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Centro sulle dinamiche economiche, sociali e della cooperazione
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Contribution to the Evolution of the Single Market

(2024)

Executive Summary

Current issues of the Economy in Europe

The European Council of June 2023 stressed the need to trace the path along which the future of the Single Market will develop, while preserving its integrity and the four fundamental freedoms, identifying certain priorities. Mr. Enrico Letta was entrusted with a broad mandate for the drafting of a "High Level Report" on the relevant subject.

The costs of tax compliance: ongoing projects and proposals

The future Single Market must address the issue of tax compliance costs that hinder its growth, definitively depriving both large and (mainly) small and medium enterprises from enjoying the benefits of the Single Market.
It is worth starting with the establishment of a level playing field in tax matters, grounding upon the efforts already undertaken by the European Union with the BEFIT, TP and HOT Directive proposals, to achieve, at a later stage, the adoption of a uniform set of rules for determining the taxable base of corporate income.
It is necessary to set the scene for a deep and ingrained harmonization of the rules on Corporate Income Taxation. In this regard, two possible solutions are at a stake: on the one hand, in parallel with substantive rules, a uniform discipline could be prepared at the European level also for the procedural ones; on the other hand, a solution that seems more appropriate to the principle of proportionality, the management of the control activity by the tax authorities could be entrusted to the Member State of the
parent company.

The resolution of tax disputes as an obstacle to the (future of the) internal market

The future Single Market shall, increasingly, aim to ensure that the resolution of international tax disputes is assured with efficient and consistent mechanisms and procedures in the 27 Member States.
At the present stage, the uniform application of European Union law is guaranteed by the Court of Justice of the EU, whose access is "mediated" by the national Courts through the mechanism of the preliminary ruling. Conversely, in the case of double taxation disputes involving Double Taxation Conventions, the arbitration mechanism has been introduced, at the initiative of the party. An extension of this latter mechanism also to tax controversies arising from EU law – such as the Directive on the Global Minimum Tax – would assure more efficiency and effectiveness for businesses.

The freedom to stay and the necessary measures to implement it

The Single Market, today, sees in emigration from the less developed States (and areas) a phenomenon that highlights a critical point of European social policies. The measures implemented by individual States, on the other hand, do not seem to be sufficient to put a stop on this hemorrhage of human capital that, without interruption, deprives vital areas of the single market of lifeblood and continues to strengthen others, exacerbating pre-existing inequalities.

States often have to balance their efforts between the anvil (of their public revenues) and the hammer (of the prohibitions imposed by the State Aid discipline).

The future Single Market must propose structural solutions to this situation, preferably, through increasing the redistribution powers of European institutions, or, alternatively, through a deep reform of the State Aid system.

1. Current issues in Economics in the EU

At the Meeting of June 29-30, 2023, the European Council, addressing economic issues, clearly identified the following priorities: (i) preserving the integrity of the single market and the four freedoms and the simultaneous opening of the same market; (ii) achieving conditions of equality and the creation of a regulatory framework favorable to growth and aimed at reducing administrative burdens; (iii) strengthening the industrial policy and reducing strategic dependencies.

The priorities on which the Council has placed emphasis are, among the others: (i) accelerate work related to the proposals for regulations on the net zero emissions industry; (ii) the importance of Artificial Intelligence (AI) and the need to gain the opportunities and face risks by strengthening trust in this technology; (iii) demographic challenges and their impact on European competitive advantage.

In this context, the Council has concluded that *«an independent high-level report on the future of the single market will be presented on the occasion of its meeting in March 2024 and invites the upcoming presidencies of the Council and the Commission to advance the work on the matter, in consultation with the Member States»*. Mr. Enrico Letta was asked to draft the document.

This document focuses exclusively on certain tax policy issues to be considered in adopting the "High-Level Report on the Future of the Single Market", given the objectives and priorities emerging from the Conclusions of the European Council of June 2023, as well as the challenges in the intervention areas outlined by the Council, aiming to identify the solutions that, in our opinion, appear most appropriate, also considering the geopolitical approach that Mr. Letta upholds.

2. The costs of tax compliance: ongoing projects and proposals

2.1. The preservation of the Single Market (as a priority) is being considered by the European Council, together with the goal of reducing administrative burdens and, namely, sc. "tax compliance" burdens.

