POSITION PAPER

BUSINESSEUROPE

24 January 2024

Business in Europe: Framework for Income Taxation (BEFIT)

KEY MESSAGES

1 BusinessEurope supports the Commission's initiatives to improve the corporate income tax system in the EU. Nevertheless, the proposed BEFIT directive **does not deliver the Commission's goals** of simplifying the tax landscape and reducing compliance costs in the EU. This is attributed to several key factors:

- Whilst common corporate tax rules have the potential of improving the EU's tax landscape, operating the proposed BEFIT regime in parallel to national tax systems and with material divergences from the OECD's Pillar Two Framework significantly increases compliance, complexity, and administrative burden, deterring business investments and job growth.

- Whilst the proposal allows for offsetting cross-border losses in the EU, the benefits from this important element have been significantly reduced when compared to the earlier proposal for a Common Consolidated Corporate Tax Base (CCCTB). This is an inevitable outcome of the global minimum tax rules.

- Whilst there is potential for significantly reduced transfer pricing through a formulary apportionment of profits, the same cannot be said for the proposed transitional method of allocating profits. The transitional method and the traffic light approach for transfer pricing compliance introduce further complexity and do not deliver the necessary tax and legal certainty for ensuring effective relief from double taxation. Consensus on a formula remains a distant prospect.

2 Given the significant complexities introduced by, and the remaining work necessary for completing, the G20/OECD Inclusive Framework's Two-Pillar solution, **global rules should now be allowed to stabilise** in order for businesses and policy makers to have the opportunity to thoroughly assess their effectiveness and appropriateness over time.

3 In light of these complexities, **European businesses should have the ability to exercise a choice** in determining whether the proposed BEFIT regime is a viable strategy for them to achieve administrative simplification and the proposed reduction of 65% in their tax compliance costs.

POSITION PAPER

DIRECTIVE ON BUSINESS IN EUROPE: FRAMEWORK FOR INCOME TAXATION (BEFIT)

Background

On 12 September 2023, the EU Commission issued the BEFIT tax package consisting of the following three proposals for Directives:

- **Business in Europe: Framework for Income Taxation (BEFIT):** a new framework to determine the tax base of groups of companies operating in the EU, which will be mandatory where they have an annual combined revenue of at least €750 million and the ultimate parent entity holds at least 75% of the ownership rights or the rights giving entitlement to profit.

- **Transfer pricing (TP)**: rules to ensure common application of the OECD arm's length principle across the EU and incorporate related OECD guidelines into the EU's legal framework.

- **Head Office Tax System for SMEs:** simplified provisions for computing the taxable result of permanent establishments (PEs) of certain micro, small, and medium-sized enterprises (SMEs) located in another EU member State (MS).

BEFIT, introduced by the Commission in the 2021 Communication on Business Taxation for the 21st Century, supersedes the previously pending common corporate tax base (CCTB) and common consolidated corporate tax base (CCCTB) proposals, which have been withdrawn. The Commission asserts that the complex nature and interplay of diverse tax systems across the 27 Member States escalate tax uncertainty and compliance costs, dissuading cross-border investment and placing EU businesses at a competitive disadvantage globally.

Against this backdrop, the Commission proposed new rules for a common corporate income tax framework for in-scope groups of companies operating in the EU – BEFIT.

Scope of the BEFIT rules

The BEFIT rules are obligatory for EU-resident companies and their EU-based permanent establishments (PEs), and for EU-based PEs of entities Third-Country resident companies, subject to the condition that they either belong to a domestic or multinational group preparing consolidated financial statements with annual combined revenues of at least €750 million in two of the last four fiscal years and the ultimate parent entity (UPE) holding at least 75% of ownership rights.

Optional application of BEFIT is proposed for groups not meeting the aforementioned criteria. BEFIT rules are not mandatory for companies or PEs with a UPE outside the EU, provided that the combined EU revenues of the group do not exceed 5% of total revenues or €50 million in at least two of the last four fiscal years.

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Determining the taxable base

A four-step mechanism is proposed to determine the taxable base of in-scope groups:

1. Calculate the preliminary tax result of each BEFIT group member using a common set of rules.
2. Aggregate the preliminary tax result of each BEFIT group member into a single BEFIT tax base.
3. Allocate the BEFIT tax base to the BEFIT group members using a transitional allocation rule.
4. Adjust the allocated portions at the individual level of each BEFIT group member.

