investment**. The Recovery and Resilience Facility (RRF), which lies at the heart of the EU's recovery agenda, and the Technical Support Instrument (TSI) can provide essential funding for the modernisation and digital transformation of tax administrations, while also supporting important tax policy reforms.

The EU has taken important steps forward in recent years, for instance, by adopting and starting to implement the Anti-tax Avoidance Directives (ATAD) and the Directive on Administrative Cooperation (DAC)<sup>22</sup>. Under the Code of Conduct Group on Business Taxation, Member States continue to peer review each others' tax regimes to ensure that they comply with the principles of fair tax competition. In addition, the European Parliament has been very active in the area of taxation in general, and business taxation in particular. Moreover, in July 2020 the Commission adopted **an ambitious Action Plan<sup>23</sup> to make taxation fairer, simpler and more adapted to modern technologies** and the Communication on Tax Good Governance in the EU and beyond,<sup>24</sup> which aims to further

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<sup>21</sup> Estimated tax compliance costs for large companies amount to about 2% of taxes paid, while for SMEs the estimate is about 30% of taxes paid.

[https://ec.europa.eu/taxation\\_customs/sites/taxation/files/resources/documents/tax\\_survey.pdf](https://ec.europa.eu/taxation_customs/sites/taxation/files/resources/documents/tax_survey.pdf)

<sup>22</sup> Council Directive 2011/16/EU of 15 February 2011 on administrative cooperation in the field of taxation, OJ L 64, 11.3.2011, p. 1.

<sup>23</sup> COM(2020) 312 final.

<sup>24</sup> COM(2020) 313 final.

strengthen the EU's **promotion of transparency and fair taxation both at European and global level.**

This Communication sets out further measures in the area of business taxation in both the short and longer term. The Commission will act swiftly to implement the forthcoming global agreement on the reallocation of taxing rights and minimum effective taxation (see section 2). It will also take action over the next two years to address the most immediate challenges (see section 3). Moreover, the Communication sets out a plan for a holistic EU business tax framework fit for the decades to come (see section 4).

## **2. Reform of the international corporate tax framework**

### **2.1 On-going global discussions**

Mandated by the G20, the OECD Inclusive Framework is working on a global consensus-based solution to reform the international corporate tax framework. The discussions focus on two broad work streams: Pillar 1 (partial re-allocation of taxing rights) and Pillar 2 (minimum effective taxation of multinationals' profits). The two pillars aim to address different but related issues linked to the increasing globalisation and digitalisation of the economy.

The EU has consistently promoted ambitious reforms at international level, and the global discussions can now also build on the positive engagement of the new US administration. The withdrawal of the previous “safe harbour” proposal<sup>25</sup> and the tabling of concrete and constructive proposals on Pillar 1 is an important step and offers a promising opportunity to make real progress towards a global agreement on sharing part of the taxable base of multinational enterprises (MNEs). The recent announcements of the US administration on their intentions for domestic corporate tax reform are an ambitious milestone and an important step towards an agreement on Pillar 2, which will put an end to the race to the bottom. G20 Finance Ministers have recently reaffirmed their commitment to reaching a global and consensus-based solution by mid-2021<sup>26</sup>.

Pillar 1 aims to adapt the international rules on the taxation of corporate profits to reflect the changing nature of business models, including the ability of companies to do business without a physical presence. It will give market jurisdictions a right to tax part of the profits of certain non-resident businesses by providing for a reallocation of a portion of these global profits among the jurisdictions where the group has customers or users, using an agreed formula. Pillar 1 discussions initially focused primarily on companies active in the digital sector. However, the proposed solution could now be simplified with a lower number of MNEs in

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<sup>25</sup> Which would have essentially made the application of Pillar 1 optional for businesses.

<sup>26</sup> <https://www.g20.org/wp-content/uploads/2021/04/Communique-Second-G20-Finance-Ministers-and-Central-Bank-Governors-Meeting-7-April-2021.pdf>.



scope and at the same time broadened to cover the largest and most profitable multinational companies, regardless of their business sector.

