Fit For Purpose or Overly Taxing?

The EU's Business Taxation Agenda for the 21st Century

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Abstract

This paper will explore three of the European Commission's central proposals within its business taxation agenda, namely: the proposal for a single corporate tax rulebook, the digital levy, and the country-by-country reporting Directive. It will also discuss how the Commission's business taxation proposals will aim to support its goals of generating own resources and achieving net zero emissions by 2050. Further, it will explore how the Commission's business taxation agenda, including its proposals within its *Business Taxation for the 21st Century* Communication, intersect with the broader negotiations on corporate tax reform taking place at the OECD.

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Introduction

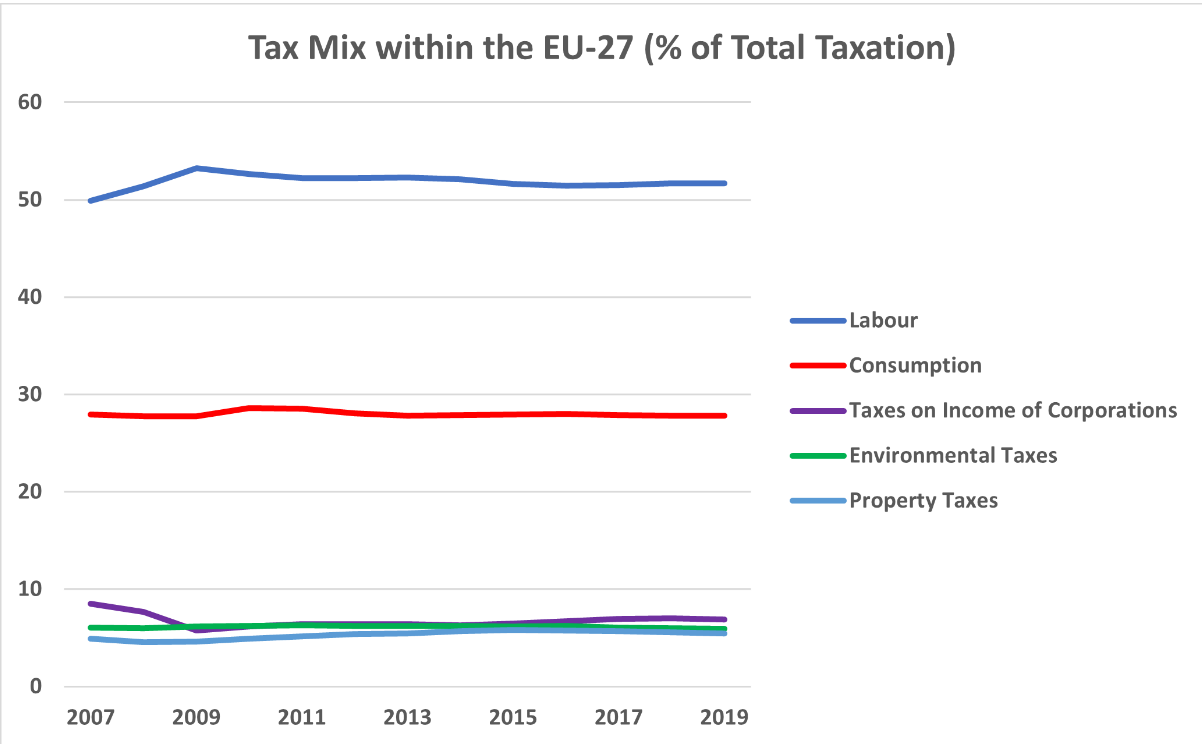
On Tuesday, 18 May 2021, the European Commission published a Communication entitled *Business Taxation for the 21st Century*.[1] The Communication outlines the Commission's updated agenda for corporate tax and includes a range of new proposals which "accompany" and "supplement" the broader international tax reform agenda taking place at the OECD and the G20.

