



2 February 2022

Directive on ensuring a minimum level of taxation for multinational groups within the European Union ('Pillar Two')

KEY MESSAGES

- 1** We welcome the global agreement reached at the OECD/Inclusive Framework (IF) on a global corporate tax reform. Provided that they are implemented globally and in a harmonised way, both 'Pillar One', regarding the reallocation of taxing rights and 'Pillar Two', introducing a global minimum effective corporate tax, have the potential to provide stability and coherence to the international corporate tax system. We strongly urge EU Member States to incorporate the detailed technical rules, concerning the implementation and administration of the minimum tax, which will be agreed at the OECD in the following months, into the EU directive.
- 2** A priority in the implementation of the EU directive should be the protection of European competitiveness. While the current proposal aligns closely with the key elements of the OECD/IF agreement, any EU directive in this area must continue to avoid a 'gold-plated' approach, as it would risk putting European companies at a competitive disadvantage and cause double taxation.
- 3** Similarly, the OECD/IF agreement must not end up as an 'EU only' agreement, with the United States not implementing either (or both) Pillar One or Pillar Two a particular risk. If major trading partners of the EU do not join the global minimum tax in full, then this raises critical questions in particular about the feasibility, effectiveness and fairness of the minimum tax at EU level and increases the risk of legal uncertainty and double taxation. The EU must ensure that implementation of the Pillar Two directive limits as much as possible the danger of European companies being put at a competitive disadvantage. This will require in particular more safeguards to ensure that the 'backstop' mechanism - the Undertaxed Payments Rule (UTPR) - works efficiently.



DIRECTIVE ON ENSURING A MINIMUM LEVEL OF TAXATION FOR MULTINATIONAL GROUPS WITHIN THE EUROPEAN UNION ('PILLAR TWO')

Background

Following the conclusion of the 2015 OECD Base Erosion and Profit Shifting (BEPS) project, the G20 and the OECD Inclusive Framework (IF) have presented a two-pillar-based agreement to address the increasing tax challenges stemming from the digitalisation of the economy. Pillar One implies a partial re-allocation of taxing rights towards market jurisdictions of excess profits and Pillar Two introduces a minimum effective corporate tax of 15% per jurisdiction. Following the OECD/IF agreement reached on 8 October and the publication of the OECD Model rules on 20 December, which provided more detail on how the minimum tax would work, the European Commission presented on 22 December its directive to implement Pillar Two in the EU.

We agree with Commissioner Gentiloni's assessment that the OECD package is "nothing less than a tax revolution"¹. The global nature of the (digital) economy required a global agreement at the OECD/IF level. Otherwise, companies would have been faced with a patchwork of national or regional unilateral initiatives. A global and harmonised implementation of the OECD package has the potential to bring stability and coherence to the international corporate tax framework.

In this position paper, aside from further more general observations at the end of the paper, we set out 4 critical issues in detail, which we do believe require immediate attention at EU level if an implementation of the minimum tax in the EU is to be successful:

- **Full alignment with OECD/IF agreement**
- **Interaction and level playing field with third countries**
- **Purely domestic large-scale groups**
- **Filing obligations and administrative simplifications**

Full alignment with OECD/IF agreement

Pillar Two will apply to all multinational enterprises (MNEs) with a revenue above €750 million. This means not only that each MNE will need to pay corporate tax rate at a 15% minimum rate in each jurisdiction where they operate, but also that each MNE will need to understand and adhere to the Pillar Two rules and accurately calculate their effective tax rate (ETR) per country and, regardless of the resulting ETR, collect sufficient evidence in order to withstand scrutiny from the tax authorities and avoid long and costly (legal) disputes or double taxation in relation to the calculations. While there will indeed be a 'tax cost' for those MNEs that currently have an ETR below 15%, we want to stress that all MNEs within the scope of Pillar Two will in the end be faced with high administrative costs in implementing such a system.

Therefore, a first priority should be to guarantee that an **implementation of the minimum tax at EU level is fully harmonised between EU Member States but also fully in line with the OECD agreement**. If the minimum tax rules are unharmonised

¹ https://ec.europa.eu/commission/presscorner/detail/en/STATEMENT_21_5247



between EU Member States or between EU and non-EU countries, the door is left open for potential double tax disputes, with a direct negative effect on a large set of world-leading companies with potential repercussions on their suppliers (often SMEs), tax revenue collected, trade and investment.

a) Technical implementation

While the OECD Model rules, published on 20 December 2020, did provide clarity on some of the aspects, we want to stress that businesses have already identified several instances of unclear provisions where further interpretation and clarification would be necessary². Business at the OECD (BIAC) also highlighted in a recent letter³ technical and policy issues that will require urgent clarification or modification in order to avoid double taxation and ensure workability.

