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BEFIT: A Company Tax System Layering Exercise for the Internal Market (Part 2)

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This is the second part of the authors' blog on the Proposal for a Council Directive on Business in Europe: Framework for Income Taxation (BEFIT) that the European Commission (EC) published on 12 September 2023. In this part we present our observations on the envisaged EU corporate tax framework BEFIT proposal. Reference is made to the first part of this blog for an outline of the backgrounds and basic elements of the BEFIT proposal.

1. BEFIT: our observations

1.1 Focusing on 4 elements

On 12 September 2023, the European Commission (EC) published a Proposal for a Council Directive on Business in Europe: Framework for Income Taxation (BEFIT) (the BEFIT proposal).[1] The BEFIT proposal introduces a common company tax base for large European companies (annual turnover of more than €750 million). BEFIT replaces the 2016 Directive proposals for a Common Corporate Tax Base (CCTB)[2] and a Common Consolidated Corporate Tax Base (CCCTB)[3]. Groups with an annual turnover below the €750 million threshold and that draw up consolidated financial statements can opt for the application of the new rules. The envisaged implementation date of the BEFIT Directive is 1 January 2028, after which the Directive will apply from 1 July 2028.

The authors refer you to the first part of this article for the basic elements of the BEFIT proposal.

It could be said from the outset that any ambitions to strengthen the EU internal market and the competitiveness of the EU deserve support providing that the harmonizing rules achieve a robust, efficient and fair company tax system for all European companies. The same applies to achieving a level playing field within the EU for the mitigation of tax competition between the EU Member States.

Our observations focus on the following 4 elements:

- administrative burden for companies,
- legal certainty for companies,

- simplicity of the tax system in the EU, and
- aggregation into a single BEFIT tax base.

1.2 Administrative burden for companies

BEFIT reduces the administrative burden for companies

A harmonized company tax system within the EU could allow companies to directly enjoy the benefits of the internal market without incurring an unnecessary additional administrative burden which is inherent when a MNE deals with different tax systems, as is currently the case. Therefore, BEFIT seems to ease the administrative burden and compliance for EU and non-EU headquartered MNEs given that the EU Member States would need to apply common rules for the determination of the BEFIT tax base of each BEFIT group member.

BEFIT increases the administrative burden for companies

Although the BEFIT tax base of each BEFIT group member will be calculated based on harmonised rules, the compliance required from the BEFIT group should not be neglected. Groups will need to file the BEFIT return and continue to file tax returns locally so that post-allocation the tax authorities can ensure that adjustments to the BEFIT tax base have been applied correctly. From a compliance perspective it is doubtful whether BEFIT will in essence reduce the tax compliance and administrative burdens faced by groups.[4]

1.3 Legal certainty for companies

BEFIT enhances legal certainty for companies when doing business in the EU

A standardized tax system has the potential to significantly improve legal certainty for companies when doing business in the EU. Specifically, a harmonized tax base aligned with accounting standards could be seen as a progressive stride towards achieving legal certainty, especially in light of the concurrent Pillar Two system, which uses accounting standards as well as a starting point.

BEFIT undermines legal certainty for companies when doing business in the EU

The emerging disparities between BEFIT and Pillar Two, particularly in the adjustments to financial accounting profits and losses, will undoubtedly present challenges for EU and non-EU groups. This discrepancy hampers, in our view, the pursuit of legal certainty in the EU: compliance with Pillar Two does not inherently also ensure compliance with BEFIT and vice versa. In essence, the calculations under Pillar Two occur independently from those under BEFIT. This disconnection does not assure a cohesive tax system in the EU, even when considering the distinct objectives between BEFIT and Pillar Two.

Furthermore, due to differences in the distribution of the tax base, BEFIT base allocation may give rise to Pillar Two top-up taxation.[5] The Dutch government has acknowledged this effect and outlined it as follows (author's translation): *"Under the Pillar Two rules, top-up taxation might occur based on the commercial results within that year. As BEFIT's recognized profit relies on results from the previous three years, an undesired discrepancy might arise. For instance, if losses were incurred in the past three years and a commercial profit is gained in the present year. This scenario could lead to BEFIT showing a loss for the tax year, despite the commercial profit, thus*

resulting in no tax liability. However, according to Pillar Two rules, top-up taxation will be applicable in that year. The situation becomes more intricate with the potential offsetting of losses against profits in another Member State." The Dutch government explains the effect with a numerical example, which we include in full below for the sake of convenience.

Box 1. Numerical example concurrence Pillar Two rules with BEFIT

Multinational group ABC falls within the scope of both BEFIT and Pillar Two. ABC has three entities (A, B and C) that are established in EU Member States A, B and C. For the sake of convenience, the differences between BEFIT and Pillar Two have been abstracted for purposes of the income calculations. In Member State A, the income is €200, in Member State B it is €150, and in Member State C there is a loss of €50. The statutory tax rate in Member State A is 20%, and in EU Member States B and C it is 15%.

