CFE tax advisers europe

OPINION STATEMENT

Opinion Statement FC 1/2023 on the European Commission Public Consultation on the Introduction of a New Corporate Taxation System in Europe (BEFIT)

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CFE Tax Advisers Europe is the European umbrella association of tax advisers. Founded in 1959, CFE brings together 33 national tax institutes, associations and tax advisers' chambers from 24 European countries. CFE was the initiator of the Global Tax Advisers Platform through which it is associated with more than 600,000 tax advisers worldwide. CFE is part of the EU Transparency Register no. 3543183647-05.

We would be pleased to answer any questions you may have concerning our Opinion Statement. For further information, please contact Bruno Gouthière, Chair of the CFE Fiscal Committee or Aleksandar Ivanovski, Director of Tax Policy at info@taxadviserseurope.org. For further information regarding CFE Tax Advisers Europe please visit our web page http://www.taxadviserseurope.org/

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1. Background

The European Commission's plans to overhaul Europe's business taxation rules by introducing a single corporate tax rulebook, known as the Business in Europe: Framework for Income Taxation ("BEFIT"), merits a thorough dialogue with all involved stakeholders and Member states.

CFE welcomes the opportunity to contribute through ongoing engagement with the European Commission and European Parliament, in discussions in our role as Member at the EU expert group Platform for Tax Good Governance and Aggressive Tax Planning and via the public consultation process.

Given the degree of difficulty in finding a common ground concerning the reform of EU corporate taxation, our response does not necessarily represent the view of each and every Member Organisation of CFE, although reasonable efforts have been made to provide a coherent and representative view of European tax institutes and associations of tax advisers.

2. Key Remarks of CFE Tax Advisers Europe

Before proceeding with the drafting of the BEFIT proposal, CFE Tax Advisers Europe recommends that the following factors are taken into consideration by the European Commission:

- BEFIT would represent a fundamental shift in the corporate tax landscape, and CFE would encourage the European Commission to defer further consideration of BEFIT until the rules for the implementation of Pillar Two have had sufficient time to be operational in practice. Only then should the European Union proceed with a process to analyse whether BEFIT would provide a benefit to tax authorities and MNEs.

- The Commission should take into account the subsidiarity principle of EU law and conduct a thorough quantitative and qualitative assessment of the impact of investment and revenue for all Member states, including sustainable revenue for the EU budget.

- Taxpayers have invested heavily over the last number of years to ensure that they comply with OECD Transfer Pricing requirements. The European Commission has not provided a rationale for moving away from that approach.

- The system will not eliminate the Arm's Length Principle ("ALP") and transfer pricing as we know it; it will only apply within the EU for the companies coming within the ambit of the legislation. MNEs will still be subject to traditional transfer pricing rules outside of the EU. This will create a two-tier system, which will lead to increased complexity and compliance costs for companies and tax authorities.

- The proposed 'risk-based' approach to transfer-pricing does not address these concerns, and instead focuses on one non-traditional transfer-pricing method, which might be controversial from the perspective of policy and practice.

- The BEFIT proposal envisages that tax authorities would operate two different tax systems in parallel, which would not meet the stated objective of administrative simplification.

- In addition to tax authorities, a two-tier system could increase the administrative burden for companies balancing on the 'application edge' of the BEFIT rules - i.e. if local non-BEFIT rules and BEFIT rules would deviate to a large extent, it would make moving from one system to another difficult for taxpayers (such as an SMEs).

- If BEFIT rules would be introduced, it would not be just a one-off transition from current system(s) to the new BEFIT era. Going forward there would be a number of taxpayers balancing between the two systems each year.

- If there is an objective to prevent certain companies from abusing the ALP and the transfer-pricing provisions, certain provisions must be included to deter MNEs from engaging in formula-factor manipulation.

3. The Architecture of BEFIT

In setting out the architecture of EU corporate tax reform, the primary starting point for such a dialogue would be outlining:

1. the objectives of the EU reform;
2. the model under which the rules would be introduced;
3. the interaction with Pillar 1 and Pillar 2, should these proposal be adopted;
4. the feasibility of introducing formulary apportionment for European taxpayers, Member states and tax administrations;
5. an economic model estimation and impact assessment on the effects of introducing formula apportionment; and
6. agreement and discussion on the technical/ design elements of the BEFIT formula.

As a corollary to such a dialogue we welcome the public consultation, in order to evaluate the balance of the tax sovereignty concerns of certain Member states, taxpayers and their advisers, against the potential benefits of BEFIT. These could potentially include streamlining the operation of the European corporate tax systems and improving the competitiveness of the Single Market, against the background of a very challenging geopolitical environment that we operate in at this time.

