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

[●] January 2023

Re: European Commission - Call for evidence for an impact assessment on Business in Europe: Framework for Income Taxation (BEFIT)

Dear Sir / Madam,

The International Bar Association ("**IBA**") would like to take this opportunity to provide comments as part of the Call for evidence for an impact assessment ("**Call for evidence**") on Business in Europe: Framework for Income Taxation ("**BEFIT**"), open for feedback from 13 October 2022 to 26 January 2023.

The IBA, the global voice of the legal profession, includes over [80,000] of the world's top lawyers and [some 190] Bar Associations and Law Societies worldwide.

We are submitting our comments on behalf of the IBA Taxes Committee which has [over 1,000] members from around the world. This committee formed a Working Group to respond to the Call for evidence.

The comments made in this report 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 comments are enclosed with this letter.

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

Working Group Participants:

Marco Adda

Tax Partner
BonelliErede
Italy

Antonietta Alfano
Tax Senior Associate
Maisto e Associati
Italy

Amelia O'Beirne
Tax Partner
A&L Goodbody
Ireland

Wiebe Dijkstra
Tax Partner
De Brauw Blackstone Westbroek
Netherlands

Emma Hartnett
Tax Senior Associate
A&L Goodbody
Ireland

Hanna Hordiienko
Tax Legal Assistant
Binder Grösswang
Austria

Umberto Lorenzi
Tax Associate
BonelliErede
Italy

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

Roberto Padilla Ordaz
Tax Partner
Chevez Ruiz & Zamarripa
Mexico

Sophia van Straalen
Tax Senior Associate
De Brauw Blackstone Westbroek
Netherlands

Christian Wimpissinger
Tax Partner
Binder Grösswang
Austria

1. INTRODUCTION

1.1.1. The proposed BEFIT policy objectives include a reduction of complexity in tax law and compliance costs for EU businesses, a more attractive single market and a simplification of tax administration (the "**Policy Objectives**"). The IBA understands the wish for a common corporate tax system to realise these Policy Objectives. At the same time, the introduction of a common corporate tax system within the EU is a serious and far reaching project. Success in achieving the Policy Objectives will depend on harmonizing interpretation and application, resolving disputes in an effective and efficient manner, and addressing the complications arising from dealings with third countries. In the latter case, we note that the proposal will affect cross-border businesses that are active in and outside the EU, which have to deal with multiple international tax systems (e.g. the at arm's length principle and formulary apportionment). The design of the tax system in all respects -- procedural, administrative as well as formal aspects, and the interaction with non-EU jurisdictions -- should therefore be carefully considered.

1.1.2. This contribution addresses the following topics:

(a) tax base determination (paragraph 2);

(b) formulary apportionment (paragraph 3);

(c) interaction with third countries and tax treaties (paragraph 4); and

(d) dispute prevention and resolution (paragraph 5).

2. TAX BASE DETERMINATION

2.1. Policy considerations

2.1.1. In light of the Policy Objectives, and while noting that all options raise certain issues and complications, it is our view that the tax base should be determined under Option 1 using the financial accounts with tax adjustments, rather than an option requiring a uniform and comprehensive corporate tax system with detailed rules for all aspects of determining profits and losses. In this regard, BEFIT should be harmonized with the OECD's Pillars 1 and 2, in particular with respect to apportionment of profits within Member States. Significant divergences between BEFIT and the OECD's pillars would frustrate the purposes of both.

2.1.2. From the discussions of the past in the context of the 2016 CCCTB directive proposal[1] (the "**CCCTB Proposal**"), we believe four alternative accounting standards may be under consideration: (i) IFRS, (ii) an accounting system based on the EU Accounting Directive[2], (iii) the national accounting rules, or (iv) specifically crafted rules for the BEFIT tax base. Alternatives (iii) and (iv) would introduce new rules, and thus, create additional complexity. Therefore, the focus should be on alternatives (i) and (ii).

2.1.3. From these alternatives, IFRS is most likely to achieve the Policy Objectives because it is already required by the Member States (since 2005 for listed companies) and by other countries around the world. Thus, adoption of IFRS for BEFIT purposes would facilitate:

[1] COM(2016) 683 final.

[2] Directive 2013/34/EU.

(a) comparability, transparency, and consistency of financial statements used for further tax base calculations;

(b) administrative cost savings by avoiding a separate set of financial statements created for BEFIT purposes only;

(c) better reflection of complex transaction due to the principle-based approach of the consistent accounting standards;

(d) use of the most current financial information as IFRS requirements are periodically updated to reflect, among other things, globalization, digitalization, and other developments (i.e., reacting to the steps of implementing Pillar 2 in December 2022, the IASB published amendments to IAS 12 “Income Taxes” with temporary exceptions regarding deferred taxes on 9 January 2023).

2.1.4. Ultimately, the taxpayers who have to apply BEFIT in the future should have a say in this determination.

2.2. Use of accounting rules with adjustments

2.2.1. Whether and how to use accounting rules as the source for the tax base has been the subject of much debate, including for example at the turn of the century within the German speaking tax community. From this debate, a consensus arose that if accounting rules are used for the tax base determination, adjustments should be made in order to comply with fundamental principles of an income tax system and, in particular, to ensure that:

(a) no taxation arises from dry income, e.g., gains on 'business assets' recognized for accounting purposes are not taxed until the respective asset is sold;

(b) transactions treated as realization events for accounting purposes are not necessarily treated as such for tax purposes, e.g., in the partnership context when capital interests are shifted;

(c) the accrual principle as commonly used for tax purposes is applied, which is potentially different to the way used for accounting.

