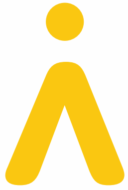


ACCOUNTANCY EUROPE.

BEFIT PROPOSAL: A COMMON TAX BASE FOR THE EU

Factsheet

FACTS.

TAX
NOVEMBER 2023

HIGHLIGHTS

The European Commission (EC) released a legislative proposal to simplify the tax reporting and the tax base calculation for cross border groups with a presence in the EU.

Accountants should be aware of this proposal to advise their clients. The changes can heavily impact very large groups of companies.

This publication provides a high-level summary of the main provisions.

INTRODUCTION

On 12 September the European Commission published a proposed Directive as part of the Business in Europe: Framework for Income Taxation (BEFIT) package. It aims to introduce a common European framework for calculating the tax base for corporate income tax and simplify the EU's tax environment.

This new proposal follows the rejected Common Consolidated Corporate Tax Base (CCCTB) proposal in 2011 as well as the second CCCTB and the Common Corporate Tax Base (CCTB) initiatives in 2016.

This publication highlights the proposal's key features. For more detail, please consult the Directive full text.

As this is a proposed Directive, all details and timelines are subject to change during the legislative process.

WHY HAS THE PROPOSAL BEEN INTRODUCED?

The BEFIT proposal is intended to simplify the EU's tax environment, "create a level playing field, enhance legal certainty, reduce compliance costs, encourage businesses to operate cross-border and stimulate investments and growth in the Union."

The Commission highlights the costs for cross border businesses that have to comply with up to 27 different national tax systems. It also highlights that recent initiatives have helped to address specific aspects of tax avoidance but have resulted in more complex tax systems.

WHO WILL BE AFFECTED, AND WHEN?

MANDATORY

BEFIT is mandatory for groups (the BEFIT group, see section below) operating in the EU (even if headquartered in a third country) that:

- belong to a group that has prepared consolidated financial statements, and
- has a combined revenues of at least €750 million for at least 2 of the last four fiscal years, and
- are constituted as a limited company or similar (details in Appendix I of the Directive), and
- are subject to corporate income tax or an equivalent tax (Appendix II of the Directive).

This is the same scope that applies to the OECD's Pillar Two Rules.

VOLUNTARY

In addition, other groups operating in the EU that prepare consolidated accounts may also voluntarily apply the BEFIT rules for their EU entities.

NON-APPLICABLE

Non-EU headquartered groups that would normally be mandatorily subject to BEFIT rules will not be automatically subject to BEFIT rules if, in two of the last four years, the combined revenues of the groups EU subsidiaries and permanent establishments do not exceed either:

- 5% of the total worldwide group's revenue, or
- €50 million

WHEN?

It is proposed that BEFIT would come into force on 1 July 2028.

For the first seven years to 30 June 2035 ('the transition period') the 'baseline allocation method' described below will be used. During this time work will continue to replace the baselines allocation method with a method

based on formulary apportionment. If this is unsuccessful the baseline allocation method will become permanent from 1 July 2035.

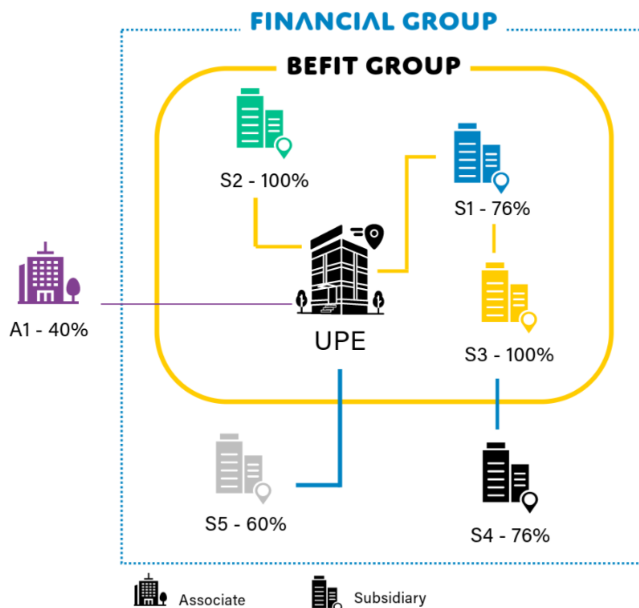
THE BEFIT GROUP

A BEFIT group will be formed where two or more companies or permanent establishments that fall within the scope detailed above meet the following criteria:

1. the company is the ultimate parent entity (UPE) or any other company of the group in which the UPE holds, directly or indirectly, at least 75% of the ownership or profit rights, **or**
2. the head office of the permanent establishment is either the UPE of the of the group or any other member of the group in which the UPE holds, directly or indirectly, at least 75 % of the ownership or profit rights.