On Thursday, 7 October 2021, Ireland made the decision to sign up to the OECD's international tax agreement, endorsed by 135 other countries, which will introduce a global minimum effective corporate tax rate of 15%. As part of this agreement, it is clear that significant changes to the manner in which tax will be treated at an international level could be on the horizon.

The Business Taxation for the 21st Century Communication outlines several new proposals including, most notably, a single corporate tax rulebook in the EU and mandatory disclosures of effective country-by-country corporate tax rates. It also proposes to implement conclusions that are reached within the OECD's parallel negotiations on international tax across every EU Member State through a series of Directives.

The European Commission has also embarked upon its own agenda within the sphere of taxation as a means of generating new own resources for the European Union.[2] This goal is particularly important as the EU will be obliged to repay over €385 billion in borrowings to fund its NextGenerationEU recovery package.[3]

The Commission rationalises its new suite of tax reform measures by arguing that the EU cannot continue to be as dependent on labour taxes, which form 50% of the overall tax mix in the EU27, to deliver revenues to fund public finances in the Member States. Figure 1 illustrates the tax mix in the EU27 expressed as a percentage of the overall tax take.



Source - European Commission[4]

1 https://ec.europa.eu/taxation_customs/system/files/2021-05/communication_on_business_taxation_for_the_21st_century.pdf
2 Own resources are the main sources of revenue to fund the EU's budgetary commitments. These include sources such as customs duties on imports to the EU, a percentage of Member States' VAT receipts, a percentage of Member State GNI, and since January 2021, a contribution from EU countries based on the quantity of non-recycled plastic packaging waste. https://eur-lex.europa.eu/summary/glossary/community_own_resources.html
3 https://ec.europa.eu/info/strategy/recovery-plan-europe_en
4 https://ec.europa.eu/taxation_customs/business/economic-analysis-taxation/data-taxation_en

The Commission contends that factors such as an ageing population, an increase in non-standard working arrangements, climate change and digitalisation of the labour market are likely to mean that revenues accrued from taxes on labour will no longer be as sustainable into the future. To address this, in conjunction with its proposals on business taxation, the Commission has committed to launching a symposium addressing the *EU tax mix on the road to 2050* in 2022.

BEFIT: A New Corporate Tax Rulebook for the EU

The Commission's latest Communication: *Business Taxation for the 21st Century*, contains a new proposal to establish a system of business taxation within the EU known as Business in Europe: Framework for Income Taxation (BEFIT). The Commission clarifies that BEFIT will replace its 2016 proposal for a Common Consolidated Corporate Tax Base (CCCTB), and it will seek to implement BEFIT by 2023.

In 2011, the European Commission unveiled its new proposal to establish a CCCTB within the EU. The CCCTB would have created a single system for determining companies' taxable profits within the EU and allowed companies to consolidate profits and losses across all EU Member States. Based on this single consolidated tax return, the tax base would have been apportioned to Member States in which the companies were active, using a formula which considered assets, labour, and sales. The CCCTB would have been optional and opt-in for companies doing business in the EU.[5]

After the CCCTB was published, nine Member States expressed the view that the CCCTB violated the principle of subsidiarity within the EU, meaning that the benefits of enacting the legislation at EU level did not outweigh the benefits of doing so at the national level.[6] As an agreement could not be reached, the Commission tabled an updated CCCTB proposal in 2016. The subsequent 2016 CCCTB would have been mandatory for companies with revenues exceeding €750 million per annum and proposed alternative measures to the 2011 proposal to address double taxation disputes within the EU.[7] Once again, Member States have, to date, failed to reach an agreement on the 2016 CCCTB proposal, as momentum for global corporate tax reform slowed. At the time, the Irish Government reiterated that issues related to reform of international tax should be dealt within the OECD/G20 Base Erosion and Profit Shifting (BEPS) Project where such a workstream was already underway and where an international consensus could be reached.

BEFIT would develop upon the current discussions taking place at the OECD and the G20, which seek to establish new international rules to determine the reallocation of a taxable base (Pillar One) and the imposition of a global minimum effective rate of corporate tax (Pillar Two). In a similar manner to Pillar One of the OECD/G20 negotiations, BEFIT would develop a mechanism to allow for formulary apportionment of taxable profits between Member States.