Transfer pricing

Aimed at simplifying transfer pricing compliance, the BEFIT proposal suggests using public benchmarks for low-risk activities. Where expenses or income from intra-BEFIT group transactions remain within a limit of less than 10% increase compared to the average of the previous three fiscal years (the 'low-risk zone'), there is a presumption that the arm's length principle has been applied. For those in the remaining 'high-risk zone', there is a presumption that the pricing does not comply with the arm's length principle and (subject to provision of evidence to the contrary) the relevant increase beyond 10% threshold will not be recognised when computing the respective baseline allocation percentage.

For those in the low-risk zone, Member States "may not dedicate additional compliance resources to further review the transfer pricing results" but will have a right to perform adjustments of the profit margins. Those in the high-risk zone may be subject to review or audit and those in the middle may be monitored before deciding whether to dedicate resource to investigate further.

Administration

An administrative framework is proposed to allow businesses to deal with one single authority in the EU for filing the BEFIT information return. The filing entity, typically the UPE, submits a single information return for the entire BEFIT group to its respective tax administration, which then shares this return with other Member States where the group operates. Additionally, each BEFIT group member files an individual tax return with their local tax administration to apply local adjustments to their allocated portion.

New BEFIT teams with representatives from different tax authorities would be created to help ease communication and resolution of issues between tax authorities as well as enabling amendments to the BEFIT tax base to be made across the BEFIT group through a coordinated process. Member States retain right to initiate any audits in accordance with national law, although other Member States can request a joint audit.

Should BEFIT be adopted, Member States are required to implement the rules into their national law by 1 January 2028, with the rules becoming effective from 1 July 2028.

Overall comments

BusinessEurope supports the Commission's objectives of strengthening the Single Market, attracting further investment, fostering innovation, and stimulating growth by simplifying the tax landscape for European businesses and reducing compliance costs.

Nevertheless, the proposed BEFIT directive **does not deliver the Commission's goals** of simplifying the tax landscape and reducing compliance costs in the EU.

This is attributed to several key factors:

1. Whilst common corporate tax rules have the potential of improving the EU's tax landscape, operating the proposed BEFIT regime in parallel to national tax systems and with material divergences from the OECD's Pillar Two framework significantly increases compliance, complexity, and administrative burden, deterring business investment and job growth.

2. Whilst the proposal allows for offsetting cross border losses in the EU, the benefits from this important element have been significantly reduced when compared to the earlier proposal for a Common Consolidated Corporate Tax Base (CCCTB). This is an inevitable outcome of the global minimum tax rules.

3. Whilst there is potential for significantly reduced transfer pricing through a formular apportionment of profits, the same cannot be said for the proposed transitional method of allocating profits. The transitional method and the traffic light approach for transfer pricing compliance introduce further complexity and do not deliver the necessary tax and legal certainty for ensuring effective relief from double taxation. Consensus on a formula remains a distant prospect.

4. A key strategy for enhancing corporate tax compliance involves implementing a comprehensive one-stop-shop system. However, the BEFIT proposal lacks clarity and ambition, making it insufficient for achieving a significant improvement in the existing framework.

5. The Commission also needs to provide a proper impact assessment of how the specific proposals will impact businesses. The current impact assessment, considering only potential benefits from a theoretical simplification of corporate tax rules, clearly falls short of this.

Recommendations

As European businesses grapple with the implementation of the OECD's Pillar Two rules and considering the remaining work needed to adopt the OECD's Two-Pillar Framework in full, global rules should be allowed to progress gradually.

To be effective and ensure that companies do not face unnecessary burdens, the EU should wait until there is more stability at a global level on corporate taxation, before taking forward detailed proposals such as BEFIT.

In the interim, European businesses should have the ability to exercise a choice in determining whether the proposed BEFIT regime is a viable strategy for them to achieve administrative simplification and the proposed reduction of 65% in their tax compliance costs.

BusinessEurope recommends that **a review of the existing EU tax framework** is conducted to address identified shortcomings in the global rules. This should also be aimed at establishing a competitive EU tax framework that reevaluates the effectiveness of numerous existing tax measures. This review is crucial for promoting an attractive fiscal system with initiatives aligning investments with ambitious goals, such as the green transition outlined in the Green Deal. It should also ensure tangible benefits for both European businesses and tax administrations.

Unlike previous common corporate tax proposals, the current BEFIT proposal lacks sufficient fiscal features to achieve these ambitious targets. This is particularly concerning given the considerable efforts made by other major economies in accomplishing their green transition.

Furthermore, this exercise should **prioritise effective and inclusive stakeholder consultation** in the development of common EU tax initiatives.

Key Concerns in the BEFIT proposal

1. The interaction of BEFIT with the OECD's Pillar Two framework is unclear and risks increase compliance and complexity.

