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DRAFT REPORT

on the impact of national tax reforms on the EU economy
(2021/2074(INI))

Committee on Economic and Monetary Affairs

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MOTION FOR A EUROPEAN PARLIAMENT RESOLUTION

on the impact of national tax reforms on the EU economy (2021/2074(INI))

The European Parliament,

- having regard to Articles 110-113 of the Treaty on the Functioning of the European Union (TFEU) related to the harmonisation of legislation concerning turnover taxes, excise duties and other forms of indirect taxation,
 - having regard to Articles 114-118 TFEU, which covers taxes that have an indirect effect on the establishment of the internal market,
 - having regard to the Commission's Annual Report on Taxation 2021 – Review of taxation policies in the EU Member States,
 - having regard to Rule 54 of its Rules of Procedure,
 - having regard to the report of the Committee on Economic and Monetary Affairs (A9-0000/2021),
- A. whereas the issue of harmful tax practices is debated in the report of its Committee on Economic and Monetary Affairs of 21 July 2021 on reforming the EU policy on harmful tax practices (including the reform of the Code of Conduct Group);
- B. whereas although tax policy largely remains a Member State responsibility, the single market requires a minimum degree of coordination in setting tax policy¹;
- C. whereas tax policy fragmentation creates various obstacles for companies and citizens in the single market, including legal uncertainty, red tape, the risk of double taxation and difficulties claiming tax refunds; whereas these obstacles discourage cross-border economic activity in the single market; whereas policy fragmentation also creates risks for tax authorities such as double non-taxation and arbitrage possibilities (such as tax planning);
- D. whereas within the EU's social market economy, adequate tax levels and simple and clear tax laws should not distort economic actors' decision-making; whereas sound tax policies should support the creation of jobs and economic growth and improve the competitiveness of the EU and its Member States;
- E. whereas the overall level of taxation differs considerably between Member States, as demonstrated by the fact that the tax-to-GDP ratio varied between 22.1 % in Ireland and 46.1 % in Denmark in 2019²; whereas on aggregate, the tax burden in the EU (40.1 %) is high even when compared to other advanced economies (the Organisation for

¹ As laid down in Articles 110-118 TFEU.

² Commission Annual Report on Taxation 2021, p. 24.

Economic Co-operation and Development (OECD) average was 34.3 % in 2018);

- F. whereas during the pandemic, many countries resorted to tax reforms in order to support the economy and only a subset of these measures were temporary; whereas these tax reforms encompassed immediate relief measures for businesses and households such as payment deferrals, enhanced loss carry-forwards or accelerated tax refunds, as well as recovery-oriented stimulus measures³;

General remarks

1. Recalls that Member States are free to decide on their own economic policies and in particular their own tax policies; recalls, however, that Member States must exercise this competence consistently with Union law;

Impact on SMEs

2. Notes that the estimated tax compliance costs for large companies amount to about 2 % of taxes paid, while for small and medium-sized enterprises (SMEs) the estimate is about 30 % of taxes paid⁴;
3. Highlights that differences in national tax regimes present obstacles to SMEs trying to operate across borders; stresses that compared to multinational enterprises, SMEs have fewer resources to spend on tax compliance and tax optimisation; points out that the share of expenditure used for tax compliance purposes is higher for SMEs than for multinational enterprises;
4. Notes that tax base harmonisation such as the common corporate tax base or the ‘Business in Europe: Framework for Income Taxation’ could reduce the cost of tax compliance for SMEs that operate in more than one Member State;
5. Notes that many Member States as well as the EU have introduced dedicated regimes favouring SMEs such as special VAT rules in order to offset the higher effective tax rates and higher tax compliance costs for SMEs; stresses that such special treatment, while generally positive, could risk introducing further distortions and further increasing the overall complexity of the system;

Coordination of tax policy

6. Notes that the EU has developed coordination mechanisms such as peer review procedures within the Code of Conduct Group and country-specific recommendations in the context of the European Semester; points out that the Commission has recommended to six Member States that they curb aggressive tax planning as part of the 2020 country-specific recommendations;
7. Highlights that the ideal level for tax policy coordination is on the international stage through the G20/OECD; notes that EU tax proposals based on international agreements

³ OECD, *Tax Policy Reforms 2021 – Special Edition on Tax Policy during the COVID-19 Pandemic*, 21 April 2021, p. 30.