Unlike Pillar One, however, instead of apportioning a percentage of the total taxable base and retaining existing rules for calculating the taxable base at the national level, BEFIT would instead replace existing national rules with formulary apportionment of the taxable base between Member States. The Commission argues that such a system will reduce the administrative burden for companies operating across the EU of having to comply with the rules of 27 different tax jurisdictions.

On the surface, it may be felt that BEFIT represents a revised form of the CCCTB proposal, rebranded and repackaged in light of the fact that political agreement could not be reached on the CCCTB. The Commission, perhaps pre-emptively anticipating this criticism, says that the proposal will reflect the changes in the economy and institutional framework since the CCCTB was originally proposed, including the ongoing negotiations at the OECD, and will better account for digitalisation in the economy

5 https://ec.europa.eu/commission/presscorner/detail/en/IP_11_319
6 https://www.taxpolicy.gov.ie/wp-content/uploads/2012/11/Common-Consolidated-Corporate-Tax-Base-CCCTB-An-Update.pdf
7 https://ec.europa.eu/commission/presscorner/detail/en/IP_16_3471

through a different apportionment formula.

However, national rules to determine both taxable bases and rates of tax are utilised by smaller Member States, such as Ireland, as a means of attracting investment and remaining competitive within the global economy. While it is true that within a single corporate tax rulebook, companies would face fewer administrative and compliance costs within the EU as a whole and it would allow the tax system to account for digitalisation within the economy, this must be balanced against the potential economic impact on smaller Member States of further reallocating the tax base beyond the scope of the OECD's draft agreement. This would most likely deliver increased corporate tax receipts to larger Member States such as France and Germany.

In summary, BEFIT seeks to create a single rulebook to govern the calculation of the tax base and the allocation of taxable profits across Member States. As was the case with the CCCTB, if implemented, it would represent a monumental shift in the longstanding principle of tax sovereignty within the EU, and as such, is likely to be met with considerable resistance from the Irish Government and other EU Member States.[8]

Implementing the OECD Agreement within the EU

On Friday, 8 October 2021, the OECD released an updated statement which announced that six more countries, including Ireland, Hungary and Estonia, the remaining EU countries who had yet to endorse the OECD's statement from Thursday, 1 July 2021, had agreed to sign up to the OECD process.

Business Taxation for the 21st Century proposes to implement this agreement reached at the OECD across the EU through a series of Directives. Pillar One and Pillar Two will both be implemented through separate EU Directives, while the Directive on Pillar Two will "reflect the OECD Model Rules with the necessary adjustments."

When the Irish Government refused to sign up to the OECD agreement in July 2021, its primary reservation regarding the agreement was the implementation of a global minimum effective rate of "at least 15%". The Department of Finance said on Thursday, 1 July 2021, that Ireland fully supports the proposals on Pillar One "in recognition that the way in which business is conducted has evolved and that the taxation system must evolve with it" but "noting [its] reservation" regarding the global minimum effective rate of at least 15%, it was not in a position to sign the agreement at this stage.[9] Speaking at an IIEA webinar on Tuesday, 21 September 2021, Minister for Public Expenditure and Reform, Michael McGrath stated that Ireland continued to have "significant concerns about the minimum effective global rate of corporate tax" as part of Pillar Two and that Ireland needed "absolute certainty about what we're being asked to sign up to".[10]

Before signing up to the OECD agreement on Friday, 8 October 2021, the Irish Government sought and received assurances from the European Commission that it would not seek to implement a global minimum effective rate of corporate tax above the agreed 15% rate within its Directive, and that the Government would be able to maintain its Research and Development tax credits. Regarding this, Minister of State for European Affairs, Thomas Byrne stated: "We still don't know all the detail of the EU Directive . . . they have given some assurances to the Government." [11]

