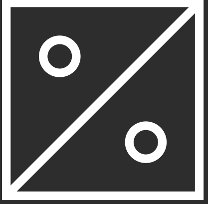

January 2024

EU Gateway Publication

BEFIT proposal: a new company tax system in the EU?

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EU Gateway

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In this EU Gateway publication, we present the fundamental aspects of the European Commission's BEFIT proposal and highlight the correlation between the proposed rules and the Pillar Two system[1]. Furthermore, we delve into four elements of BEFIT that could be welcomed, yet simultaneously, these elements present challenges for EU and non-EU companies.

BEFIT, short for "Business in Europe: Framework for Income Taxation", is a Directive proposal by the European Commission issued on 12 September 2023. If adopted, it will enact substantial alterations to the corporate tax system across the EU27, impacting both domestic, EU, and non-EU headquartered groups doing business in the EU. Consensus among all EU Member States is necessary for the adoption of BEFIT. In such a case, BEFIT would apply in parallel with the Pillar Two rules in EU27 and national corporate income tax systems.

1. BEFIT in a nutshell

BEFIT introduces an aggregated common company tax base for the so-called "BEFIT groups" that is distributed among the EU Member States on the basis of a 7-year transitional allocation rule for the further application of domestic Corporate Income Tax (CIT) rules.

BEFIT groups

- Sublets of a domestic group or EU sublets of an Multinational Enterprise (MNE) group with annual combined revenues of at least EUR 750 million in at least two of the last four years*, including the entities whose ultimate parent entity (UPE) holds an interest in terms of ownership rights or profit rights of >75%.
- For non-EU groups to be out-scoped their EU revenues should not exceed 5% of the total group revenues or EUR 50 million in two of the last four fiscal years. If in scope, application only to the intra-EU part of the groups concerned, including permanent establishments.
- Optional for companies below the EUR 750 million threshold and that prepare consolidated financial statements.

Determination of the BEFIT tax base of each BEFIT group member

- Financial accounts as the basis for computing the BEFIT tax base.*
- The financial accounts of each BEFIT group member must be reconciled with the accounting standard of the ultimate parent entity, or if the group is headquartered outside of the Union, the one of the filing entity in the EU Member State.*
- Adjustments to financial accounting profits and losses, different from the Pillar Two adjustments. Amongst others:
- 95% exclusion of dividends and capital gains or losses on shares or ownership interests, in the case of >10% ownership held for more than 1 year and unless they are held for trading or by a life insurance undertaking
- Non-deduction of exceeding borrowing costs paid by a BEFIT group entity to non-BEFIT group entities.

Regional blending: BEFIT tax base

- Aggregation into a single BEFIT tax base for the whole BEFIT group.
- Cross-border loss relief allowing groups to set off operational losses across borders. This contrasts with the jurisdictional blending approach in the Pillar Two system.
- No withholding taxes or source taxation on intra-BEFIT group transactions, unless the beneficial owner of the payment is not a BEFIT group member.
- Comfort zone system for transfer pricing compliance: a result of an intra-BEFIT group transactions, expenses or income remaining within a limit of < 10% increase compared to the average of the previous three fiscal years is at arm's length.

***BEFIT element inspired by the Pillar Two system**

1 Pillar Two introduces a global minimum Effective Tax Rate (ETR) where multinational groups with consolidated revenue over EUR 750m will be subject to a minimum ETR of 15% on income earned in low-tax jurisdictions

Allocation: transitional allocation rule & national CIT rules

- Allocation to each BEFIT group member based on the average of the taxable results of each BEFIT group member in the 3 previous fiscal years.
- Application of national CIT rules to their allocated part of the BEFIT tax base of their resident companies by the EU Member States.
- EU Member States need to respect the Pillar Two rules thereby ensuring a minimum level of taxation of 15% for the allocated tax result.
- Transitional allocation rules paving the way for a permanent allocation method that can be based on a formulary apportionment using subjective factors.

“Traffic light system” for certain transitions with group entities outside the BEFIT group

- Pricing of so-called low-risk activities (distribution activities by low-risk distributors, manufacturing activities by contract manufacturers).
- Use of a public benchmark (based on the transactional net margin method; TNMM) with the help of an expert group.
- Three risk zones with the tax authorities focusing their efforts to the high-risk zones.

Compliance

- One-stop-shop: filing of a BEFIT information return for the whole BEFIT group, similar to that of the GloBE Information Return (GIR) in the Pillar Two system.*
  In principle, the Ultimate Parent Company.
- Filing of individual tax returns by other BEFIT group members for the application of national CIT rules.

Adoption process

Unanimity from all EU Member States – the Directive needs to be discussed in working groups and eventually at the ECOFIN (Council of EU27 Finance Ministers).

Proposed date of application

1 July 2028

***BEFIT element inspired by the Pillar Two system**

2. BEFIT - Our EU Gateway Observations

It could be said from the outset that any ambitions to strengthen the EU internal market and the competitiveness of the EU deserve support providing that the harmonizing rules achieve a robust, efficient and fair company tax system for all European companies. The same applies to achieving a level playing field within the EU for the mitigation of tax competition between the EU Member States.

Our EU Gateway observations focus on the following 4 elements:

- administrative burden for companies,
- legal certainty for companies,
- simplicity of the tax system in the EU, and
- aggregation into a single BEFIT tax base.

We have prepared a *table* on the next page in which we examine the positive and challenging aspects of each element.

