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EU Commission's initiatives in Direct Tax matters: State of play

OUR INSIGHTS AT A GLANCE

- Ongoing direct tax initiatives of the European Commission have not really evolved over the past 4 months and why we see more and more EU national Parliaments taking a very critical stand on the reforms proposed by the European Commission.
- On 1 January 2024, Belgium took over the Presidency of the Council of the EU for the next six months. Belgium defined the adoption of the Faster and Safer Relief of Excess Withholding Taxes directive proposal, called "**FASTER**", as a top priority and the chances of having this directive proposal formally adopted are rather high.
- The proposal laying down rules to prevent the misuse of shell entities for tax purposes, called "**Unshell**", is still ongoing 2.5 years after its release and there is still a big question mark on its chances to succeed. The related initiative on "enablers" of tax evasion and aggressive tax planning, called "**SAFE**", is on hold as it cannot be launched as long as the future of the Unshell project remains uncertain.
- The examination of the Debt-Equity Bias Reduction Allowance directive proposal, called "**DEBRA**" is also still on hold, and it is expected that this situation will remain unchanged in the coming months.
- Finally, the 3 most recent directive proposals - (1) called "**BEFIT**", (2) the Head Office Tax System for SMEs and (3) on transfer pricing - are only at the very early stage of the legislative procedure. However, the EU Council has been working actively on the transfer pricing proposal so far, illustrating its willingness to have this project move forward quickly.
- We provide hereafter an overview of the state of play of the most recent European direct tax initiatives of the European Commission.

Over the few past months, with a rhythm never seen before, a series of significant tax directive proposals were adopted by the European Commission in the name of the transparency, the fight against tax fraud and tax evasion and "fair" taxation but also, more recently with the purported aim to simplify and harmonise the corporate tax systems and reduce compliance costs.

Many of the ongoing direct tax initiatives of the European Commission have however not evolved over the past months and we see more and more national Parliaments taking a very critical stand on the reforms proposed by the European Commission. Various European Member States seem not eager to have additional tax changes adopted quickly and introduced in the short term anymore because a sheer amount of tax reforms, whose effects cannot all be evaluated yet, are still in their implementation phase. The adoption of additional new rules would create an even more challenging context of constantly evolving tax rules, especially in the current economical context.

Nevertheless, the adoption of the Faster and Safer Relief of Excess Withholding Taxes directive proposal was set as a top priority by the EU institutions and the chances of having this directive proposal formally adopted are rather high. Indeed, the Council reached an agreement (general approach) on new rules for withholding tax procedures.

In this article, we provide an overview of the state of play of the most recent European direct tax initiatives of the European Commission, from the ones that are the most likely to be adopted in the short term to the ones that have, currently, the least chances to succeed in the near future.

The FASTER Proposal

On 19 June 2023, the European Commission published the proposal for a Council Directive on Faster and Safer Relief of Excess Withholding Taxes, the "**FASTER Proposal**". With this new initiative, the Commission aims to tackle the current particularly burdensome withholding tax ("**WHT**")

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refund procedures - which differ between Member States - for cross-border investors in the EU and, at the same time, the risks of tax abuse related to refund procedures revealed notably by the Cum/Ex and Cum/Cum scandals. For a presentation of the FASTER Proposal, please read our ATOZ Alert of 21 June 2023 "European Commission releases FASTER Directive Proposal".

In the same way as the Spanish Presidency did since the release of the FASTER Proposal, the Belgian Presidency of the EU Council, which started on 1 January 2024, has been giving this legislative proposal a high level of priority and the EU Council has been very active on discussing and analysing the FASTER Proposal during the first part of 2024.

On 14 May 2024, the European and Financial Affairs Council (ECOFIN) met to discussed about the FASTER directive proposal through a compromise text which presents substantial differences compared to the original text of the proposal published in June 2023. The Council reached an agreement (general approach) on this compromise text providing for new rules for withholding tax procedures.