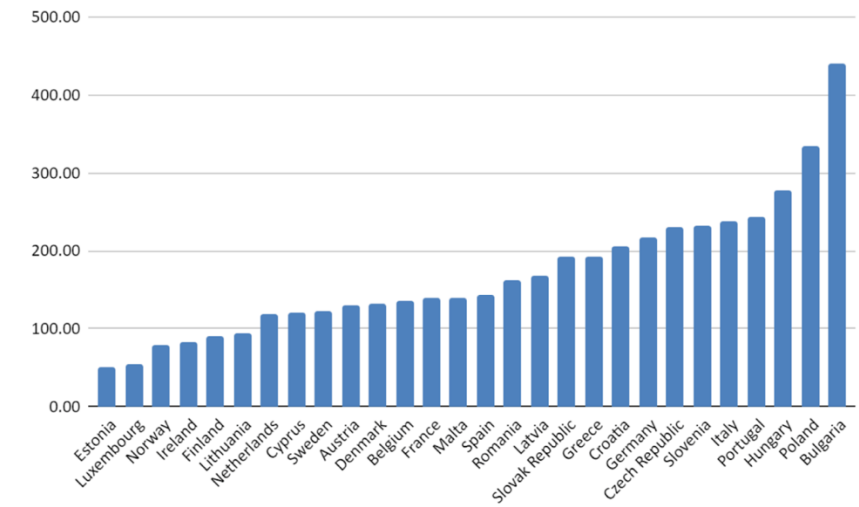
These are two sides of the same coin. The preservation (or full achievement) of the Single Market encounters an insurmountable obstacle in the implicit cost that businesses face in dealing with 27 tax systems displaying a high degree of complexity both in terms of "substantive" law (i.e. of tax laws), and of instrumental obligations (filing obligation, payment duties, procedural issues and tax trial issues).

The compliance costs, which affects both large and small businesses in order to carry out their activities in more than one state within the EU, don't find, nowadays, a satisfactory response in the unilateral efforts - highlighting a deep distance among the single European States - and calls for the adoption of common policies that address a European problem and not just a single Member State.

Although the data may vary depending on the source, reference year and methodology, the so-called "Paying Taxes" rate is a fair mirror of (such a fragmented and divided) market. In 2020, the best European countries' rate (achieved by Luxembourg and the Netherlands, both having a rate of 87.4), is the result of a different combination of data on the number of procedures (23 and 9) and hours employed (55 against 119) slightly higher than that of Austria and Germany, with ratings respectively of 83.5 and 82.2 due, also in this case, to a different combination of factors (high number of procedures but low number of hours for Austria, the opposite for Germany). The data are extremely negative for Italy (rating: 64.0) which, despite a not so high number of procedures (14), has a very high number of hours (238). The data concerning hours displays a rather puzzled and diversified market; *see* **Table I**.

Table I

Figure 3: Time (hours per year) to comply with tax obligations (for businesses)



See: European Parliament (Study Analysis Requested by the FISC Subcommittee), Overview on the tax compliance costs faced by European enterprises – with a focus on SMEs, 22.2.2023, p. 21 available at: https://www.europarl.europa.eu/RegData/etudes/STUD/2023/642353/IPOL_STU(2023)642353_EN.pdf,

2.2. The elimination of compliance costs is one of the reasons underpinning the recent proposal for the BEFIT Directive which explicitly acknowledged that *"[t]here are still no common rules for calculating the taxable income of companies operating in the Union. As a result, companies have to comply with (up to) 27 different national tax systems, a circumstance that makes it difficult and costly for companies to operate throughout the Union. The complexity and discrepancies in the interaction between the different tax systems create unequal conditions and increase tax uncertainty and compliance costs for businesses operating in more than one member"*.

