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UNION DES ENTREPRISES LUXEMBOURGEOISES

EU directive proposal laying down rules on Business in Europe: Framework for Income Taxation (BEFIT)

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UEL response to the EU public consultation

The EU Commission released in October 2022 a call for evidence for an impact assessment on the introduction of a common set of rules for EU companies across the EU to calculate their taxable base, while ensuring a more effective allocation of profits between EU countries based on a formula (hereafter the "BEFIT initiative"). This BEFIT initiative also aims to reduce compliance costs and create a coherent approach to corporate taxation in the EU.

UEL, and the Luxembourg business sectors it represents, support the EU Commission's initiative to provide a fair and sustainable business environment within the EU, including any initiative that:

- reduces the tax compliance administrative burden;
- simplifies the operations across the Single Market for businesses; and
- facilitates cross-border activity for EU resident companies.

We generally support the idea of addressing the tax complexity deriving for taxpayers from the undertaking of cross-border activities within the EU due to the application of a different set of tax rules in each Member State (MS) and the compliance burden and costs attached thereto.

However, we would like to stress the following points in relation to the BEFIT initiative:

I. General considerations

- As a preliminary comment, we believe that the main objective pursued by the BEFIT initiative should be clarified, i.e., whether it mainly aims at reducing the complexity of tax rules and compliance costs faced by EU businesses operating across borders, or if it primarily aims at reallocating tax revenues between MS. In this respect, we believe that the BEFIT initiative should only focus on effectively reducing compliance costs for corporate taxpayers since, with Pillars 1 and 2, a new tax framework is already currently being implemented with a view of providing a fairer tax environment within the EU. Attention should therefore be paid to ensuring that BEFIT would not merely operate as a mechanism to reallocate tax revenues between MS.

- It would also be worth that the EU Commission further elaborates on the reasons and opportunity for abandoning current transfer pricing rules in favor of a formula for allocating taxable profits. One may indeed wonder if the objective of simplification might not be hindered by the fact that transfer pricing rules will continue to apply to relations with non-EU companies. Furthermore, one may also fear that the new rules (including the allocation formula) could give rise to tax controversy in the first years of their application since MS will not be able to rely on existing case law and guidance for their interpretation.

II. Scope

- We understand that it is currently contemplated to have an optional system for SMEs, which we welcome. The key objective and challenge will thus be to ensure that BEFIT effectively meets its goal of simplification for SMEs and enables them to expand their business activities more easily across the Single Market.

- We fear that, contrary to the stated intention of the BEFIT initiative, the tax system will not necessarily be simplified as this initiative will only apply within the EU, thus creating two parallel tax systems for taxpayers having transactions with both EU and non-EU jurisdictions. Therefore, BEFIT should provide clear guidance on its interaction with tax rules applicable to transactions with third countries and, in particular, regarding the application of the arm's length principle. This will be key to avoid circular application of the rules and conflicts between different sets of norms which would generate legal uncertainty and additional tax disputes.

- Two parallel tax systems will inevitably also remain as smaller companies are likely to remain out of the scope of the initiative, which raises the question whether the initiative might not lead to increased complexity and additional administrative costs for national tax authorities, rather than a simplification. Indeed, it is likely that continuous training, possibly additional human resources, adaptation and/or development of new local IT tools, are some of the areas where MS will have to invest for the two parallel tax systems to function properly.

III. Tax base calculation

- To achieve the goal of simplification, the following elements should be taken into consideration when determining the tax base for BEFIT purposes:
    - **General interaction with the existing EU and OECD tax frameworks**: the OECD and the EU have undertaken an ambitious modernisation of the tax landscape which is largely driven by the desire to fight perceived abuses. This modernisation has added significant complexity to the tax framework. We understand from the consultation document that "*BEFIT will complement other EU policies on direct taxation such as the Anti-Tax Avoidance Directive and its amendments*". However, and assuming that BEFIT would not be optional (except for SMEs), we believe that the BEFIT initiative should not result in adding another layer of rules but should rather aim at consolidating all the existing corporate tax rules (e.g., BEPS, ATAD 1, ATAD 2, Pillars 1 and 2) into one single set of tax rules applicable withing the EU for in-scope taxpayers. In doing so, it will be key to ensure that certain specificities (e.g., industry carve-outs) of the current tax rules are kept in BEFIT. This consolidation work should also be taken as an opportunity to assess the scope and effectiveness of the existing corporate tax rules and to remove any unnecessary or overlapping legislation. This would be key to ensure the competitiveness of the EU tax framework in comparison to non-EU countries so as to avoid relocations of business activities outside the EU.
    - **Specific interaction with Pillars 1 and 2**: We understand that Pillars 1 and 2 are likely to be the basis of the BEFIT initiative (as per the consultation document). We believe that this alignment would ensure a certain level of simplification for groups having both EU and non-EU entities (even if some complexities will remain such as in the transfer pricing area). However, based on the consultation document, it is not clear whether the EU Commission intends to propose an EU-wide set of generally

acceptable accounting principles and how it plans to handle the differences between national GAAPs and the fact that non-EU MNEs typically use GAAPs that may differ from IFRS (e.g., US GAAP). Considering the large efforts and investments that will have to be made by taxpayers to comply with Pillar 1 and 2 rules, we believe that the same accounting standards as used for Pillar 2 purposes should remain the reference for BEFIT. Therefore, we believe that the introduction of a new accounting methodology would not be appropriate.