Whereas we recognise that the BEFIT rules draw significant inspiration from the Pillar Two framework and aim for a simpler adjustment process compared to Pillar Two requirements, companies subject to the BEFIT rules will need to undertake separate sets of computations, factoring divergences from IFRS rules, to comply with both regimes.

This arises due to the following factors:

- The methodology for determining the BEFIT tax base relies on aggregation of the preliminary tax results of each entity in scope, followed by the allocation of profits to Member States. In contrast, the Pillar Two rules, implementing a global minimum taxation framework, operate at an entity-by-entity level, precluding the blending of results across jurisdictions.

- Although the proposed mandatory scope of BEFIT attempts to mirror the scope of the Pillar Two rules, it introduces a nine-month holding period requirement for a company or permanent establishment to become a BEFIT group member, regardless of IFRS consolidation criteria.

- The scope of BEFIT is further limited to cases in which the ultimate parent exercises 'qualified control' through the direct or indirect holding of (i) 75% of the ownership rights or (ii) 75% of the rights giving entitlement to profit. This additional requirement complicates achieving coherence between the two regimes.

This lack of clarity is increased by the fact the Pillar Two rules require all transactions between constituent entities to be at arm's length. In contrast, BEFIT aims at formulary apportionment in due course. The coexistence and priority of the two regimes, therefore, remain unclear. Hence, it becomes imperative to establish how BEFIT interacts with the Pillar Two requirements to avoid mismatches and the risk of double taxation.

2. **The benefit of utilising cross border losses under BEFIT is significantly reduced as an inevitable result of the OECD's Pillar Two framework.**

The main benefit of the BEFIT proposal lies in the ability to offset cross-border losses indefinitely and unconditionally between BEFIT group members, offering a significant potential to eliminate certain obstacles within the Single Market.

Nevertheless, as an inevitable outcome of the application of the global minimum tax rules, where the utilisation of cross-border losses results in a reduction of the effective tax rate for specific entities within the BEFIT group in certain Member States, the expectation is that this will trigger top-up taxes by Member States for entities in scope of Pillar Two, thereby diminishing substantially any benefits derived from the application of the BEFIT regime.

3. **Using financial accounts to determine corporate income will require additional guidance.**

Acknowledging the intent of the BEFIT framework to leverage financial accounting for the assessment of corporate income in alignment with Pillar Two, it is important to address potential concerns arising from this approach. Notably, since accounting standards primarily focus on gauging a company's income and expenses — a distinct objective from determining tax liability — more guidance between tax regulations and financial accounting standards will be necessary.

4. **The acceptable accounting standards for BEFIT purposes increase administrative burden and compliance costs.**

The requirement imposed by BEFIT for companies within its scope to prepare financial accounts under an EU-law compliant accounting standard, limited to either national GAAP or IFRS, poses an additional administrative burden for many taxpayers. This requirement obliges these entities to translate their existing financial records into an acceptable standard.

The rationale behind this requirement remains unclear, particularly when considering that the Pillar Two rules, as adopted in the EU Minimum Tax Directive, afford more flexibility. Under the Pillar Two framework, companies are permitted to use any acceptable financial accounting standard to identify accounting results to which adjustments are subsequently applied.

5. **The proposed withholding tax exemption for certain intra-group payments needs additional guidance in order for it to be effective.**

Whereas we recognise the benefits in exempting certain intra-group payments from withholding tax, there is a clear need for additional guidance to ensure the effective implementation of this exemption. Particularly, the definition of ‘beneficial ownership’ remains a point of contention across Member States. Given the challenges associated with establishing a common definition to date, it will be important to address and clarify this issue for the effective and consistent application of the withholding tax exemption.

6. **The calculation of the BEFIT tax base introduces a bias against new investments.**

In evaluating businesses’ capital cost recovery, specifically their ability to deduct investment costs under the BEFIT proposal, the Tax Foundation considers multiple factors set out in the BEFIT proposal, including the loss carryover provisions, inventory treatment allowance for corporate equity and capital allowances. The Tax Foundation contends that the BEFIT proposal introduces a bias against new investments due to less favourable treatment of these aspects.[1]

According to the Tax Foundation’s findings, the BEFIT proposal would negatively impact most decisions for businesses operating in multiple Member States, attributed to the following aspects:

- The BEFIT proposal, in contrast to the previous CCCTB proposal, restricts businesses from deducting inventory costs on a last-in, first-out (LIFO) basis. Instead, it limits inventory treatment to the weighted average cost and first-in-first-

[1] Capital Cost Recovery under BEFIT vs EU Member State Policies (taxfoundation.org)

out method. Allowing the LIFO method reflects the current economic conditions more realistically and could mitigate the impact of volatile prices or inflation and reduce the tax cost of new inventory.