Simultaneously, the proposal for a Directive on Transfer Pricing ("TP Directive") was presented. In this case too, the proposal aims to remedy the problems raised by the

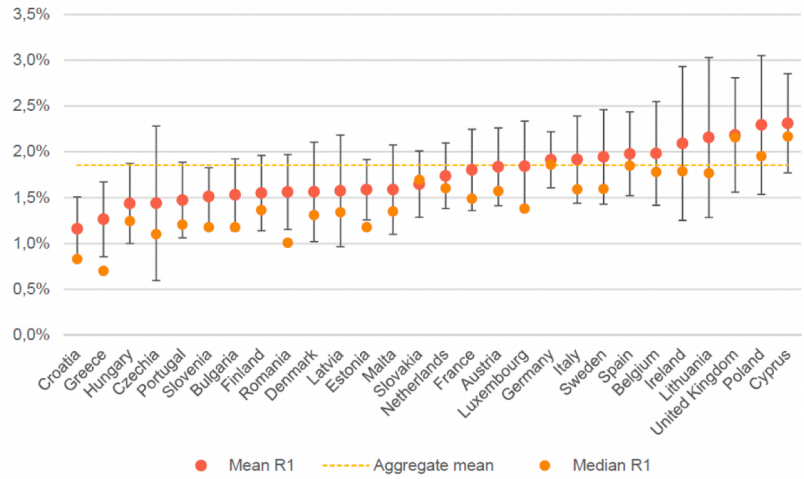
"complexity of transfer pricing rules and their different implementation in the national law of Member States"; and, among others, the "compliance costs"; given that *"the tax compliance costs related to transfer pricing are significant"*.

The absence of uniform principles and rules at European level therefore results in "high costs of compliance and ... frequent and expensive legal disputes". In the same vein, the sc. HOT ("Head Office Tax") draft Directive, an optional tool for small and medium enterprises, holds that *"Union businesses, in particular SMEs, face significant compliance costs linked to taxation, due to the absence of a solution for the computation of their taxable base"* in a uniform and consistent manner through Europe stressing that: (i) *"[t]he 24 million SMEs established in the Union represent two thirds of private sector jobs and 99 % of all businesses in the Union"* and that, (ii) they *"spend approximately 2,5 % of their turnover on compliance costs related to tax obligations. The situation of very small enterprises is particularly serious, as their corporate income taxes-related compliance costs represent 90 % of the estimated yearly Union businesses compliance costs of EUR 54 billion"*.

While tax compliance costs are, in general terms, more burdensome for SMEs in all European States, such costs (if compared to annual turnover) are, furthermore, different across Europe (as shown in **Table II**).

Table II

Figure 7: Cross-country comparison of corporate tax compliance costs as percentage of turnover (cost-to-turnover)



See European Parliament (Study Analysis Requested by the FISC Subcommittee), Overview on the tax compliance costs faced by European enterprises – with a focus on SMEs, 22.2.2023, p. 25 available at: https://www.europarl.europa.eu/RegData/etudes/STUD/2023/642353/IPOL_STU(2023)642353_EN.pdf,

These initiatives can provide the basis for a broader rethinking of the set of rules - which are based on a plurality of sources, layered over time - which require a consolidation effort (similarly to what happened with VAT in 2006) in order to concretely achieve the objective of simplifying tax compliance. Because - at closer sight - the effort to simplify

must start from the roots (European Law) so that the expected benefits (simplification in each State's national laws) can naturally arise.

The BEFIT proposal, aiming at the adoption of common rules in the determination of the taxable base of companies - based on existing accounting rules and already accepted at a European level - will involve, in the drafters' intentions, also the solution of the problem of compliance costs in the medium term and is aimed at both large groups (for which it will be mandatory) and smaller enterprises (who can opt to adopt it on a voluntary basis).

The BEFIT proposal has been undertaken in furtherance of the projects aiming at adopting the CCCTB and aims to be consistent with existing Directives and with the principles underlying the international taxation projects kicked-off by the OECD/G20 since 2015. It is fairly intended to pave the road towards a less complicated tax environment for enterprises through Europe and the success of such initiatives depends on the attitude of these new rules to represent - themselves - the first step towards a simplification process in a context where the costs of tax compliance must be reduced, not increased.

However, the goal of reducing tax compliance costs could be difficult to achieve if the Directive itself increases inconsistencies and complexities. This could happen, in concrete terms, where the rules adopted in new Directives (e.g. in the BEFIT rules) would increase compliance costs if not entirely overlapping (or consistent) with the ones embedded in the Globe rules: (i) as for their scope (i.e. the relevant 'group' the Directive applies to); (ii) with regard to losses offset or (iii) with respect to the method adopted to calculate the taxable base. Similar problems may arise due to the overlap of notions and principles dealt with in other EU Directives (and in Tax Treaties, as well), such as the beneficial owner clause.