2.2.2. We note here that similar adjustments are allowed for purposes of determining the tax base in the context of the GloBE regime of Pillar 2.[3] For example, tax exempt dividends and penalty payments are not to be taken into account for GloBE purposes when determining the tax base. In addition, entities using fair value accounting are allowed to determine gains and losses using the realization principle when computing the GloBE income.[4]

2.2.3. These adjustments are made necessary if IFRS is adopted as the base, among other things because IFRS has more principle-based standards rather than rule-based standards – noting that rule-based is the more common approach for taxation laws, and keeping in mind that the

---

[3] *Pfirrmann in Čičin-Šain/Riedl* (eds), Justice, Equality and Tax Law (2022), Pillar Two: Ensuring “fairer” Taxation through the Introduction of a Global Minimum Tax Rate, p. 163 with references in footnote 22.

[4] *Pfirrmann in Čičin-Šain/Riedl* (eds), Justice, Equality and Tax Law (2022), Pillar Two: Ensuring “fairer” Taxation through the Introduction of a Global Minimum Tax Rate, p. 164 with references in footnote 23.

main aim of IFRS is to inform capital markets of the relevant financial condition and prospects of reporting entities.[5]

2.2.4. Additionally, because the IFRS is developed by two standard-setting boards of the IFRS Foundation, which is a private structure and a non-profit organization governed by the Trustees (22 individuals), adoption of IFRS as the base can itself pose a risk of possible manipulation. Indeed, two arguments often brought forward against using IFRS as the starting point for any tax base include that the relevant accounting standards are developed by a board of experts, not by a legislative body, and that the formal linkage between accounting and the tax base leads to distortive results because accounting judgments are motivated by different concerns than those motivating the need to determine taxable profits.[6] In this regard, we note that, when adopting the CCCTB Proposal in 2016, the European Commission explicitly stated that using IFRS accounting is not possible due to handing over power to a private standard setter (the IASB).[7] But for the GloBE Directive in 2022[8], using IFRS was no longer considered problematic. In any event, consideration should be given to adopting a working group or committee that will work closely with the IFRS Foundation to ensure that fiscal sovereignty is observed.

2.2.5. Finally, transition rules will be required if EU countries move from the status quo to a common corporate tax base. It goes without saying that the current corporate tax base rules of respective Member States differ significantly between themselves and from any new EU common corporate tax rules.

2.3. Scope of application of the BEFIT rules

2.3.1. If IFRS is adopted as the starting point for the common tax base, then all groups using IFRS accounting should be covered by BEFIT. Additionally, all groups of companies with revenues over € 500 million should be covered by BEFIT, leaving those businesses who have not adopted IFRS and who have revenues below € 500 million the right to opt out of BEFIT.

3. FORMULARY APPORTIONMENT

3.1. General

3.1.1. As a preliminary matter, we note that any notion of formulary apportionment of profits among the Member States raises political and policy considerations, most importantly with regard to the choice of metrics used for profit apportionment. The Call for Evidence states that the Policy Objectives include reducing administrative burdens and increasing attractiveness of the internal market, it does not identify as a goal the reallocation of taxation rights among the Member States. If a reallocation of taxation rights among the Member States is envisaged, this should be made clear and the motive properly identified.

---

[5] *Antonio Lopo Martinez*, Are IFRS standards a good starting point for a corporate tax base? Tax principles for CCCTB, Revista Electronia de Direito – Outobro 2019, No.3 Vol. 20, p. 122–125.

[6] *Antonio Lopo Martinez*, Are IFRS standards a good starting point for a corporate tax base? Tax principles for CCCTB, Revista Electronia de Direito – Outobro 2019, No.3 Vol. 20, p. 118–119.

[7] See for a more in-depth discussion: *Aumayr/Mayr* in CCTB – Is There a Chance of a Breakthrough, European Taxation 2019, p. 157.

[8] COM(2021) 823 final.

3.1.2. For BEFIT, a three-factor apportionment formula has emerged, which takes into account (i) assets, (ii) labour, and (iii) sales by destination. In evaluating these factors, preliminary consideration should be given to whether current arm's length principles giving weight to the place where value is created are to be continued where possible. These principles may be continued, at least in part, by properly describing and weighting each of the above factors, thus for example, by considering both tangible and intangible assets in the asset weighting as discussed below. Preserving the arm's length principal of value creation would help maintain the status quo with regard to each Member State's current taxation rights, and may prove essential to many countries in assessing their willingness to approve the proposal. Of course, taking such principles into account will make the proposal more complicated.

3.1.3. Essential questions regarding the apportionment metrics include (i) which assets are included for the Asset Factor, (ii) which parameters are included in the Labour Factor, and (iii) how the Sales Factor shall be applied in a practical manner, and (iv) how much weight is given to the respective factors. The following paragraphs discuss a number of observations and suggestions for further discussions that should follow.

