Submitted at the website of the European Commission

European Commission
Directorate-General for Taxation and Customs Union
Company Taxation Initiatives Unit (D1)
P.O. Box 1049 Brussels
Belgium

13 December 2023

Re: European Commission – Feedback regarding the Business in Europe: Framework for Income Taxation (BEFIT) directive and Transfer Pricing (TP) directive

Dear Sir / Madam,

The International Bar Association ("**IBA**") would like to take this opportunity to provide comments as part of the invitation of the European Commission provide feedback on the BEFIT Package that consists of the BEFIT directive and TP directive. The IBA, the global voice of the legal profession, includes over 80,000 of the world's top lawyers and 180 Bar Associations and Law Societies worldwide.

We are submitting our comments on behalf of the IBA Taxes Committee which now has over 1,100 members from around the world. This committee formed a Working Group to respond to the invitation to provide feedback. The comments made in this submission are the personal opinions of the Working Group participants and should not be taken as representing the views of their firms, employers or any other person or body of persons apart from the IBA Taxes Committee of which they are members.

The detailed comments of the IBA Taxes Committee regarding the BEFIT package, consisting of the BEFIT directive and TP directive, are set out in Annex 1 (BEFIT directive) and Annex 2 (TP directive) to this letter. In general terms, the IBA Taxes Committee understands the policy objective to further harmonize the corporate income tax rules within the internal market with a view to reducing tax compliance costs for businesses that are active in the single market. The IBA Taxes Committee recognizes that harmonization of corporate taxation rules would contribute towards a reduction in compliance costs as they would mitigate the number of differences that arise from the 27 different national tax systems in the EU. The idea of reducing the compliance burden of taxpayers in the single market may be welcomed. The IBA Taxes Committee recognizes that the introduction of a common set of rules for determining the taxable basis would be able to reduce the complexities arising from the application of 27 different sets of corporate income tax rules, each with specific rules, for the purposes of determining the taxable profits, as well as the complexities that arise in connection with cross-border tax relief under the case law of the Court of Justice of the EU. Additionally, the IBA Taxes Committee recognizes that the transfer pricing rules are not necessarily uniformly applied throughout the internal market and that dispute resolution may be time-consuming. Therefore, the IBA Taxes Committee understands the rationale underlying the TP directive that would seek to ensure a uniform application of the arm's length principle in the EU while introducing a fast track 180 day resolution procedure for dispute resolution.

Whereas the IBA Taxes Committee recognizes the potential benefit arising from the BEFIT package, The IBA Taxes Committee does note that inconsistencies between the directive and the international tax landscape may jeopardize the effectiveness of the BEFIT package and result in double taxation and non-taxation risks. With a view to addressing these inconsistencies, the following general recommendations are made by the IBA Taxes Committee:

- Alignment of tax treaties with the BEFIT package. In general terms, the IBA Taxes Committee notes that tax treaties may jeopardize the effectiveness of the BEFIT directive

London São Paulo Seoul The Hague Washington DC

Chancery House, 53-64 Chancery Lane. London WC2A 1QS, United Kingdom Tel: +44 (0)20 7842 0090 www.ibanet.org

International Bar Association is incorporated as a Not-for-Profit Corporation under the laws of the State of New York in the United States of America and is registered with the Department of State of the State of New York with registration number 071114000655 - and the liability of its members is limited. Its registered address in New York is c/o Capitol Services Inc, 1218 Central Avenue, Suite 100, Albany, New York 12205.

The London office of International Bar Association is registered in England and Wales as a branch with registration number FC028342.

and TP directive. With respect to the BEFIT directive, the IBA Taxes Committee notes tax treaties do not seem to be aligned with the (transitional) allocation mechanism. As a consequence, the tax residency of entities within the meaning of article 4 of the OECD Model Tax Convention ("**OECD Model**") may be affected by the BEFIT directive's allocation rule, which may give rise to double taxation. Moreover, the allocation mechanism of the BEFIT directive may allocate profits to EU Member States that are precluded from taxing those profits under article 7 OECD Model, which may give rise to both double taxation and non-taxation in respect of such profits. Finally, the allocation mechanism may affect the effectiveness of the transfer pricing rules of article 9 OECD Model, which may result in double taxation of income. Regarding the TP directive and tax treaties, the IBA Taxes Committee notes that there may be instances where the TP directive would not be aligned with tax treaties. Therefore, the IBA Taxes Committee recommends aligning the tax treaties of the EU Member States with the BEFIT directive and TP directive. With a view to aligning those tax treaties, the IBA Taxes Committee recommends the following:

- Tax treaties between EU Member States ("**Intra-EU Treaties**"): the IBA Taxes Committee notes that the BEFIT directive would not automatically seem to amend Intra-EU Treaties under public international law and that EU Member States may face difficulties when implementing the BEFIT directive if the directive would be inconsistent with Intra-EU Treaties. Therefore, the IBA Taxes Committee recommends that the EU Member States conclude a multilateral treaty when the Council adopts the BEFIT directive and/or TP directive that ensures that the Intra-EU Treaties are aligned with these directives. With respect to the BEFIT directive, such a treaty could explicitly provide that (i) tax residency under Intra-EU Treaties shall not be affected by the BEFIT directive, (ii) that Intra-EU Treaties shall not prevent the taxation of profits allocated between EU Member States and (iii) that the effect of transfer pricing adjustments throughout a BEFIT group are taken into account for the purposes of article 9 OECD Model. Regarding the TP directive, the treaty could provide that the TP directive shall take precedence over the transfer pricing rules of their Intra-EU Treaties. If the conclusion of such a multilateral treaty would not be feasible, similar wording may be included in the directives in order to reflect the common intentions of the EU Member States with respect to their Intra-EU Treaties, which common intentions may then be able to result in the alignment of the Intra-EU Treaties with the directives under public international law.

- Tax treaties with third states ("**Extra-EU Treaties**"): with respect to Extra-EU Treaties, it is also recommended to ensure that they are aligned with the BEFIT directive and TP directive with a view to avoiding double taxation or non-taxation. The alignment of Extra-EU Treaties may prove more difficult in practice than would be the case for Intra-EU Treaties as third states would not be bound to achieve the result of the directives while also not being subject to the duty of sincere cooperation. In order to ensure that Extra-EU Treaties would not jeopardize the effectiveness of the BEFIT package and give rise to double taxation or non-taxation, the IBA Taxes Committee recommends that the European Commission proactively reaches out to third states so as to discuss the alignment of their tax treaties with EU Member States with the BEFIT package with a view to reaching agreements, by means of mutual agreements or (amendments to) treaties, or unilateral statements by third states, that ensure that the application of Extra-EU Treaties is aligned with the BEFIT directive so as to avoid double taxation and non-taxation and that the directives clarify its intended effect in the absence of such agreements or unilateral statements.

The IBA Taxes Committee recognizes that these recommendations with respect to Intra-EU Treaties and Extra-EU Treaties may seem novel. Nevertheless, unless tax treaties are amended, they may be able to prevent the uniform application of the BEFIT package throughout the EU and this would result in a very complex, incoherent, system. With a view

International Bar Association is incorporated as a Not-for-Profit Corporation under the laws of the State of New York in the United States of America and is registered with the Department of State of the State of New York with registration number 071114000655 - and the liability of its members is limited. Its registered address in New York is c/o Capitol Services Inc, 1218 Central Avenue, Suite 100, Albany, New York 12205.

The London office of International Bar Association is registered in England and Wales as a branch with registration number FC028342.

to achieving a more simple system, the IBA Taxes Committee therefore considers addressing the tax treaty issues crucial for ensuring the effectiveness of the BEFIT package and achievement of its policy goals.

- Alignment of unilateral tax relief rules and the BEFIT directive. In addition to the risk of double taxation arising from the interaction between tax treaties and the BEFIT directive, the IBA Taxes Committee notes that double taxation may also arise from the application of unilateral credit rules, such as the US foreign tax credit regime. In order to avoid double taxation resulting from the way in which unilateral tax relief rules are applied, the IBA Taxes Committee recommends that the European Commission reaches out to third states to discuss alignment of such tax relief rules with the BEFIT directive.

- Alignment of the BEFIT directive with the Pillar 2 directive. In general terms, the IBA Taxes Committee recognizes that the BEFIT directive, in its present form, may result in a reduction of the administrative burden. With a view to further reducing the administrative burden, especially for those taxpayers that are already facing the administrative burden of the Pillar 2 directive, the IBA Taxes Committee recommends that the BEFIT directive is aligned, as much as is possible and efficient, with the Pillar 2 directive in terms of tax base determination rules. In this respect, the IBA notes Taxes Committee that this recommendation must be understood as entailing that alignment should, essentially, only be sought for those measures of the Pillar 2 directive that do not give rise to issues, inconsistencies and overkill. If the BEFIT directive's tax base determination rules would be aligned, as much as is possible and efficient, with the Pillar 2 directive, the IBA Taxes Committee further recommends aligning the personal scope of both directives so as to ensure that only taxpayers that are already confronted with the Pillar 2 directive's administrative burden would also face the administrative burden of the BEFIT directive. By aligning the personal scope and tax base determination rules, the BEFIT directive would limit the additional tax burden for in-scope taxpayers. At the same time, taxpayers that would fall outside the scope of the Pillar 2 directive would then be able to independently assess the benefits of opting-in for the BEFIT directive. If the personal and tax base determination rules would be aligned, as much as possible and efficient, with the Pillar 2 directive, the IBA Taxes Committee believes that this would contribute towards achieving the policy objective of simplifying the corporate tax practice for corporations, reducing the required compliance administration, and increasing cost-efficiency.

- Alignment of the Pillar 2 rules with the BEFIT directive's allocation rules and cross-border loss relief. At present, the Pillar 2 directive, as well as the OECD's model rules, apply a jurisdictional approach for assessing the top-up tax liability. As a result of the BEFIT directive's profit allocation mechanism, profits that may be part of the taxable basis for the purposes of Pillar 2 may be allocated to another EU Member State under the BEFIT directive and, consequently, not be subject to tax for the purposes of Pillar 2. Additionally, the IBA Taxes Committee notes that top-up tax liability may also be triggered by the cross-border loss relief rules of the BEFIT directive as such losses would reduce the effective tax rate in an EU Member State for Pillar 2 purposes. The IBA Taxes Committee recommends the interaction between the BEFIT allocation and cross-border loss relief rules and the Pillar 2 rules is addressed.

- Effective dispute resolution / prevention under the BEFIT directive. The BEFIT directive would result in harmonization of corporate income tax bases within the EU with a cross-border allocation of the aggregate corporate income tax base (the BEFIT tax base). The IBA Taxes Committee considers it conceivable that, in practice, there may be situations wherein the BEFIT team would not reach consensus. With a view to ensuring effective cross-border dispute resolution and/or prevention for those instances wherein the BEFIT team would not reach consensus or where disputes would affect the BEFIT tax base and its allocation, the IBA Taxes Committee recommends, as suggested in the submission of January 2023, a dispute resolution mechanism may be contemplated that provides

International Bar Association is incorporated as a Not-for-Profit Corporation under the laws of the State of New York in the United States of America and is registered with the Department of State of the State of New York with registration number 071114000655 - and the liability of its members is limited. Its registered address in New York is c/o Capitol Services Inc, 1218 Central Avenue, Suite 100, Albany, New York 12205.

The London office of International Bar Association is registered in England and Wales as a branch with registration number FC028342.

taxpayers direct access to EU courts, preferably in two instances (at (a tax chamber of) the General Court and the CJEU). Granting such direct access would seem to provide for efficient and effective dispute resolution, thereby contributing towards legal certainty. Additionally, centralized dispute resolution would entail that it is avoided that multiple disputes arise at the same time in different EU Member States that may each affect the BEFIT tax base and, consequently, the allocation of taxable income by means of the BEFIT directive. From this perspective, centralized dispute resolution would contribute towards the policy goal of simplification. Additionally, the IBA Taxes Committee would recommend that the European Commission looks into extending the scope of the Arbitration Directive to disputes relating to the BEFIT directive or that the TP directive's fast track procedure for disputes is also applied to disputes that may affect the allocation of the BEFIT tax base.