The future of the Single Market (from the perspective of the costs of tax compliance for companies) also depends on the success of these two initiatives and the importance that will be placed on the necessary simplification that must accompany their implementation, considering not only the complexities in the
implementation of the Directives, in an isolated fashion, but also in relation to the other sources of European law.

2.3. The search for a solution to tax compliance problems in national systems must find a common origin in a simplification of the "European system" (given by existing and to-be-adopted Directives) which, in several parts, appear inconsistent with each other, adopting divergent tools (even if, sometimes, they
achieve the same objectives) that sometimes are unnecessarily redundant (duplicating or tripling identical notions or "copy-past" fulfilments) or complex (requiring a necessary constant coordination between internal and European regulation).

Therefore, it is necessary to start from the European system, reconsidering the existing Directives and searching for common bases (and any necessary derogations or special rules) that allow us to reach a corpus unit of rules, mandatory or optional, on the common

tax base, on the taxation of dividends, interests, royalties, anti-avoidance rules, exchange of information, dispute resolution, etc. within a single "Recast" Corporate Tax Directive (with the necessary clarification that it would not be a Directive aiming at introducing a "new tax " but just a Directive that consolidates the rules of European law intended to affect income taxes existing in individual Member States).

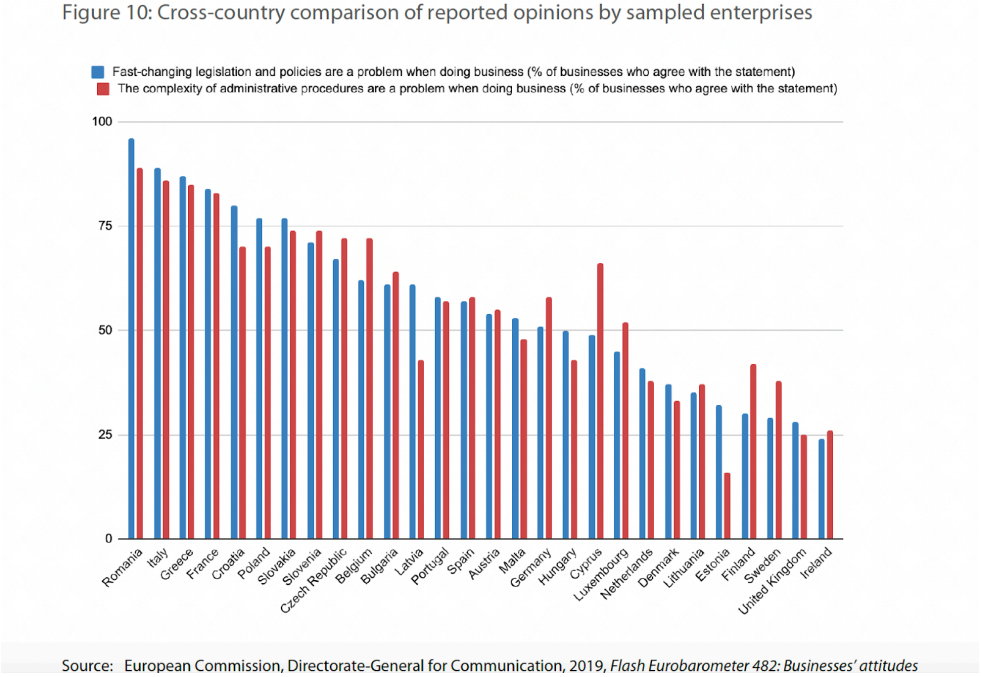
The costs of tax compliance would already be reduced due to this intervention aimed at simplifying the approach of companies, including those of medium and small size that do not have the technical skills to be able to face such a detailed analysis that allows a compliance faithful with European law (or to be able to fully exploit the rights that these rules today, in the abstract, recognize them).