3.2. Asset Factor

3.2.1. Intangible assets, such as intellectual property ("**IP**"), brands, designs, etc, should not be excluded from the Asset Factor. In a world of fast emerging digitalization, innovation, and development, intangible assets have an important share in businesses' profits and in many cases they are the prevailing source of value creation. Of course, there are practical difficulties associated with the valuation and location of such assets. However, such issues should be dealt with rather than simply ignoring intangible assets altogether.

3.2.2. As a starting point, IP should be included in the country in which it was created, because that is where education, research facilities and engineers are located, and therefore, where infrastructure, schools and universities are need. If necessary to properly focus this consideration, the BEFIT rules may limit the scope of considered IP by creating a specific list of eligible IP, or by excluding IP that is not actually used in the production or value creation cycle, including for example IP developed by a contractor.

3.3. Labour Factor

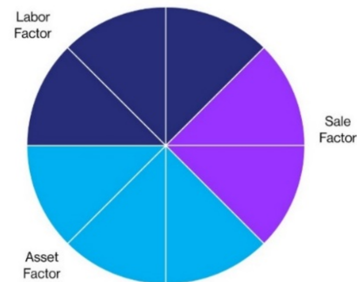
3.3.1. The Labour Factor may reference any combination of labour cost, staff headcount, employees' residence status, and employees' place of remote work. Labour cost, like staff headcount, is likely an easy metric to apply, and may be a more reliable factor as a basis for apportionment if a goal is to reflect overall value contribution. But, while a complicating factor, residence may also be important. Indeed, considering residence and/or tax residence may allow the rules to take into account cases of cross-border work in border areas. These latter considerations are important as overall tax burden could shift significantly the Labour Factor is determined with reference to headquarters, place of residence or tax residence.

3.3.2. Consideration should be given to independent contractors, which for some companies is a significant source of both labour and value creation. If considered, simplifying assumptions may be in order, for example, by including independent contractors only if they work for one company for more than 75% of their working time.

3.4. Sales Factor

3.4.1. For the Sales factor we agree that, in general, the location of the end-customer should control. But the location of the end customer may be difficult to identify at various points in complicated supply chains, and may be inappropriate altogether in certain business to business ("B2B") contexts. In this regard, the Pillar 1 proposals may provide beneficial guidance.

3.5. Weight given to each of the Factors



3.5.1. While it may be most straightforward to give equal weight to each factor, such an approach is neither necessary in light of the Policy Objectives nor likely to be the best approach to ensure acceptance by the Member States. In this regard, in implementing formulary apportionment among the various states in the United States, different weights have been placed on the factors as discussed below. Thus, we suggest that the weight given each factors should be chosen in light of the sometimes conflicting objectives of simplicity, harmonization, and preserving the tax burden status quo. In this regard, in order to properly weight infrastructure needs and the status quo, it might be appropriate to split each factor by eighths, giving the Sales Factor two eighths and the Asset Factor as well as the Labour Factor three eighths.

3.5.2. In assessing the proper weight to be given each factor it may, in fact, be appropriate to assign a different weight to each factor for different areas of the economy. For example, in the case of a service-based business, the split might exclude fixed tangible assets, since these are less relevant. Based on the specifics of some industries (i.e., financial institutions, oil and gas industry, IT services, etc.), it may be reasonable to provide for specific regulations in terms of each factor of the formula.

3.6. Experiences with formulary apportionment in the United States

3.6.1. The U.S. formulary apportionment system among the states illustrates that flexibility in weighing the various factors was essential to ensure both fairness and stakeholder willingness, and was not free of challenges. Against this backdrop, the challenges facing BEFIT, where all countries part of the system will be required to apply the same formulary apportionment method, are compounded.

3.6.2. For many decades, U.S. states and the District of Columbia (collectively "states") have used formulary apportionment to determine the state income tax liability of multistate taxpayers. Taxpayers have challenged the use of formulary apportionment in the courts on various grounds, but the U.S. Supreme Court has upheld the constitutionality of formulary apportionment, subject to limitations based on fundamental fairness as discussed further below.

3.6.3. States have adopted various formulary apportionment methods over the years. Although there is commonality among state formulary apportionment methods, no single method is used by all the states. In fact, states generally have settled on the use of one of three different formulary apportionment methods. The first method uses three equally-weighted factors based upon the relative percentage of the taxpayer's sales, payroll, and property within the state to the taxpayer's sales, payroll, and property everywhere. The second method uses the same three

factors as the first method, but it double-weights the sales factor. Finally, the third method uses only a single sales factor. The latter two are generally intended to impose a greater taxing burden on taxpayers with no physical presence (i.e., payroll or property) within the taxing state. Other variables also exist that may result in differences in the application of formulary apportionment rules, including the application of throwback rules (i.e., rules that require sales of goods to be sourced to the state of origin rather than destination when the taxpayer is not subject to tax in the destination state) and differences regarding how the factors are applied. These issues and others result in a level of variation in the application of formulary apportionment among the states.