- Amendment of associated enterprises definition in the TP directive. One of the key differences between the TP directive and the existing international tax landscape concerns the definition of the term "associated enterprises". In this respect, the IBA Taxes Committee recommends aligning to this definition with the more generally accepted definition so as to avoid inconsistencies.

- Clarify the nature and process of the Fast Track Procedure in the TP directive. The IBA Taxes Committee considers it key for effective dispute resolution in respect of the TP directive that the role of taxpayer, as well as the interaction with existing objections and appeals, is clarified.

We are happy to elaborate on the recommendations set out above and the analysis set out in the Annexes to this letter and to further expend on these topics.

Sincerely yours,

Wiebe Dijkstra
International Organisation Liaison Officer
IBA Taxes Committee
Netherlands
Tax Partner
De Brauw Blackstone Westbroek N.V.

Daniel Luchsinger
International Organisation Liaison Officer
IBA Taxes Committee
U.S.A.
Tax Partner
Covington & Burling LLP

International Bar Association is incorporated as a Not-for-Profit Corporation under the laws of the State of New York in the United States of America and is registered with the Department of State of the State of New York with registration number 071114000655 - and the liability of its members is limited. Its registered address in New York is c/o Capitol Services Inc, 1218 Central Avenue, Suite 100, Albany, New York 12205.

The London office of International Bar Association is registered in England and Wales as a branch with registration number FC028342.

Working Group Participants

Antonietta Alfano
Tax Senior Associate
Maisto e Associati
Italy

Sandy Bhogal
Tax partner
Gibson, Dunn & Crutcher LLP London

Francesco Capitta
Tax Partner
Facchini Rossi Michelutti
Italy

Andrea D'Ettorre
Tax Senior Associate
Facchini Rossi Michelutti
Italy

Dearbhla O'Gorman
Senior Associate
A&L Goodbody LLP
Ireland

David Hardy
Tax Partner
McDermott Will & Emery
U.S.A.

Hanna Hordiienko
Tax Legal Assistant
Binder Grösswang
Austria

Margriet Lukkien
Tax Partner
Loyens & Loeff
The Netherlands

Natalie Reypens
Tax Partner
Loyens & Loeff
The Netherlands

Joseph Sullivan
Tax Partner
Covington & Burling LLP
U.S.A.

Mees Vergouwen
Tax adviser
De Brauw Blackstone Westbroek N.V.
The Netherlands

Amelia O'Beirne
Tax Partner
A&L Goodbody
Ireland

Nikolaj Bjørnholm
Partner
Bjørnholm Law
Denmark

Wiebe Dijkstra
Tax partner
De Brauw Blackstone Westbroek N.V.
The Netherlands

Peter Flipsen
Tax partner
Maran Tax
The Netherlands

Marco Graziani
Partner
Legance
Italy

Monique van Herksen
Tax partner
Simmons & Simmons
The Netherlands

Daniel Luchsinger
Tax partner
Covington & Burling LLP
U.S.A.

Aistė Medelienė
Partner
Walless
Lithuania

Simone Schiavini
Managing associate
Legance
Italy

Michael Schmidt
Founder
Schmidt Taxlaw
Germany

Christian Wimpissinger
Tax Partner
Binder Grösswang
Austria

International Bar Association is incorporated as a Not-for-Profit Corporation under the laws of the State of New York in the United States of America and is registered with the Department of State of the State of New York with registration number 071114000655 - and the liability of its members is limited. Its registered address in New York is c/o Capitol Services Inc, 1218 Central Avenue, Suite 100, Albany, New York 12205.

The London office of International Bar Association is registered in England and Wales as a branch with registration number FC028342.

ANNEX 1. COMMENTS REGARDING THE BEFIT DIRECTIVE

1 INTRODUCTION

1. The IBA Taxes Committee understands the policy objectives underlying the BEFIT directive to simplify the corporate tax practice for corporations, reduce the required compliance administration, increase cost-efficiency and, therefore, boost the competitiveness of the single market and support investments in the EU. With respect to the BEFIT directive's effectiveness to achieve these policy objectives, the IBA Taxes Committee recommends that it is ensured that this directive is consistent with the existing international tax landscape so as to ensure that the international tax landscape does not limit the effectiveness of the BEFIT directive. Inconsistencies between the BEFIT package and the existing international tax landscape may arise in connection with the Pillar 2 rules (section 2.1), state aid rules (section **Error! Reference source not found.**), tax treaties (section 3) and the OECD's arm's length principle (section 3.5). Additionally, the BEFIT package's rules should ensure that dispute prevention / resolution is effective and efficient in light of its cross-border nature (section 3.5). The IBA Taxes Committee considers addressing the inconsistencies identified in this submission as well as ensuring effective dispute prevention / resolution essential for ensuring that the BEFIT directive is net beneficial for taxpayers and achieves its policy objectives set out above.

2. In this submission, the IBA Taxes Committee focuses on the following topics relating to the BEFIT directive:

   (a) The design of the BEFIT directive (section 2);

   (b) Areas of potential conflicts between the BEFIT directive and tax treaties (section 3);

   (c) Dispute prevention and resolution and administrative proceedings under the BEFIT directive (section 3.5).

2 DESIGN OF THE BEFIT DIRECTIVE

3. The IBA Taxes Committee welcomes the initiative to introduce a common set of rules for computing taxable income within the EU with a view to simplifying the administrative burden for businesses in the EU. In general terms, the IBA Taxes Committee understands that the introduction of a harmonized set of rules for the determination of the taxable base of business in the EU can be beneficial for reducing the administrative burden for businesses in the EU. The IBA Taxes Committee does note that, at the same time, the introduction of a common corporate tax system within the EU is a serious and far-reaching project. As such, it is our strong recommendation that any proposal should be carefully designed so that it achieves its objectives without creating undue burden or additional uncertainties for businesses, or tax authorities, in the EU.

International Bar Association is incorporated as a Not-for-Profit Corporation under the laws of the State of New York in the United States of America and is registered with the Department of State of the State of New York with registration number 071114000655 - and the liability of its members is limited. Its registered address in New York is c/o Capitol Services Inc, 1218 Central Avenue, Suite 100, Albany, New York 12205.

The London office of International Bar Association is registered in England and Wales as a branch with registration number FC028342.

4. To design an effective, more simplified, corporate income tax system, the IBA Taxes Committee notes that it considers it necessary that the objectives and desired outcomes of the system must be clearly outlined and understood.

2.1 The transitional nature of the BEFIT directive

5. In its present form, the BEFIT directive is a purely transitional measure. It makes provision for agreement to be reached later among EU Member States on the method of allocation of the BEFIT tax base. As such, the BEFIT directive constructs a transitional system that would require significant investment by taxpayers and tax authorities, without a final blueprint for how that system should operate once complete. Consequently, there is no certainty that the mechanisms proposed under this proposal would be the optimum arrangements under the ultimately agreed position. Although there is no certainty regarding the final method for allocation, the purely transitional measure may already contribute towards achievement of the policy objectives of the BEFIT directive provided that certain key issues are addressed that limit its effectiveness. According to the IBA Taxes Committee, the main issues that would have to be addressed in order for the BEFIT directive, in its transitional form, to be effective are the areas of potential conflict with the Pillar 2 rules and tax treaties as well as dispute prevention and/or resolution mechanisms. If these issues would be addressed, the IBA Taxes Committee would be inclined to think that the BEFIT directive, as a purely transitional measure, may already be net beneficial for taxpayers in terms of a reduction of the administrative burden, the ability to set off losses on a cross-border basis and effective cross-border dispute prevention / resolution. If net beneficial as a transitional measure, the absence of final profit allocation mechanism would not affect achievement of the policy objectives. Therefore, the absence of agreement on the final profit allocation mechanism does not necessarily entail that the BEFIT directive should not be pursued in its present form. If the key issues are addressed and the BEFIT directive, in its transitional form, would be net beneficial, the IBA Taxes Committee would be supportive of moving ahead with the transitional measure.

2.2 Alignment with the Pillar 2 Directive

6. The BEFIT directive provides for the following four step approach for the taxation of income from entities that are part of the BEFIT group:

Step 1 Determination of the preliminary tax result of each BEFIT group member on the basis of a common set of rules as set out in the BEFIT directive (financial accounting net income or loss ("**FANIL**") as adjusted in accordance with article 8 to 41 of the directive (the "**BEFIT-adjusted FANIL**").

Step 2 Determination of the BEFIT tax base by aggregating the preliminary tax results of all BEFIT group members as calculated in step 1.

Chancery House, 53-64 Chancery Lane. London WC2A 1QS, United Kingdom Tel: +44 (0)20 7842 0090 www.ibanet.org

International Bar Association is incorporated as a Not-for-Profit Corporation under the laws of the State of New York in the United States of America and is registered with the Department of State of the State of New York with registration number 071114000655 - and the liability of its members is limited. Its registered address in New York is c/o Capitol Services Inc, 1218 Central Avenue, Suite 100, Albany, New York 12205.

The London office of International Bar Association is registered in England and Wales as a branch with registration number FC028342.

Step 3 Allocation of the BEFIT tax base to BEFIT group entities ("**BEFIT profits**") on the basis of an allocation mechanism that divides the BEFIT tax base on the basis of the average of the taxable results in the three previous years of the BEFIT group members (the "**BEFIT Allocation Mechanism**").

Step 4 Taxation of BEFIT profits at the national level, which requires alignment of BEFIT profits with national laws.

Alignment of profit determination rules and personal scope

7. In general terms, the IBA Taxes Committee notes that the rules for determining the preliminary tax result of each BEFIT group member, although based on the financial accounts (step 1), deviates from the rules for determining the taxable result under the Pillar 2 directive. Considering that entities that would fall within the scope of the Pillar 2 directive would generally also fall within the scope of the BEFIT directive, the IBA Taxes Committee is curious, in light of the objective to achieve a more simplified, corporate income tax system, to understand the rationale for proposing a common set of rules that differs from the common set of rules under the Pillar 2 Directive. The IBA Taxes Committee would be inclined to think that applying the same common set of rules for the BEFIT directive and Pillar 2 directive, to the extent possible and effective, for taxpayers that already fall within the scope of the Pillar 2 directive would fit the policy objective to simplify the corporate income tax system best. In this respect, the IBA Taxes Committee notes that this recommendation must be understood as entailing that alignment should, essentially, only be sought for those measures of the Pillar 2 directive that do not give rise to issues, inconsistencies and overkill while deviations should also be sought if that would be more efficient for the purposes of the BEFIT directive's objective. As such, the IBA Taxes Committee recommends that the Pillar 2 directive profit determination rules would be used as a basis but that the BEFIT deviates where those rules give rise to issues, inconsistencies or overkill or would otherwise not contribute towards the objective of the BEFIT directive. In such a way, the rules for determination of the preliminary tax result would be aligned in a way that is efficient and effective. Moreover, if the BEFIT directive's tax base determination rules would be aligned, as much as possible and efficient, with the Pillar 2 directive, the IBA Taxes Committee further recommends aligning the personal scope of both directives so as to ensure that only taxpayers that are already confronted with the Pillar 2 directive's administrative burden would also face the administrative burden of the BEFIT directive. By aligning the personal scope and tax base determination rules, the BEFIT directive would limit the additional tax burden for in-scope taxpayers, which would seem aligned with the policy objective of achieving simplification and a reduction of the administrative burden for taxpayers in the internal market. The Pillar 2 Directive and BEFIT directive would then, essentially, become a package deal. If a business falls within the scope of one directive, it falls within the scope of both (notwithstanding the fact that below-threshold businesses would be able to opt-in for the BEFIT directive only).