Under Pillar Two, a top-up tax should be levied up to 15% if the effective tax rate in a jurisdiction is less than 15%. In the situation where BEFIT is not yet applicable, there is no low-tax jurisdiction and no Pillar Two top-up tax will take place. The effective tax rate ('ETR') of the group is 20.8%. In the scenario where BEFIT does apply, Pillar Two seems to result in top-up taxation. This can be illustrated as follows. The BEFIT basis is the aggregate result of the three BEFIT entities and is €300 (€200 + €150 – €50). The results of the three group entities in the three previous years were the same, which means that the basis is distributed equally. €100 will be allocated to each BEFIT group entity. This amount is subject to the BEFIT levy. Based on the above-mentioned statutory tax rates, this means that €20 (20% of 100) will be paid in Member State A. In EU Member States B and C, €15 is paid.

Pillar Two seems to be based on income and not on the BEFIT allocation. As a result, the ETR in EU Member States A and B is 10%, i.e., lower than the minimum of 15%. Due to the concurrence with BEFIT, it seems that under Pillar Two in EU Member States A and B an additional €10 and €7.5 respectively will have to be levied. This is despite the fact that without the application of BEFIT, there is no Pillar Two top-up tax. As a result, the group's ETR increases from 16.7% to 22.5%.

	Member State A	**Member State B**	**Member State C**	**Total**	**ETR Group**
Income*	200	150	-50	300	
Tax rate	20%	15%	15%		
Pillar Two (without BEFIT)					
National tax	40	22.5	-7.5	55	
Effective rate	20%	15%	0%		
Pijler 2 minimum %	15%	15%	15%		
Pillar Two additional levy %	0%	0%	0%		
Pillar Two additional levy	–	–	–		
	40.0	22.5	–	62.5	20.8%***
Pillar Two (with BEFIT)					
BEFIT attribution **	100	100	100		
BEFIT levy	20	15	15	50	16.7%
Effective rate ***	10%	10%	0%		
Pijler 2 minimum %	15%	15%	15%		
Pillar Two additional levy %	5%	5%	0%		
Pillar Two additional levy	10	7.5	–	17.5	
				67.5	22.5%

* It is assumed that Pillar Two income and BEFIT income (for the application of the formula) are the same.
**It is assumed that countries have contributed equally over the past 3 years.
*** Loss relief rules, and related deferred tax liabilities, have been abstracted under Pillar Two.

Source: Fact sheet 3 Working Group on the Assessment of New Commission Proposals (werkgroep Beoordeling Nieuwe Commissie voorstellen (BNC)): Business in Europe Directive: Framework for income taxation, annex to Letter from the Minister of Foreign Affairs, 6 October 2023 (BZDOC-1953107355-69).

1.4 Simplicity of the tax system in the EU

BEFIT ensures a simpler tax system in the EU

A harmonized tax system holds the potential to ensure a simpler tax system within the EU. In this scenario, national corporate income tax laws would not be the starting point, but rather the accounting standards. This means that MNEs would not have to navigate through different tax systems and tax administrations, thus contributing to a simpler tax system.

BEFIT complicates the tax system in the EU

The implementation of BEFIT and its EU-wide tax base results in a significant revamp of the current CIT systems across individual EU Member States. BEFIT introduces multiple parallel company tax systems within the EU Member States, encompassing diverse taxable profit structures relating to BEFIT, CIT[6] (post-BEFIT allocation) and Pillar Two (post-BEFIT allocation). The option for smaller groups to choose BEFIT introduces potential transitional challenges, such as how to handle losses both during and after the designated “BEFIT period”.

In addition, the concurrence with Pillar Two, the Pillar One initiative, the EU TP Proposal[7] and the HOTS Proposal[8] seems to make things complex and far-reaching from the outset. Besides affecting financial reporting, BEFIT introduces a fourth accounting system for companies. Its implementation is likely to have far-reaching consequences for the tax authorities of EU Member States, impacting areas like automation, enforcement, service provision, communication, international collaboration, and potentially necessitating capacity expansions. EU and non-EU groups can expect a similar scenario, and it might take time for the new system to solidify in practice. The unanimity requirement for decision-making in the EU could pose challenges in adapting to future developments.

1.5 Aggregation into a single BEFIT tax base

Aggregation eliminates obstacles to conducting business across various EU Member States

The aggregation of results across the borders of the EU Member States brings an advantage to taxpayers compared to the current CIT systems in the EU.The current reality of a netting of CIT basis within national borders, territoriality, or jurisdictional blending in Pillar Two terminology, creates a lock-in effect for company tax purposes. This is the case as such (i.e., a tax-netting of domestic investment returns) favors investments in jurisdictions in which the market operator is already operative over investments across national borders in other jurisdictions (i.e., by not allowing a tax-netting of cross-border investment returns). Within the scope of EU law, this goes against the idea of an internal market without internal borders for groups. Hence the regional blending in BEFIT is a renewed expression of the EC’s long-cherished wish for intra-EU netting of taxable bases.

Aggregation may result in Pillar Two top-up tax liability

The aggregation of BEFIT results may be offset by the Pillar Two system. When BEFIT results are combined, the effects could be nullified by the Pillar Two system. Offsetting losses against profits in another EU Member State might reduce the Effective Tax Rate (ETR) of the group in an EU Member State to below 15%, potentially triggering a top-up tax under the Pillar Two rules. For further details, including a numerical example, please refer to section 3.2 of this article.