Some CFE Member Organisations believe that the introduction of a formula apportionment has the potential to facilitate and encourage business in Europe and boost the economy to everyone's best interest. However, we need to ensure a level playing field across the board.

For instance, SMEs play a vital role in developing the European economy and their success is pivotal to the success of the economy of the Single market. CFE welcomes any proposals that aid and facilitate SMEs to develop and expand their business in a cost-effective manner. Some CFE Member Organisations believe that formula apportionment has the potential to facilitate SMEs wishing to expand into different Member states through the simplification and reduction of compliance burdens and associated costs.

4. Scope

The European Commission intends to focus its proposal around five building elements: scope; tax base; formulary apportionment; transactions with parties outside the BEFIT group; and administration.

Regarding the scope, at this stage of the policy discussion, CFE supports optional introduction of BEFIT.[1] As such, all EU tax resident companies and EU-located Permanent Establishments ("PEs") which are members of a group that files consolidated financial statements could opt-in to apply the BEFIT consolidation, regardless of annual revenue thresholds previously considered for mandatory introduction of consolidation.

5. Tax Base Calculation

CFE is supportive of limited financial adjustments, a similar approach already taken in the EU Directive on minimum tax which implements Pillar 2 in the EU.[2] As such, the limited financial adjustments in the tax base calculation in the BEFIT group would use the EU's accepted financial accounting standards as a starting point. This would be the financial accounting net income and loss of each BEFIT group member, derived from the consolidated financial statements. Where the Ultimate Parent Entity ("UPE") is outside the EU, the group would choose one common, EU-acceptable accounting standard as a starting point. A defined list of acceptable adjustments would then be applied to the financial accounting result of each BEFIT group member to arrive at the BEFIT tax base.

Tax consolidation within a group might facilitate profit shifting by reorganisations etc, so these aspects must be taken into account. Intra-group transactions will have to be neutralised to avoid double deductions or double taxation. The Profit and Loss ("P&L") will be apportioned according to a formula, which can be adjusted by Member states for Research & Development ("R&D"), credits, deductions etc.

[1] Some CFE Member organisations do not support BEFIT at all, citing among other issues additional costs for companies in introducing and complying with a new tax system, as well as the uncertainty of what is involved in complying with Pillar Two Minimum Tax, including the administrative cost.

Other CFE Member organisations support a 'hybrid' approach (mandatory introduction of BEFIT, with certain high revenue threshold and optional below that), if transition period is provided for mandatory application, as in practice BEFIT would likely require lot of efforts from the companies transferring to apply new rules.

[2] Idem.

CFE is not supportive of a comprehensive set of new rules where an alternative system of tax base calculations would be designed by the EU.

6. Formulary Apportionment

It must be stated from the outset that there is no unanimous position within the CFE on introduction of formulary apportionment within the Single Market. Several members are opposed to such a solution and would not wish to see traditional rules of international tax law being abandoned, including the arm's length principle.

Any proposal which purports to introduce a common set of rules to determine a single tax base for MNE groups to be allocated between Member states using a formula will not be well received by some Member states. Even though it may be argued that countries have now accepted the principle of formulary apportionment by signing up to Pillar One, accepting "CCCTB" by another name is another matter entirely. Issues identified with the earlier CCCTB proposals remain pertinent to the BEFIT policy initiative, which appears to be substantially similar.

The basic principle that CFE might agree on is a formula which incorporates intangible assets, in addition to sales, labour and tangible assets. We would welcome further details on how intangibles would potentially be incorporated to give our conclusive comments on this matter.

We agree in principle that the intangible assets should be apportioned according to the location where significant R&D expenses were incurred, i.e., with reference to the location where intangible assets are booked in financial accounts). As such, R&D costs for marketing and advertising could potentially serve as a proxy value for apportionment and would make this formula factor more resilient against manipulation and less mobile solely for tax reasons.

CFE does not support location of critical staff involved in R&D being a formula factor, given that this is largely outdated in today's post-COVID world of modern economy and mobile workers working from home. CFE recognises that a degree of employee presence is required by the OECD Transfer-pricing Guidelines to comply with DEMPE requirements.[3] In including intangibles in the formula to be used, it must be said that the use of a proxy based on R&D expenses and costs for marketing and advertising would not fully reflect the investment made by businesses in both developing and acquiring intangibles.