The compromise text of the FASTER Proposal, compared to the suggestion made by the Spanish Presidency, extends notably the scope of jurisdictions which could be exempted from applying the WHT relief procedures under FASTER to avoid additional administrative burden on them without any real added value (given their already well-functioning system): only small stock markets with comprehensive withholding tax relief-at-source systems could be exempt from the related provisions of the FASTER Proposal.

Under the Belgian compromise text, EU Member States with comprehensive relief-at-source systems that have, during four preceding consecutive years, a market capitalisation ratio equal to or more than 1,5% (instead of 1% under the suggestion made by the Spanish Presidency) shall irrevocably apply the WHT relief procedures of the FASTER Proposal. The Presidency defined market capitalisation ratio as "*the ratio expressed as a percentage of the market capitalisation of a Member State on [31 December] to the overall market capitalisation of the European Union*" on the same day. The compromise text says that countries without a comprehensive relief-at-source system would also be required to apply the WHT relief procedures regardless of whether their market capitalisation is below, equal to, or above the 1,5% threshold.

On Wednesday 28 February, the European Parliament adopted its non-binding opinion on the initial FASTER Proposal. While supportive of the FASTER Proposal, the European Parliament suggests some amendments and clarifications. It notably recommends to identify the beneficial owner of the dividend/interest income by applying the rules of the source Member State or those of the applicable tax treaty, to continue the fight against illegal WHT reclaim procedures by introducing cooperation and mutual assistance on the exchange of information amongst the relevant parties (e.g. tax authorities, law enforcement bodies), and examine possible measures to facilitate self-processed WHT claims for small investors (without the intermediation of certified financial intermediaries). However, due to the changes the Council made in the FASTER Proposal during the negotiations, the European Parliament will be consulted again on the compromise text agreed upon on 14 May 2024 by the Council.

Following this re-consultation with the European Parliament, the FASTER Proposal will need to be formally adopted by the Council (unanimity required) before being published in the EU's Official Journal and entering into force. In this respect, the Council is currently expected to adopt the FASTER Proposal in early 2025.

Member States will then have to transpose the directive into national legislation by 31 December 2028, but the national rules will, in principle, become applicable only as from 1 January 2030.

For more information about the compromise text agreed upon by the EU Council, please read our ATOZ Alert of 21 May 2024 "The Council reached an agreement (general approach) on new rules for withholding tax procedures (FASTER)"

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The Unshell Proposal

On 22 December 2021, the European Commission submitted a proposal for a Council Directive laying down rules to prevent the misuse of shell entities for tax purposes and amending Directive 2011/16/EU, the "**Unshell Proposal**".

The objective of the Unshell Proposal is to prevent tax avoidance and evasion through actions by undertakings without minimal substance. The Unshell Proposal aims to fight against the misuse of shell entities for improper tax purposes and to ensure that shell companies in the European Union that have no or minimal economic activity are unable to benefit from certain tax advantages (for a presentation of the Unshell Proposal, please read the article "The new Directive proposal to fight against the misuse of shell entities" in our April 2023 ATOZ Insights).

By the end of 2023, European Member States had not managed to reach an agreement on various technical aspects of the directive proposal. When taking over the Presidency, Belgium expressed its support to an adoption of the Unshell Proposal. However, since the priority was finally given to other files, for the first time since the release of the Unshell Proposal by the European Commission, the proposal is currently stalled at the Council as it was not discussed, at least officially in a dedicated forum such as a meeting of Working party on Tax Questions, during the first five months of this year.

On 22 January 2024, MEPs of the ECON Committee held an Economic Dialogue and exchange of views with Vincent Van Peteghem, President of the ECOFIN during the Belgian Presidency. MEP Paul Tang notably questioned a possible adoption of the Unshell Proposal. Although the Belgian Presidency has made the fight against tax evasion and avoidance a priority, the President of the ECOFIN noted that the adoption of this proposal requires unanimity at the Council and some Member States have expressed concerns about the excessive administrative burden for tax administrations and businesses it involves. According to the current President of the ECOFIN, this issue is, therefore, under analysis by the Presidency, before embarking on further work.