There are concerns in some Member States about the legality of the tax agreement. Hungary and Estonia have previously expressed reservations that the implementation of the OECD tax agreement within the EU is incompatible with EU law, as a global minimum effective rate would contravene a 2006 decision by the European Court of Justice (ECJ), which stated that locating

8 https://www.irishtimes.com/business/economy/state-likely-to-oppose-eu-plan-for-unified-tax-code-1.4568577
9 https://www.gov.ie/en/press-release/7815e-ireland-broadly-supports-oecd-inclusive-framework-agreement-on-key-aspects-of-new-international-tax-rules-with-reservation-donohoe/
10 https://www.youtube.com/watch?v=GuK-MkvgzrM
11 https://www.rte.ie/news/2021/1008/1252439-corporate-tax-reform/

subsidiaries of companies in jurisdictions with lower tax rates does not constitute tax avoidance. According to the Financial Times, the Commission is confident that the application of Pillar Two across the EU law would not constitute a breach of EU law.[12]

The Commission will view it as being in the interest of the EU as a whole to ensure the uniform implementation of any OECD agreement across the EU, in order to ensure a level playing field on corporate taxation between Member States. The issues highlighted above illustrate that a seamless transition from the agreement at OECD level to the subsequent implementation of this agreement across the EU is far from a foregone conclusion.

Digital Levy Proposal

In July 2021, the European Commission was due to unveil a proposal for a digital levy. It was intended that this levy would be a tax which would apply to companies offering digital services within the EU and would be used as an EU own resource to fund the NextGenerationEU recovery fund. The new proposal was considered after a proposal by the Commission in 2018 to introduce a similar tax on digital services failed to secure agreement at the European Council.[13]

However, the EU agreed to postpone its digital levy proposal following tensions that arose between the United States and the European Commission during the course of the negotiations on international tax at the OECD. Differences arose between the US and the EU as the US Government felt that the introduction of a digital levy ran counter to its insistence that that all digital taxes be suspended as part of any agreement at the OECD. United States Secretary of the Treasury, Janet Yellen said, when speaking about the digital levy, that EU Member States had "agreed to avoid putting in place in the future and to dismantle taxes that are discriminatory against US firms".[14]

Speaking on Friday, 2 July 2021, European Commission Executive Vice-President, Margrethe Vestager, presented a counter-argument stating that the digital levy differs to what is being proposed at the OECD. While Pillar One of the OECD Inclusive Framework will only apply to companies with global revenues exceeding €20 billion and profitability above 10%, many of which are US multinationals, Executive Vice-President Vestager said that the digital levy will apply to hundreds of companies, most of which would be European. She was also keen to stress that "as a matter of principle, it is a levy, it is not a tax."[15]

European Budget Commissioner Johannes Hahn has stated that regardless of whether an agreement was secured at the OECD, the Commission would put forward an updated proposal for a digital levy in October 2021.[16]

At this stage, however, little detail is known regarding what exact form any proposed digital levy would take. POLITICO reported on Thursday, 8 July 2021, that the digital levy would take the form of a 0.3% tax on the sale of online goods and services by companies doing business in the EU with an annual turnover greater than €50 million.[17] However, given the proposals have not to date been published, it is unclear whether this figure is accurate or whether the proposal may be revised to account for the outcome of the OECD negotiations.

Moreover, should the OECD process fail to be implemented, if, for example, the Biden Administration fails to obtain Congressional approval for the requisite legislation which would increase its global minimum rate of tax, the European Commission will be keen to ensure that companies with large digital sales operating in the Union are adequately taxed on their activities. Such a principle, they argue, is in line with the Commission's goals to ensure fair and adequate tax treatment of the digital economy and to diversify its tax mix in the decades ahead.