This is why **we are very strongly concerned about the timing of the EU directive, and in particular the ambition to adopt it as soon as possible**. While the current EU directive matches broadly with the current Model rules, we stress that the Model rules will be (and need to be) further developed at the OECD:

- An OECD 'Commentary', which will further detail the interpretation of certain provisions, is expected to be published in February.
- An OECD public consultation for input on the implementation framework, focusing on such particular issues as administration and compliance, will be launched, providing businesses an important opportunity to flag unclear provisions to policymakers and analyse the workings of Pillar Two in more detail.
- Following the public consultation, the 'Implementation Framework' will be published by the end of 2022, considering simplifications, including the issue of safe harbours, which could lower high administrative costs for compliant entities. The 'Implementation Framework' should also provide information to businesses on what documents to use in order to prove to tax authorities in a straightforward way how they have fully complied with the rules.

If a directive is already formally agreed at EU level before all these further detailed provisions are evaluated and decided at the OECD and if EU businesses do not have sufficient time to analyse and interpret the rules and highlight unclear provisions to policymakers, EU companies and tax authorities risk ending up with an unclear and underdeveloped minimum tax regime in the EU. Furthermore, EU countries may find themselves in a cumbersome procedure to revisit the agreed directive again, with no political guarantee of a unanimous outcome. While it is understandable that the Commission is committing to the internationally agreed (but very ambitious) timetable at the OECD, the EU implementation of the directive may only be successful if at least EU companies are not faced with differences between EU and OECD rules. Therefore, **it is essential that the to-be-published OECD Commentary and further technical details to the Model rules are included in the EU directive in full and not fall victim to a rushed transposition**.

² For example, A) it is currently unclear what kind of entities can be excluded from jurisdictional blending (referring to constituent entities of a Joint Venture group which should be treated as if they were a separate MNE according to the Model Rules)? How about constituent entities that belong to a Partially-Owned Parent entity? B) How are tangible assets defined in the list of allowed Recapture Exception Accruals (Model rules 4.4.5) C) the reasoning behind the exclusion of current tax expenses not paid within 3 years?

³ Formerly known as 'Business and Industry Advisory Committee at the OECD' <https://biac.org/wp-content/uploads/2022/01/01-06-2022-Business-at-OECD-BIAC-6-Jan-Pillar-Two-Issues-Letter-I.pdf>



Aside from concerns about the Model rules itself, we should also stress that while the EU directive broadly aligns, there do remain **several instances of deviations between the EU directive and OECD rules** (some may be due to EU law specificities). For example, Art. 19(1)(a) refers to “taxes accrued”, whereas the OECD Model rules refer to “taxes recorded”. The differences in the text could lead to different results, in particular from a legal perspective and which will require in turn further careful consideration by policymakers about their terminology and application. We are concerned about some of the ‘new’ definitions used in the directive, and how they may not be fully aligned with definitions already established in international tax law, which would have provided more legal certainty. This is why it will also be crucial to cross-check the translations of the EU directive, as there will need to be precise alignment with countries’ tax law concepts.

The rules as we know them today are already incredibly complex and - aside from the rules that are still upcoming - adopting Pillar Two in domestic law, the development of IT solutions by third party service providers, and the rolling-out of projects in companies will require a long time and considerable efforts. As such, we are not confident that a successful implementation can be achieved by January 2023, and **the proposed timetable risks rolling out a minimum tax regime which neither businesses nor tax authorities may be fully prepared for**. If we want an effective implementation to happen in 2023, it will require swift and significant further administrative guidance from both the OECD and national tax administrations and continued consultation with local businesses to ensure legal certainty and workability.