The formula apportionment system requires a careful balance on the elements of the formula and their allocation among Member states. In designing the formula, the allocation key that would be chosen by the Commission as part of the proposed formulary apportionment method must strike

[3] Development, enhancement, maintenance, protection, and exploitation of intangibles (DEMPE) is a concept first introduced by the OECD in the 2015 BEPS Final Report on Actions 8-10, "Aligning Transfer Pricing Outcomes with Value Creation,". Actions 8-10 report provides guidance on determining arm's-length conditions for transactions that involve the use of intangibles between related parties under Article 9 of the OECD Model Tax Convention. This guidance, has been incorporated into the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (OECD Guidelines) ; OECD (2015), Aligning Transfer Pricing Outcomes with Value Creation, Actions 8-10 - 2015 Final Reports, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, https://doi.org/10.1787/9789264241244-en.

a balance between traditional economies and the knowledge or service orientated industries and the digital economy.

In outlining the issue, the Commission's Call for Evidence for an Impact Assessment states that: *"the current corporate tax systems do not fully reflect the realities of today's economy and global developments as they are still mainly based on the principles of local brick-and-mortar production. These principles are believed to be outdated since globalisation, digitalisation and the intensified use of intangibles have substantially changed how companies do business. These changes should also be reflected in how they are taxed."* Therefore, the effective exclusion of purchased intangibles from the formula would distort the allocation of profits and be inconsistent with the principles articulated and stated by the European Commission.

7. Key Suggestions on Cooperative Compliance as a Corollary to the BEFIT Reform

In order to arrive at a more efficient system, CFE encourages the Commission to focus on the value of cooperative compliance. CFE has highlighted areas for policymakers in which the current tax system could be improved whilst longer term reforms are being developed.

Member states should co-operate, with the help of the European Commission, to develop effective co-operative compliance programmes suitable for all sizes and types of businesses which facilitate cross-border trade and reduce the possibilities for double taxation. We call on the European Commission to encourage and enable exchanging best practices on co-operative compliance in Europe, and to issue recommendations for co-operative compliance fit for SMEs.

Cooperative compliance programmes should be transparent and respect taxpayers' rights, as set out in national and international / EU law.

Stakeholders should consider the advantages of voluntary public tax transparency as an integral part of their sustainability policies. The European Commission should monitor and assess the effectiveness of voluntary tax transparency initiatives.

Businesses and tax authorities should invest in the latest IT solutions to improve the quality of data, communication, and remote access to services. We look forward to the European Commission's initiatives aiming to promote IT solutions in tax administrations and stand ready to help.

8. Tax Competitiveness & Knowledge-Based Economies

CFE welcomes any measure that makes Europe more attractive as a location for R&D investment and as such would welcome the introduction of a R&D credit in the design of the proposal. This would be particularly beneficial for those countries that are trying to encourage innovation in SMEs.

It is important that the EU remains an attractive location for R&D investment in comparison to competitor territories. In order to achieve this, we believe that Member states should have the flexibility to design tax policy for R&D as they see fit.

A concern exists that knowledge and service-based economies will be adversely affected if the formula results in a lack of flexibility to develop and implement tax policy for R&D as they see fit within the framework. For example, an element that must be taken into account in the design: the exclusion of intangibles from the formulary apportionment will have a damaging effect on Member states with service and knowledge-based economies.

9. Tax Certainty

Concern exists about the implementation of formula apportionment in the EU – it will have practical implications and challenges for both tax authorities and taxpayers alike. In practice, the simultaneous operation of two systems (one with formula apportionment and one grounded on the ALP) would create significant implementation issues.

Tax authorities will require additional time and financial resources to implement an additional supranational system and will have to oversee two concurrent systems of tax administration, depending on the chosen model for BEFIT. The situation will be compounded if there is not sufficient guidance provided on new measures. The legislation in its proposed form would not be sufficient to provide clarity, particularly in light of the lacuna that will inevitably develop in the interim period between the loss of domestic tax jurisprudence to the development of new European jurisprudence.

Member states' corporate tax regimes are based on detailed legislation, guidance, precedents and case law spanning many thousands of pages – all of this would become redundant under a formula apportionment regime based on new rules and new definitions, creating uncertainty for businesses and tax authorities.

Tax certainty is of paramount concern to business and should be the focus of attention in the legislative design of the proposal. Any proposed changes to the corporate tax system on a European-wide level, will not be successful if it leads to tax uncertainty, increased compliance burden and increased disputes.

10. Dispute Resolution

Concerns exist about the potential dispute resolution mechanism in a corporate tax system based on a formulary apportionment. The primary concern is that the jurisprudence of domestic courts, developed over many years will become void and leave a vacuum in relation to legal certainty of key taxation concepts.