Interaction between the BEFIT allocation mechanism and the Pillar 2 directive

International Bar Association is incorporated as a Not-for-Profit Corporation under the laws of the State of New York in the United States of America and is registered with the Department of State of the State of New York with registration number 071114000655 - and the liability of its members is limited. Its registered address in New York is c/o Capitol Services Inc, 1218 Central Avenue, Suite 100, Albany, New York 12205.

The London office of International Bar Association is registered in England and Wales as a branch with registration number FC028342.

8. The BEFIT Allocation Mechanism can result in profits of a BEFIT group member in one EU Member State being allocated to another BEFIT group member in another EU Member State. Consequently, the BEFIT Allocation Mechanism can result in profits of a BEFIT group member not being taxable in its residence state (while being taxable in another EU Member State). The fact that profits may not be taxable in the residence EU Member State as a result of the BEFIT Allocation Mechanism may result cause a top-up tax liability under the Pillar 2 directive or OECD's Pillar 2 model rules being triggered notwithstanding the fact that such profits would be subject to a sufficient level of taxation in the EU. The top-up tax liability would be triggered because the Pillar 2 rules seem to only take into account the level of taxation in the residence state (and, for permanent establishments, the state where the permanent establishment is situated). If profits would not be taxed in the residence state, the effective tax rate for Pillar 2 purposes would seem to be zero. The IBA Taxes Committee considers such an outcome undesirable and therefore recommends that it is clarified that taxation in other EU Member State as a result of the BEFIT Allocation Mechanism must be taken into account for the purposes of determining the top-up tax liability. It should, according to the IBA Taxes Committee, be avoided that profits become subject to a top-up tax liability if the effective tax rate in respect of those profits, determined by the level of taxation in other EU Member State, would not trigger the top-up tax liability.

Interaction between the cross-border loss relief rules and the Pillar 2 directive

9. The IBA Taxes Committee very much welcomes the introduction of cross-border loss relief in the EU. The IBA Taxes Committee does note, however, that the BEFIT directive does not address its interaction with the Pillar 2 Directive in this respect (or the Pillar 2 rules in general). According to the IBA Taxes Committee, the application of the cross-border loss relief rules in the BEFIT directive could result in losses being allocated to an EU Member State where those losses are not taken into account for the purposes of the Pillar 2 directive. As the allocated losses would reduce the taxable profits in an EU Member State, the effective tax rate may fall below 15 percent for the purposes of the Pillar 2 directive, thereby triggering a top-up tax liability. The IBA Taxes Committee would consider a top-up tax liability as a result of the cross-border loss relief in the BEFIT directive contrary to the objective of this directive. Taking this into account, the IBA Taxes Committee recommends that the interaction with the Pillar 2 Directive is clarified in the event of cross-border loss relief that results in an effective tax rate below 15 percent in a jurisdiction. In this respect, the difference in approach between the BEFIT directive (per entity level) and the Pillar 2 directive (jurisdictional basis), would appear to be a fundamental mismatch between the two directives that would have to be addressed. Within this context, the IBA Taxes Committee notes that this interaction may also have to be addressed with respect to third states as those third states would compute the liability under Pillar 2 on a jurisdictional basis as well.

International Bar Association is incorporated as a Not-for-Profit Corporation under the laws of the State of New York in the United States of America and is registered with the Department of State of the State of New York with registration number 071114000655 - and the liability of its members is limited. Its registered address in New York is c/o Capitol Services Inc, 1218 Central Avenue, Suite 100, Albany, New York 12205.

The London office of International Bar Association is registered in England and Wales as a branch with registration number FC028342.

2.3 **Alignment of allocated profits with national law**

10. In light of the objective to achieve a more simplified, corporate income tax system, the IBA Taxes Committee wonders why the BEFIT directive allows EU Member States to increase or decrease the BEFIT profits allocated to them under the BEFIT Allocation Mechanism. The possibility for EU Member States to make adjustments to the BEFIT profits allocated to it, seems to detract from the level of harmonization of the corporate income tax bases that is provided for by the rules in the BEFIT directive regarding the BEFIT-adjusted FANIL. Essentially, the possibility to adjust the BEFIT profits allocated to an EU Member State entails that businesses may continue to face 27 different corporate income tax systems after the introduction of the BEFIT directive. Taking this into account, the IBA Taxes Committee would recommend that the ability to make adjustments to the BEFIT profits allocated to an EU Member State is excluded or limited to a very large degree. The smaller the opportunity for amendments, the larger the degree of harmonization that would be achieved and the more simple the corporate income tax system in the internal market.

2.4 **The rationale for a three year look-back period**

11. During the transitional period, the BEFIT tax base is allocated throughout the EU based on each entity's portion of the BEFIT group's taxable profits in the last three years by means of the BEFIT Allocation Mechanism. While we acknowledge the benefit for Member States of having certainty that tax revenues in their jurisdiction will not vary significantly during the transitional period, the application of the three-year look-back period may lead to distortive outcomes with respect to some taxpayers. For example, the three-year look-back period does not adequately take into account the effect that one-off transactions can have on a group's comparative taxable profits across the EU. Similar issues arise when the relative size of the profits of certain entities or jurisdictions increases or decreases substantially in a short period of time or in the event that a group could cease operations in a particular jurisdiction and continue to pay tax there for a number of years following cessation (or vice versa).

<u>Example 1: cessation of operations</u>

Over the period 2028-2030, Company A has generated average profits of EUR 50 million while the aggregate average profits of the BEFIT group amount to EUR 500 million. Based on article 45, the BEFIT baseline percentage would be 10%. In 2031, Company A's operations have ceased. The aggregate profits of the BEFIT group amount to EUR 450 million. Based on the baseline percentage, Company A would be allocated EUR 45 million of the profits realized by the BEFIT group without having any operations in the relevant fiscal year. In 2032 and 2033, the baseline percentage would remain above 0 percent as well. As such, the profits of the BEFIT group would be allocated to Company A in those years as well.

Taking these issues into account, the IBA Taxes Committee is curious as to the reasons underlying the three-year period as opposed to, for example, an allocation on the basis of the fiscal year concerned. In this respect, the IBA Taxes Committee wonders whether the

Chancery House, 53-64 Chancery Lane. London WC2A 1QS, United Kingdom Tel: +44 (0)20 7842 0090 www.ibanet.org

International Bar Association is incorporated as a Not-for-Profit Corporation under the laws of the State of New York in the United States of America and is registered with the Department of State of the State of New York with registration number 071114000655 - and the liability of its members is limited. Its registered address in New York is c/o Capitol Services Inc, 1218 Central Avenue, Suite 100, Albany, New York 12205.

The London office of International Bar Association is registered in England and Wales as a branch with registration number FC028342.

three-year look-back period has been introduced in connection with the possibility of cross-border loss relief that is provided for in the BEFIT directive. It would be appreciated if this particular question may be addressed.

12. More generally, the IBA Taxes Committee notes that it finds it difficult to assess the appropriateness of the BEFIT Allocation Mechanism for the transition period without agreement between Member States on the end goal of BEFIT in terms of the basis for allocation of taxing rights between Member States. Starting with an allocation method that is aligned with that policy objective would appear to be a more reasonable approach, even where certain transitional measures are necessary to ease the transition for Member States from existing rules (and the effect the transition will have on national tax revenues).

3 AREAS OF POTENTIAL CONFLICT WITH TAX TREATIES

3.1 Introduction

13. In its submission of January 2023 in response of a call for evidence for an impact assessment for the Business in Europe: Framework for Income Taxation initiative, the IBA Taxes Committee highlighted certain areas of potential conflict between that initiative and tax treaty articles with third states based on the OECD Model. Upon analysis of the BEFIT directive, the IBA Taxes Committee notes that these areas of potential conflict continue to exist notwithstanding the less far-reaching allocation mechanism in the BEFIT directive. In this submission, the IBA Taxes Committee seeks to provide further context with respect to the areas of potential conflict that have been identified in its earlier submission, i.e., residence, the ability to tax business profits, and transfer pricing adjustments in connection with transactions between associated enterprises, and to highlight how these areas could result in double taxation or non-taxation.

14. With respect to the areas of potential conflicts identified earlier, the IBA Taxes Committee notes the following. First, the areas of potential conflicts identified that relate to tax treaties with third states ("**Extra-EU Treaties**") are relevant in light of the circumstance that only a minority of the EU Member States would be able to override their Extra-EU Treaties, if required by the BEFIT directive, whereas the majority would not.[1] As the majority would not be able to override Extra-EU Treaties, such treaties would (potentially) be able to jeopardize the uniform application of the BEFIT directive within the internal market and, consequently, its effectiveness. Second, the IBA Taxes Committee notes that the areas of potential conflicts may also arise with respect to tax treaties concluded between the EU Member States ("**Intra-EU Treaties**"). Whether such areas of potential conflicts would arise in practice may be dependent on the extent to which a directive, viewed as a source of public international law, would be able to set aside Intra-EU Treaties under public international law. In this respect, the IBA Taxes Committee notes that it has been argued

[1] See T.M. Vergouwen, *The Effect of Directives in the Area of Direct Taxation on the Interpretation and Application of Tax Treaties* (Series on International Taxation no. 84), Alphen aan den Rijn: Kluwer Law International 2023, p. 15.

International Bar Association is incorporated as a Not-for-Profit Corporation under the laws of the State of New York in the United States of America and is registered with the Department of State of the State of New York with registration number 071114000655 - and the liability of its members is limited. Its registered address in New York is c/o Capitol Services Inc, 1218 Central Avenue, Suite 100, Albany, New York 12205.

The London office of International Bar Association is registered in England and Wales as a branch with registration number FC028342.

that it is conceivable that a directive would be able to set aside an incompatible Intra-EU Treaty under the *lex posterior* and/or *lex specialis* conflict rules of public international law (Extra-EU Treaties cannot be set aside under public international law in the absence of their consent due to the *pacta tertiis* principle).[2] At the same time, the IBA Taxes Committee recognizes that it is not aware of any case law that confirms such an application of these conflict rules to a conflict between a directive and an Intra-EU Treaty. As such, the ability of a directive to set aside a conflicting Intra-EU Treaty seems uncertain at present. Given this uncertainty and the circumstance that the majority of the EU Member States would not seem able to set aside incompatible Intra-EU Treaties in the event of a conflict with a directive, the IBA Taxes Committee Taxes Committee recommends that the areas of potential conflicts with Intra-EU Treaties are also addressed.

15. Taking this into account, the IBA Taxes Committee considers the areas of potential conflict relevant for both Intra-EU Treaties as well as Extra-EU Treaties. The IBA Taxes Committee does recognize that it might be easier in practice to resolve areas of potential conflict arising from Intra-EU Treaties than it would be for Extra-EU Treaties. After all, if adopted, the EU Member States have agreed to the adoption of the BEFIT directive and would be subject to a duty to take any appropriate measure to ensure fulfilment of the obligations resulting from the BEFIT directive (article 4(3) TEU). If such appropriate measures include, for some EU Member States, amendments to their Intra-EU Treaties, such measures would have to be taken. This is different for third states because they have neither adopted the directive nor are they subject to a duty to ensure fulfilment of the obligations resulting from the BEFIT directive. As such, a different approach seems necessary with respect to addressing areas of potential conflicts with Extra-EU Treaties. Therefore, the IBA Taxes Committee will draw a distinction between recommendations for Intra-EU Treaties and Extra-EU Treaties below.