b) Key elements

While the EU should join its global partners in transposing the OECD minimum tax into law, it is essential that European companies are not faced with stricter rules than others. If EU companies are faced, now or in the future, with a ‘gold-plated’ EU minimum tax (e.g. a lower revenue threshold, higher minimum rate, fewer carve-outs, less favourable treatment of losses, ...), EU companies will be damaged in terms of their global competitiveness, carrying significant negative consequences for the trade and jobs of EU parented companies, and their affiliates in both EU and non-EU jurisdictions. We therefore welcome and support the Commission’s decision to align their proposal with the OECD’s key elements as well as their defense and inclusion of such elements as the substance-based carve-out. **A ‘gold-plated’ approach to the minimum tax, now or in the future, could only further weaken the activity of MNEs and businesses in general in the EU economy** (see annex), and leave the EU in a less open business environment, with less economic growth, fewer jobs and capabilities and resources to provide answers to the innovation challenges of today.

While the exact size of the effect on corporate tax revenue across the EU remains unclear, the measures are sure to set a strong barrier against profit shifting, with the OECD stating Pillar Two would be “the end of tax havens”. The agreement of a 15% minimum ETR is expected to bring in additional corporate tax revenue, but we should at the same time acknowledge that the Pillar Two system will affect the behaviour of investors and companies (likely in dynamic and hard to predict ways). While an EU impact assessment is not available, a full assessment would and should show not only the potential rise in corporate tax revenue, but also how the minimum tax regime will affect investment, employment, growth, trade or tax incidence. Any change to a tax, and in particular a tax of such a scale as that of the OECD’s, on a set of the world’s leading companies, should be considered cautiously as it will lead to many different responses in different countries (residence vs. source countries) and different companies (sector,



profitability, labour-intensive companies, capital-intensive companies). Moreover, the economic impact will also depend on who bears the economic 'incidence' of the higher corporate tax. It can ultimately fall on workers (in the form of lower wages) or consumers (through higher prices) or their shareholders (through lower dividends).

It is important to underline here that, for example the OECD's analysis⁴, which did study the consequences of the reform to a wide range of factors, estimated that there would be some €100bn in additional corporate tax revenue worldwide if there would be a worldwide minimum tax of 12.5%. However, at the same time, they also acknowledged there would also be a negative effect on global GDP due to higher post-tax investment costs for companies. As the minimum tax rate was set at 15% in the end, it is thus likely that the negative impact on the cost of investment will be higher.

Interaction and level playing field with third countries

We have always believed that a long-term solution to the tax challenges of the (digital) global economy and BEPS can only be found at global level. The strength of the OECD agreement lies in its worldwide coverage of 137 countries. A scenario in which the EU would have unilaterally imposed a minimum tax would have weakened the competitiveness of EU companies and would have led to corporate inversions or relocations outside the EU and thus losses in jobs, know-how, trade and tax revenue. Therefore, we fully agree with the Commission's remarks in the directive that **"the effectiveness and fairness of the global minimum tax reform heavily relies on its worldwide implementation", and that it is "vital" that "all major trading partners" of the EU apply the minimum tax.**

However, there is at the moment no legal guarantee that the 137 countries will both effectively implement a minimum tax and do so in accordance with the OECD rules: some non-EU countries may implement a 'weaker' or a differently structured minimum tax compared to the OECD's, some may implement a minimum tax later than the EU, and others may even not implement anything at all. This is why it is essential that the situation in third countries is followed closely. **The OECD/IF agreement must not end up as an 'EU only' agreement** and thus formal adoption of the EU minimum tax directive should not be finalised as long as there is no clear view on whether our major trading partners implement Pillar Two. Not only could a non-implementation of the rules outside the EU be damaging to EU competitiveness, a rushed agreement in the EU could also be exploited by third countries to gain advantage.

Our concerns do not only relate to the issue of having equivalent rules worldwide, but also to the **global timing of implementation**: while the EU plans to implement the agreement on 1 January 2023, we note that e.g. the Swiss government argued it will only be able to implement the agreement in 2024. While the OECD agreement did call for implementation in 2023, we cannot automatically assume other countries will stick to this timeline. Multiple different implementation dates across the world will raise the complexity of the system and raise concerns about the fairness of the system if EU companies are the first and only ones to implement this revolutionary new system. If a large number of non-EU countries evaluate the minimum tax proposals and consider that a short postponement would be necessary to ensure feasibility and workability of the

⁴ OECD (2020), *Tax Challenges Arising from Digitalisation – Economic Impact Assessment: Inclusive Framework on BEPS*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, <https://doi.org/10.1787/0e3cc2d4-en>.



minimum tax, the EU should follow to avoid subjecting EU companies to a stricter regime than others and leave them faced with an uncoordinated global system.