Therefore, it is necessary to start from the European system, reconsidering the existing Directives and with regard to the review of the (current and to be adopted) system of substantial rules, it is necessary to provide for a new approach to the issue of instrumental obligations that can represent a far more burdensome obstacle, given the variety of forms, tax filing methods, deadlines, procedures and guarantees that vary depending on numerous variables, from State to State.

Complexity of administrative procedures is largely perceived as an overreaching problem in lifting tax compliance costs for businesses across Europe (as shown in **Table III**).

Table III

Figure 10: Cross-country comparison of reported opinions by sampled enterprises



Source: European Commission, Directorate-General for Communication, 2019, *Flash Eurobarometer 482: Businesses' attitudes*

See European Parliament (Study Analysis Requested by the FISC Subcommittee), Overview on the tax compliance costs faced by European enterprises – with a focus on SMEs, 22.2.2023, p. 28 available at: https://www.europarl.europa.eu/RegData/etudes/STUD/2023/642353/IPOL_STU(2023)642353_EN.pdf,

It is, therefore, appropriate to identify, depending on the stages of a company's life, those obligations that are directly connected (or related) to the substantive rules contemplated in the Directive dealt with above and that (although they may overlap with Member States' income taxes) would reduce as much as possible the risk of non-compliance by the Member States with the obligations arising from the Directives.

This system, accompanied by the digitization of the aforementioned services, could significantly reduce the costs of compliance for small and medium-sized enterprises on the example of the "Single Notification System" aiming at reducing the "compliance costs" for businesses and also considered in the proposal for the TP Directive, together with the experience of the One-Stop-Shop in VAT matters. The draft HOT Directive (in the latest version of February 2024) clearly puts an emphasis on the importance to reduce tax compliance costs through a system resembling the VAT one-stop-shop system, holding that such a solution would be the most appropriate, at least for SMEs. In the same direction is oriented - considering only the tax filing obligation - the provision for a "single" filing obligation provided for by the BEFIT Directive (and the related "BEFIT Team" which will group the interested Tax Revenue Authorities).

The above proposals aim at taking a first step towards eliminating tax compliance costs by aggregating several tax duties in just one batch and in just one State.

However, States hardly accept to waive hands from their (own) tax assessments' powers that remains a prerogative of each single Member State.
Henceforth, tax Assessments undertaken by more than one (theoretically speaking, 27 Member States' Tax Authorities) is a clear and very serious obstacle towards the achievement of the reduction of tax compliance costs, since all such solutions (id est BEFIT, TP and HOT Directive proposals) still accept that shall enter into a "dialogue" with 27 Tax Authorities (and related, potential, tax assessments and tax claims) and such Directives cannot impede that this overlap continues.

The future Single Market shall ensure a one-stop-shop approach also for assessment activities that are, in concrete terms, the more burdensome and risk-related ones for groups (both large and, mainly, small groups). This might boost the race towards an effective and (much awaited) elimination of tax compliance costs, allowing both taxpayers and tax authorities to save (tax compliance) costs and spend such revenues for other purposes (i.e. investing in business, for taxpayers, investing in other - compliance, assessment and recovery - activities, for tax authorities).

3. The resolution of tax disputes as an obstacle to the (future of the) internal market

The resolution of tax disputes represents one of the parameters on the basis of which to evaluate the attractiveness of the future Single Market.

Certainty on relationships and disputes arising in tax matters requires that the resolution of disputes be expanded to include, as much as possible, disputes involving third states as well.

Within the framework of extrajudicial remedies aimed at finding a solution to the problems emerging at the European level, by the overlap of tax claims made by several Member States, the current Dispute Resolution Directive ("DRD") applies, at the actual stage, only on a bilateral basis.

The possibility of finding out a solution only to disputes falling under Double Taxation Conventions and concerning a "resident" of either of the two European Member States to which the Convention applies fairly shows, from the outset, the limits of the Directive.

Expanding the scope of the Directive could ensure the achievement of such outcome - i.e. resolution of disputes - even with reference to disputes involving enterprises from third states with a permanent establishment in Europe. The exclusion of such entities results (immediately, in worst treatment for third States' investors but), ultimately, in a deficit of compliance of the European market.
This results in lower attractiveness (and, therefore, competitiveness) of the European Union if compared to other regional markets with a single actor (China, India) as the counterpart of tax disputes and, therefore, ensuring potentially easier resolution of bilateral disputes according to a single (and not 27) standard.