3.2 The effect of the allocation of profits on the liability to tax within the meaning of article 4 OECD Model

16. Under the BEFIT directive, profits of a BEFIT group member may be (partially) allocated to other EU Member States under the BEFIT Allocation Mechanism. This means that profits of an entity may not be fully subject to tax in its residence state. If the profits of an entity are not fully subject to tax, the question arises as to whether such an entity would still be fully liable to tax within the meaning of article 4 OECD Model if its profits are allocated to other EU Member States as a result of the BEFIT Allocation Mechanism. The interaction between the BEFIT Allocation Mechanism and the liability to tax for the purposes of tax treaties can be illustrated as follows.

Example 2: interaction between BEFIT Allocation Mechanism and full tax liability

[2] See T.M. Vergouwen, *The Effect of Directives in the Area of Direct Taxation on the Interpretation and Application of Tax Treaties* (Series on International Taxation no. 84), Alphen aan den Rijn: Kluwer Law International 2023, p. 193 et seq.

International Bar Association is incorporated as a Not-for-Profit Corporation under the laws of the State of New York in the United States of America and is registered with the Department of State of the State of New York with registration number 071114000655 - and the liability of its members is limited. Its registered address in New York is c/o Capitol Services Inc, 1218 Central Avenue, Suite 100, Albany, New York 12205.

The London office of International Bar Association is registered in England and Wales as a branch with registration number FC028342.

A BEFIT group has a BEFIT tax base of EUR 50 million. Entity X, part of the BEFIT group, is a resident of EU Member State A with a preliminary tax result, as determined in accordance with the BEFIT directive's rules, of EUR 10 million. If, based on the previous three years, the baseline allocation percentage for entity X amounts to 10 percent, EUR 5 million of the BEFIT tax base is allocated to entity X and EUR 5 million is allocated to other BEFIT group members. As a consequence, only EUR 5 million of entity X's EUR 10 million preliminary tax result would be subject to tax in EU Member State A. This then raises the question whether entity X is fully liable to tax in respect of its preliminary tax result of EUR 10 million.

As the BEFIT Allocation Mechanism may result in a BEFIT group member not being fully subject to tax in respect of its profits in its residence state, the IBA Taxes Committee considers it conceivable that the full tax liability criterion in article 4 OECD Model may not be satisfied and, as such, that such an entity would not be considered a resident within the meaning of this provision.

17. According to the IBA Taxes Committee, the BEFIT directive should not affect the tax residency of entities under tax treaties because this could have adverse tax consequences for the entity itself (inapplicability of the tax treaty, which may result in, inter alia, denial of withholding tax limitations in respect of payments from third states), entities receiving income from that entity (denial of credit and/or exemptions by third states in connection with withholding taxes levied by the relevant EU Member State) and individuals (mismatches in allocation of personal income because of the relevance of residency within the meaning of article 4 OECD Model for the purposes of articles 15 and 16 OECD Model). Taking into account the consequences that a denial of tax residency would have, the IBA Taxes Committee recommends the following solutions:

(a) Intra-EU Treaty recommendation: the EU Member States conclude a multilateral mutual agreement or treaty, at the time of adoption of the BEFIT directive, that confirms that the BEFIT Allocation Mechanism does not affect the full tax liability of an entity within the meaning of article 4 OECD Model.

Alternatively, it could be clarified in the BEFIT directive that the directive shall not affect the full tax liability of an entity for the purposes of Intra-EU Treaties. Such a clarification that reflects the common intentions of the EU Member States could then serve as a basis for EU Member States and their courts to interpret article 4 OECD Model in a way that the full tax liability of an entity is not affected by the BEFIT Allocation Mechanism.

(b) Extra-EU recommendation*:* reach out to third states with a view to entering into a multilateral mutual agreement or treaty between (the European Commission on behalf of) the EU Member States that confirms that the BEFIT Allocation Mechanism does not affect the full tax liability of an entity within the meaning of article 4 OECD Model. Wording to this effect in the BEFIT directive would not seem

International Bar Association is incorporated as a Not-for-Profit Corporation under the laws of the State of New York in the United States of America and is registered with the Department of State of the State of New York with registration number 071114000655 - and the liability of its members is limited. Its registered address in New York is c/o Capitol Services Inc, 1218 Central Avenue, Suite 100, Albany, New York 12205.

The London office of International Bar Association is registered in England and Wales as a branch with registration number FC028342.

capable of achieving the same result as the directive would not be able to reflect the intention of the third states.

3.3 **The effect of article 7 OECD Model on the ability to tax allocated profits of another BEFIT group entity**

18. The IBA Taxes Committee notes that the BEFIT Allocation Mechanism can result in profits of a BEFIT group member in one EU Member State, either generated as an entity or attributable to a permanent establishment, being allocated to (an)other EU Member State(s). When profits are allocated to other EU Member State(s), tax treaties, in particular article 7 OECD Model, could restrict the extent to which such other EU Member State(s) can tax those profits. This applies to both Intra-EU Treaties and Extra-EU Treaties.

<u>Example 3: the risk of non-taxation due to article 7 OECD Model in Intra-EU Treaties</u>

Company A, a resident of EU Member State X, has a permanent establishment in EU Member State Y and a subsidiary in EU Member State Z that constitute a BEFIT group. Company A has no permanent establishment in EU Member State Z. In a fiscal year, the permanent establishment has a preliminary tax result of EUR 10 million, which is also attributable to that permanent establishment under the Intra-EU Treaty, while the subsidiary has a preliminary tax result of EUR 40 million. Company A has no taxable result. Based on the previous three fiscal years, the baseline allocation percentages are as follows: 30 percent for the permanent establishment and 70 percent for the subsidiary. In accordance with the BEFIT Allocation Mechanism, the permanent establishment would be allocated EUR 15 million of the BEFIT tax base while the subsidiary is allocated EUR 35 million of such tax base.

<u>The application of article 7 OECD Model in Intra-EU Treaties</u>. Article 7 OECD Model provides that business profits of the subsidiary in EU Member State Z shall be taxable only in that EU Member State, unless they can be allocated to a permanent establishment in EU Member State X or EU Member State Y. In this example, the subsidiary does not have a permanent establishment in those EU Member States. Consequently, article 7 OECD Model allocates the right to tax the EUR 40 million exclusively to EU Member State Z, thereby precluding EU Member State Y from taxing the EUR 5 million allocated to it under the BEFIT Allocation Mechanism. If the EUR 5 million is removed from the taxable basis of EU Member State Z and would not be taxable in that EU Member State, while EU Member State Y is precluded from taxing the EUR 5 million due to the Intra-EU Treaty, non-taxation arises in respect of the part of the BEFIT profits that is allocated from EU Member State Y to EU Member State Z.

19. It follows from the example that Intra-EU Treaties that contain article 7 OECD Model would not allow for the taxation of BEFIT profits of another EU Member State. Taking into account that it is the goal of the BEFIT directive to allocate profits generated in a fiscal year from one EU Member State to another EU Member State on the basis of the three-year look-back period, it would seem that alignment of Intra-EU Treaties so as to allow for the taxation of allocated profits is necessary. Otherwise, the effectiveness of the BEFIT Allocation Mechanism may be substantially limited by Intra-EU Treaties, especially in light of the

International Bar Association is incorporated as a Not-for-Profit Corporation under the laws of the State of New York in the United States of America and is registered with the Department of State of the State of New York with registration number 071114000655 - and the liability of its members is limited. Its registered address in New York is c/o Capitol Services Inc, 1218 Central Avenue, Suite 100, Albany, New York 12205.

The London office of International Bar Association is registered in England and Wales as a branch with registration number FC028342.

circumstance that the majority of the EU Member States seems to be unable to unilaterally override their tax treaties.

20. In addition to the risk of non-taxation under Intra-EU Treaties, the IBA Taxes Committee notes that the fact that permanent establishments of third states also qualify as BEFIT group members can result in double taxation as well as non-taxation of profits attributable to those permanent establishments under Extra-EU Treaties. This can be illustrated by means of the following example.

> Example 4. The risk of double taxation and non-taxation due to article 7 OECD Model in Extra-EU Treaties
>
> Company A, a resident of Third State X, has a permanent establishment in EU Member State Y and a subsidiary in EU Member State Z that constitute a BEFIT group. Company A has no permanent establishment in EU Member State Z. In a fiscal year, the permanent establishment has a preliminary tax result of EUR 10 million, which is also attributable to that permanent establishment under the Extra-EU Treaty, while the subsidiary has a preliminary tax result of EUR 40 million. Based on the previous three fiscal years, the baseline allocation percentages are as follows: 10 percent for the permanent establishment and 70 percent for the subsidiary. In accordance with the BEFIT Allocation Mechanism, the permanent establishment would be allocated EUR 5 million of the BEFIT tax base while the subsidiary is allocated EUR 45 million of such tax base.
>
> The application of article 7 OECD Model in Extra-EU Treaties. Pursuant to article 7 OECD Model, EU Member State Y and EU Member State Z would be allowed to tax the profits of Company A to the extent that they would be attributable to a permanent establishment in their territories. In this example, EUR 10 million of the profits of Company A is attributable to EU Member State Y while EUR 0 is attributable to EU Member State Z. As a consequence of the BEFIT Allocation Mechanism, of the EUR 10 million in taxable profits, EUR 5 million is allocated to EU Member State Y and EUR 5 million is allocated to EU Member State Z. Based on the Extra-EU Treaties, EU Member State Y would be allowed to tax the EUR 5 million while EU Member State Z is not. Hence, EUR 5 million would not be taxed due to the application of article 7 OECD Model in Extra-EU Treaties.

21. With respect to this example relating to the allocation of profits of a third state resident company, the IBA Taxes Committee notes the following. Firstly, this example is relatively straightforward in the sense that there are only three BEFIT group members. In practice, a BEFIT group may consist of many more entities and permanent establishments whose profits may be allocated from one EU Member State to another. As such, the IBA Taxes Committee cannot exclude the possibility that income of a plurality of BEFIT group members is allocated to a plurality of other BEFIT group members, which may be resident in other EU Member States. If this would be the case, it would seem that the taxpayers would be required to track and trace income from one BEFIT group member to another so as to determine whether the income may be taxed under article 7 OECD Model of tax treaties. In general terms, this might prove to be very complex in practice and, as such, contrary to the policy objective of the BEFIT directive. Second, the IBA Taxes Committee notes that the application of article 7 OECD Model in this example could give rise to non-

International Bar Association is incorporated as a Not-for-Profit Corporation under the laws of the State of New York in the United States of America and is registered with the Department of State of the State of New York with registration number 071114000655 - and the liability of its members is limited. Its registered address in New York is c/o Capitol Services Inc, 1218 Central Avenue, Suite 100, Albany, New York 12205.

The London office of International Bar Association is registered in England and Wales as a branch with registration number FC028342.

taxation if the third state concerned applies an exemption for profits that are attributable to a permanent establishment. If, in this example, Third State X would exempt the profits attributable to the permanent establishment in EU Member State Y, this would entail that EUR 5 million is subject to non-taxation as Third State X would exempt it, EU Member State Y would not tax it because this amount has been allocated to EU Member State Z, while EU Member State Z is precluded from taxing the EUR 5 million under the Extra-EU Treaty with Third State X. In order to avoid such a non-taxation outcome, the IBA Taxes Committee recommends that the European Commission reaches out to third states to discuss the interaction of the BEFIT Allocation Mechanism with Extra-EU Treaties so as to ensure that when profits are attributable to a permanent establishment in one EU Member States, such profits may be taxed by other EU Member States if that would be in accordance with the BEFIT Allocation Mechanism (provided that, overall, the profits that are subject to taxation throughout the EU do not exceed the profits that may be taxed by the EU Member State where the permanent establishment is situated).

22. If the European Commission would reach out to third state to discuss the risk of non-taxation, it may also want to address the risk of double taxation when a third state would not apply the exemption method, but a credit method or exemption method with a subject to tax requirement. It may want to address this risk due to the bilateral nature of Extra-EU Treaties with respect to the duty to provide a credit or the assessment of whether income is subject to tax for the purposes of a tax treaty. This can be illustrated by means of the following example, which takes the facts of example 4 as a starting point.