In more detail, the implementation of the Pillars by our major trading partners (e.g. China, India, etc) is of significant importance. The situation is particularly concerning in the United States. Aside from the uncertain implementation of Pillar One by the US Congress (see below), the US has also not been able to bring its minimum tax regime (the Global Intangible Low Tax Income; GILTI and the Base Erosion and Anti-Abuse Tax; BEAT) into line with the Pillar Two criteria. This situation raises three critical issues:

a) Fairness and effectiveness of Pillar Two

A worldwide minimum tax regime in which the US, or other large trading partners of the EU, does not fully participate raises serious questions about the effectiveness and fairness of the system as a whole. As minimum tax regimes are generally less damaging to larger economies, a non-participation of the US would put EU countries and their companies at an unfair competitive disadvantage. The Undertaxed Payments Rule (UTPR) can to a certain extent limit this, but this does not solve the situation in full, in particular as the rule is very complex to apply in practice (see below). Given the US' economic weight in the world, a potential non-participation of the US in Pillar Two may also lead to other signatories of the OECD agreement to reconsider their participation. In the long term, there is a risk that more and more affiliates of foreign groups could relocate from the EU to the US and to other non-participating countries. This is why the EU should not rush to formally adopt the current directive without considering the rest of the world. **The EU must not find itself in a position whereby the directive on the minimum tax is already formally adopted in Council, without any certainty that our trading partners will implement the same rules.**

Regardless of whether all third countries participate or not, we should point out that due to the proposal to apply the IIR within the EU to domestic entities (which is understandable because of EU law concerns), it already does create an uneven level playing field in itself. Third country MNEs with entities in the EU can through incentives, for example in R&D, create a tax burden below 15% on their domestic activities and not pay a top-up tax, whereas EU MNEs can never have a domestic ETR below 15%. Under the use of the UTPR vis-à-vis a third country MNE, it would still be the EU entity whom will be denied deductions on payments or whom will be required to pay an equivalent adjustment. This in itself will create an uneven level playing field in which the EU could become less attractive, for example for R&D activities or investments in the energy and climate transition.

b) Role of Income Inclusion Rule and Undertaxed Payments Rule

A non-participation of the US (and perhaps other countries) increases the importance of the crucial role of the 'backstop': the UTPR. As mentioned, the UTPR can to a certain extent address competitiveness issues, but cannot eliminate them, in particular if more and more countries do not implement the OECD agreement in full. In this light, the directive's Article 51 - regarding the evaluation of third-countries' IIRs - should serve as a tool to determine whether an UTPR needs to be applied and should aim to decrease competitiveness risks for EU companies as a result of third countries implementing no minimum tax regime (or not in line with the OECD standards). It is important the EU takes a firm stance on this.

Yet, using the UTPR rule (for low-taxed entities of foreign groups) is far more complex than the standard Income Inclusion Rule (IIR) and is very likely to lead to far more



disputes, double taxation and administrative costs. Too little attention seems to be paid to such a rule as, indeed, the rule is mostly superfluous in a scenario where everyone adopts a compliant IIR. However, again, if the US (and other countries) do not join the agreement (or if countries decide to implement the minimum tax later than the EU), **it is critical that more work is done in advance of any agreement to ensure that the use of the UTPR is worked out in full.** This should cover both the UTPR itself (the Commission should also introduce criteria to assess third' countries UTPR-regimes and see whether they are compliant or not. In particular, the US' BEAT has considerable differences) and the coordination of GILTI & IIR (we are concerned that situations could arise where EU companies will be subject to both).

c) Balance of Two-Pillars agreement

The agreement reached in October at the IF was a delicate balance between the different interests of the 137 countries involved. Throughout the negotiations, countries made clear that they would only agree on the Pillars as a package, both Pillar One and Pillar Two. The balance reflected the advantages and disadvantages of each Pillar for individual countries, between both residence and source jurisdictions. While we had hoped to see both Pillars agreed at the same time and implemented in a harmonised way, observers have raised doubts about the ability of the US to transcribe Pillar One into law. As Pillar One is expected to allocate a significant part of corporate tax revenue from the US to the EU, we are concerned that a non-participation of the US in Pillar One may undermine the purpose and balance of the OECD agreement as a whole. Another issue which needs to be considered in this context is how the Pillar Two directive will take into account the tax due under Pillar One.