This is a higher hurdle than the criteria for preparing group accounts under the 2013 Accounting Directive, which requires more than 50 % holding of the ownership or profit rights.

This, and the restriction that a BEFIT group member must have its tax residence in the EU, means that there can be considerable differences between the financial reporting group and BEFIT group.

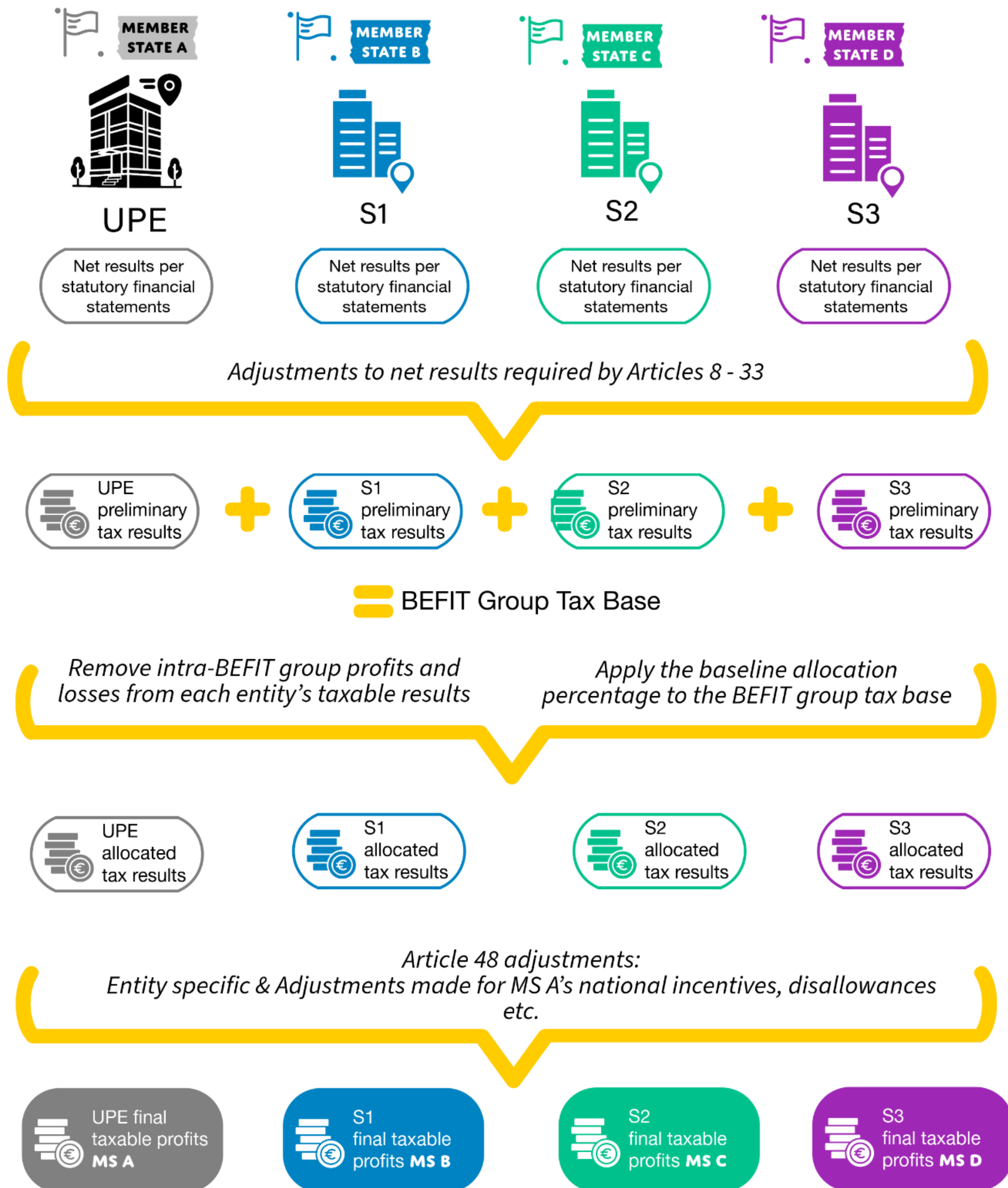


WHAT HAS BEEN PROPOSED?