- The absence of an allowance for corporate equity in the BEFIT proposal, unlike the CCCTB proposal, incentivises businesses to opt for debt financing, potentially increasing leverage and negatively affecting financial stability. While the explanatory memorandum aligns the BEFIT proposal with recent Commission proposals, including DEBRA (Debt-Equity Bias Reduction Allowance), it is regrettable that no allowance for corporate equity that incentivises businesses to have a neutral financial structure has been incorporated into this proposal.

- The treatment of capital allowances could be improved to support growth by enabling permanent full expensing. This approach allows businesses to immediately deduct the entire cost of certain investments in new or improved technology, equipment, or buildings, rather than adhering to a straight-line depreciation schedule that may penalise business investment.

- Clarity is needed regarding any time limits imposed on loss carry-forwards and potential restrictions on the maximum amount offset against future losses under the BEFIT rules for cross-border loss offsetting.

In addition to the above findings, BusinessEurope views the limitations imposed on the participation exemption (in particular, the misaligned treatment of dividends and capital gains under BEFIT and the Pillar Two rules) coupled with the lack of clarity surrounding the viability of incentives for specific industries within a BEFIT system (such as the innovation and patent boxes offered by some EU Member States) as having the potential to reduce the EU's competitive edge over other global regions.

This concern is increased by certain aspects of the BEFIT proposal that warrant further consideration:

- The proposal to disregard profits or losses attributable to permanent establishments of a BEFIT group may pose practical challenges in Member States that provide taxpayers with a tax imputation system offering relief for foreign taxes (as opposed to an exemption method). This also contradicts specific tax relief provisions in the tax treaties entered into by Member States.

- The lack of guidance on the treatment of final losses incurred by subsidiaries or permanent establishments of the BEFIT group located outside the EU introduces uncertainty regarding the economic outcomes of a group.

- More guidance is needed on the computation and treatment of the difference between the tax basis and the individual financial accounts basis for fixed assets upon entry. The five-year recapture period could significantly impact the cash tax line in case of significant differences and long depreciation period.

- Provisions allowing for the deduction of bad debts between associated entities (within or outside the BEFIT group) are deemed necessary in cases where the insolvency circumstances are objectively verifiable.

Finally, at a time when sustainable investment should be encouraged to stimulate the economy, any upcoming EU tax reforms should focus on promoting the use of effective fiscal measures that facilitate the green transition and contribute to the transformation of the EU's economy into a modern, resource-efficient and competitive one.

7. The proposed transitional system to allocate profits does not deliver simplification. Consensus on a permanent allocation formula remains a distant prospect.

A transitional system for the allocation of profits among Member States is in stark contrast to the policy options considered in the Commission's Call for Evidence of October 2022.

Businesses are sceptical about the viability of operating under such a transitional framework as that would instigate a constant shift in corporate income tax rules, promoting an unstable business environment with increased tax and legal uncertainties.

The proposed transitional allocation rule hinges on taxable results that may be subject to challenges by tax authorities, raising the risk of double taxation where no consensus is reached on the taxable results among relevant tax authorities. While joint tax audits might mitigate the risk of double taxation, they contribute to heightened tax uncertainty because they do not impact the final tax assessment carried out by a Member State's tax authority. This approach fails to achieve the desired corporate tax simplification.

In addition, whilst there is potential for significantly reduced transfer pricing through the formulary apportionment of profits, consensus on the elements of a formula remains a distinct prospect.

It will be important that potential benefits introduced in the EU are not reversed by the application of global tax rules. Given the remaining work that is required to be done to complete the OECD's Two-Pillar framework, it is important for policymakers to allow these rules to be adopted and then undertake a comprehensive stakeholder consultation process to reform the EU tax framework strategically, enhancing its competitiveness over the long term.

8. The simplified transfer pricing compliance does not provide effective relief from double taxation.

Whilst we welcome the proposed simplified transfer pricing mechanisms to address both intra-BEFIT group transactions and extra-BEFIT group transactions, it will be important to acknowledge that transfer pricing compliance will remain a necessary aspect especially for those entities in a group of companies that are not part of the BEFIT group.

Certain elements will undoubtedly continue to be subject to national interpretation, review, and audit, thereby undermining the overarching goal of achieving increased tax simplification through a single set of corporate tax rules.