⁴ Commission Communication of 15 July 2020 on an action plan for fair and simple taxation supporting the recovery strategy, p. 6 (COM(2020)0312).

have historically been more likely to be adopted by the Council;

Recommendations and areas for reform

8. Points out that in areas of high importance for the functioning of the single market and the capital markets union, more harmonisation is warranted either through better Member State coordination or EU action;
9. Notes that digitalisation and a heavy reliance on intangible assets that pose challenges to the current tax system warrant a high degree of policy coordination; deplores the fact that some Member States have pressed ahead with the introduction of national digital taxes despite ongoing negotiations at EU and OECD levels; stresses that these national measures should be phased out following the implementation of an effective international solution;
10. Deplores the debt equity bias in corporate taxation that allows for generous tax deductions on interest payments, while equity financing costs cannot be deducted in a similar manner; highlights the structural disadvantage facing companies that rely on equity financing, which are often young and small companies with poor access to credit;
11. Notes that debt equity bias varies considerably between the Member States; welcomes the fact that some Member States have introduced allowances for corporate equity to address this issue; stresses that a common European approach would be preferable in order to avoid distortions in the single market;
12. Looks forward to the Commission's proposal for a debt equity bias reduction allowance⁵;
13. Notes that the effective marginal tax rate (EMTR) is often a decisive factor for corporations making investment decisions; notes that there is considerable variation in the EMTR across Member States; invites the Commission to look into whether some Member States are distorting competition by artificially lowering their EMTR, e.g. through accelerated depreciation schedules or adjusting the tax deductibility of certain items;
14. Highlights that tax incentives for private research and development (e.g. via tax credits, enhanced allowances or adjusted depreciation schedules) can help to lift an economy's overall spending towards research and development, which often comes with positive externalities; is concerned, however, that certain types of tax incentives such as patent box / intellectual property box regimes do little to increase research and development spending and may actually distort the single market;
15. Stresses that further harmonisation regarding tax incentives for research and development spending may be warranted; notes that that this was part of the Commission's initial common corporate tax base proposal; deplores the fact that the topic was not addressed in the recent communication on business taxation for the 21st century;

⁵ Commission communication of 18 May 2021 on business taxation for the 21st century (COM(2021)0251).

EU taxation scoreboard

16. Takes note of the Commission's ongoing work on an EU taxation scoreboard and calls on the Commission to inform Parliament about its political intentions and the possible financial implications of this system;

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17. Instructs its President to forward this resolution to the Council, the Commission, and the governments and parliaments of the Member States.

EXPLANATORY STATEMENT

The Treaty of the Functioning of the European Union (TFEU) gives the Member States the sovereign right to decide on their taxation policy but obliges them to respect EU norms. At the same time, the tax policy choices made by Member States have obvious consequences for the functioning of the Single Market. A certain degree of policy coordination is therefore desirable in order to prevent problems such as legal uncertainty, red-tape, risk of double taxation and difficulties claiming tax refunds, all of which can ultimately dissuade companies and citizens from engaging in cross-border economic activity. At the same time, tax policy fragmentation combined with a lack of cooperation of tax authorities might facilitate arbitrage possibilities and aggressive tax planning.