> Credit method. If an EU Member State would tax the profits allocated to it under the BEFIT Allocation Mechanism (irrespective of the compatibility with article 7 OECD Model), the consequence would be that profits that have been attributed to a permanent establishment have been taxed in two EU Member States. The provision in an Extra-EU Treaty that provides for the credit method generally only takes into account the taxes levied in the other contracting state. In example 4, this means that Third State X would only provide a credit for the taxes levied in EU Member State Y; for the taxes levied in EU Member State Z, which relate to profits that may not be taxed in that EU Member State under the Extra-EU Treaty, no credit is provided for. Consequently, the EUR 5 million that is allocated to EU Member State Z would be subject to taxation in Third State X without a credit being granted for the taxes due in EU Member State Z. The result is double taxation arising from the interaction between article 7 OECD Model, the credit method and the BEFIT Allocation Mechanism.
>
> Exemption method with subject to tax requirement. Double taxation may also arise if the exemption method would only apply if the income is subject to tax in the other contracting state. If the income is allocated to another EU Member State, it is not subject to tax in the other contracting state. The consequence would be that Third State X would not provide for an exemption while the income is, in fact, subject to tax but not in EU Member State Y. If no exemption is provided for in Third State X, double taxation would arise because the EUR 5 million is taxed in Third State X as well as EU Member State Z.

23. Although not expressly linked to an example in practice, the IBA Taxes Committee notes that the risk for double taxation would not necessarily be limited to Extra-EU Treaties only.

International Bar Association is incorporated as a Not-for-Profit Corporation under the laws of the State of New York in the United States of America and is registered with the Department of State of the State of New York with registration number 071114000655 - and the liability of its members is limited. Its registered address in New York is c/o Capitol Services Inc, 1218 Central Avenue, Suite 100, Albany, New York 12205.

The London office of International Bar Association is registered in England and Wales as a branch with registration number FC028342.

Intra-EU Treaties that provide for a credit of exemption method with a subject to tax requirement may also give rise to double taxation outcomes within the EU for profits of a permanent establishment that are allocated to other EU Member States. Therefore, the IBA Taxes Committee recommends that the risk of double taxation is also addressed within the EU. With a view to mitigating the risk of double taxation and non-taxation arising from the BEFIT Allocation Mechanism, the IBA Taxes Committee recommends the following solutions.

(a) Intra-EU Treaty recommendation: the EU Member States conclude a multilateral mutual agreement or treaty, at the time of adoption of the BEFIT directive, that provides that "*Intra-EU Treaties shall not prevent the application of the BEFIT directive and the taxation of profits allocated in accordance with the BEFIT directive*". Such a treaty would then ensure that Intra-EU Treaties would not prevent taxation of profits allocated under the BEFIT directive to other EU Member States.

Alternatively, it could be clarified in the BEFIT directive that the directive, similar to the 2011 proposal for a CCCTB directive,[3] overrides Intra-EU Treaties. Such a clarification would indicate a clear common intention between the EU Member States as to how to resolve areas of potential conflicts between the BEFIT directive and Intra-EU Treaties. Such a clear common intention may then be relevant for resolving a conflict under public international law, which resolution might be relevant for EU Member States that are incapable of overriding their Intra-EU Treaties under national law.

(b) Extra-EU recommendation*:* the European Commission reaches out to third states, on behalf of the EU Member States, with a view to entering into a multilateral mutual agreement or treaty between (the European Commission on behalf of) the EU Member States that confirms:

(i) that profits that are allocated to a permanent establishment in an EU Member State, may be taxed by other EU Member States as well if such profits are allocated to those other EU Member States in accordance with the BEFIT Allocation Mechanism;

(ii) that third states, when applying a credit method or an exemption method with a subject to tax requirement, take into account the extent to which the relevant income has been taxed, or has been subject to tax, in other EU Member States as well, to the extent that the income has been allocated to those other EU Member States under the BEFIT Allocation Mechanism.

[3] See article 8 of COM(2011) 121/4 which provides that "*The provisions of this Directive shall apply notwithstanding any provision to the contrary in any agreement concluded between Member States.*"

International Bar Association is incorporated as a Not-for-Profit Corporation under the laws of the State of New York in the United States of America and is registered with the Department of State of the State of New York with registration number 071114000655 - and the liability of its members is limited. Its registered address in New York is c/o Capitol Services Inc, 1218 Central Avenue, Suite 100, Albany, New York 12205.

The London office of International Bar Association is registered in England and Wales as a branch with registration number FC028342.

3.4 **The interaction between transfer pricing adjustments on the basis of article 9 OECD Model and the BEFIT directive**

24. In its submission of January 2023, the IBA Taxes Committee highlighted that transfer pricing adjustments resulting from application of the arm's length principle under article 9 OECD Model could give rise to challenges. The main challenge in this respect seems to be the effect of transfer pricing adjustments made by third states and the obligation of an EU Member State to make a corresponding adjustment under article 9(2) OECD Model.

25. Pursuant to the BEFIT Allocation Mechanism, the BEFIT tax base shall be allocated to the BEFIT group members on the basis of the baseline allocation percentage. This baseline allocation percentage is calculated by dividing a BEFIT group member's taxable result by the total taxable result of the BEFIT group. If a third state would make a transfer pricing adjustment that requires an EU Member State to make a corresponding adjustment in accordance with article 9(2) OECD Model, such a corresponding adjustment is not necessarily borne by that EU Member State. If, for example, the profits of that EU Member State are (partially) allocated to other EU Member States under the BEFIT Allocation Mechanism, a corresponding adjustment would also be partially allocated to those other EU Member States. This can be illustrated by means of the following example.

> Example 5: the allocation of corresponding adjustments between the EU Member States
>
> Company A, resident in third state X, sells products to Company B, resident in EU Member State Y, for EUR 1,000. Third state X considers the price to be not at arm's length and makes a transfer pricing adjustment pursuant to which Company A is deemed to have sold the products to Company B for EUR 1,100 and third state X taxes the additional EUR 100 accordingly. Based on article 9(2) OECD Model, EU Member State Y is required to make a corresponding adjustment to the taxable profits of Company B.
>
> On the basis of the previous three years, the BEFIT allocation percentage for Company B amounts to 10 percent. Before the transfer pricing adjustment, the preliminary tax result of Company B amounts to EUR 1,000 and the preliminary tax result of the BEFIT group amounts to EUR 10,000. Consequently, Company B would be allocated the EUR 1,000 profits generated in the relevant year. As a result of the transfer pricing adjustment, Company B's preliminary tax result amounts to EUR 900 (additional cost of EUR 100) while the preliminary tax result of the group amounts to EUR 9,900. The transfer pricing adjustment does not, however, affect the baseline percentage as this percentage would be based on the prior three years. As a consequence, Company B would be allocated EUR 990 of the total preliminary tax result notwithstanding the fact that its preliminary tax result has been adjusted downwards by EUR 100.

The example indicates that a downward adjustment that must be made by one EU Member State under article 9(2) OECD Model may result in the adjustment being only partially borne by that EU Member State because of the fact that the BEFIT allocation percentage is based on the previous three years. In the event that a downward adjustment is not fully borne by the relevant EU Member State, the question may be raised as to whether that EU Member

International Bar Association is incorporated as a Not-for-Profit Corporation under the laws of the State of New York in the United States of America and is registered with the Department of State of the State of New York with registration number 071114000655 - and the liability of its members is limited. Its registered address in New York is c/o Capitol Services Inc, 1218 Central Avenue, Suite 100, Albany, New York 12205.

The London office of International Bar Association is registered in England and Wales as a branch with registration number FC028342.

State would comply with its obligation to make an appropriate adjustment to "*the amount of the tax charged therein on those profits*" if the adjustment effectively results in a reduction of taxes charged in multiple EU Member States as a result of the BEFIT allocation mechanism. In order to avoid third states from taking the position that the relevant EU Member State fails to comply with the duty to make an adjustment for the tax charged in that EU Member State, the matter of corresponding adjustments may be clarified in the BEFIT directive.

26. Another area of attention would seem to be the situation wherein an EU Member State makes an upward adjustment to the taxable profits of an entity that is part of a BEFIT group in connection with a transaction with an entity of a third state. This can be illustrated as follows.

Example 5: the BEFIT Allocation Mechanism and the need to tax upward adjustments

The facts are the same as example 4 but EU Member State Y considers the price to be not at arm's length and makes a transfer pricing adjustment pursuant to which Company A is deemed to have sold the products to Company B for EUR 900. Consequently, EU Member State Y increases the taxable profits of Company B by EUR 100. Based on article 9(2) OECD Model, third state X would then be required to make a corresponding adjustment to the taxable profits of Company A if EU Member State Y would tax the additional profits of EUR 100 accordingly.

Based on the BEFIT allocation percentage of 10 percent for Company B, the transfer pricing adjustment would have the following consequences. The preliminary tax result of Company B is increased from EUR 1,000 to EUR 1,100 whereas the preliminary tax result of the BEFIT group is increased from EUR 10,000 to EUR 10,100. Based on the BEFIT allocation percentage of Company B, EUR 1,010 of the preliminary tax result of the BEFIT group is allocated to Company B. As such, only EUR 10 of the transfer pricing adjustment made by EU Member State Y of EUR 100 is subject to tax in that EU Member State after application of the BEFIT allocation mechanism.

If a transfer pricing adjustment by an EU Member State of EUR 100 would only be included in the profits of an enterprise of that EU Member State for EUR 10 – and taxed accordingly in that EU Member State – as a result of the BEFIT Allocation Mechanism, the question arises as to whether the third state concerned would be obliged to make a corresponding adjustment under article 9(2) OECD Model. This question arises because article 9(2) OECD Model only requires the third state to make a corresponding adjustment insofar as the EU Member State includes the profits resulting from that adjustment in its taxable base and taxes those profits accordingly. If the third state would not make a full corresponding adjustment, this could give rise to double taxation or non-taxation. In the example above, for example, the additional profits of EUR 100 are taxed within the BEFIT group. If, however, the third state concerned would only make a corresponding adjustment of EUR 10, there would be double taxation for EUR 90. Non-taxation arises in the event that EU Member State Y would have made a downward adjustment that only partially results in a reduction of taxable profits in that EU Member State.

International Bar Association is incorporated as a Not-for-Profit Corporation under the laws of the State of New York in the United States of America and is registered with the Department of State of the State of New York with registration number 071114000655 - and the liability of its members is limited. Its registered address in New York is c/o Capitol Services Inc, 1218 Central Avenue, Suite 100, Albany, New York 12205.

The London office of International Bar Association is registered in England and Wales as a branch with registration number FC028342.

27. With a view to avoiding that the BEFIT Allocation Mechanism affects the effectiveness of the transfer pricing adjustment rules of article 9 OECD Model, the IBA Taxes Committee recommends the following:

Intra-EU Treaty recommendation: the EU Member States conclude a multilateral mutual agreement or treaty, at the time of adoption of the BEFIT directive, that provides that transfer pricing adjustments for BEFIT group members shall be shared between the BEFIT group members and the "taxed accordingly" requirement shall be applied on a BEFIT group level. Alternatively, this could be clarified in the preamble of the BEFIT directive or a specific provision.

(c) Extra-EU recommendation*:* the European Commission reaches out to third states, on behalf of the EU Member States, with a view to entering into a multilateral mutual agreement or treaty between (the European Commission on behalf of) the EU Member States that confirms that, for the purposes of assessing the level of taxation in respect of a transfer pricing adjustment, the level of taxation for the BEFIT group is taken into account and not merely the level of taxation of the individual BEFIT group member.