3.6.4. Although the U.S. Supreme Court's jurisprudence restricts the use of formulary apportionment methods that fail the internal consistency test, the Court has held that multiple taxation of the same income does not violate constitutional standards when states apply different formulary apportionment methods that individually satisfy the internal consistency test. In 1978, the Court upheld Iowa's single-factor sales formula under the Due Process and Commerce Clauses, notwithstanding the use of a three-factor formula of property, payroll, and sales by all other states at the time. The Court reasoned that the Commerce Clause does not require uniformity in formulary apportionment formulas to prevent duplicative or overlapping taxation and states have wide latitude to adopt formulary apportionment formulas. An formulary apportionment formula is generally considered fair and will be upheld under the Due Process and Commerce Clauses if the factors applied in the formulary apportionment formula (i) satisfy the internal consistency test and (ii) reflect a reasonable sense of how income is generated ("external consistency"), which can only be rebutted by evidence establishing that the income attributed to the state is disproportionate to the business transacted in the state or leads to a grossly distorted result. Thus, as long as the internal and external consistency requirements are satisfied, the use of different state formulary apportionment methods is lawful even if certain income is subject to multiple taxation by virtue of differences in state formulary apportionment methods.

4. INTERACTION WITH THIRD COUNTRIES AND TAX TREATIES

4.1. Transfer pricing / arm's length principle – administrative burden

4.1.1. Whether or not BEFIT adopts some means of formulary apportionment within the EU Member States, the arm's length principle will continue to apply in other contexts. In this regard, the public consultation documents provide that, under BEFIT, the arm's length principle[9] will *"continue to apply to pricing transactions between companies of the BEFIT Group and (i) companies of the same group that are tax-resident outside the EU (i.e. outside the BEFIT Group); and/or (ii) their associated companies[10] in the EU or a country outside the EU"*.

4.1.2. As a starting point, the arm's length principle is a core principle of international transfer pricing and a key feature of tax treaties based on the OECD Model. Indeed, it is so engrained in international tax norms that companies within a BEFIT Group may not diverge from this standard in dealings with group companies and associated companies outside the EU.

---

[9] An internationally acknowledged principle according to which the price agreed in a transaction between two related parties must be the same as the price agreed in a comparable transaction between two unrelated parties.

[10] Companies that are part of a group, but not of the BEFIT Group, so below the accounting threshold for consolidating financial statements.

4.1.3. Complying with BEFIT within the EU, and with the arm's length principle in other contexts, significantly increases compliance and administrative burdens that will be placed on taxpayers, which likely will hinder BEFIT's its ability to achieve the Policy Objectives. This is because BEFIT introduces an entirely new framework for apportioning income and tax burden within the EU, while still requiring taxpayers to comply with arm's length principles when dealing with third parties outside of the EU. In this regard, we detail our main concerns with this two-fold framework in Annex 1.

4.1.4. And while simplification of transfer pricing rules within the EU could be somewhat helpful, it is unlikely to resolve the difficulties associated with the more complex cases where disputes are more common. In addition, whether and to what extent third countries accept any such simplification measures is unknown, at best, and unlikely if they require deviation from the arm's length principle.

4.2. Tax Treaties

4.2.1. Like transfer pricing, Member State's double tax treaties create significant compliance and administrative burdens. This is because companies within a BEFIT Group will be required to comply with such treaty obligations, which have been concluded on a bilateral basis and independent of BEFIT. We have highlighted below certain areas of potential conflict with tax treaty articles based on the OECD Model, but inevitably more issues in this context can be identified. For dispute resolution with respect to third countries, reference is made to paragraph 5.5. Given the identified challenges, it seems likely that it would be necessary for existing double tax treaties entered into by Member States with non-EU jurisdictions to be re-negotiated in order to address areas of incompatibility with BEFIT. This would be a very significant undertaking, perhaps most efficiently achieved by way of multilateral instrument, assuming such an instrument could be implemented with non-EU states. This should be factored in, from a timing perspective, in terms of target implementation dates with respect to BEFIT rules. And, ideally, transitional provisions would be agreed with third countries in the event that not all tax treaties can be successfully amended and re-negotiated in advance of any target implementation date.

Residence (Article 4)

4.2.2. Residence, for treaty purposes, generally depends on whether a purported resident is liable to tax under the domestic law of the country in which the person is claiming to be a resident. BEFIT, as discussed above, would apportion tax burden among various EU states, and may in certain cases raise issues as to whether a person claiming treaty benefits is liable to tax in the country of residence (or another EU state to which the income is apportioned). BEFIT should provide guidance for cases where income is generated in one jurisdiction under treaty principles, but subject to taxation in other jurisdiction(s) as a result of the income-apportionment formula.

Permanent Establishment (PE) Article (Article 5)

4.2.3. All treaties contain Permanent Establishment clauses, setting minimum connection standards for taxation. Because BEFIT proposes to significantly alter the nexus requirements for taxing rights within the EU Member States, it raises a number of issues with respect to the allocation of taxing rights under existing double tax treaties. These issues are best demonstrated by way of example:

4.2.3.1. Company A is tax resident in Country A, a non-EU jurisdiction. Company A has a PE (**Company A PE**) in Country B, an EU jurisdiction. Country B has a double tax treaty with Country A. Company A makes significant sales in Country C, another EU jurisdiction, but does not have any physical presence or PE there. Country C has a double tax treaty with Country A.