Broadly, it is proposed to compute the tax base of individual members of the BEFIT group as follows:

- the starting point is the financial accounting net income or loss before consolidation adjustments per the entity's individual financial statements
- a limited range of BEFIT adjustments are proposed to produce the preliminary tax result of BEFIT group members
- the preliminary tax results are aggregated for the BEFIT group
- the BEFIT preliminary tax results are reviewed by a dedicated BEFIT team
- the aggregated BEFIT group results are then apportioned to individual BEFIT group members
- national adjustments are applied to the apportioned BEFIT results to provide the final entity tax base.

This can be represented graphically:



FINANCIAL ACCOUNTING RESULTS

The preliminary tax results calculation of an individual member of the BEFIT group starts with the accounting profit and loss of the individual entity, prior to consolidation adjustments.

In principle, this means that all expenses included in individual financial statements are automatically deducted for the purpose of corporate income tax, if they are incurred for business purposes.

This is one of the benefits of BEFIT.

However, as is the case with national tax systems, BEFIT has a list of adjustments to the profit or loss as shown in the individual financial statements. These will be described in the next section.

The financial statements used as the basis for the preliminary tax result must be prepared in accordance with the accounting standards applied by the UPE. If the UPE is resident in the EU, the accounting standard could be either IFRS or the accepted accounting standard in force in the Member State where the UPE is located.

If the UPE is not tax resident in a Member State, the acceptable accounting standard will be that of the Member State where the BEFIT group filing entity is located for tax purposes.

REQUIRED ADJUSTMENTS

The accounting net profit or loss must be adjusted for certain items, if the circumstances apply to the BEFIT group member.

These adjustments are detailed in Articles 8 to 33 and are similar in nature to, but less extensive than, those contained in the OECD's Pillar Two calculations.

The adjustments cover such areas as:

- dividends, distributions and some gains or losses
- changes in fair value
- income or loss from a permanent establishment
- specific provisions covering shipping and insurance activities
- fines and Illegal payments
- depreciation (noted as being the single biggest source of adjustments in Member States' tax systems)
- timing and quantification rules covering such items as stocks\work in progress, accounting provisions, bad debts etc.

There are also detailed rules covering situations when an entity enters or leaves a BEFIT group (Articles 36 -41).

AGGREGATION OF THE PRELIMINARY TAX RESULTS

The preliminary tax results of all BEFIT group members are added together to produce the BEFIT tax base – after removing all profits or losses arising from intra-BEFIT group transactions.

If one or more of the BEFIT members have a preliminary tax loss, this is automatically offset against preliminary tax profits of other BEFIT members - irrespective of which Member State they are located.

This automatic cross-border loss relief is another advantage of BEFIT.

If the aggregated BEFIT tax base shows a net loss, this can be carried forward to be automatically offset against the next net aggregated BEFIT taxable profit. No other forms of loss relief are proposed for an aggregated BEFIT group loss.

ALLOCATION OF THE BEFIT TAX BASE

In the first seven fiscal years following implementation (which is known as the 'transitional phase'), the BEFIT tax base is allocated to members of the BEFIT groups using the following baseline allocation percentage:

$$\text{Share for each BEFIT member} = \frac{\text{Average taxable result of the BEFIT member for the last 3 fiscal years}}{\text{Average taxable result of the BEFIT group for the last 3 fiscal years}} \text{ x BEFIT tax base}$$

There are detailed rules covering situations where a group has not been a BEFIT group for three consecutive years.

Where a BEFIT group member has made a loss for a fiscal year, this is treated as zero for the purposes of calculating the baseline allocation percentage.

If a BEFIT group member has losses or profits arising from intra-group transactions not conducted at arm's length, the member's tax results must be adjusted accordingly.

Member States are not permitted to impose source taxation of any sort on intra-BEFIT group transactions unless payment is made from a BEFIT group member to a recipient that is not a member of the BEFIT group. In this case, any tax withheld is shared using the same allocation method shown above.

Where income in a BEFIT group has been subject to taxation in another jurisdiction, a corresponding tax credit shall be shared amongst the BEFIT group using the allocation method shown above.

BEFIT group members are also required to increase or decrease its allocated part for certain circumstances described in Article 48. That same Article also clarifies that Member States are able to increase or decrease the allocated part of the BEFIT group results – this would cover, for example, national tax incentives or specific items disallowed as tax deductible expenses.

Special rules exist to deal with distribution-based tax systems (Article 49).