In order to avoid legal uncertainty, tax disputes would need to be resolved within a short timeframe. As the EU Directive for Dispute Resolution and, at bilateral level, under treaty law which follows the

OECD Model currently demonstrate, it is vital that taxpayers have access to and are actively involved in time effective and efficient recourse to dispute resolution.

Given the length of procedures at ECJ level at present, this would not be a time efficient or effective forum for dispute resolution under a common tax base. Consideration must be given for a separate forum for dispute resolution under the proposed formulary system.

11. Transfer Pricing

The European Commission has indicated in consultation with relevant stakeholders that traditional rules of international tax law, i.e., Article 9 of the OECD Model on which the Arm's Length Principle is largely based, would need to be adapted to simplify the rules applicable to transactions between an EU-member of a BEFIT group and the BEFIT member (entities outside EU consolidation), and between members of a BEFIT group and outside EU entities.

A traffic-light system based on risk assessment that largely relies on the TNMM as a transfer-pricing method; with ROS = EBIT/ total sales; RoTC = EBIT/ total costs as net profit indicators is considered as one of the potential approaches going forward.[4]

CFE is opposed to introduction of specific, EU-imposed transfer pricing rules. As accepted by the Court of Justice in the fiscal State aid cases, the choice of the transfer pricing methodology is for the taxpayers, in accordance with EU law, national tax law (and OECD Transfer-Pricing Guidelines, if implemented), provided they reflect market transactions and commercial reality.

Restricting existing options for profit allocation and transfer pricing methodology as set out by the OECD Transfer-Pricing Guidelines would represent a new interpretation of the Arm's Length Principle which could lead to uncertainty, higher compliance costs and disputes.

12. Final Remarks

Whilst the policy objectives of BEFIT might be acceptable[5], maintaining 'balanced allocation of taxing rights' for Member states to guarantee their current tax revenues remains essential. This is relevant for taxpayers too, if the imbalance in taxing rights would result in an increase in domestic tax rates in the longer run.

[4] The transactional net margin method ("TNMM") examines a net profit indicator, i.e. a ratio of net profit relative to an appropriate base (e.g. costs, sales, assets), that a taxpayer realises from a controlled transaction (or from transactions that are appropriate to aggregate) with the net profit earned in comparable uncontrolled transactions. The arm's length net profit indicator of the taxpayer from the controlled transaction(s) may be determined by reference to the net profit indicator that the same taxpayer earns in comparable uncontrolled transactions (internal comparables), or by reference to the net profit indicator earned in comparable transactions by an independent enterprise (external comparables) ; OECD (2022), OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2022, OECD Publishing, Paris, https://doi.org/10.1787/0e655865-en.

[5] Not all CFE Member organisations agree and support the policy objectives set out by the European Commission regarding BEFIT: Press Release IP/21/2430, European Commission; Future-proof taxation – Commission proposes new, ambitious business tax agenda, Brussels (May 2021).

Article 5(3) of the Treaty on European Union (TEU) provides: *"Under the principle of subsidiarity, in areas which do not fall within its exclusive competence, the Union shall act only if and in so far as the objectives of the proposed action cannot be sufficiently achieved by the Member States, either at central level or at regional and local level, but can rather, by reason of the scale or effects of the proposed action, be better achieved at Union level."*

To assist national parliaments in their evaluation of subsidiarity compliance, Article 5 of Protocol (No 2) on the application of the principles of subsidiarity and proportionality states: *"Any draft legislative act should contain a detailed statement making it possible to appraise compliance with the principles of subsidiarity and proportionality. This statement should contain some assessment of the proposal's financial impact and, in the case of a directive, of its implications for the rules to be put in place by Member States . . ."* Should the European Commission decide to proceed with the BEFIT proposal, a statement would need to be provided per primary EU law, with sufficient quantitative and qualitative indicators to allow national parliaments to fully assess all the implications in a cross-border proposal of this nature. The statement should demonstrate that the aims of the initiative cannot be sufficiently addressed by the Member states themselves and that action at the EU level would have additional benefits.

In particular, the statement would need to provide the following:

- An analysis of whether costs will be reduced for taxpayers, looking at the wider impact of the initiative.
- An analysis of the impact of the initiative on investment in individual Member states.
- An analysis of the impact of the requirement for tax authorities to run two different tax systems in parallel.
- An analysis of why the European Commission considers that BEFIT would provide a better solution than the current transfer pricing rules.
- An analysis of the impact of the proposals on smaller Member states and the EU budget overall, securing existing sustainable tax revenues for individual Member states as well as the EU budget.
- An analysis of the impact of the use of a single rate of tax on the tax revenues of Member states.

CFE and its Member Organisations stand ready to assist the Commission in considering the issues above in the course of the policy dialogue and public consultation.