  - **Other elements**: the contemplated harmonisation of the tax base should be combined with other simplification measures. In particular, tax returns, tax compliance and assessment processes should be harmonised as well.

- Furthermore, we believe that the EU Commission should take the opportunity of the BEFIT initiative to ensure that certain local tax incentives can be recognised for BEFIT purposes, such as tax incentives for digital and green investments, in order to allow MS to implement a tax policy that will support economic growth and long-term investments within the EU.

IV. Formulary apportionment

- We understand that the impact assessment of BEFIT on the MS' revenues has not yet been achieved. However, this assessment is a key component for MS and stakeholders to provide an informed opinion on this initiative. Indeed, based on studies[1] provided at the time of the CCCTB assessment, we understand that the new rules would lead to a decrease of tax revenues for certain MS, and in particular for smaller countries, depending on the details of the formulary apportionment (the destination-based element of the formula being particularly detrimental to these countries). In this respect, the impact assessment achieved by the OECD on Pillar 1 (*inter alia*)[2], demonstrates that "*the effect of the revenue nexus thresholds on allocated residual profit is mainly significant in the first two groups (i.e. the smallest economies) and negligible in the last two groups (i.e. the largest economies).*" Indeed, we fear that smaller countries might have to levy additional taxes as a compensation which could be detrimental to groups operating in these countries and ultimately to the competitiveness of the EU. Furthermore, we believe that (i) the new common framework should replace all existing national levies on corporate income (including withholding taxes) and future levies as envisaged by Pillar 2 (top-up taxes) and (ii) the implementation of BEFIT should not increase the global corporate tax burden of taxpayers. Finally, we believe that BEFIT should not override MS' national governments in any decision on tax rates.

- We further understand that one of the building blocks of the BEFIT initiative would include a consolidation component (in conjunction to the formula for the allocation of profits). It is important that this component includes both cross-border profits and losses, as seems to be foreseen in the consultation document. Moreover, in case of consolidation, a one-stop shop mechanism should be implemented allowing multinational groups to deal with only one tax administration. However, as mentioned above, we fear that this building block may create additional complexity and tax disputes in relation to the application of the apportionment formula. Attention should therefore be paid to the compliance costs, especially for the lower-resourced tax administrations who will have to invest significantly to be properly equipped to support the ambitions of BEFIT.

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[1] Impact assessment of the CCCTB Proposal, 25 October 2016
An evaluation of the effects of the European Commission's proposals for the Common Consolidated Corporate Tax Base, 2021

[2] Tax challenges arising from digitalisation – Economic impact assessment, 2020

V. Administration

- More generally, it will be of paramount importance to ensure the implementation of a comprehensive and workable set of rules which would effectively achieve the goal of simplification pursued by this initiative. As local tax authorities will have to apply an entirely new set of rules without having detailed guidance (including case law) on their practical application and interpretation for a number of years, it will be necessary to foresee the implementation of various mechanisms which will allow to provide as much early tax certainty as possible for taxpayers and ensure a consistent interpretation of the new rules across all MS. Absent any case law of the CJEU on the interpretation and the application of BEFIT (which may take years, if not decades), there may be divergent, if not opposite, judgments rendered by the local Courts of the various MS, contributing to an even greater legal uncertainty and insecurity for taxpayers. It will further be key to ensure that efficient dispute prevention and resolution mechanisms between MS are in place.

- Finally, a close look should be kept on the timing of implementation of BEFIT to leave MS and taxpayers sufficient time to first implement the Pillar 2 rules and then to adapt to the new BEFIT rules once they are finalised at EU level.

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***About UEL**:*

UEL (Union des Entreprises Luxembourgeoises) is the Luxembourg Employers' Association. UEL represents the Luxembourg private-sector businesses, except for the primary sector, and includes the Grand Duchy's professional chambers and employer federations.

UEL works for a sustainable and prosperous economy for Luxembourg, its inhabitants and those who work there. It endeavors to provide an economy that is attractive to both investors and talented individuals.

To accomplish its mission, UEL facilitates working groups and discussions with its member organizations on major inter-branch topics. It is thereby able to present joint positions to the public authorities and social partners on these topics which they can then review together.

The initiatives launched by UEL are based on the values of the social market economy, sustainable development, business ethics, good governance and dialogue.