Allocation example

Fiscal year	BEFIT group taxable results (€ million)	BEFIT group member A results (€ million)
31/12/2032	1000	100
31/12/2031	1400	120
31/12/2030	1200	90
Average	1200	103

Group member A's allocated taxable results for year ended 31 December 2032 would be:

$$\frac{103}{1\ 200} \text{ x } 1\ 000 = €88.4 \text{ million}$$

BEFIT GROUP FILING REQUIREMENTS

All BEFIT group members must have the same 12-month financial reporting period (fiscal year) as the UPE. Apportionment applies when entities leave or enter a BEFIT group during the 12-month period.

The BEFIT group's filing entity (normally the UPE) must submit a BEFIT information return within four months of the end of the fiscal year. This return shall detail the BEFIT group members, tax identification numbers and information on the corporate structure - including tax residence of members. The return also contains the preliminary tax result of each group member, the BEFIT tax base and the amounts allocated to individual BEFIT group members.

The BEFIT aggregated results are examined by the 'BEFIT Team' - representatives of the tax administrations in each Member State where the BEFIT group has residence for tax purposes. The BEFIT team is to agree the contents of the BEFIT information return. Once agreed, with certain exceptions, the information in the return cannot be further challenged.

The increased tax certainty that should arise from this process is considered an advantage of BEFIT.

The elements of the BEFIT return that can be further challenged by the national tax authorities are:

- the outcomes of the preliminary tax result of the BEFIT members in their territories
- the BEFIT tax base, and
- the allocation of this tax base to each BEFIT member.

BEFIT group members are still obliged to submit individual tax returns in their Member State of tax residence.

SIMPLIFIED TRANSFER PRICING RULES

Transfer pricing remains an issue within the BEFIT group. Consequently, apart from the linked but separate Commission proposal to harmonise and simplify transfer pricing in the EU, the BEFIT proposal contains two provisions to reduce the burden of transfer pricing within a BEFIT group.

A) TRANSFER PRICING SIMPLIFICATION IN THE TRANSITION PERIOD

For the first seven years post implementation it is proposed that Member States are required to deem that intra-BEFIT group transactions are priced at arm's length where such income or expenses increase at less than 10 % compared to the average amount of the income or expense over the preceding three fiscal years.

Where the increase exceeds 10%, the excess over 10% is removed from the baseline allocation percentage – unless the BEFIT group member provides evidence that the relevant transaction was priced in accordance with the arm's length principle.

B) SIMPLIFIED RISK ASSESSMENT FOR LOW-RISK ACTIVITIES

It is proposed that Member States must apply simplified transfer pricing compliance for transactions between a BEFIT group member and an associated enterprise outside the BEFIT group where the activity is performed in the EU and is either:

- a low-risk distribution activity
- a contract manufacturing activity

The profits of entities within scope would be compared to public benchmarks for equivalent activities and Member State tax authorities would rank them as low, medium, or high risk depending on how close their profits were to the benchmarks.

This risk assessment would then determine the degree to which resources would be dedicated to checking the transfer pricing of the entities in question.

In any event, the Member State tax authorities would maintain the right to make transfer pricing adjustments.

MAIN DIFFERENCES FROM EARLIER PROPOSALS

The preliminary tax base in the BEFIT proposal starts from the net results from the individual financial statements with to a limited number of adjustments. The 2011 and 2016 proposals, on the other hand, effectively constructed the tax base from first principles using detailed rules.

As the starting point is statutory financial statements before consolidation adjustments, intra-BEFIT group transactions still require considerations of transfer pricing adjustments. These would not have been necessary for intra-EU group transactions under the previous proposals.

As mentioned, unlike the CCCTB proposals, there is no provision in this proposed Directive (or in a related proposal) for the group profit to be allocated to its individual EU members using apportionment formula, based on, for example, the respective turnover, staff costs and tangible assets for each entity. During the transition period, the Commission will investigate the possibility of introducing formulary apportionment.

The 2016 CCTB proposal included additional allowances designed to address the debt-equity bias and to provide additional deductions for qualifying expenditure on research and development. The debt-equity bias

measure was subsequently separated into the DEBRA legislative proposal. In BEFIT, there is no additional allowance for research and development expenditure although it should be noted that:

- Member States can still offer such deductions at a national level for BEFIT entities tax resident in their jurisdictions (if they comply with the OECD's Pillar Two GloBE rules), and
- if research and development costs can be justifiably expensed in the accounting profit or loss, such expenses would automatically obtain tax relief.

THE NEXT STAGES

The proposal will follow the normal legislative process for a tax file, meaning unanimity decision by all EU Member States in the Council, and a non-binding opinion by the European Parliament.

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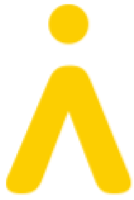

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