12 https://www.ft.com/content/e51c4a7b-a64d-40e5-b45c-e53ebdf284fe
13 https://www.consilium.europa.eu/en/meetings/ecofin/2019/03/12/
14 https://www.euractiv.com/section/economy-jobs/news/eu-puts-its-digital-tax-on-hold-after-us-pressure/
15 https://www.reuters.com/business/exclusive-eus-planned-digital-levy-cover-hundreds-firms-vestager-says-2021-07-02/
16 https://www.theparliamentmagazine.eu/news/article/hahn-vs-budg-on-the-eus-own-resources
17 https://www.politico.eu/article/brussels-pushes-on-with-eu-digital-levy-despite-us-resistance/

Nonetheless, the language used by the OECD in their latest statement from Friday, 8 October 2021 would suggest that the EU's digital levy may prove to be incompatible with the spirit of the agreement as it currently stands. The Statement outlines that the Multilateral Convention, which will translate the agreement into international law, "will require all parties to remove all Digital Services Taxes and other relevant similar measures with respect to all companies, and to commit not to introduce such measures in the future".[18] This would suggest that the Commission is likely to once again encounter significant pushback, particularly from the United States, should it decide to relaunch its digital levy proposal in Autumn 2021.

Corporate Tax Transparency

The success, to date, of the negotiations at the OECD and the G20 has provided a new impetus to previously unsuccessful negotiations on tax transparency for large multinationals.

In April 2016, the European Commission first proposed a Directive to introduce public disclosure of corporate tax information of multinationals operating within the EU on a country-by-country basis. The purpose of the proposed Directive was to ensure that accurate information regarding both the amount of taxes paid and the jurisdictions in which the revenues were collected in was publicly available. This type of public disclosure would ensure that companies engaged in aggressive tax planning could not privately continue with the practice of shifting profits across jurisdictions for tax purposes, known as base erosion and profit shifting (BEPS).[19]

After five years of failing to reach an agreement, negotiators from the European Parliament and the European Council announced on Tuesday, 1 June 2021 that they had reached a deal which would require companies earning over €750 million and doing business in more than one EU Member State to publish the amount of taxes paid in each Member State. Specifically, companies will be required to publish the nature of their activities, the number of their full-time employees, their profit or loss level before tax, the amount of their accumulated and paid income tax and their accumulated earnings.

The text of the agreement must be endorsed by both the European Council and the European Parliament. On Tuesday, 28 September 2021, the European Council adopted its position at first reading of the country-by-country reporting Directive, and it will now travel to the European Parliament where a decision will be made on whether to adopt the Directive within the next three months.[20]

Carbon Border Adjustment Mechanism (CBAM)

As part of the EU's Fit for 55 package, which aims to reduce CO_2 emissions by 55% when compared to 1990 levels by 2030, the Commission unveiled its much-anticipated proposal for a carbon border adjustment mechanism (CBAM).

The CBAM is intended to operate as a means to incentivise exporters into the EU to reduce their carbon footprint, by applying a carbon price to imports that is proportionate to the EU's carbon pricing rules. Exporters to the EU will purchase a carbon certificate which will contain information regarding the carbon price that would have been paid had the goods been produced under the EU's carbon pricing rules. If the producer can exhibit that they have already paid a carbon price in a third country for the goods produced, this value can be deducted from the final carbon border adjustment price paid by exporters to the EU.

If introduced, the CBAM will be implemented on a phased basis. From 2023 to 2025, there will be a transition phase, whereby firms importing cement, iron and steel, aluminium, fertilisers

18 https://www.oecd.org/tax/beps/statement-on-a-two-pillar-solution-to-address-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-october-2021.pdf
19 https://ec.europa.eu/commission/presscorner/detail/en/IP_16_1349
20 https://www.consilium.europa.eu/en/press/press-releases/2021/09/28/public-country-by-country-reporting-council-paves-the-way-for-greater-corporate-transparency-for-big-multinationals/

and electricity will be required to report on any direct emissions occurring during the production process of their products but will not be required to pay an adjustment. From 2026 onwards, the adjustment mechanism would begin, and the EU will consider whether to expand the scope of the CBAM to a greater number of goods and services. It will also consider whether to cover indirect emissions – such as emissions which arise from the electricity used during the production process.[21]

Should an agreement be reached on implementing the CBAM, the EU will face a considerable challenge to ensure that the CBAM does not, in any manner, contradict the WTO rules which prohibit differential treatment of EU and non-EU trading partners.