We recognise that the Commission intends to simplify transfer pricing compliance through its proposal for a Directive on Transfer Pricing. However, the interaction between the BEFIT Directive and the Transfer Pricing directive remains unclear, particularly considering the differing definitions of a group under the two proposed Directives. This raises the risk of further complicating the interpretation process.

9. The co-existence of national tax systems with the proposed BEFIT framework increases complexity and compliance.

Whereas we acknowledge the value in preserving the distinctiveness of national tax systems, to reflect the varied economic landscapes of each Member State, the attempt to grant Member States the flexibility to operate their national tax regimes to the allocated profit share will not achieve the desired level of simplification if BEFIT operates in parallel to the national tax rules of the Member States and the OECD's Pillar Two Framework.

This is an inherent flaw in the proposal that undermines the overarching policy objective of streamlining corporate tax regulations into a single framework that benefits businesses and tax administrations, and that will inevitably result in increased administrative burdens.

For example, the proposal requires Member States to grant foreign tax credits (i.e. taxes on a BEFIT group member's income imposed by another Member State or in a Third Country) in line with the applicable double taxation treaties or national law. Subsequently, the tax credit must be distributed amongst the BEFIT group members based on the respective baseline allocation percentage of each BEFIT group member. However, challenges may arise since the criteria for obtaining tax credits can differ between national law and double taxation treaties. To ensure the continued granting of tax credits, it is crucial to establish clearer rules on the interplay between the BEFIT rules, national laws and tax treaties.

In addition, there are concerns around special tax regimes such as resource taxation. Indeed, the proposed rules for resource taxation necessitate significant additional complexities to separate upstream profits and losses in fiscal and accounting systems that are not configured for such distinctions. Moreover, this differentiation is distinct from, for example, the extractives exclusion currently proposed for Pillar 1 Amount A of the OECD/G20 Inclusive Framework's Two-Pillar project.

It will also be important to clarify the practical impact of the BEFIT rules on national tax rules operating the concept of fiscal unity to avoid tax and legal uncertainties.

As such, and in order to align the need for simplification with respect for national tax systems, a balanced approach will be essential for successful implementation of future common corporate tax rules.

10. The proposed administrative framework duplicates corporate income tax compliance within the EU.

The proposal for a BEFIT group to file BEFIT information returns with the tax administration of a single EU Member State does not seem to significantly alleviate the complexity of corporate income tax compliance within the EU.

As suggested, companies in scope of the BEFIT rules would be required to comply with an additional tax framework and file a Pillar Two information return, a BEFIT information return and separate national tax returns in every Member State where they conduct business to ascertain their final tax liabilities.

This duplicates the complexity for businesses in scope of the BEFIT rules raising the question of how investment will be boosted, and administrative costs reduced as is being suggested.

Businesses envisage substantial initial and ongoing operational expenses, along with adjustment costs tied to maintaining IT systems and continuous training of human capital. Furthermore, there is anticipation that local tax authorities will bear significant costs in adapting to new systems for scrutinising BEFIT information returns.

11. No quantitative evidence that BEFIT could reduce compliance costs, let alone achieve the targeted reduction of up to 65%.

Much of the media interest in the proposal has related to the Commission's suggestion, as noted in its press release that, *"The new, simpler rules could reduce tax compliance costs for businesses operating in the EU by up to 65%."*

However, upon examination of the impact assessment, it is clear that whilst it may be possible (and welcome) to achieve such a reduction in compliance costs by simplifying corporate tax rules, there is no quantitative evidence presented regarding the capacity of this specific BEFIT proposal to deliver such reductions.

More specifically, as outlined in the Commission's impact assessment, the basis for the Commission's assessment is a study published by the Commission in January 2022 and prepared by VVA and KPMG. The study was in part based on a telephone questionnaire to participating businesses. Of the 25 questions asked, the impact assessment uses question number 8, *"Is your enterprise subject to Corporate Income Taxation or to a simplified tax regime?"*

Assuming that responses have not been impacted by the clear misformulation of the question (a simplified regime is not an alternative to corporate income taxation as (wrongly) implied by the question), the Commission's analysis may represent a helpful attempt to estimate the potential benefits from a (undefined) simplified corporate tax regime. However, as noted above, no attempt has been made to calculate the specific compliance reduction relating to BEFIT.

We believe that if the Commission wishes to maintain this proposal, it should produce a specific study, which we would be happy to assist with, on the compliance cost savings that may be achieved by this proposal and that takes into consideration the compliance costs introduced further to the introduction of the Pillar Two rules in the EU.

Until such a study is produced, we ask that the Commission is clear that any suggestions it has made regarding potential reductions in compliance costs do not relate to the BEFIT proposal itself.