3.5 The interaction between unilateral tax relief rules and the BEFIT directive

28. Although not specifically linked to the interaction between tax treaties and the BEFIT directive, the IBA Taxes Committee notes that double taxation may also arise from the application of unilateral credit rules, such as the US foreign tax credit regime. Pursuant to this regime, foreign income taxes are only creditable where the relevant US company or subsidiary would have substantial nexus in a jurisdiction. Under the BEFIT directive, it is conceivable that a jurisdiction is allocated profits of a subsidiary of a US company under the BEFIT Allocation Mechanism where there would be insufficient nexus for US foreign credit regime purposes. In the event of insufficient nexus, the US would not provide for a credit for the taxes levied in the EU Member State concerned, thereby giving rise to double taxation.

4 DISPUTE PREVENTION AND RESOLUTION AND ADMINISTRATIVE PROCEDURES

29. Taking into account the cross-border nature of the BEFIT directive, the administrative aspect of this directive is of fundamental importance to achieve its objective of achieving simplification. In this respect, the BEFIT directive seems to favor a balanced approach between simplicity and national tax sovereignty (e.g. audits and dispute resolution). Simplicity is achieved by means of the Hybrid One-Stop-Shop approach pursuant to which the BEFIT information return has to be filed with the filing authority, which in turn has to share it with other Member States where other BEFIT group members are resident for tax purposes. National tax sovereignty is maintained by requiring the filing of individual tax returns with local tax administrations and the need for alignment of the profits allocated under the BEFIT directive with national laws.

International Bar Association is incorporated as a Not-for-Profit Corporation under the laws of the State of New York in the United States of America and is registered with the Department of State of the State of New York with registration number 071114000655 - and the liability of its members is limited. Its registered address in New York is c/o Capitol Services Inc, 1218 Central Avenue, Suite 100, Albany, New York 12205.

The London office of International Bar Association is registered in England and Wales as a branch with registration number FC028342.

30. With respect to the dispute prevention and resolution and administrative procedures of the BEFIT directive, the IBA Taxes Committee has identified the following areas in respect of which it has formulated recommendations:

(a) Deadline for filing BEFIT information return (section 4.1);

(b) Role of the BEFIT Team in the BEFIT information return (section 4.2);

(c) Audits (section 4.3);

(d) Appeals (section 4.4);

(e) Administrative procedures (section 4.5).

4.1 Deadline for filing BEFIT information return (article 57 BEFIT directive)

31. Businesses falling within the scope of the BEFIT directive generally file their financial statements within three months after a financial year. On the basis of the BEFIT directive, a business would have to submit the BEFIT information return no later than four (4) months after the end of a fiscal year. This deadline would seem to provide businesses with a timeframe of approximately one (1) month. Considering that the taxable basis deviates from the profits in the financial statements, the IBA Taxes Committee considers a timeframe of approximately one (1) month too short to file the BEFIT information return. The IBA Taxes Committee therefore suggests extending the deadline to six (6) months after the end of the financial year to allow the BEFIT group members to finalize their financial statements before submitting the BEFIT information return.

4.2 Role of the BEFIT Team in the BEFIT information return (article 61 BEFIT directive)

32. Under the BEFIT directive, an important role will be played by the BEFIT Team, composed of representatives of different tax authorities from each Member State involved, and chaired by the representative of the filing authority. The BEFIT Team should help to facilitate communication and resolution of issues between tax authorities while also enabling amendments to the BEFIT information return through a coordinated process. One of the most important tasks of the BEFIT Team will be that of examining in a timely manner the completeness and accuracy of the information reported in the BEFIT information return so as to allow the submission of the individual tax returns of the various BEFIT group members. It follows from article 61 BEFIT directive, in this respect, that the BEFIT Team shall endeavor to achieve a (simple majority) consensus on the content of the BEFIT information return within a clear period of time. The consensus of the BEFIT Team will prevent any future challenges by the tax administrations concerned regarding (i) the identification of the filing entity and other BEFIT group members, (ii) the information on the overall structure of the BEFIT group, (iii) the fiscal year covered by the BEFIT information

Chancery House, 53-64 Chancery Lane. London WC2A 1QS, United Kingdom Tel: +44 (0)20 7842 0090 www.ibanet.org

International Bar Association is incorporated as a Not-for-Profit Corporation under the laws of the State of New York in the United States of America and is registered with the Department of State of the State of New York with registration number 071114000655 - and the liability of its members is limited. Its registered address in New York is c/o Capitol Services Inc, 1218 Central Avenue, Suite 100, Albany, New York 12205.

The London office of International Bar Association is registered in England and Wales as a branch with registration number FC028342.

return, and most importantly (iv) information about the 'baseline allocation percentage', as calculated in accordance with article 45 BEFIT directive.[4]

33. For the purposes of reaching consensus, a quorum is required. If the quorum is not reached, the BEFIT information return will still form the basis for the individual tax returns of the BEFIT group members and for the tax assessments of the Member States. However, in this case, it is not clear whether tax administrations could raise future challenges regarding the above-mentioned information to be examined by the BEFIT Team due to the lack of consensus. The IBA Taxes Committee suggests, with a view to protecting legal certainty, that it is clarified what the consequences would be if no quorum is reached.

4.3 **Audits (article 65 BEFIT directive)**

34. If adjustments resulting from audits performed by a Member States individually or jointly with other Member States (conducted in accordance with the national law of the Member State in which an audit is carried out) would require a change in the BEFIT tax base, it follows from the BEFIT directive that the filing authority shall (i) notify the results to the BEFIT team and (ii) issue a revised BEFIT information return granting to other Member States the right to adjust their tax assessments accordingly. Interestingly, article 65(4) of the BEFIT directive provides that 'the other members of the BEFIT team shall express their views' on the results of the audits affecting the allocation of the BEFIT tax base. The IBA Taxes Committee notes that it is left open what the consequences will be if one of the BEFIT team members would disagree with the results. In order to provide certainty to taxpayers, the IBA Taxes Committee would appreciate it if this could be clarified.

4.4 ***Appeals (articles 67-69 BEFIT directive)***

35. The IBA Taxes Committee notes that the BEFIT directive has a cross-border allocation mechanism that is dependent on the BEFIT-adjusted FANIL for each BEFIT group member. With respect to the determination of the BEFIT-adjusted FANIL, the BEFIT directive provides for a common set of rules. This common set of rules may, however, be interpreted and applied differently by the various EU Member States. A diverging interpretation and/or application of the BEFIT-adjusted FANIL rules may give rise to disputes that have cross-border consequences as they could affect the nominator and denominator of the BEFIT Allocation Mechanism. Taking into account the cross-border effects of the BEFIT directive, the IBA Taxes Committee would have expected an efficient cross-border dispute prevention / resolution mechanism. It appears from the BEFIT directive, however, that dispute prevention / resolution would not be cross-border, but within the border of a single EU Member State given that appeals against the BEFIT information return must be made in the Member State of the filing authority, while appeals against the individual tax assessment must be made in the Member State where the BEFIT group member is resident

[4] The Member States in which the BEFIT group members are resident for tax purposes will have the exclusive competence regarding the information on (i) the outcome of the preliminary tax result of each BEFIT group member, (ii) the BEFIT tax base and (iii) the allocated part of each BEFIT group member.

International Bar Association is incorporated as a Not-for-Profit Corporation under the laws of the State of New York in the United States of America and is registered with the Department of State of the State of New York with registration number 071114000655 - and the liability of its members is limited. Its registered address in New York is c/o Capitol Services Inc, 1218 Central Avenue, Suite 100, Albany, New York 12205.

The London office of International Bar Association is registered in England and Wales as a branch with registration number FC028342.

for tax purposes. Appeals are made to an administrative body or, in the absence of such a body, directly to the competent judicial authority and would seem to follow the ordinary course of litigation.

36. The IBA Taxes Committee is curious as to why no common cross-border dispute prevention and/or resolution mechanism is part of the BEFIT directive. Appeals in EU Member States may, depending on the EU Member State concerned, take a considerable amount of time especially in Member States where the administrative body does not exist. Such appeals may then affect the BEFIT Allocation Mechanism with retroactive effect. If, for example, appeals would be pending in five EU Member States at the same time, the profit allocation under the BEFIT directive may have to be adjusted retroactively up to five times. The IBA Taxes Committee considers this inefficient and recommends that a common method would be defined for proceedings relating to a certain BEFIT taxable year in order to avoid retroactive adjustment after retroactive adjustment. In this respect the IBA Taxes Committee would suggest, as it has also done in its submission of January 2023, to look further into whether a dispute resolution mechanism may be introduced that provides BEFIT groups direct access to EU courts, preferably in two instances (at (a tax chamber of) the General Court and the CJEU). Additionally, the IBA Taxes Committee would suggest exploring the possibility of multilateral Advance Pricing Agreements ("**APAs**") to provide a stronger legal basis and administrative framework for multilateral instruments such as APAs and/or extending the scope of Council Directive (EU) 2017/1852 of 10 October 2017 on tax dispute resolution mechanisms in the European Union ("**DRMD**") to disputes concerning the application of the BEFIT directive while allowing the BEFIT group to benefit from the results of the resolution procedure also in respect of different tax years or similar cases, without the need to start new dispute prevention/resolution procedures. In this scenario, the BEFIT group should be entitled to submit a request for dispute prevention / resolution to the filing authority where it is subject to inconsistent results due to differences in interpretation and application of the BEFIT rules. The tax administrations concerned would be required to enter into discussions to resolve the case within a clear and binding timeframe.

4.5 Administrative procedure

37. In addition, as already pointed out in our response of January 26, 2023, we would reiterate that in order to have a harmonized interpretation and application of the BEFIT rules within the Union, consideration should be given to the publication in a publicly accessible centralized register of anonymized (i) determinations or opinions issued by tax authorities, (ii) decisions of courts of Member States in relation to BEFIT application, and (iii) any determinations made under the proposed dispute prevention / resolution procedure.

5 CONCLUSION

38. Overall, the IBA Taxes Committee welcomes the BEFIT directive and its policy objectives to simplify tax obligations and compliance within the internal market. With respect to

International Bar Association is incorporated as a Not-for-Profit Corporation under the laws of the State of New York in the United States of America and is registered with the Department of State of the State of New York with registration number 071114000655 - and the liability of its members is limited. Its registered address in New York is c/o Capitol Services Inc, 1218 Central Avenue, Suite 100, Albany, New York 12205.

The London office of International Bar Association is registered in England and Wales as a branch with registration number FC028342.

ensuring the effectiveness of the BEFIT directive in its transitional form, and also with a view to ensuring the effectiveness of the future allocation mechanism, the IBA Taxes Committee recommends that the BEFIT directive aligned with the existing international tax landscape. Misalignment with such landscape could give rise to inconsistencies that affect the effectiveness of the BEFIT package. With a view to avoiding inconsistencies and thereby increasing the effectiveness of the BEFIT directive, the IBA Taxes Committee recommends that it is ensured that alignment is achieved between the BEFIT directive and the Pillar 2 Directive as well as between the BEFIT directive and (Intra-EU and Extra-EU) tax treaties. Additionally, the IBA Taxes Committee considers effective dispute resolution and prevention essential for achieving the policy objectives of the BEFIT directive.

International Bar Association is incorporated as a Not-for-Profit Corporation under the laws of the State of New York in the United States of America and is registered with the Department of State of the State of New York with registration number 071114000655 - and the liability of its members is limited. Its registered address in New York is c/o Capitol Services Inc, 1218 Central Avenue, Suite 100, Albany, New York 12205.

The London office of International Bar Association is registered in England and Wales as a branch with registration number FC028342.