According to a briefing note prepared by Craig Emerson, former Minister for Trade and Competitiveness of Australia, and Stefano Moritsch, an Associate Director at KPMG Australia, the design of a CBAM must meet four key criteria to be compliant with WTO rules:

- It must not favour domestic production over imports.
- It must not discriminate against an individual trading partner.
- It must allow exporters to calculate their own carbon intensities.
- It must not impose unduly high compliance costs on exporters.

The paper by Emerson and Moritsch highlights that if the EU were to place a fixed tariff on non-EU imports, given the variable emissions trading system (ETS) price, this would lead to a situation where the ETS price could vary from the CBAM price, which would be in breach of WTO rules. The Commission has therefore stated that the CBAM price will be linked to the prevailing ETS price within the EU.

The EU is not permitted to discriminate against exporters from countries which it perceives to have a lower ambition for emissions reduction and must instead base its CBAM price on actual emissions intensity. The Commission has stated it will apply the CBAM to all non-EU countries who do not participate in the ETS or have a cap-and-trade scheme linked to the EU's. Similarly, it will also allow importers to receive emissions calculations directly from non-EU producers, to satisfy the requirement to allow exporters to declare their own carbon intensities.

The fourth requirement, concerning compliance costs of non-EU producers, will require the EU not to impose onerous compliance criteria, such as factory inspections or other unrealistic burdens of proof, in pursuit of the fair application of the CBAM across all non-EU producers.[22]

The EU's CBAM proposal has already generated considerable concern within the international community, with countries such as China, Brazil, South Africa and India expressing reservations regarding plans to introduce the carbon border tax.[23] On Monday, 26 July 2021, a spokesperson for the Chinese Government said it was China's view that the EU's proposal for a CBAM "violates WTO principles . . . and (will) seriously undermine mutual trust in the global community and the prospects for economic growth."[24]

Given the concerns which exist within the EU itself, where the proposal must secure approval, and its influential industries such as the steel and cement industries, the Commission will have to endeavour to ensure a negotiating outcome that counterbalances the spirit of its current proposals with the appropriate compatibility with WTO rules. Anything short of this would result in the failure of CBAM and a serious setback to the von der Leyen Commission's European Green Deal ambitions.

21 https://ec.europa.eu/commission/presscorner/detail/en/qanda_21_3661
22 https://assets.kpmg/content/dam/kpmg/xx/pdf/2021/03/making-carbon-border-adjustment-proposals-wto-compliance.pdf
23 https://www.gov.za/nr/speeches/joint-statement-issued-conclusion-30th-basic-ministerial-meeting-climate-change-hosted
24 https://www.euractiv.com/section/energy-environment/news/eus-planned-carbon-border-levy-violates-trade-principles-says-china/

Conclusion

Given the almost €800 billion funds of stimulus that the EU will provide under NextGenerationEU between now and 2026, the EU will be required to generate an increased amount of own resources to fund its support for Member States' economies. Though the repayments on the Commission's common debt borrowings have maturities which extend far into the future, in many cases almost 40 years from now, the Commission will likely come under increasing scrutiny to reconcile how it intends to fund its large recovery package and meet its outstanding debt obligations.

However, the reaction within certain Member States to proposals such as BEFIT and the CBAM has already demonstrated that significant divisions exist within the EU regarding the scale and design of the Commission's existing proposals to generate own resources.

A significant component of the EU's taxation agenda will include a suite of business taxation proposals which, if accepted, would require Ireland to further expand the degree to which it taxes its multinationals beyond the scope of the OECD agreement. While it may not be in Ireland's national interest to accept proposals such as the BEFIT proposal on corporate taxation, opportunities exist to continue to engage with the Commission regarding other options to diversify the tax mix within the EU and shift the taxation burden away from the EU's labour force. The EU's fiscal policy would be fairer and more sustainable as a result.

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