2. Will BEFIT be adopted?

It is too early to say whether BEFIT will be adopted, at all or in its current form. Recently, the Netherlands[9] and Finland[10] have announced that they are supportive of the BEFIT but they have serious reservations. Both states are referring to unpredictable tax bases.

The Netherlands government largely supports BEFIT but seeks a closer link to the Pillar 2 tax base, preferring to gain experience with Pillar 2 before transitioning to a harmonized tax base. It anticipates significant challenges dealing with four different tax systems, expresses concerns about unpredictability in tax base allocation, and doubts the reduction of compliance costs. Recently, the Dutch parliament requested its government to convey its disapproval of the proposal to the EC. Before the government can give approval, the parliament wants to make clear arrangements on how it will be informed about the negotiations of the proposal.

Finland supports BEFIT but has concerns. The government doubts whether the administrative burden will decrease and emphasizes the need for attention during legislation. Additionally, Finland is apprehensive about the transfer of taxing powers to the national level, highlighting significant harmonization challenges and uncertainties in tax revenue, coupled with demanding implementation deadlines in the evolving international corporate taxation landscape.

3. Closing remarks

The BEFIT proposal brings a new dynamic to the debate on the taxation of multinational business profits within the internal market. The arguments for or against BEFIT are to some extent similar to those that also played a role in the context of Pillar Two. Pillar Two is now almost a reality, at least within the EU.

How will BEFIT fare? The EU Member States still have their own tax policies. On the one hand, BEFIT is about strengthening the internal market and the EU's competitive position. A harmonized tax base can contribute to this. BEFIT, on the other hand, is about a cumulation of tax legislation and a possible coexistence of parallel company tax systems (CIT, Pillar Two, BEFIT). The proposed transitional distribution mechanism will result in a tax netting for businesses within the internal market and a more volatile treasury revenue for EU Member States. The suggestion to limit the EU Member States' room for maneuver and at the same time to promote it represents a trade-off in terms of the administrative simplification sought, amongst others. Furthermore, the EC reminds the public that '[i]n 2020, the Council, Parliament and the EC agreed that a common corporate tax base could be the basis for a new own resource that the EC will propose'.[11]

Looking at the experiences in the past within the Council with the EU directive proposals for a CC(C)TB of 2011 and 2016, the BEFIT proposal may very well also give rise to complex political discussions. At the same time, times have changed. After Pillar Two, EU Member States will no longer be able to play the autonomy card nearly as firmly as they did with the CCCTB.

[1] The authors express their gratitude to their PwC colleague Anna van Beek for her meticulous work in researching and adding the necessary footnotes to this article.

[2] See European Commission, Proposal for a Council Directive on a Common Corporate Tax Base, COM(2016) 685 final, 25 October 2016 (withdrawn).

[3] See European Commission, Proposal for a Council Directive on a Common Consolidated Corporate Tax Base, COM(2016) 683 final, 25 October 2016 (withdrawn).

[4] According to the EC, however, these compliance costs are estimated to be outweighed by compliance cost savings as well as simplified administrative procedures and in the long run, the improved allocation of resources by businesses and tax administrations. See BEFIT proposal, Explanatory Memorandum, Sec. 2, page 6.

[5] This effect has already been observed in practice (see e.g., Stephanie Soong, 'Slow EU Pillar Two Adoption Is a Challenge, Says EU Official', Tax Notes International, 19 September 2023).

[6] Or even personal income tax system (PIT) when the CIT refers directly to PIT for the definition of certain concepts.

[7] See Council Directive on Transfer Pricing, COM(2023) 529 final.

[8] See Council Directive establishing a Head Office Tax system for micro, small and medium sized enterprises, and amending Directive 2011/16/EU, COM(2023) 528 final.

[9] See https://open.overheid.nl/documenten/e0787088-e0c7-428f-a932-0aa7f58cadf6/file (Dutch).

[10] See https://valtioneuvosto.fi/-/10623/hallitus-suhtautuu-varauksella-yritysten-tuloverotusta-euroopassa-koskevaan-befit-kehykseen (Finnish).

[11] BEFIT proposal, Explanatory Memorandum, Sec. 1, pages 1-2.

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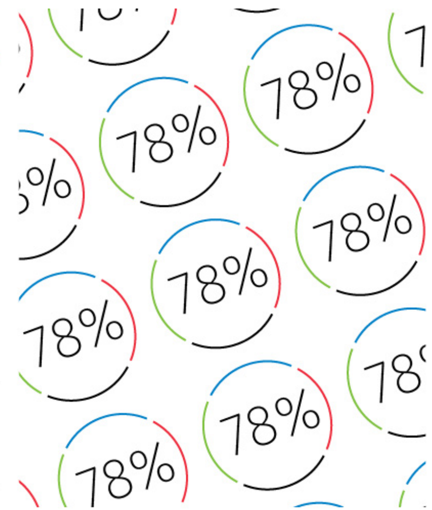

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