Pillar 2 will set a floor to excessive tax competition by ensuring that multinational businesses are subject to a certain minimum level of tax on all of their profits each year. The globalisation of economies and intensification of the use of intangible assets in global value chains have enabled certain multinational companies to shift profits to low-tax jurisdictions. Pillar 2 will enable jurisdictions to top up the amount of tax paid by large multinationals to a minimum effective level, while leaving individual countries free to decide on the features of their own tax systems. Such a minimum effective taxation of businesses profit will limit tax avoidance opportunities.

Both pillars of the future global agreement are in line with the Commission's vision for a business taxation framework for the 21st century, as outlined in Section 4. Their objectives are complementary and a solution on both is needed as part of the global discussions. They mark steps towards the important principles of formulary apportionment (through the use of a formula for the partial reallocation of taxing rights under Pillar 1) and a common definition of the tax base. The Commission is playing an active part in the international discussions, and is working with Member States to ensure that issues of common concern for the EU – such as Single Market compatibility and minimising administrative complexity – are taken into account, and that the solutions are beneficial to the EU. In its conclusions of 25 March 2021, the European Council also reiterated “its strong preference for and commitment to a global solution”, and stated that it would strive to reach a consensus-based solution by mid-2021 within the framework of the OECD<sup>27</sup>.

## 2.2 How the global agreement will be implemented 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**, including those that are not Members of the OECD and do not participate in the Inclusive Framework, 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 (see box 2 below).

### **Box 2: Interactions between an agreement on minimum effective taxation and existing EU initiatives**

Implementation of Pillar 2 will have implications for existing rules under the ATAD, and specifically for the Controlled Foreign Company (CFC) rules, which will interact with the

<sup>27</sup> <https://www.consilium.europa.eu/media/48976/250321-vtc-euco-statement-en.pdf> (europa.eu)

primary rule under Pillar 2 (the Income Inclusion Rule or ‘IIR’). When the IIR is implemented in the EU, it will be necessary to explore how to best accommodate the interaction between the two rules.

The transposition of Pillar 2 should pave the way for agreeing the **pending proposal for recasting the Interest and Royalties Directive (IRD)**<sup>28</sup>, which has been in the Council since 2011. The aim of the recast Directive was to make the benefits of the Directive (which eliminates withholding tax obstacles to cross-border interest and royalty payments within a group of companies) conditional on the interest being subject to tax in the destination state. Some Member States held the view that the IRD should go further and set a minimum level of tax in the destination state as a condition for benefiting from the absence of withholding tax. Agreement on Pillar 2 will resolve this issue.

As reflected in the recent Communication on Tax Good Governance in the EU and Beyond<sup>29</sup>, the Commission will propose to introduce Pillar 2 in the criteria used for assessing third countries in the EU listing process, so as to incentivise them to join the international agreement. This is in line with the EU’s existing approach to use the listing process to promote internationally agreed good practices.

### 3. Going beyond the OECD agreement – targeted solutions

This section sets out the EU’s business tax agenda for the next two years, with measures that improve the current system, focusing on the dual priorities of ensuring fair and effective taxation and promoting productive investment and entrepreneurship.

#### 3.1 Ensuring fair and effective taxation

A first step for a fairer tax system is a **greater public transparency on the taxes paid by large economic actors**. There is a growing demand from citizens and civil society organisations to ensure both more transparency and fairness regarding business taxation, in particular corporate income taxation.

The Commission will put forward a new proposal for the annual publication of the effective corporate tax rate of certain large companies with operations in the EU, using the methodology agreed for the Pillar 2 calculations. The effective corporate tax rate provides information regarding the proportion of corporate tax paid by companies relative to the amount of profits they generate rather than relative to their ‘taxable profits’, which can be reduced through various means such as tax allowances. Hence, the proposal will improve public transparency around the real effective tax rate experienced by large EU companies.

The EU will also further step up the **fight against the abusive use of shell companies** – i.e. companies with no or minimal substantial presence and real economic activity – through a

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<sup>28</sup> COM(2011) 714 final.