Thus, the uncertainty related to this initiative has even increased since our last state of play as Member States do not seem to find any solution in order to come to an agreement on this file and have no longer been working on this file since the beginning of the year.

The European Commission is nevertheless determined to find an agreement on a directive proposal setting up a minimum substance requirement for European companies. This would be key for the Commission as one of the criteria used for the assessment of foreign jurisdictions for purpose of the bi-annual EU list of non-cooperative third countries relies on the implementation of substance requirements by zero-tax countries. Yet how can the European Commission impose substance requirements to third countries when it does not have propre substance requirements for its own entities? The adoption of the Unshell Proposal, whatever its final form, seems thus to be a matter of credibility. This argument disregard however that European Member States have to respect the propre substance requirements under anti-abuse rules and the concept of artificial arrangement established by the European Court of Justice.

The BEFIT Package

On 12 September 2023, the European Commission adopted package of initiatives including:

- The Business in Europe: Framework for Taxation (BEFIT) proposal with the aim to introduce a common set of rules for European companies to calculate their taxable base while ensuring a more effective allocation of profits between European countries, based on a formula ("**BEFIT Proposal**").
- a directive proposal establishing a Head Office Tax ("**HOT**") System for small and medium-sized enterprises ("**SMEs**"), which aims to encourage cross-border expansion of SMEs by simplifying the tax rules which they are subject to when they operate through permanent establishments ("**PE**") as well as reduce the related tax compliance burden and costs ("**HOT Proposal**").
- a directive proposal on transfer pricing which aims at integrating key transfer pricing principles into EU

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law with the objective of putting forward common approaches for Member States (the "**TP Proposal**").

To find out more about the BEFIT Proposal and the HOT Proposal, please refer to our article "*EU Commission Releases Proposal for a Council Directive on BEFIT: A Critical Analysis*" in the December 2023 ATOZ Insights. For a presentation of the key aspects of the TP Proposal, please refer to our ATOZ News of 25 September 2023.

- **The BEFIT Proposal**

Because BEFIT replaces the European Commission's proposal for a common corporate tax base ("**CCTB**") and the proposal for a common consolidated corporate tax base ("**CCCTB**") that have never reached consensus, it was expected that the BEFIT Proposal would be subject to a lot of criticism.

The expected criticism is confirmed by the numerous reactions of the EU national parliaments. Nine national Parliaments (Sweden, Ireland, Poland, Germany, Malta, the Czech Republic, Italy, Finland, and the Netherlands) provided their comments on the BEFIT Proposal, either by means of a reasoned opinion or by means of a statement. Reasoned opinions enable national parliaments to notify the European Commission of their belief that a proposal violates the subsidiarity principle. While many national parliaments are positive on the ambition to simplify administration for cross-border companies within the EU, they mainly consider that:

- It is not clear that the objective of simplification will be met with BEFIT (e.g. Sweden, Ireland, Finland);
- Rather, the BEFIT Proposal is expected to be burdensome for smaller tax administrations which would be required to handle an additional set of rules in addition to their national rules (Malta);
- The BEFIT Proposal is not compatible with the EU's principle of subsidiarity (e.g. Sweden, Ireland, Malta, Czech Republic);
- Each State is better suited to determine corporate taxation and group taxation laws and regulations at its own level (Sweden) and the BEFIT Proposal limits Member States' sovereignty in the field of corporate income taxation, despite direct tax collection and usage falling within national competence (e.g. Sweden, Ireland, Poland, Finland);
- The BEFIT Proposal raises concerns similar to the currently withdrawn CCCTB Proposal (Malta);
- The implementation of the BEFIT Proposal would lead to a massive change in the tax system and a significant workload for both businesses and the administration (e.g. Germany);
- Tax competition is an important policy tool, particularly for smaller Member States. The BEFIT Proposal appears to replace a large part of domestic tax laws with an EU corporate tax system over which individual Member States would have only very limited control (Ireland);
- Formulary apportionment of profits, if introduced, would also likely lead to a considerable redistribution of corporate tax revenues across the EU and would be likely to benefit larger Member States at the expense of smaller ones (Ireland);
- It is doubtful as to whether the BEFIT Proposal is proportionate, necessary, and effective (Germany).

