

Proposed New Framework for Business Taxation in the European Union

On 18 May 2021, the European Commission adopted a [Communication on Business Taxation](#)¹ for the 21st century which takes account of the G20 / OECD discussions on global tax reform and sets out both a short term and a long term vision to support the EU's recovery from the COVID-19 pandemic. There are three key strands to this Communication:

Business in Europe: Framework for Income Taxation ("BEFIT")

Firstly, by 2023, the Commission will present a new framework for business taxation in the EU. The BEFIT aims to:

- (a) Provide a single corporate tax rulebook for the EU;
- (b) Distribute a fairer allocation of taxing rights between EU Member States;
- (c) Reduce compliance costs;
- (d) Minimise tax avoidance opportunities; and
- (e) Support investment in the EU Single Market.

BEFIT will replace the long pending but never agreed EU proposal for a Common Consolidated Corporate Tax Base (CCCTB) across the EU. It will be based on the key features of a common tax base and the allocation of profits between EU Member States based on a formula (formulary apportionment).

The Commission notes that *"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".

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.

Tax Agenda

Secondly, the Communication also defines a tax agenda for the next two years, with measures that promote productive investment and entrepreneurship, better safeguard national revenues, and support the green and digital transitions. This builds on the July 2020 EU Tax Action Plan. Measures will include:

- (a) Ensuring greater public transparency by proposing that certain large companies operating in the EU publish their effective tax rates based on the methodology under discussion in Pillar 2 (minimum effective taxation of multinationals' profits) of the OECD Inclusive Framework negotiations. The planned publication of this legislative proposal is by 2022.

¹ [Future-proof taxation – Commission proposes new, ambitious business tax agenda](#)

- (b) The use of so called 'shell companies' will also be tackled through new anti-tax avoidance measures (see more below).
- (c) Supporting the recovery by addressing the debt-equity bias in the current corporate taxation, which treats debt financing of companies more favourably than equity financing. A legislative proposal creating a Debt Equity Bias Reduction Allowance ("DEBRA") is to be introduced by Q1 2022.

Domestic Treatment of Losses

Thirdly, the Commission has adopted a non-binding Recommendation on the domestic treatment of losses. It encourages EU Member States to allow loss carry back for businesses to at least the previous fiscal year due to the pandemic. This will benefit businesses that were profitable in the years before COVID-19, allowing them to offset their 2020 and 2021 losses against the taxes they paid before 2020. EU Member States are asked to inform the Commission about the measures it implements based on this recommendation.

'Shell Companies' and Substance Roadmap

Following on from the above, on 20 May 2021 the Commission adopted an [inception impact assessment roadmap](#)² for an EU Council Directive to fight business tax avoidance arising from the use of so called 'shell companies' and arrangements for tax purposes.

The Commission states that although the EU has taken several actions to address abusive tax arrangements, the use of shell companies (entities with little or no economic substance, in cross-border arrangements for purposes of avoiding taxes) continues to be an issue.

The Commission noted that there are existing measures addressing the substance of legal entities in the context of certain preferential tax

regimes, however there are no legislative measures defining substance requirements for tax purposes within the EU. This roadmap aims to provide an EU legislative measure which defines substance requirements for tax purposes to be met by entities within the EU. This will focus on situations where the ultimate objective is to minimise the overall tax of a group or structure.

Under the roadmap, several policy options will be analysed for the purpose of designing the legislative proposal, including:

- (a) Current national anti-tax avoidance legislation and practice providing for anti-tax avoidance rules, including those deriving from the transposition of existing EU rules (e.g. the EU Anti-Tax Avoidance Directive ("ATAD")).
- (b) The extent to which existing or new 'soft law' instruments could achieve the planned objectives.
- (c) A possible new legislative initiative, which would define tax related substance requirements and 'real economic activity' indicators for tax purposes.
- (d) Options for enhanced cooperation, monitoring and enforcement of the new rules.

The roadmap acknowledges the potential risk that multinationals would relocate shell companies to non-EU 'third countries', but states that this negative impact would be offset by the benefits of a standardised common assessment of substance for tax purposes.

This roadmap is open for feedback until 17 June 2021. It will support the preparation and inform the Commission's decision of this proposal. A public consultation will be launched in June 2021. The Commission is planning to adopt a Directive in last quarter of 2021.

² Tax avoidance – fighting the use of shell entities and arrangements for tax purposes

In addition to the corporate tax reforms set out in the Communication, the Commission is to publish measures to ensure fair taxation in the digital economy shortly.

Our Comments on the Communication

This is a detailed and far reaching set of proposals from the European Commission which would affect businesses based in and investing into the EU. It comes on top of already significant new EU tax measures such as the ATAD which have been or are currently being implemented across the EU. It will be important that proposed measures in this initiative such as the DEBRA are carefully considered by all stakeholders as it is similar to and would come in alongside the new EU 'interest limitation' rules which are, and will continue to be, a very significant and complex tax change for companies doing business in the EU.

The initiative as regards companies which do not have 'substance' will also need to be carefully considered to ensure that this is consistent with existing EU law, such as the 'freedom of establishment' and 'free movement of capital' and European Court of Justice case such as the Cadbury Schweppes case ([Case C-196/04³](#)), and also evolving OECD and international tax principles such as the business 'principal purpose test'. It should recognise the legitimate use of holding companies in international groups and that certain sectors, such as securitisation companies set up across the EU, will outsource their business requirements to investment managers and service providers rather than employ staff.

We will be part of industry groups involved in the public consultations on the Communication and please let us know if we can discuss any matters in that regard.

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³ [Case C-196/04 - Cadbury Schweppes plc and Cadbury Schweppes Overseas Ltd v Commissioners of Inland Revenue](#)