<sup>29</sup> COM(2020) 313 final.

new legislative initiative to neutralise the misuse of shell entities for tax purposes. While several actions at EU and international level provide instruments to tackle the use of abusive tax structures, legal entities with no or only minimal substance and economic activity continue to pose a risk of being used for improper purposes, such as aggressive tax planning, tax evasion or money laundering. While there can be valid reasons for the use of such entities, there is a need for further action to tackle entities and structures created for the main purpose of reducing the tax liability or disguising improper conduct of the group or operations they belong to, without substance and real economic activities in the countries where they are incorporated.

The Commission proposal would encompass actions such as requiring companies to report to the tax administration the necessary information to assess whether they have substantial presence and real economic activity, denying tax benefits linked to the existence or the use of abusive shell companies, and creating new tax information, monitoring and tax transparency requirements. The Commission also intends to take further steps to prevent royalty and interest payments leaving the EU from escaping taxation (so-called ‘double non-taxation’).

In parallel, the Commission will continue to use all tools at its disposal to ensure companies pay their fair share of tax, including the enforcement of State aid rules. While direct taxation falls within the competence of Member States, Member States must exercise that competence consistently with Union law, including State aid rules.

Actions to ensure fair and effective taxation:

*Action 1: Table a 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 (by 2022)*

*Action 2: Table a legislative proposal setting out union rules to neutralise the misuse of shell entities for tax purposes (by Q4 2021)*

### **3.2 Enabling productive investment and entrepreneurship**

Taxation has an important role to play in supporting businesses to invest and grow by encouraging and enabling economic decisions by entrepreneurs that are socially desirable. This ‘enabling’ side of tax policy is an especially important part of the twin transitions and the economic recovery from the COVID-19 pandemic.

Because of more limited cash flow, SMEs are often less able to absorb or finance losses than larger companies. This is why many Member States have acted quickly during the current crisis to relieve the immediate tax burden on SMEs, for example via deferral of tax obligations. However, the treatment of losses in Member States is still very different and there is scope to improve the environment for investment and growth. Alongside this Communication, the Commission is adopting a **recommendation to Member States on the domestic treatment of losses**. This will help to ensure fair competition between companies

and better support businesses during the recovery. This is likely to be of particular benefit for SMEs. The Commission services will also investigate more generally the prospect of a coordinated treatment of cross-border loss relief to address challenges experienced by SMEs and other businesses in the initial stages of their European expansion.

Given the current tax framework allowing for a tax deduction of interest on debt, there is a persisting pro-debt bias of tax rules. This means that a company can deduct interests attached to a debt financing but not the costs related to an equity financing, such as the payment of dividends, thus incentivising it to finance investments through debt rather than equity. This can contribute to an excessive accumulation of debts, with possible negative spill-over effects for the EU as a whole, should some countries face high waves of insolvency. The debt bias also penalises the financing of innovation through equity. This issue has become more pressing, as the stock of debts of companies has increased significantly due to the economic crisis following the COVID-19 pandemic. The Commission will therefore make a **proposal to address the debt-equity bias in corporate taxation, via an allowance system for equity financing**, thus contributing to the re-equitisation of financially vulnerable companies. The proposal will incorporate anti-abuse measures to ensure it is not used for unintended purposes.

#### Actions to enable productive investment and entrepreneurship

*Action 3: Adopt a recommendation on the domestic treatment of losses (alongside this Communication)*

*Action 4: Make a legislative proposal creating a Debt Equity Bias Reduction Allowance (DEBRA) (by Q1 2022)*

#### 4. Going beyond the OECD agreement - An EU Business taxation environment for the 21<sup>st</sup> Century

A consensus on the reform of international corporate tax rules will constitute a historic step forward towards the modernisation of global business tax rules. For good reasons, the global agreement on Pillar 1 will apply first only to a limited number of companies. For such a solution to work globally, it needs to be administrable for and between 139 jurisdictions, with diverse economic profiles and levels of administrative capacity. A closely integrated European Union with its Single Market, however, can and should go further.

The lack of a common corporate tax system in the Single Market acts as a drag on competitiveness. This is a result of distortions of investment and financing decisions (where these are driven by tax optimisation strategies rather than other considerations), and higher compliance costs for businesses active in more than one EU Member State. This creates a competitive disadvantage compared to third country markets.