4.2.3.2. Under BEFIT rules, the EU profit of Company A is apportioned between Country B and Country C (based on the presence of the relevant factors for formulary apportionment). However, under the double tax treaty in place between Country A and Country C, Country C should not have any taxing rights in respect of Company A's business profits, because Company A does not have a PE in Country C. In addition, the measure of profit attributable to Company A PE in Country B must be calculated based on the arm's length principle.

4.2.4. While one possibility for addressing the incompatibility of BEFIT rules with the PE article in existing double tax treaties might be to retain existing rules for taxation of EU PEs of non-EU resident companies, any such proposal would also need to be considered in the context of the Non-Discrimination Article in the relevant treaty.

Associated Enterprises Article (Article 9)

4.2.5. The Associated Enterprises Article in treaties applies the arm's length principle to transactions occurring between associated enterprises in different Contracting States. In particular, Article 9 permits Contracting States to tax the profits of associated enterprises on the basis of the arm's length principle, and requires Contracting States to eliminate double taxation on that basis. This gives rise to a number of challenges in the context of BEFIT, as demonstrated by the below example.

4.2.5.1. Company A is tax resident in Country A, a non-EU jurisdiction. Company B is an associated enterprise of Company A, tax resident in an EU jurisdiction. Country B has a double tax treaty with Country A. Under BEFIT rules, the EU profit of Company B is apportioned between Country B, Country C and Country D (based on the presence of the relevant factors for formulary apportionment). Country A has a double tax treaty with Country B, Country C and Country D.

4.2.5.2. Company A sells products to Company B. The tax authority in Country A challenges the pricing of the sales made by Company A to Company B, allocating an increased measure of taxable profit to Company A. Where the adjustment made by the tax authority in Country A is determined to be in accordance with the arm's length principle, Country B should, in accordance with Article 9, be required to make a corresponding adjustment reducing the taxable profits of Company B by an equivalent amount. However, this mechanism would require that Country B make a downward adjustment even though a portion of the income was taxed by other member stats, or that Countries B, C and D accept proportional downward adjustments.

4.2.6. In the opposite situation, whereby an upward adjustment is made for determination of the "EU taxable profits", a similar issue may arise because under the BEFIT rules Country B is not entitled to tax the full amount of the adjustment because a portion would be allocated to Countries C and D. Therefore it is doubtful whether Country A will make a corresponding adjustment under the Associated Enterprise Article in the treaty with Country B, and the Associated Enterprise Articles in the treaties with countries C and D are not necessarily applicable either because there is not necessarily an enterprise of countries C and D as referred to in those articles.

5. DISPUTE PREVENTION AND RESOLUTION

5.1. Need for harmonisation, technical deficiencies

5.1.1. In order for BEFIT to achieve the Policy Objectives, implementation by the Member States will have to be harmonized to the greatest extent possible. In this regard, necessary harmonization is likely to be blocked by certain technical requirements of EU law, including as follows.

5.1.2. Legal form of a directive: legislative initiatives in the field of direct taxation fall within the ambit of Article 115 of the Treaty on the Functioning of the European Union ("**TFEU**"), empowering the European Commission to make directives. Under Article 288 TFEU, a directive is binding on Member States as to the result, but Member States have discretion as to choice of form and methods of implementation. A rule-based approach for BEFIT would be appropriate, with the directive drafted in very prescriptive terms and any derogations available to Member States being limited.

5.1.3. Conflicts with domestic tax law of Member States: the basis for treating BEFIT as falling within the ambit of Article 115 TFEU is that differences in tax legislation and tax compliance frameworks between Member States affect the functioning of the internal market and as such are a shared competency under Article 4(2) TFEU. Protocol No 25 to the TEU and TFEU on the Exercise of Shared Competence confirms that when the EU has taken action in a certain area, the scope of this exercise of competence only covers those elements governed by the EU act in question and therefore does not cover the whole area. In effect, this would leave Member States free to adopt domestic tax measures for issues affecting their corporate tax base that are not explicitly dealt with by BEFIT, e.g. in Member States that will see their tax base decrease under BEFIT.

5.2. Information exchange

5.2.1. Exchange of information will be a key requirement to the smooth functioning of the BEFIT system, and Member States already have information sharing obligations at both EU and OECD level. The CCCTB Proposal provided for a centralised database, accessible for tax authorities of all Member States, into which the principal tax authority would upload the consolidated tax return and supporting documents filed by the principal taxpayer and all decisions and notices issued by the principal tax authority. BEFIT should adopt this or a similar approach. In addition, the existing reporting system established under DAC6 could serve as a useful tool, particularly in the context of selecting taxpayers for audit.

5.3. Tax certainty

5.3.1. The establishment of a stable and certain tax framework will be key to BEFIT's success. There are a number of factors that will impact tax certainty under the BEFIT proposals, including as follows.

5.3.2. Tax compliance - filing of tax return: tax compliance costs are a significant burden on businesses, and their reduction should be a significant benefit of BEFIT. In this regard, it would be appropriate if, as under the CCCTB Proposal, BEFIT provides that tax compliance, such as the submission of the BEFIT tax return, is fulfilled by the principal taxpayer, i.e. the parent company of the group, vis-à-vis the tax authority of the Member State ("principal tax authority")

where it is resident for tax purposes. Groups should then deal with a single tax authority according to the "*one-stop shop"* principle.