Impact on Small and Medium Enterprises:

The detriments of tax policy fragmentation as well as the potential benefits of better coordination of national tax policies are unevenly distributed among different economic actors, with Small and Medium Enterprises (SME) suffering the most. Tax compliance costs do not fully scale with an enterprise's overall growth and are therefore significantly more noticeable for smaller companies than for larger ones. Some Member States attempt to compensate SMEs for the challenges they face in relation to higher tax compliance costs by setting up favourable tax regimes for smaller companies. While support to SMEs is generally welcome, such measures come with a certain risk of introducing new distortions, e.g. by incentivising companies to stay small. Therefore, the benefits of such preferential regimes need to be carefully weighed against potential downsides. Another option to facilitate cross-border economic activity would be to harmonise the tax base as intended in the Commission proposal for a common (consolidated) corporate tax base (C(C)CTB)) as well as the upcoming Commission initiative 'BEFIT - Business in Europe: Framework for Income Taxation'.

Coordination of Tax Policy:

While there is a need for tax policy coordination across the EU, the European Union has primarily soft law instruments available to establish tax policy coordination, the most important ones being the Code of Conduct Group for Business Taxation, country-specific recommendations in the context of the European Semester as well as legislative procedure subject to unanimity voting in the Council. While the European Union's toolkit is somewhat limited, the ideal level for tax policy coordination is the global level. If history is a guide, policy proposals emanating from OECD discussions often have a higher likelihood of actually being adopted in the Council and come with the benefit of reducing tax policy fragmentation even beyond the Single Market. This in turn is particularly beneficial for SMEs that aim to enlarge their potential market even beyond European borders.

Recommendation/Areas for Reforms:

While there is ample room for improvements in relation to more effective EU tax policy coordination, the report concentrates on a few key areas where reforms both necessary and realistic.

Debt-Equity Bias:

The corporate tax systems in most Member States are set up in a way that they allow for generous tax deductions of debt-servicing costs, while having no similar mechanism to deduct equity financing costs thus making debt-financing comparatively more attractive than equity financing. The different tax treatment of different financing channels might incentivise companies to overleverage making them less resilient in adverse economic scenarios. Furthermore, this debt-equity bias constitutes a structural disadvantage for young and small companies that have to rely more heavily on equity financing. In order to counter that problem, some Member States have introduced an allowance for corporate equity, yet a European approach would be more sensible in order to avoid distortions across the Single Market.

Effective Marginal Tax Rate (EMTR) Competition:

The effective marginal corporate tax rate is a factor that can heavily influence corporate investment decisions, e.g. when choosing a location for a new operation. Hence, Member States sometimes compete for business via lowering the effective marginal corporate tax rate. Therefore, the variation in effective marginal corporate tax rates across Member States is significantly higher than the variation in statutory rates with the forward-looking EMTR in some Member States even being negative in 2020.¹ Hence, this metric would be worthwhile for the European Commission to look at in order to determine whether some Member States are distorting competition by artificially lowering marginal rates, e.g. by introducing accelerated depreciation schedules or granting too generous deductibility possibilities.

Tax Incentives for Research and Development:

Research and development spending comes with obvious benefits for society and the economy as it encourages innovation and ultimately results in falling prices and more competition. Nonetheless, the overall research and development expenditure as a percentage of gross domestic product is considerably lower in the EU than it is in other advanced economies. In order to counter this, many Member States attempt to stimulate additional investments in research and development by providing tax incentives. However, there are doubts if all tax incentives in this area are equally effective. IP box and patent box regimes in particular have historically done little to boost additional research and development spending, but have on the contrary introduced new distortions to the Single Market. A joint understanding of Member States how to handle tax incentives for research and development would therefore be worthwhile. The Commission's attempt to introduce a common framework for research and development spending as part of the Common Corporate Tax Base should therefore be revisited.

EU Taxation Scoreboard:

The European Commission has signalled its intention to work on an EU Taxation Scoreboard in order to better detect Member States' tax policies that could facilitate aggressive tax planning and threaten the Single Market. The European Commission is invited to inform the European Parliament about the state of play of its planning and to take into consideration the input provided by the European Parliament on the matter.

¹ cf. European Commission (2021). Annual Report on Taxation 2021. p. 36