We should of course allow non-EU partners reasonable opportunity and time to enact the reforms in a spirit of trust and cooperation and we strongly welcome the Commission's removal of the proposal for a digital levy, which would have undermined the chances of the US' adopting any OECD Pillar.

Purely domestic large-scale groups

As a deviation from the OECD/IF agreement, the Commission proposes to extend the scope to 'purely domestic large groups' to avoid discrimination between domestic and foreign companies. We agree that policymakers should do all that is possible to ensure that the new minimum tax is EU law compliant to avoid legal uncertainty. However, **the inclusion of these 'purely domestic' companies does raise questions about the additional administrative cost for these companies and in particular the role of the directive.** While we assume that the number of these companies is relatively limited at the moment in (smaller) EU countries, the number of companies that exceed the €750 million threshold will increase over time (due to inflation). As such, the EU directive will play an ever-increasing role in purely domestic corporate tax policy. It may also imply that countries may have to change their corporate tax system (in particular countries which levy taxes upon distribution). Such a step should be very carefully assessed and we ask the Commission and Member States to consider other possible options first (e.g. by designing a system that is only targeted at abusive tax situations). We note that e.g. a paper by professor Joachim Englisch⁵ presents an alternative option which does not extend the scope to domestic entities within the EU. If after due evaluation, the inclusion of purely domestic groups is deemed to be absolutely necessary by the Commission and Member States from a legal point of view, we strongly encourage the design, where

⁵ Englisch, EC Tax Review 2021, p. 136 et seq



possible, of simplification measures for these purely domestic groups.

While the Commission explains its decision of not providing an impact assessment on the overall proposal by referring to the thorough analysis made by the OECD and the challenging timeline, we regret in particular that an impact assessment was not provided on the issue of purely domestic large-scale groups, as it was by definition not covered in the OECD's own analysis. As such, it is currently unclear how many purely domestic large-scale groups there are in the EU, and what the tax and administrative cost would be of such a measure. According to our network, this type of company can certainly be found in most EU member states, with naturally a greater presence in the largest Member States. We also expect that a majority of such groups will not have any top-up tax to pay. Yet, they will have to bear the administrative burden of the complex calculations of Pillar Two.

Filing obligations and administrative simplifications

Within a harmonised EU framework, we believe that there should be no instances of “local filing” within the EU, i.e. no Member State should be authorised to obtain the top-up tax information return directly from a constituent entity of an MNE Group. Such information should only be communicated through official exchange of information between tax administrations, subject to strict confidentiality and appropriate use conditions. The proposed rules in the directive do not provide for any protection of what constitutes sensitive data for MNE Groups. **We are deeply concerned by the lack of confidentiality safeguards and the risk of potentially unfounded reassessments which may proliferate** (e.g. for the application of UTPR), which would create very serious issues in terms of legal certainty. Defensive measures should be considered in the directive, e.g. in the equivalence conditions in Article 51. The control of the top-up tax should not lead to conflicts of interpretation or disputes, for MNE groups operating in the EU and outside the EU: there should be a centralised procedure within the EU whereby the control of the top-up tax is primarily conducted by the MS of the UPE.

One way to limit the cost of implementation to businesses and tax authorities is by implementing administrative simplifications. Apart from reconsidering previous BEPS legislation (see next chapter), countries should examine how to ensure that the administrative burden remains as low as possible. While a full harmonised implementation can already provide significant benefits, further administrative simplifications should be considered.

We welcome the Commission's inclusion, in line with the OECD Model rules, of the *de minimis* mechanism. We do note however that it does not include an indexation mechanism. As a result of rising inflation, more and more companies will exceed the threshold of the mechanism, thus eroding the simplification potential of such an instrument. We encourage Member States in coordination with their IF counterparts to design such an indexation tool.