ANNEX 2. COMMENTS REGARDING THE TP DIRECTIVE

1 INTRODUCTION

39. The IBA Taxes Committee welcomes the initiative of the Commission to harmonize the transfer pricing rules within the European Union in an effort to avoid profit shifting and tax avoidance, avoid litigation and double taxation and to reduce compliance costs. We are pleased to offer you our comments in an effort to optimize the working of the Directive in line with its aim and obtain clarification in areas that in our opinion are not yet clear.

2 PRELIMINARY COMMENTS

40. With respect to the comments of the IBA Taxes Committee regarding the design of the TP directive, the IBA Taxes Committee notes that these must be interpreted and understood against the background of the following two preliminary comments regarding the interaction with tax treaties (section 2.1), the Pillar 1 proposal (section 2.2) and the BEFIT directive (section 2.3).

2.1 Interaction with tax treaties

41. The IBA Taxes Committee highlights that alignment with the international tax landscape should be considered so as to avoid that the positions and interpretations of the TP directive lead to mutual agreement procedures that fail and end with double taxation. While it is understood that the TP directive definitions are to be incorporated in domestic law of the EU Member States, there appears to be room for inconsistencies between these definitions and those of non-EU Member States. Reference can be made to the comments included in the paragraphs hereafter on the definition of associated enterprises, the application of the arm's length range and the static versus dynamic interpretation of the OECD TP Guidelines. In those cases, transfer pricing adjustments based on definitions and interpretations resulting from the EU TP directive are likely to be submitted to the mutual agreement procedure under Article 25 of the applicable double tax treaty, assuming there is a treaty for avoidance of double taxation in place between the respective countries involved. Between competent authorities, the country of the primary adjustment has the burden of proof to substantiate the accuracy of the transfer pricing adjustment and that such an adjustment is consistent with the arm's length principle. Therefore, the competent authority of the country of the primary adjustment is starts out as the leading party in the MAP discussions. While the competent authorities ought to endeavor to resolve matters, it is possible that the Country where the corresponding adjustment is required to alleviate double taxation considers the position of the Country of the primary adjustment irreconcilable with its own interpretation of the arm's length principle. Taking this into account, the IBA Taxes Committee recommends that the TP directive addresses its interaction with the existing international tax landscape. In this respect, the IBA Taxes Committee would recommend that it is made clear that the competent authorities can

Chancery House, 53-64 Chancery Lane. London WC2A 1QS, United Kingdom Tel: +44 (0)20 7842 0090 www.ibanet.org

International Bar Association is incorporated as a Not-for-Profit Corporation under the laws of the State of New York in the United States of America and is registered with the Department of State of the State of New York with registration number 071114000655 - and the liability of its members is limited. Its registered address in New York is c/o Capitol Services Inc, 1218 Central Avenue, Suite 100, Albany, New York 12205.

The London office of International Bar Association is registered in England and Wales as a branch with registration number FC028342.

deviate from the TP directive in a mutual agreement procedure ("**MAP**"), in order to reach avoidance of double taxation with third states Interaction with the Pillar 1 proposal.

42. The IBA Taxes Committee notes that the project of Pillar 1 and Pillar 2 is still ongoing. It is, at present, unclear how the two pillars will look like in the end, how they operate in practice, and which countries will accept and transform the proposals of the OECD into their domestic law. According to the IBA Taxes Committee, the TP directive should not conflict with the resolutions regarding Pillar 1 that still need to be made. Taking into account the ongoing development of the Pillar 1 and Pillar 2 project at the level of the OECD, the IBA Taxes Committee wonders whether it is opportune to move forward with this directive with a view to adopting it on short notice by the Council before the OECD's work on this project has been finalized and accepted as to be transformed into the domestic laws by a satisfying number of other countries with corporations resident in the EU Member States that engage in cross-border intra-group business transactions. At the same time, however, the IBA Taxes Committee does recognize the potential benefits of the TP directive in terms of its policy objectives. Therefore, the IBA Taxes Committee would recommend to further develop the TP directive so as to address the comments made in this submission but to also keep in mind the interaction with the Pillar 1 proposal.

3 DEFINITION OF ASSOCIATED ENTERPRISES (ARTICLE 5)

43. For the purpose of the TP directive, an ‘associated enterprise’ means an enterprise who is related to another person by participating in the control of another entity through (i) a holding that exceeds 25% of the voting rights, or (ii) a participation in the capital through a holding that directly or indirectly exceeds 25%, or (iii) entitlement to 25% of the profits, or (iv) participation in the management with a position to exercise significant influence over the other person. This definition of the term “associated enterprise” is narrower than in some of the EU Member States' domestic tax laws[5] as well as the laws of third states, such as the United States.[6] Taking into account this difference, the IBA Taxes Committee notes that the (more than) 25% threshold may not be aligned with the purposes of the TP directive (section 3.1), while it may also give rise to potential inconsistencies with tax treaties (section 3.2).

3.1 The (more than) 25% threshold and the purpose of the TP directive

44. With respect to the rationale for the (more than) 25% threshold, the IBA Taxes Committee wonders whether it is aligned with the purpose of transfer pricing rules in general. In this respect, the IBA Taxes Committee refers to the context of the TP directive that indicates that it is the purpose of the TP directive that

[5] For example Denmark, Italy and Ireland have control provisions (in practice) that entail a threshold of more than 50 percent.
[6] The United States applies a threshold of more than 50%.

Chancery House, 53-64 Chancery Lane. London WC2A 1QS, United Kingdom Tel: +44 (0)20 7842 0090 www.ibanet.org

International Bar Association is incorporated as a Not-for-Profit Corporation under the laws of the State of New York in the United States of America and is registered with the Department of State of the State of New York with registration number 071114000655 - and the liability of its members is limited. Its registered address in New York is c/o Capitol Services Inc, 1218 Central Avenue, Suite 100, Albany, New York 12205.

The London office of International Bar Association is registered in England and Wales as a branch with registration number FC028342.

"..intragroup transactions are not necessarily governed by market forces but may largely be driven by common interest of the group as a whole. Since tax calculations are generally based on entity-level accounts, the prices and other conditions at which these intragroup transactions take place will effect the relevant entities' income and/or expenses in relation to those transactions";

"The complexity of the transfer pricing rules and their different implementation in national law of Member States gives rise to a number of other problems:

*- **Profit shifting and tax avoidance**: transfer prices can be easily manipulated to shift profit and be used in the context of aggressive tax planning schemes"*

According to the IBA Taxes Committee, this purpose indicates that only if a company has the ability to influence the pricing of intragroup transactions, there is a reason to apply the arm's length principle. This is only the case if a company has control to influence the transfer pricing towards another company. Viewed from this perspective the IBA Taxes Committee considers the (more than) 25% threshold as too low. If a company that meets the (more than) 25% threshold would, in fact, have no influence in respect of the intercompany pricing, there is in the opinion of the IBA Taxes Committee no reason for applying the arm's length principle since in that case the pricing is by definition at arm's length. The introduction of a (less than) 50% threshold may thus result in application of the arm's length principle to transactions with respect to transactions wherein enterprises have no ability or control to influence the pricing, which would seem contrary to the objective of the TP directive.

45. Support for the view that the TP directive does not intend to apply to transactions where the companies concerned have no ability or control to influence the pricing may be derived from the comparability analysis of article 11(3) TP directive where it is stated that:

*an uncontrolled transaction is comparable to a controlled transaction if… (a) none of the differences (if any) between the transactions being compared or between enterprises undertaking those transactions **could materially affect the price in the open market**".*

Setting a too low threshold, such as the (more than) 25% threshold, can in practice also lead to unnecessary complications and unnecessary compliance costs which is not in line with the aim of the Directive to avoid disputes and high compliance costs. This can be illustrated by means of the following example.

Example 1:

Suppose a company has three 33 1/3%-shareholders who do not cooperate in three different EU Member States. All these shareholders deliver products but cannot influence the pricing. According to the current wording of the Directive each shareholder must however fulfill the obligation to prepare transfer pricing documentation to establish that the transfer pricing is at arm's length. This is an unnecessary burden and leads to unnecessary costs.

Suppose one of these shareholders in an effort to gain an additional market share drops the pricing substantially so that it prices are outside the interquartile range according to the comparable analysis. In that case the a discussion may/will arise with the tax authorities

International Bar Association is incorporated as a Not-for-Profit Corporation under the laws of the State of New York in the United States of America and is registered with the Department of State of the State of New York with registration number 071114000655 - and the liability of its members is limited. Its registered address in New York is c/o Capitol Services Inc, 1218 Central Avenue, Suite 100, Albany, New York 12205.

The London office of International Bar Association is registered in England and Wales as a branch with registration number FC028342.

whereby the taxpayer has the burden of proof. This can easily lead to differences of opinion and therefore additional costs for the company involved while in reality the company is in the same situation as an independent enterprise.

This example illustrates that the 25 percent threshold entails that transfer pricing documentation may be required in situations wherein there is no control on the pricing of a transaction. This would seem to be an additional administrative burden for enterprises in practice.

3.2 **The consistency of the (more than) 25% threshold and tax treaties**

46. As highlighted in section 2.1, the TP directive would become part of the international tax landscape. This international tax landscape may provide for a different threshold for the application of the arm's length principle than the TP directive. If a state applies, for tax treaty purposes, a (more than) 50% threshold while the TP directive provides for the lower (more than) 25% threshold, this could give rise to conflicts in the sense that the tax treaty may not provide a basis for the transfer pricing adjustment and/or the corresponding adjustment that must be made on the basis of the TP directive. Depending on the hierarchy of national legislation aimed at implementing a directive, such as the TP directive, and tax treaties, this could result in diverging application of the TP directive throughout the EU considering that some EU Member States may then rely on the tax treaty's (more than) 50% threshold, such as the Netherlands, while other EU Member States would rely on the domestic law that implements the TP directive, such as Germany, and apply the (more than) 25% threshold.

3.3 **Recommendation**

47. With a view to achieving a consistent application of the TP directive throughout the EU, which is consistent with the international tax landscape, the IBA Taxes Committee recommends amending the definition of associated enterprises as follows.

For the purpose of this Directive, 'associated enterprise' means a person who is related to another person in any of the following ways:

(a) a company owns more than 50% of the shares capital of another entity; or

(b) has more than 50% of the voting rights; or

(c) minority shareholders of a company materially or contractually cooperate as result of which they jointly can exercise decisive influence on the transfer pricing (a so-called "Cooperating group of shareholders")

(d) a person participates in the management of another entity by being in a position to exercise decisive influence over the other person.

(e) a person is entitled to more than 50% of the profits of another person.

International Bar Association is incorporated as a Not-for-Profit Corporation under the laws of the State of New York in the United States of America and is registered with the Department of State of the State of New York with registration number 071114000655 - and the liability of its members is limited. Its registered address in New York is c/o Capitol Services Inc, 1218 Central Avenue, Suite 100, Albany, New York 12205.

The London office of International Bar Association is registered in England and Wales as a branch with registration number FC028342.

4 ARTICLE 14 APPLICATION OF THE ARM'S LENGTH PRINCIPLE

48. Article 14(1) TP directive states that member States shall include in their national rules the transfer pricing rules laid down in Chapter II of the Directive provisions that ensure that those rules are applied in a manner consistent with the OECD Transfer Pricing Guidelines. The OECD Transfer Pricing Guidelines are defined as the 2022 Guidelines. Many EU Member States apply, however, a static approach that entails that only the OECD TP-guidelines that were published in a given taxable year are relevant unless the changes thereafter are more of an elaborated, clarifying, nature.[7] The fact that many EU Member States apply a static approach raises the question what the impact would be of the introduction of the TP-Directive based on the 2022 TP-Guidelines for the years prior to the year in which the Directive has entered into force. It furthermore raises the question as to the effect of (mandatory) changes in the TP model as a result of the entry into force of the TP directive.