The Commission will therefore propose a new framework for income taxation for businesses in Europe (Business in Europe: Framework for Income Taxation or BEFIT). BEFIT will be a single corporate tax rulebook for the EU, based on the key features of a common tax base and

the allocation of profits between Member States based on a formula (formulary apportionment). 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 ensure that businesses in the Single Market can operate without any undue tax barriers. At the same time, it will ensure that the existence of mismatches between corporate tax systems in the EU does not undermine the ability of Member States to raise revenue to fund national spending priorities.

Common rules for determining the corporate tax base will deliver substantial simplification for groups of companies operating in the Single Market. Instead of having to comply with up to 27 different sets of corporate tax rules, a group will be able to determine its tax liability in each EU Member State according to one single set of rules. This will also pave the way for even further administrative simplifications, such as the possibility of a single EU corporate tax return for a group.

This new proposal will replace the pending proposals for a Common Consolidated Corporate Tax Base (CCCTB)<sup>30</sup>, which will be withdrawn.

BEFIT will...

- ...create a common rulebook for groups of companies operating in the Single Market in more than one Member State, reducing barriers to cross-border investment;
- ...reduce red tape and cut compliance costs in the Single Market, thereby lessening the administrative burden on tax authorities and taxpayers;
- ...combat tax avoidance, and support job creation, growth, and investment;
- ...provide a simpler and fairer way to allocate taxing rights between Member States;
- ...ensure reliable and predictable corporate tax revenues for Member States.

BEFIT will consolidate the profits of the EU members of a multinational group into a single tax base, which will then be allocated to Member States using a formula, to be taxed at national corporate income tax rates. Key considerations will include how to give appropriate weight to sales by destination, to reflect the importance of the market where a multinational group does business, as well as how assets (including intangibles) and labour (personnel and salaries) should be reflected, to ensure a balanced distribution of corporate tax revenue across EU Member States with different economic profiles.

The use of a formula to allocate profits will remove the need for the application of complex transfer pricing rules within the EU for the companies within scope. Different types of

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<sup>30</sup> COM(2016) 685 final and COM(2016) 683 final.

formulary apportionment are already used in various countries. For example in the US, Canada and Switzerland, a formula is used to compute the tax base at regional or subnational level. By contrast, transfer pricing requires entities to price transactions between members of the same multinational group in the same way as a comparable transaction would be priced between two non-related entities ('Arm's Length Principle'). The OECD BEPS actions on Transfer Pricing updated the international guidelines but nonetheless these principles are difficult to apply and enforce in a modern economy relying on intangible and non-marketed assets. The work on Pillar 1 has demonstrated an interest in a different approach to the allocation of taxing rights through its use of a formula for the reallocation of a small part of the taxable base. BEFIT will build on this step, and take it further to create a simpler system within the Single Market. In contrast to Pillar 1, where the current rules and the reallocation of profit according to a formula would operate in parallel, under BEFIT, formulary apportionment would replace the current rules for the allocation of taxable base within the Single Market for the companies within scope.

Through a combination of formulary apportionment with a common rulebook for the tax base, BEFIT will mark important step in building a more robust business tax system in the Single Market. 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.

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.

Action for a longer-term business taxation framework

***Action 5: Table a proposal for BEFIT (Business in Europe: Framework for Income Taxation), moving towards a common tax rulebook and providing for fairer allocation of taxing rights between Member States (2023)***

## **5. Conclusion**

The forthcoming global agreement will mark a decisive step forward in the reform of the international corporate tax system, addressing important challenges related to the allocation of taxing rights and minimum effective taxation at global level. At EU level, we must build on this progress and take forward a similarly ambitious business taxation agenda that ensures fair and effective taxation and that supports productive investment and entrepreneurship. The measures announced in this Communication, together with work already underway, will take

the EU forward and fulfil this vision for an EU business tax framework that is fit to meet the challenges of the 21<sup>st</sup> century and geared towards a well-functioning Single Market.