On 15 February 2024, Members of the European Parliament (MEPs) of the Committee on Economic and Monetary Affairs ("**ECON Committee**") discussed the draft report on the BEFIT Proposal. While the report generally supports the intention of the BEFIT Proposal, it includes several suggestions of amendments, including mainly ensuring an alignment with the Directive of 14 December 2022 on ensuring a global minimum level of taxation for multinational enterprise groups and large-scale domestic groups in the Union ("**Directive Pillar Two**"), and even considering delaying the transposition deadline so as not to disrupt this initiative, lowering the scope of the annual revenue threshold to EUR 40 million, after a transitional period, revising the interest limitation rules for BEFIT groups as a means to reduce the debt-to-equity bias created by excessive intra-group interest payments, identifying a way to ensure the minimum taxation of royalties (e.g. via a royalties' limitation rule), strengthening CFC rules in terms of offshoring profits and taxing passive income, providing for penalties proportionate to the turnover of the BEFIT group and shifting from an indefinite to a 5-year limit for carrying forward a negative BEFIT tax base. So far, no agreement could be reached at committee level on the draft report, as initially planned.

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The BEFIT Proposal has not been analysed in depth during meetings of the Working Party on Tax Questions (Direct Taxation) so that the legislative procedure is still in a very early stage. In addition, given the reactions of the various EU national parliaments, which, for some of them, are still busy implementing Pillar 2, the chances of BEFIT being adopted in the short term are rather limited at the moment and its chances to succeed in the longer term remain uncertain as well.

- **The HOT Proposal**

On 17 January 2024, the advisory (non-binding) opinion of the European Economic and Social Committee ("**EESC**") on the HOT Proposal was adopted. The EESC emphasised the urgency of adopting the HOT Proposal. While supporting the proposal's focus on standalone micro and SMEs initially, the EESC calls for an evaluation of the possibility to extend the HOT system to include SMEs operating cross-border through subsidiaries during the planned ex-post assessment five years after the directive comes into force. While acknowledging the complementary nature of the HOT system and the BEFIT Proposal, it stressed on the need for vigilance regarding the coexistence of different legal frameworks, urging the European Commission to monitor and address potential fragmentation and discrepancies that may arise.

On 10 April 2024, the European Parliament adopted its opinion on the HOT Proposal. The European Parliament's opinion, although non-binding, is mandatory under the consultation procedure. The Parliament supports the initiative, which is considered as a step in the right direction. However, it considers that the HOT Proposal should become more ambitious by widening its scope to also include companies that operate cross border by way of a maximum of two subsidiaries. It considers further mainly that one should delineate the opportunities created by the SMEs, the financial and administrative obstacles they face and the corresponding solutions that the HOT Proposal would bring, reassess the usefulness of excluding international shipping (and SMEs which are covered by the tonnage tax regime) after 5 years of HOT having been in place and finally accelerate the adoption of the HOT Proposal to allow SMEs to access the HOT system by 2025.

As far as the technical analysis of the HOT Proposal at EU Council level is concerned, only one single meeting of the Working Party on Tax Questions (Direct Taxation) took place on 9 April 2024. Thus, the legislative procedure is still in an early stage, the position at Council level on the amendments suggested by the EU Parliament is unknown for the time being and the chances of the HOT Proposal succeeding remain to be confirmed.

- **The TP Proposal**

The technical work at EU Council level started very quickly end of 2023 and the work has been continuing, on a regular basis, since Belgium took over the Presidency and lately during a meeting of the Working Party on Tax Questions (Direct Taxation) on 22 April 2024.