5.3.3. Tax Audit: under the CCCTB Proposal, the principal tax authority could start and coordinate a tax audit of the group members, while the tax authorities of each group member could request an audit. BEFIT should envisage coordinated and harmonised audit activities carried out by the various tax authorities concerned in the framework related to administrative cooperation within the EU, as provided by DAC6/DAC7, including on joint audits to reduce disputes and thus result in a reduction of costs and administrative burden for both taxpayers and tax administrations.

5.3.4. Disputes between Member States: The proposals should include a dispute resolution mechanism in which taxpayers have direct access to EU courts in relation to the interpretation and application of BEFIT. Paragraph 5.4 describes in more detail a possible mechanism.

5.3.5. Accessibility for tax practitioners and taxpayers: consideration should be given to the publication of anonymised (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 resolution procedure in a publicly accessible centralised register. This would give both taxpayers and tax practitioners a basis for interpretation of BEFIT rules. In addition, it may be useful to establish an intra-EU tax forum at which tax authorities from Member States could meet to discuss issues with the implementation of BEFIT and, where necessary, agree steps to ensure alignment.

5.3.6. Opinions and Rulings: the tax authorities should be required to provide taxpayers with written determinations so that a taxpayer who disagrees with the determination may refer it to an appropriate administrative or judicial body under the dispute resolution mechanism. This would serve to ensure a more uniform application of BEFIT and provide precedents for taxpayers to rely on when interpreting BEFIT rules.

5.3.7. Toolkits and precedent forms: toolkits and precedent forms should be made available containing clear and concise instructions on the implementation of BEFIT to taxpayers prior to the introduction of BEFIT. However, if there are divergences as between Member States in the manner of implementation of BEFIT, a *'one size fits all'* approach to these documents may prove difficult.

5.4. Dispute resolution within the EU

5.4.1. To achieve coherent and consistent interpretation and application of BEFIT throughout the EU and to realize the Policy Objectives, an effective and efficient dispute resolution mechanism is required.

5.4.2. It is inevitable that disputes will arise, especially in the early years of BEFIT implementation, recognizing that the nature and quantity of disputes may be minimized depending on the form and quality of the proposed legislation, accompanying guidance and dispute prevention tools. The disputes may be among the Member States and between taxpayers and the tax administration(s) involved. The quantity, scope and depth of these disputes will go well beyond the scope of current disputes on EU law in the field of taxation because harmonisation of corporate taxation within in the EU, as is now suggested, goes well beyond the scope of the current rules. Disputes are likely to arise in relation to transition questions, tax base

determination, formulary apportionment and interaction with third countries (see paragraphs 2, 3 and 4 respectively).

5.4.3. The current framework for legal proceedings regarding EU directives in the field of tax is not an effective or efficient choice as it requires taxpayers to litigate tax disputes regarding EU directives before domestic courts of Member States without the right to initiate proceedings before the EU courts.

5.4.3.1. It is only through the process of preliminary questions that domestic courts can decide to ask the Court of Justice of the European Union ("**CJEU**") to rule on legal questions regarding the application or interpretation of EU law. While this mechanism has secured a level of harmonisation within the EU regarding the application of EU law in the field of tax, experience over the past decades has shown its limitations. The length of proceedings before domestic courts obviously depends on the Member State involved. And the process of preliminary questions comes on top of the length of domestic proceedings and takes significant time as well. Currently there is a significant backlog at the CJEU (1,113 pending cases as of 31 December 2021) and a procedure before the CJEU on average takes seventeen months (2021).[11] The quantity and complexity of EU law, especially in the field of taxation, is rapidly increasing. As a result, the number of cases to be handled as well as the average duration of procedures will likely increase further if no action is taken.

5.4.3.2. In addition, rulings on preliminary questions do not in all cases provide the desired legal certainty on the application and interpretation of EU law, for instance because questions asked by domestic courts are not clear or accurate, and may be interpreted differently by the CJEU. There are examples of high profile cases where domestic courts have interpreted answers by the CJEU differently than what subsequent CJEU rulings have confirmed.[12]

5.4.4. Similarly, the administrative procedures in the CCCTB Proposal, while having some benefits over current EU law, suffer from infirmities. Under that proposal, in principle, the taxpayer only interacts with the principal tax authority and disputes would only have to be brought to the courts of the Member State of the principal tax authority. However, tax authorities of other Member States may also dispute assessments by the principal tax authority before the domestic courts of the Member State of the principal tax authority, increasing risks of multiple and lengthy proceedings. In those instances, domestic courts, particularly in the early years of implementation, will inevitably feel compelled to ask preliminary questions to the CJEU, thus adding unnecessary levels and time to the proceedings.

5.4.5. We suggest that centralizing dispute resolution with EU courts best serves to harmonize corporate taxation within the EU and achieve the identified Policy Objectives. The EU courts may offer the most effective and efficient proceedings if implemented properly and, therefore, should be preferred from a rule of law perspective as well.