Other issues

a) Substance-based carve-out

We fully support the Commission inclusion and defense of the substance-based carve-



out. The substance-based carve-out allows countries to a certain extent⁶, and in particular smaller countries with an open economy, to still provide tax incentives to attract foreign investment but on the strict condition that they will spur real economy activity by hiring more employees, paying employees more or investing in tangible assets. This recognition of economic substance was also necessary in order to comply with ECJ case law in the area of tax abuse (“Cadbury Schweppes case”). The inclusion of the substance-based carve-out is also fully in line with what the OECD BEPS project ultimately aims to achieve: to stop aggressive base erosion and profit shifting. **The minimum tax was not designed to eliminate all tax competition, nor should it, but it rather sets multilaterally agreed limitations to it.** Such a substance-based carve-out, as designed under the OECD agreement, is not a loophole for harmful tax competition over artificial profits, but rather allows to some extent for the presence of legitimately competitive and growth-friendly tax environments in Europe and the world.

b) Sanctions

On the issue of sanctions, while we agree with the provision that sanctions should be applied to non-compliant entities, the penalty proposed seems much too harsh. This may be particularly pronounced in the first years of implementation, when the new tax rules may prove to be especially burdensome to both tax authorities and businesses, whereby a flawed business ‘Globe Information Return’ may be due to unclear rules, rather than willful misconduct from the business involved. In this light, we do ask to consider a more ‘proportionate’ approach regarding sanctions. Ideally, a sanction regime is worked out at OECD level, by also including a “testing phase”, e.g. for the first year of implementation, a ‘learning process’ could be built both for taxpayers and tax administrations, during which no penalties would be applicable.

c) Other BEPS legislation

The Commission concludes in the directive on the minimum tax that it is ‘not necessary’ to amend CFC rules as the additional taxes paid under CFC will be incorporated when companies are calculating their effective tax rates per jurisdiction under Pillar Two. While the combination of CFC rules and Pillar Two rules may potentially not directly alter the ‘tax revenue’ cost itself, the CFC rules do pose still an additional layer of administrative costs and complexity and thus a potential source of disputes.

Businesses and tax administrations have spent major resources in the past few years on anti-avoidance measures (ATAD, DAC, BEPS, ...), and this will be joined now by the OECD’s minimum tax. In this respect, we strongly encourage the Commission to start an evaluation **of the numerous anti-avoidance measures taken in the past decade and evaluate their efficiency, effectiveness, coherence and EU added value** in terms of tax revenue raised (including how Member States have been implementing such legislation in their audit activity). Such an analysis should consider which BEPS-measures can be changed, simplified or even removed when implementing the Pillars. This should be a prerequisite for any new action taken in the area of corporate tax avoidance and is a matter of fairness and accountability of public action.

The Commission should also assess whether the 2017 EU dispute mechanism can be

⁶ However, we do note that the provision on the substance-based carve out is solely based on the balance sheet valuation, causing depreciated fixed assets to fall out of the carve-out, although there would still be an existing substantial economic presence. As a potential solution to this, EU Member States and their partners in the IF should consider e.g. fixed assets could be revalued at the effective date of the directive (asset step-up) or a kind of “carve-out credit” could be granted.



used for Pillar 2, or whether modifications are needed.

d) Future challenges and EU Member States' tax systems

Countries have designed and implemented in the past decades several national tax incentives, designed to spur employment and innovation in local economies. A more recent and important phenomenon is the rise of tax incentives specifically designed to encourage R&D in the area of the EU Green Deal, e.g. the adoption of renewable energy resources and other measures to effectively reach our common goal of carbon neutrality, as part of the wider EU Green Deal. In general, tax incentives related to R&D often provide preferential treatment to either the inputs to innovation, (e.g. the wage of researchers) or to the output of an innovation (e.g. the income from a patent). The inevitable consequence of the minimum tax regime is that it will impose additional taxation on companies, raising the cost of investment and hence some of the tax incentives currently used in Member States will not be possible anymore or be less attractive from an investment point of view. **The Commission and Member States' tax authorities should start to analyse as soon as possible how to update and redesign their tax systems to ensure they can still encourage (green) innovation, growth and employment.**

Multinational Enterprises in the Global Economy

In the OECD paper "Multinational Enterprises in the Global Economy"⁷, it is estimated that MNEs "accounted roughly for one-half of international trade, one-third of output and GDP and one-fourth of employment in the global economy." Furthermore, studies suggest MNE affiliates tend to invest more in R&D, be more productive and be more capital intensive, playing a key role in the challenges the world faces today. While corporate tax is just one area, their global outreach and employment also plays a role in e.g. the collection of personal income taxes, social security contributions and VAT.