As far as reactions of European Member States are concerned, following the first concerns raised by the Finnish government back in December 2023 (please refer to our previous article in the ATOZ Insights of December 2023 in this respect), on 23 January 2024, the Swedish Parliament issued a reasoned opinion on the TP Proposal. While welcoming the ambition of the European Commission to increase predictability in taxation and reduce the number of situations of double taxation and double non-taxation, thereby reducing the number of disputes and compliance costs for companies, Sweden notes that the existence of transfer pricing guidelines at OECD level, which are not binding, updated on a regular basis and are a dynamic framework that evolves over time, is positive. In contrast, there is a risk that a codification of the arm's length principle in the EU will lead to the loss of the flexibility necessary for an effective application of the principle and that this in turn, contrary to the Commission's stated objective in the proposal, will lead to increased legal uncertainty, an increased number of disputes and increased compliance costs for companies. Sweden stresses further that the Member States' competence in the field of taxation must be safeguarded when it comes to direct taxation. Sweden concludes that the TP Proposal is contrary to the principle of subsidiarity.

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On 10 April 2024, the European Parliament adopted its opinion on the TP Proposal. As a reminder, the European Parliament's opinion, although non-binding, is mandatory under the consultation procedure. The European Parliament is generally supportive of the TP Proposal. However, it recommends mainly (1) a faster implementation at national level, i.e. by 31 December 2024, with relevant measures applying from 1 January 2025 (instead of currently 1 January 2026); (2) a use of the formulary apportionment method as a long-term solution to tackle tax avoidance and ensure a minimum effective tax rate for multinational enterprises; (3) an alignment with the latest OECD Transfer Pricing Guidelines, including Amount A and Amount B of Pillar One for simplified transfer pricing rules; and (4) harmonised TP documentation standards across the EU to lower the compliance burden while enhancing transparency and mitigating tax avoidance risks.

To conclude, while the initiative is recent, the TP Proposal evolves quite quickly. However, it remains to be confirmed if Member States will manage to come to an agreement on this file.

The SAFE initiative

When the Unshell Proposal was adopted, the European Commission announced that it would propose a follow-up initiative to respond to the challenges linked to non-EU shell entities, i.e. a proposal for a Council Directive to tackle the role of tax advisers and other professionals rendering tax advice (collectively referred to as "enablers"): Securing the Activity Framework of Enablers, "**SAFE**". While the European Commission initially planned to adopt the SAFE directive proposal on 7 June 2023, despite the text of the proposal being technically ready, the Commission finally decided to indefinitely postpone its release, due to the uncertain future of the Unshell Proposal. This situation remains unchanged as of today.

To find out more on the SAFE initiative, you can read the article "SAFE - The new EU initiative targeting tax advisers" in our December 2022 ATOZ Insights.

The DEBRA Proposal

On 11 May 2022, the European Commission released a directive proposal to address Debt-Equity bias, the DEBRA Proposal. The DEBRA Proposal is one of the targeted measures announced by the European Commission in May 2021 in its Communication to promote productive investment and entrepreneurship and ensure effective taxation in the EU. The proposal lays down rules on the deduction, for corporate income tax purposes, of an allowance on increases in equity and additional rules on the limitation of the tax deductibility of exceeding borrowing costs (for a presentation of the DEBRA Proposal, please read the article "European Commission releases DEBRA Directive Proposal" in our in our July 2022 ATOZ Insights).

As mentioned in our previous article "EU Commission's initiatives in direct tax matters: state of play" released in our April 2023 ATOZ Insights, by the end of 2022, it was decided to suspend the examination of the DEBRA Proposal in order to, if appropriate, reassess it within a broader context only after other proposals in the area of corporate income taxation announced by the Commission have been put forward. Since our latest state of play in the December 2023 ATOZ Insights, no development occurred, except the work performed at European Parliament level, as required under the legislative procedure, with the adoption by the European Parliament in Plenary of its opinion on 16 January 2024. The European Parliament is generally supportive of the DEBRA Proposal but recommends certain amendments.