5.4.5.1. Disputes could either be first addressed by a tax chamber of the General Court, with the competency to decide on the full merits of the case, or an arbitrator for conflicts appointed by the CJEU. In either case, there should be a possibility of appeal to the CJEU, at least on points

[11] CJEU, 'The year in review', annual report 2021, available via https://curia.europa.eu/panorama/2021/en/index.html.

[12] E.g., in the Netherlands regarding incompatibility of the fiscal unity regime, see CJEU 25 February 2010, C-337/08 (*X Holding*), Dutch Supreme Court 24 January 2011, ECLI:NL:HR:2011:BN353, Dutch Supreme Court 21 September 2012, *BNB* 2013/15 and CJEU 2 September 2015, C-386/14 (*Groupe Steria*).

of law. Consideration should be given to whether proceedings before a tax chamber of the General Court could be realised. With respect to an arbitrator, subject to proper design, such an appointment should be possible on the basis of Article 273 TFEU. The CJEU is for instance also appointed as arbitrator for conflicts in connection with the German-Austrian double tax treaty (as laid down in Article 25(5) of that treaty).

5.4.5.2. A potential less-far reaching alternative is to establish a form of a permanent arbitration committee with judicial representatives from both EU courts and domestic courts with relevant expertise on tax law and/or EU law and otherwise apply mutual agreement and subsequent arbitration procedures based on the EU Arbitration Directive ("**MAP procedure**"), but with necessary adjustments. Such proceedings would not replace the domestic courts, but rather would provide a neutral venue at the request of a Member State (if they disagree with relevant acts of the principal tax authority) or taxpayer. Taxpayers should have the ability to refuse the outcome of the MAP procedure and continue domestic proceedings because the MAP procedure is not a true legal procedure to which the taxpayer is a party.[13] The arbitration tribunal should be given the right to ask preliminary questions to the CJEU on points of law.[14]

5.4.5.3. Such procedures at the CJEU, would require the CJEU to significantly expand relevant capacity, noting that expanding capacity will likely also be required even if the current dispute resolution mechanisms are maintained for the reasons discussed above.

5.5. Dispute resolution with third countries

5.5.1. While the BEFIT proposals do not display obvious inconsistencies with the MAP article in existing double tax treaties, it is likely that bilateral negotiations between a tax authority in a Member State and their counterpart in a non-EU jurisdiction would be hampered by the multitude of competing taxing rights, as discussed above. Bilateral competent authority processes (MAP & APA) are already long and complex. The introduction of new taxing rights that sit alongside the arm’s length principle creates the prospect of increased delays and deadlocks in dispute resolution.

5.5.2. It will be imperative for an effective and efficient dispute resolution mechanism with third countries to be devised that minimises the number of relevant Member States involved in negotiations and applies strict timelines. Clear guidance should also be formulated in relation to the impact of transfer pricing adjustments on apportionment of underlying profits within the EU.

---

[13] Member States should be required to allow taxpayers to defer domestic proceedings pending MAP. See H.M. Pit 'European Union - Commission Initiative To Improve Dispute Settlement Mechanisms within the European Union – The EU Arbitration Convention (90/436)', *European Taxation, 2016 (Volume 56), No. 11,* paragraph 5.1; H.M. Pit, 'The EU Arbitration Convention and the Dispute Resolution Directive', paragraph 32.3.2.3; H.M. Pit, H.M. Pit, *Onderling overleg en arbitrage binnen de EU (FED Fiscale brochures),* Deventer: Wolters Kluwer 2020, p. 411; W.E.J. Dijkstra, D. Horvath and F.P.G. Pötgens, 'Een labyrint van keuzes bij internationale fiscale geschilbeslechting', *WFR* 2021/145.

[14] See the literature in response to CJEU 6 March 2018, C-284/16 (*Achmea*) arguing why these concerns should not apply if domestic proceedings may be continued.

5.5.3. The interaction with tax certainty processes under Pillar 1 and 2 will also need to be considered.[15]

6. CONCLUSION

6.1.1. To conclude, the benefits of a common corporate tax system within the EU may be significant, provided harmonisation to the fullest extent possible is ensured. Such harmonisation should result in all Member States and tax authorities being aligned on the interpretation and application of the BEFIT rules. In addition, there should be sufficient means for taxpayers to obtain tax certainty and a dispute resolution mechanism that provides taxpayers direct access to EU courts, preferably in two instances (at (a tax chamber of) the General Court and the CJEU) should be in place. Further, the interaction of the BEFIT rules with third countries, and tax treaties entered into on a bilateral basis with such countries, should be effectively addressed. Without these safeguards, BEFIT runs the risk of complicating instead of simplifying the corporate tax rules and administrative tax burden for taxpayers as well as tax authorities, which would be contrary to the Policy Objectives.

[15] With regard to Pillar 1, a formula will be used to allocate only a small portion of the consolidated profits of MNE groups to market jurisdictions (i.e., Amount A), whereas the arm's length principle will remain applicable to the rest (e.g., to remunerate routine functions). This because under Pillar 1, value - for certain business categories, i.e., digital and consumer-facing - is created mostly in the market, and the arm's length principle was apparently unable to accurately reflect the market contribution. Moreover, the potential link between Pillar 2 and FA should be carefully considered, as Pillar 2 ensures that MNEs pay a minimum level of tax regardless of where they are headquartered or the jurisdiction they operate in. The effective tax rate is determined by applying the tax base and the covering taxes on a jurisdictional basis.