The future of the Single Market shall, then, pass through its "opening" which also implies a more widespread perception of the "rights" that this market ensures to all the taxpayers who fall within its scope and who can benefit from the rights and rules that are set at its base.

The initiatives aimed at changing the environment for business operating through Europe (i.e. the BEFIT, TP and HOT Directives proposal) shall, henceforth, be sided by a strong and effective Dispute Resolution
mechanism that - assuming that the proposal for a "single" tax assessment point (dealt with above in par. 2.3.) will be upheld - can be a further, solid tool to help in achieving the decrease in tax compliance
costs.

4. The freedom to stay and the necessary measures to implement it

In several speeches delivered since June 2023, Mr. Letta has emphasized the weight he attributes to the "social" dimension of European construction and, consistently, to the "freedom to stay" in one's own state (as a freedom complementary to those of movement). He has once again emphasized that *"the Single Market was both about people and for people. Economic competitiveness had to go hand in hand with social protection, and the freedom to move and the right to stay were part of the same freedom: 'The brain drain is having a devastating impact in some countries. We have to address the*

freedom to stay and freedom to come back. Today it is a one-way ticket only, and this is affecting competitiveness and creating a big problem in Europe'".

This perspective allows to "reinterpret" the Single Market as a market where, in concrete terms, inequalities have not been eliminated but have gradually become systemic and allows to consider, in a different perspective, the core role that human capital shall play in the development of companies in less developed areas. It is necessary that the EU becomes the engine of a gradual convergence of the attraction of human capital, in the part where these disciplines aim, particularly, to prevent emigration or to intervene at a later time offering incentives to return to the state of origin.

State Aid regulation should be one of the keys to solving this issue.

Article 107(1) TFEU has been repeatedly derogated during these years due to the: (i) COVID pandemic (Temporary Framework, adopted in March 2020 and amended in April, May, June and October 2020 and in January and November 2021), (ii) war crises (adopted in March 2022 and later amended in October 2022) and, last, (iii) with the purpose to foster support measures in sectors which are key for the transition to a net-zero economy, in line with the Green Deal Industrial Plan (March 2023). The approach of the EU Institution is therefore merely passive, i.e., to temporarily suspend State Aid rules during the economic crises.

The time has come to adopt an active approach on the State Aid rules.

The economic rationale behind Article 107 TFEU is to avoid that national public finances might jeopardize the Single Market. However, this goal and the linked regulation was drafted in an economic environment widely different from the current one, both within the borders of the Union and at the international level. The State Aid regulation, therefore, requires a deep rethinking to adapt the rules to a completely different economic scenario.

In addition, the current issues of the green and digital transitions – which are EU policies and objectives – impose a huge public intervention and a huge number of resources.

In our view, there are <u>two</u> different alternatives.

The <u>best solution</u> should be to attribute a redistributive power to the EU. Since, differently from the US context, the EU does not have tax instruments to realize redistribution -in particular, a supranational (income) tax -, this solution should foster the enlargement of the EU Budget and the following distribution of the resources to the national budgets or directly to national projects. This solution is coherent with Article 107 TFEU because the objectives are achieved through supranational resources but not politically feasible.

The <u>second-best solution</u> is the amendment of Article 107 TFEU allowing Member States to invest national resources (in the form of tax credits or subsidies) into the green and digital transition, embedded into a transparent, solid, long term, industrial policy at EU level. Accordingly, State Aid rules should enter into a new deal (a new State Aid

Modernization plan) aiming at adapting it to a new context, where crises are effectively not “temporary” but stable and ingrained in the economic and social context of Member States. Green and digital transitions can turn into the opportunity to achieve social objectives where enterprises are supported in their efforts to move towards these objectives that can boost the local economy, create jobs, and contrast emigration from Member States. State Aid rules should be, then, redesigned opening some “corridors” for sector of activities whose development could help in erasing social problems affecting the Single Market. Modernization of State Aid rules is, today, unavoidable because otherwise the “side effect” of State Aid prohibitions would be maintaining and increasing the deficit of social cohesion in Member States.