MNEs also rely on local SMEs for inputs in their value chains and their presence can bring further positive spill-over effects for the local business environment in terms of worker mobility, demonstration effects and competitiveness⁸. The OECD concluded that there is "no contradiction in supporting SMEs and promoting MNEs in order to establish a conducive domestic policy environment".

In 2019, there were just 10 firms from the EU in the Fortune top 50 global companies list (ranked according to revenue), while there were 11 from China and 21 from the US. According to an analysis by McKinsey⁹ on so-called 'superstar' firms, while Western Europe hosted 36% of the top 10% of global firms by economic profits in the mid-1990s. Its share had dropped to around 25% in recent years. In contrast, the decline in the combined global share of the USA and Canada has been much less dramatic (-7 pp, compared to -12 pp in Western-Europe), with them still accounting for 38% of such firms.

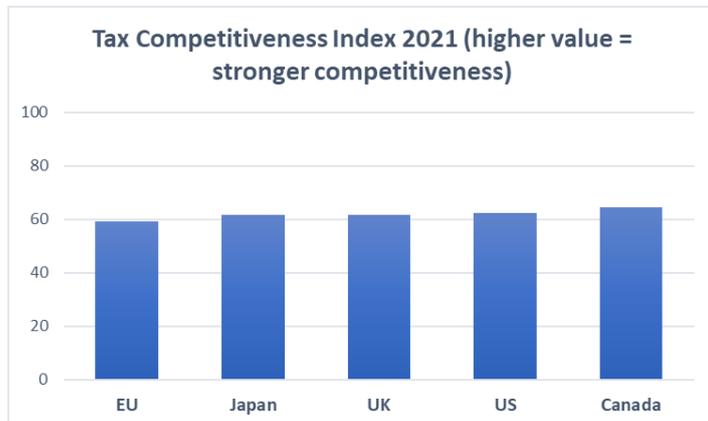
⁷ OECD, "Multinational Enterprises in the Global Economy – Heavily Debated but Hardly Measured", 2018. <https://www.oecd.org/industry/ind/MNEs-in-the-global-economy-policy-note.pdf>

⁸ Cadestin, C., et al. (2019), "Multinational enterprises in domestic value chains", *OECD Science, Technology and Industry Policy Papers*, No. 63, OECD Publishing, Paris, <https://doi.org/10.1787/9abfa931-en>

⁹ McKinsey Global Institute, "'Superstars': The dynamics of firms, sectors, and cities leading the global economy", October 2018. The paper looks at 6,000 of the world's largest public and private companies, each with an annual revenue greater than \$1 billion.



Such a re-evaluation will be particularly necessary, because, as highlighted in this paper, the EU will be facing several competitiveness risks by adopting the minimum tax regime. The EU is already behind its major competitors in terms of a competitive growth-friendly tax environment, according to an analysis of the TaxFoundation institute¹⁰ (see graph). While EU Member States differ with respect to their general tax structures and the type of incentives used, **Commission guidance on how tax incentives in line with the Pillar Two requirements can still be designed would be helpful.**



A redesign of the tax system should encourage a supportive business environment for the creation and expansion of firms, particularly since employers are increasingly able to choose where in the world to locate their activity and should also aim to reduce distortionary taxes that hamper growth. This should not only reflect on corporate tax, but also look at e.g. personal income taxes (e.g. for cross-border workers or remote workers). Another area where businesses are in need of simplification is VAT. In terms of increasing R&D, one can consider for example incentives that provide relief to payroll taxes or social security contributions of researchers, or looking at accelerated depreciation schemes to encourage investment. Countries should make sure to attract a wide range of companies and put in place the right tools so that their SMEs can grow to become MNEs.

At EU level, we are looking forward to the Commission’s proposal for a Debt Equity Bias Reduction Allowance (DEBRA), covering both MNEs and SMEs, which will be particularly relevant given that the debt-equity bias will be aggravated by the higher corporate tax rates under Pillar Two. In addition, the Commission’s upcoming proposal for a BEFIT could provide a strong simplification for businesses active across the Single Market.

¹⁰ TaxFoundation is a Washington-based policy think tank set-up in 1937 which collects data and publishes research studies on US and international tax policies. Their annual Tax Competitiveness Index ranks OECD countries’ tax systems with respect to their competitiveness and tax neutrality. The EU score was calculated by using weighted averages.