

European Commission publishes proposal for a directive to introduce a common corporate tax framework (BEFIT)

On September 12, 2023, the European Commission published a proposal for a directive aimed at the introduction of a common corporate tax framework within the EU. This framework is referred to as BEFIT, an acronym for “Business in Europe: Framework for Income Taxation”. On the same date, the European Commission also published a proposal for a directive aimed at the harmonization of the transfer pricing rules within the EU.

BEFIT would apply mandatorily, as from July 1, 2028, to EU-based entities and permanent establishments (PEs) of domestic and multinational groups with (global) combined revenues of at least EUR 750 million. Smaller groups can voluntarily apply BEFIT. The ‘ordinary’ domestic tax rules for calculating taxable profit in the respective EU Member States where the BEFIT group has a taxable presence would no longer apply. Under the BEFIT regime, profits and losses of all BEFIT group members are first calculated under a set of rules that provide for a harmonized tax base, based on financial accounts (before consolidation) with certain adjustments. After calculation of the preliminary tax results of the BEFIT group members, these results are aggregated to calculate the BEFIT tax base (and therefore effectively allowing for cross-border loss compensation). In the transition period (until June 30, 2035), the BEFIT tax base will be allocated among the BEFIT group members in their respective jurisdictions on the basis of the average of the relative taxable results of the BEFIT group members. The allocated tax base will be subject to the corporate income tax rate of the specific Member State.

The objective of the proposal is to create a level playing field, enhance legal certainty, reduce compliance cost and to encourage cross-border operations.

The BEFIT proposal

Scope

The BEFIT proposal defines a hybrid scope for the application of the rules under the proposed directive. In short, the mandatory scope includes the same large groups as the EU minimum tax directive (Pillar 2), but is limited to a sub-set of EU-based entities and permanent establishments (PEs) that meet a 75%-threshold. The application is voluntary for EU-based entities and PEs of smaller groups.

In more detail, BEFIT would apply to companies that are tax resident in a Member State, including their PEs located in other Member States. It would also apply to PEs located in Member States of entities tax resident in a third country. Whether the scope is mandatory or voluntary depends on certain scoping thresholds.

Mandatory scope: Domestic and multinational groups operating in the EU, whether headquartered in the EU or in a third country with annual (global) combined revenues of at least EUR 750 million, will be within the scope of BEFIT. However, the scope of the proposed Directive will not apply to a non-EU headquartered group if, in two of the last four years, the combined revenues of the group’s EU subsidiaries and PEs do not exceed (i) five percent of the total group revenues or (ii) EUR 50 million.

Voluntary scope: Where the scoping thresholds above are not met, a group may still opt to apply BEFIT provided the group prepares consolidated financial statements. Where a group opts to apply BEFIT, the framework will apply to the whole BEFIT group.

A BEFIT group would be formed where two or more companies or permanent establishments which fall within the scope of the Directive meet a 75 percent ownership threshold test (direct or indirect holding).

Calculation tax result of each group member

Based on the proposed directive, the first step is to determine the preliminary tax result of each BEFIT group member. This result is computed based on the financial accounts (before consolidation adjustments eliminating intra-BEFIT group transactions) with certain adjustments. To this end, the financial accounts of each BEFIT group member must be reconciled with the accounting standard of the ultimate parent entity or, if the group is headquartered outside of the EU, the accounting standard of the filing entity (the ultimate parent entity, when located in a Member State, or otherwise the entity that has been appointed by the BEFIT group). This accounting standard must also be accepted under EU law (i.e. the national generally accepted accounting principles or IFRS). In the interest of simplification, adjustments to the accounting results are kept to the minimum necessary. Therefore, BEFIT includes fewer tax adjustments than Pillar 2. There are several types of adjustments, such as items to be included or excluded (for example, shipping income covered by a tonnage tax regime is carved out from the BEFIT tax base), tax depreciation rules, timing and quantification rules and rules that are necessary for entering or leaving the BEFIT group and business reorganizations.

Aggregation and allocation

After calculation of the preliminary tax results of the BEFIT group members, these results are aggregated to calculate the BEFIT tax base (and therefore effectively allowing for cross-border loss compensation). If the aggregated BEFIT tax base is negative, the loss is carried forward indefinitely in time. If the BEFIT tax base is positive, the profit is allocated to the various jurisdictions where the BEFIT group members are located. The proposal only deals with the allocation in the transition period (July 1, 2028 - June 30, 2035); the European Commission may propose the replacement of this mechanism by formulary apportionment based on factors. During the transition period, the BEFIT tax base is allocated on the basis of the average of the relative taxable results of the BEFIT group members (i.e. calculated as a percentage of the total results of the BEFIT group, with a minimum of zero percent). Exceptions are made for profits from extractive activities (allocated to place of extraction), profits from shipping not covered by a tonnage tax regime and air transport (allocated to the State where the company is located). The allocated profit may be taxed by a Member State at national rates. Tax credits are granted in line with the applicable tax treaties or national law. Member States will not impose withholding tax on intra-BEFIT group transactions.

Procedural aspects

The filing entity must file the BEFIT information with the filing authority (the competent authority of the Member State in which the filing entity is resident or, where it concerns a permanent establishment, is situated). A “BEFIT team”, composed of representatives of each relevant administration, will examine the completeness and accuracy of the BEFIT information return. Each BEFIT group member will file its individual tax return with the competent authorities in which the group member is resident or is situated. Where required, the competent authority will issue an amended tax assessment. The proposal also encompasses rules on appeals, statute of limitations, disclosure of information and penalties.

Meijburg & Co comments

This is the third attempt by the European Commission to harmonize the corporate income tax base. The first attempt was the 2011 proposal for a Common Consolidated Corporate Tax Base (CCCTB). In 2016, the European Commission proposed a two-step approach (including a first step for the harmonization of the tax base, and a second step for the consolidation and apportionment of the results). It now seems that the European Commission is trying to seize the (perceived) opportunity created by the introduction of Pillar 2. Similar to Pillar 2, the tax base calculation is based on the financial accounts, with some exceptions. The main difference between the two is the aggregation of profits and losses, which effectively result in cross-border loss compensation. This mechanism differs from the mechanism of Pillar 2, which is based on a jurisdictional approach, and bears the risk of undertaxation under Pillar 2, resulting in the levy of top-up tax. There is no indication whether and how this effect – which might considerably impact the attractiveness of BEFIT – will be dealt with.

KPMG Meijburg & Co
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