ANNEX 1 MAIN CONCERNS REGARDING A TWO-FOLD FRAMEWORK

The BEFIT proposal appears to override the OECD BEPS principles (at least at EU level). In this respect, if the EU were to follow formulary apportionment instead of the arm's length principle, the following main concerns would arise:

(a) Interim period: it is important to ensure that the transition to the BEFIT principles goes as neutral as possible. A preliminary issue linked to BEFIT is the evident discontinuity it will bring to the method applied by MNEs to allocate profits. This discontinuity should be carefully addressed to avoid an oversimplified approach that results in a burdensome transition from the arm's length principle to formulary apportionment (especially for MNEs that operate also in non-EU Member States). Therefore, the possibility of introducing the BEFIT principles on an elective basis (at least in a preliminary phase) should be carefully considered. This way, MNEs could test out the effects of any overlap between the arm's length principle, Pillar 1, Pillar 2, and formulary apportionment.

(b) APA/BAPA in force: MNEs have several APA/BAPA in place with tax authorities. The BEFIT implementation methods will therefore have to be considered jointly with any APA/BAPA agreements, e.g., formulary apportionment could disregard any taxable profits under APA/BAPA agreements until those agreements expire.

(c) Benchmark analysis: the BEFIT proposal suggests following a "simplified approach to transfer pricing" (i.e., a sort of 'safe harbour' approach).[16] This approach raises the following main concerns:

(i) The OECD transfer pricing Guidelines expressly state (at para. 4.95 et seq.) that although safe harbours could simplify transfer pricing compliance and administration, they could raise fundamental problems with potential perverse effects on the pricing decisions of enterprises engaged in controlled transactions. When unilateral safe harbours are endorsed (e.g., when the Australian tax authority published some pre-determined benchmark analyses), those rules are generally applied to smaller taxpayers or less complex transactions.

(ii) The adoption of macroeconomic industry benchmarks might not fit with the evolution of the economic backdrop (e.g., Covid-19 and the energy crisis), the different functional profiles of the parties involved, and specific economic circumstances (e.g., loss-making entities). For instance, a limited risk distributor that is a retailer or wholesaler does not have the same functional and risk profile. Therefore, even if a retailer or wholesaler operates in the same industry, the same benchmark analysis cannot be applied (and even a different position in the interquartile range might not be appropriate). Moreover, the EU cannot always be treated as a single market for the purposes of benchmark analyses because some market characteristics that impact on the tested

[16] In more detail, the proposal envisages a simplified approach to the administration of transfer pricing rules based on macroeconomic industry benchmarks – not to replace the arm's length principle but to provide businesses simplicity and increased tax certainty. These rules also provide some guidance on tax authorities' risk approach to business transactions with related entities outside the consolidated group (i.e., entities that do not apply the FA).

party's profitability can be determined only by performing a per-country benchmark analysis.

(iii) It will be very challenging for all Member States to reach an agreement on applying the proposed macroeconomic industry benchmarks.

(iv) Third countries might disagree with the results of these benchmarks and the criteria used. This could lead to further complexities and an increased risk of double taxation.

(d) transfer pricing primary and secondary adjustments: if a primary upward/downward transfer pricing adjustment increases or decreases the taxable profits of a Member State enterprise *vis à vis* a non- Member State enterprise, an assessment will be needed as to whether the BEFIT's formulary apportionment should take account of that adjustment. In the event of a secondary adjustment deriving from a non-Member State that applies a withholding tax on that adjustment (assuming that a portion of the taxable income linked to the primary adjustment is included in the formulary apportionment), the European Commission should introduce a mechanism to assess whether the withholding tax entitles the taxpayer to foreign tax credit.

(e) Intangibles: the methodological approach described in Chapters I and VI of the OECD transfer pricing Guidelines (which is based on an analysis of the actual contribution in terms of functions, risks, and assets of the different parties to a transaction) enables the proper identification and remuneration of the intangibles' owner for transfer pricing purposes. The remuneration will be attributed based on the contribution to development, enhancement, maintenance, protection, and exploitation (DEMPE functions)[17] of each of the enterprises involved. The European Commission should evaluate whether to include some elements in the formulary apportionment to take into account activities, costs, losses, and risks incurred by the enterprise/enterprises that perform DEMPE functions.

(f) Business restructuring: in cross-border reorganisations – e.g., the transfer of functions, the conversion of a fully-fledged distributor into a limited risk distributor, or the transfer of intangibles or rights in intangibles between enterprises that belong to the same MNE group (i.e., business restructuring according to Chapter IX of the transfer pricing Guidelines) by a Member State enterprise to a third country, the European Commission should evaluate whether to include in the formulary apportionment formula the indemnification (exit tax) received. How to manage the indemnification – if agreed under a BAPA with a third country – will also need to be assessed.

(g) Relationships with third countries: member States have double taxation treaties in force with third countries that incorporate the arm's length principle into Article 9 of those treaties. We refer to paragraph 4 for our concerns in this respect.

[17] See para. 6.45 of the OECD transfer pricing Guidelines.