49. Like in the past, the OECD Transfer Pricing Guidelines will be regularly amended in the course time to reflect changes in the economy and common views. In those cases the question will come up whether future changes in the OECD TP Guidelines are more an elaborated, clarifying, nature that do not require an implementation act or a material change that requires an implementation act. The IBA Taxes Committee wonders how the Council and the Commission wish to ensure that the implementation acts are in line with the intentions of the OECD? Assuming these changes are material changes endorsed by implementing acts, it is in the interest of certainty for businesses to know for which taxable years these new guidelines will then apply.

50. The IBA Taxes Committee is of the opinion that - consistent with verdicts of the ECJ in State Aid cases (for example the May 12, 2021 verdict in the Amazon case in which the retroactive application of the later dated OECD Transfer Pricing Guidelines was rejected) [8]- these changes will only be relevant as from the start of the first taxable year after the implementing acts and would appreciate if this can be confirmed.

51. This is also in line with the verdicts of domestic tax courts of various EU Member States like e.g. Germany[9] with respect to the non-application of updated OECD commentaries to the OECD Model Treaty for interpreting formerly agreed tax treaties in effect. This highlights the need to address the interaction with tax treaties, as set out in section 2.1.

[7] For example in the Netherlands: see Supreme Court ruling dated 14 October 2022.
[8] See also a June 2021 court case in Gent, Belgium (2016/AR/455) where a retroactive effect of later amended OECD Transfer pricing Guidelines was also not accepted.
[9] See BFH, decision of July 11, 2018, file no. I R 44/16, published in the German Federal Tax Gazette (BStBl.) 2023 II (sic!), 430, and, therefore, in principle also binding to the German tax authorities.

International Bar Association is incorporated as a Not-for-Profit Corporation under the laws of the State of New York in the United States of America and is registered with the Department of State of the State of New York with registration number 071114000655 - and the liability of its members is limited. Its registered address in New York is c/o Capitol Services Inc, 1218 Central Avenue, Suite 100, Albany, New York 12205.

The London office of International Bar Association is registered in England and Wales as a branch with registration number FC028342.

52. Finally the IBA Taxes Committee wishes to point to the fact that challenges may arise in case of TP disputes with countries outside the EU who apply different approaches for example applying new TP-Guidelines on older years (a dynamic approach).

5 IDENTIFICATION OF COMMERCIAL OR FINANCIAL RELATIONS (ARTICLE 8 TP DIRECTIVE)

53. Based on the introduction and preamble of the TP directive, transfer pricing outcomes must be determined in accordance with the actual conduct of associated enterprises in the context of the contractual terms of the transaction. To achieve this objective, the provision requires careful delineation of the actual transaction between associated enterprises by analyzing the contractual relations between the parties and in combination with the conduct of the parties.

54. Within the context of identifying the actual transaction, Chapter X of the OECD Transfer Pricing Guidelines provides for guidance regarding the transfer pricing aspects of financial transactions. In this chapter, specific comments are made in respect of the accurate delineation of an actual lending transaction and related financial guarantees to the balance of debt and equity funding of an entity within an MNE group in accordance with the guidance established in CX of the Guidelines especially where it is considered that the arrangements made, viewed in their totality, differ from those that would have been adopted by independent enterprises behaving in a commercial rationale manner. The IBA Taxes Committee assumes that Chapter X is relevant and appreciates it if this could be confirmed in the TP directive.

55. In the event that arrangements made, viewed in their totality, differ from those that would have been adopted by independent enterprises behaving in a commercial rationale manner, the guidance in Section D.2 of Chapter I of the Guidelines may be relevant. According to paragraph 10.8 of Chapter X this guidance reflects the approach of accurate delineation of the actual transaction in accordance with Chapter I to determine the amount of debt to be priced. However, it is acknowledged that other approaches may be taken to address the issue of balance of debt and equity funding of an entity under domestic legislation before pricing the interest on the debt is determined. Therefore the guidance is not intended to prevent jurisdictions from implementing other approaches to address the balance of debt and equity funding (par 10.9).

56. Although jurisdictions may have different views on the application of article 9 to determine the balance of debt and equity funding of an entity within an MNE group, the purpose of Chapter X is to provide guidance for those jurisdictions that use the accurate delineation approach to determine whether a purported loan should be regarded as loan for tax purposes or should be reclassified as equity (par 10.10 of Chapter X).

57. Therefore according to Chapter X each of EU- and non-EU jurisdictions are in principle free to address the classification of loans and the deductibility of interest. Within the EU this

International Bar Association is incorporated as a Not-for-Profit Corporation under the laws of the State of New York in the United States of America and is registered with the Department of State of the State of New York with registration number 071114000655 - and the liability of its members is limited. Its registered address in New York is c/o Capitol Services Inc, 1218 Central Avenue, Suite 100, Albany, New York 12205.

The London office of International Bar Association is registered in England and Wales as a branch with registration number FC028342.

may create TP-problems for MNE's not qualifying for or not opting for common set of rules computing the tax base (BEFIT) if one jurisdiction based on the accurate delineation approach (partially) reclassifies a loan from EU-company A to EU-company B as a deemed loan to the EU-parent company of companies A and B followed by an equity injection by EU parentco to company B (see example in article 10.13 of Chapter X).

58. The same applies for situations between EU- and non-EU associated entities, especially enterprises in the US where the practice diverges sharply from the OECD's approach under Chapter X[10].

6 THE ARM'S LENGTH RANGE (ARTICLE 12 TP DIRECTIVE)

59. It follows from article 12 that the interquartile range (the 25th to the 75th percentile of results) is the range to be used when there is a range of values resulting from the application of the relevant transfer pricing method. This approach is currently applied in most, but not all, EU Member States. Where this approach is currently not applied, the question arises what the impact is for prior years after the Directive becomes effective per 1 January 2026. In this context the IBA Taxes Committee recommends to provide certainty for business that the existing practice is grandfathered until 1 January 2026 and as from this date the new rules will apply.

7 APPLICATION OF THE ARM'S LENGTH PRINCIPLE AND PERMANENT ESTABLISHMENTS (ARTICLE 14 TP DIRECTIVE)

60. Article 14 TP directive authorizes the Council to lay down further rules, consistent with the OECD Transfer Pricing Guidelines,[as amended over time and approved by means of implementing acts,] to be applied to specific transactions such as, inter alia, dealing between the head office and its permanent establishments. Within this context, the IBA Taxes Committee considers it unclear as to whether the additional guidance as laid down in the 2010 OECD report on the attribution of profits to permanent establishments and the 2018 OECD-report containing additional guidance on the attribution of profits to permanents establishments, must be taken into account and applied. The IBA Taxes Committee therefore recommends that this matter would be clarified.

61. If it is intended that these reports must be taken into account and applied for the purposes of determining the profits attributable to a permanent establishment, the IBA Taxes Committee would appreciate it if the European Commission would provide further guidance with respect to the allocation of funding costs (an amount of interest) to a permanent establishment under the Authorized OECD Approach (tracking approach and/or fungibility approach) and the question whether loans may exist between a head office and a

[10] See Vinay Kapoor, Sayantani Ghose, Hans Gerling and Sherif Assef transfer Pricing of Financial Transaction – A Challenging Landscape, Tax Notes International November 13, 2023.

International Bar Association is incorporated as a Not-for-Profit Corporation under the laws of the State of New York in the United States of America and is registered with the Department of State of the State of New York with registration number 071114000655 - and the liability of its members is limited. Its registered address in New York is c/o Capitol Services Inc, 1218 Central Avenue, Suite 100, Albany, New York 12205.

The London office of International Bar Association is registered in England and Wales as a branch with registration number FC028342.

permanent establishment where the company as a whole is solely or predominantly funded by equity.

8 PRIMARY AND CORRESPONDING ADJUSTMENTS (ARTICLE 6 TP DIRECTIVE)

62. When a primary adjustment is made, EU Member Sates have to ensure that a corresponding adjustment is made to avoid double taxation. This can be based on a mutual agreement procedure, the Arbitration Convention or the Arbitration Directive. The process of ensuring a corresponding adjustment is usually lengthy. The IBA Taxes Committee therefore welcomes the proposal for a fast track 180 day resolution procedure (the "**Fast Track Procedure**") for a corresponding adjustment in case of primary adjustments based on a request made by the taxpayer (article 6(3)(c) TP directive). With respect to the Fast Track Procedure, the IBA Taxes Committee would appreciate it if the following could be clarified:

(a) whether the required documents, proof or evidence of a definitive primary adjustment can be clarified in the TP directive with a view to avoiding lengthy discussions and challenges in this respect;

(b) whether the transfer pricing adjustment, in the event that more than one issue is raised in an audit and results in an adjustment, can be disengaged from the adjacent adjustments to make use of the Fast Track Procedure while the adjacent adjustments would go through a traditional MAP process.

(c) timing considerations that must be respected now that some time is lost following the Fast Track Procedure. Timing runs as of "first notification", which is usually to be interpreted as the most favorable (latest in time) of either (i) the date of the assessment, (ii) the date the assessment is motivated in an audit report or (iii) the date of notification of the adjustment. The IBA Taxes Committee would appreciate it if the timing considerations may be clarified.

(d) whether a mutual agreement procedure that has been filed in connection with other matters may be extended or updated so as to include the transfer pricing issue at that later moment in time?

(e) the role of the taxpayer the Fast Track Procedure and the rationale for the chosen role. For example, if the taxpayer would have no role, the IBA Taxes Committee would appreciate it if it is clarified why this decision would be deemed most appropriate.

(f) the effect of the Fast Track Procedure on domestic proceedings. The IBA Taxes Committee recommends, in this respect, that the TP directive provides, for example in article 6, that an objections and/or appeals against a primary adjustment are suspended for the duration of the Fast Track Procedure and that

International Bar Association is incorporated as a Not-for-Profit Corporation under the laws of the State of New York in the United States of America and is registered with the Department of State of the State of New York with registration number 071114000655 - and the liability of its members is limited. Its registered address in New York is c/o Capitol Services Inc, 1218 Central Avenue, Suite 100, Albany, New York 12205.

The London office of International Bar Association is registered in England and Wales as a branch with registration number FC028342.

taxpayers do not have to give up their domestic rights to object or appeal if they wish to gain access to the Fast Track Procedure.

(g) the effect of commencing the Fast Track Procedure on the ability to request a mutual agreement procedure, especially in the case that the tax authorities do not deem the required documents, proof or evidence of a definitive primary adjustment satisfactory and the Fast Track Procedure would be rejected.

(h) entitlement to a mutual agreement procedure under a tax treaty, the Arbitration Convention or the Arbitration Directive if a taxpayer would not accept the outcome of the Fast Track Procedure. This could, for example, be clarified in article 6(3)(d) and (e).

9 CONCLUSION

63. The IBA Taxes Committee welcomes the policy objective of harmonizing the application of the arm's length principle in the EU. With a view to achieving this policy objective, the IBA Taxes Committee considers it necessary to ensure alignment with the existing international tax landscape and the initiatives at the level of the OECD regarding Pillar 1 and Pillar 2. With respect to alignment with the international tax landscape, the IBA Taxes Committee notes that there are differences between the TP directive and the OECD's arm's length principle. The OECD arm's length principle would seem to be relied upon for the purposes of applying tax treaties, while the TP directive would be incorporated in the national laws of the EU Member States. In issue is whether any inconsistencies between the two ultimately are supposed to defer to the position of the Competent Authority of the country of the primary adjustment in a resulting MAP procedure commenced under tax treaties concluded by the EU Member States. Guidance in this respect might be considered.

International Bar Association is incorporated as a Not-for-Profit Corporation under the laws of the State of New York in the United States of America and is registered with the Department of State of the State of New York with registration number 071114000655 - and the liability of its members is limited. Its registered address in New York is c/o Capitol Services Inc, 1218 Central Avenue, Suite 100, Albany, New York 12205.

The London office of International Bar Association is registered in England and Wales as a branch with registration number FC028342.