As of today, it is expected that the project will be kept on hold in the coming months given that whether the DEBRA Proposal will be kept or totally abandoned will depend on the outcome of the BEFIT Proposal.

Directive 2011/16/EU on administrative cooperation

On 7 May 2024, the European Commission launched a public consultation on Directive 2011/16/EU, Directive on Administrative Cooperation ("**DAC**"). As previously announced by the Commission, this consultation aims at assessing the effectiveness, efficiency and continued relevance of DAC, as well as its coherence with other policy initiatives and priorities and EU added value. The consultation will end on 30 July 2024 and will focus on the functioning of DAC in 2018-2022. Therefore DAC 7 applicable to digital platforms operators and DAC 8 applicable to crypto-asset service providers are not covered.

Stakeholders and interested parties have thus now the chance to share their comment and experience as to whether and how DAC has actually helped them. The evaluation will assess the relevance, efficiency, coherence

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and EU added value of the DAC. For those purposes, it will evaluate whether the scope and purpose of DAC are still relevant and if DAC addresses the challenges faced by Member States. It will also consider the effectiveness of the DAC and whether the information exchange is usable in terms of completeness, quality and timeliness.

Furthermore, especially given the many amendments to the DAC, it will value its internal coherence as well as its consistency with other relevant EU initiatives. Finally, the EU added value of DAC will be assessed in comparison to other available means of exchange of information that exist at international level.

Pillar One

On 18 December 2023, the G20/OECD Inclusive Framework on Base Erosion and Profit Shifting (the "**Inclusive Framework**") issued a statement calling for a finalization of the text of the Pillar One multilateral convention ("**MLC**") by the end of March 2024 with a view to holding a signing ceremony by the end of June 2024.

On 15 February 2024, in light of the revised timeline for adoption and signature of the Pillar one MLC, the USA, Austria, France, Italy, Spain, and the United Kingdom have decided to extend from 23 December 2023 until 30 June 2024, the political agreement set forth in the joint statement issued on 21 October 2021, regarding their agreement that (as part of Pillar One) they will withdraw all unilateral measures concerning the imposition of digital services taxes ("**DST**"s) once Pillar One takes effect. have decided to extend the political compromise set forth in the October 21 Joint Statement until 30 June 2024.

As of today, the European Commission did not communicate on the consequence of the potential cancellation or postponement of the Pillar One MLC signing ceremony. We can however expect that in the first scenario, the Commission will most likely put its draft DST proposal back on the table.

Implications

Over the past few months, most of the ongoing initiatives of the European Commission in corporate tax matters have only evolved slowly or did not move forward at all. Except for the FASTER Proposal that will most likely be adopted before year-end, the outcome of most of the directive proposals on the table is totally uncertain.

This is mainly because Member States already have a lot of major tax reforms to fully implement. The fact that Member States express their concerns instead of surrendering to the pressure of the European Commission is positive, especially if we keep in mind that more is yet to come with Pillar one. However, the European Commission is not giving up the fight to make sure that its initiatives can come through: On 20 March 2024, in a communication on pre-enlargement reforms and policy reviews, the Commission indicated that it should be considered to move to a qualified majority voting in tax matters because in an enlarged European Union, "unanimity will be even more difficult to reach, with increased risks of decisions being blocked by a single Member State". However, in our view, unanimity should remain in tax matters to protect the principle of tax sovereignty and make sure that only tax measures which are really necessary should be introduced at EU level and that tax systems can remain workable for both taxpayers and tax administrations.

The HOT Proposal and the TP Proposal are moving forward but it is too early to know how the final product will look like and whether Member States will manage to reach an agreement on these 2 initiatives. Finally, the only initiative which should be adopted in the near future is the FASTER initiative, one of the few initiatives introducing improvements which are necessary: making the withholding tax reclaim procedures better in order to boost cross-border investments.

Our authors

KEITH O'DONNELL
Managing Partner
keith.odonnell@atoz.lu

MARIE BENTLEY
Chief Knowledge Officer
marie.bentley@atoz.lu