3. BEFIT: What’s Next?

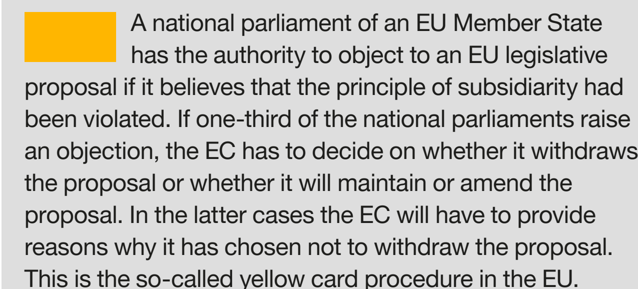
With the publication of the BEFIT, it is now up to the EU Member States. There is a widespread feeling that the discussion about BEFIT will take several years. This is because it concerns a completely new company tax system. The discussions within the Council in the EU will likely not start before 2024. Some EU Member States have already published their positions on BEFIT.

Netherlands

The Netherlands largely supports BEFIT but seeks a closer link to the Pillar 2 tax base, preferring to gain experience with Pillar 2 before transitioning to a harmonized tax base. It anticipates significant challenges dealing with four different tax systems, expresses concerns about unpredictability in tax base allocation, and doubts the reduction of compliance costs. Recently, the Dutch parliament requested its government to convey its disapproval of the proposal to the European Commission. Before the government can give approval, the parliament wants to make clear arrangements on how it will be informed about the negotiations of the proposal.

Finland

Finland supports BEFIT but has concerns. The government doubts whether the administrative burden will decrease and emphasizes the need for attention during legislation. Additionally, Finland is apprehensive about the transfer of taxing powers to the national level, highlighting significant harmonization challenges and uncertainties in tax revenue, coupled with demanding implementation deadlines in the evolving international corporate taxation landscape.



A national parliament of an EU Member State has the authority to object to an EU legislative proposal if it believes that the principle of subsidiarity had been violated. If one-third of the national parliaments raise an objection, the EC has to decide on whether it withdraws the proposal or whether it will maintain or amend the proposal. In the latter cases the EC will have to provide reasons why it has chosen not to withdraw the proposal. This is the so-called yellow card procedure in the EU.

2.1. Administrative burden for companies	**BEFIT reduces the administrative burden for companies**	**BEFIT increases the administrative burden for companies**
	A harmonized company tax system within the EU could allow companies to directly enjoy the benefits of the internal market without incurring an unnecessary additional administrative burden which is inherent when a MNE deals with different tax systems, as is currently the case. Therefore, BEFIT seems to ease the administrative burden and compliance for EU and non-EU headquartered MNEs given that the EU Member States would need to apply common rules for the determination of the BEFIT tax base of each BEFIT group member.	Although the BEFIT tax base of each BEFIT group member will be calculated based on harmonised rules, the compliance required from the BEFIT group should not be neglected. Groups will need to file the BEFIT return and continue to file tax returns locally so that post-allocation the tax authorities can ensure that adjustments to the BEFIT tax base have been applied correctly. From a compliance perspective it is doubtful whether BEFIT will in essence reduce the tax compliance and administrative burdens faced by groups.[2]
2.2. Legal certainty for companies	**BEFIT enhances legal certainty for EU and non-EU groups when doing business in the EU**	**BEFIT undermines legal certainty for EU and non-EU groups when doing business in the EU**
	A standardized tax system has the potential to significantly improve legal certainty for companies when doing business in the EU. Specifically, a harmonized tax base aligned with accounting standards could be seen as a progressive stride towards achieving legal certainty, especially in light of the concurrent Pillar Two system, which uses accounting standards as well as a starting point.	The emerging disparities between BEFIT and Pillar Two, particularly in the adjustments to financial accounting profits and losses, will undoubtedly present challenges for EU and non-EU groups. This discrepancy hampers, in our view, the pursuit of legal certainty in the EU: compliance with Pillar Two does not inherently also ensure compliance with BEFIT and vice versa. In essence, the calculations under Pillar Two occur independently from those under BEFIT. This disconnection does not assure a cohesive tax system in the EU, even when considering the distinct objectives between BEFIT and Pillar Two. Furthermore, due to differences in the distribution of the tax base, BEFIT base allocation may give rise to Pillar Two top-up taxation[3]. The Dutch government has acknowledged this effect and outlined it as follows (office translation): “Under the Pillar Two rules, top-up taxation might occur based on the commercial results within that year. As BEFIT’s recognized profit relies on results from the previous three years, an undesired discrepancy might arise. For instance, if losses were incurred in the past three years and a commercial profit is gained in the present year. This scenario could lead to BEFIT showing a loss for the tax year, despite the commercial profit, thus resulting in no tax liability. However, according to Pillar Two rules, top-up taxation will be applicable in that year. The situation becomes more intricate with the potential offsetting of losses against profits in another Member State.” For further details, including a numerical example, please refer to the Annex of this publication. Finally, someone could argue that both EU and non-EU groups would still be required to engage with national administrations during the post-BEFIT allocation stage.
2.3. Simplicity of the tax system in the EU	**BEFIT ensures a simpler tax system in the EU**	**BEFIT complicates the tax system in the EU**
	A harmonized tax system holds the potential to ensure a simpler tax system within the EU. In this scenario, national corporate income tax laws would not be the starting point, but rather the accounting standards. This means that MNEs would not have to navigate through different tax systems and tax administrations, thus contributing to a simpler tax system.	The implementation of BEFIT and its EU-wide tax base results in a significant revamp of the current CIT systems across individual EU Member States. BEFIT introduces multiple parallel company tax systems within the EU Member States, encompassing diverse taxable profit structures relating to BEFIT, CIT[4] (post-BEFIT allocation) and Pillar Two (post-BEFIT allocation). The option for smaller groups to choose BEFIT introduces potential transitional challenges, such as how to handle losses both during and after the designated “BEFIT period”. In addition, the concurrence with Pillar Two, the Pillar One initiative, the EU TP Proposal[5] and the HOTS Proposal[6] seems to make things complex and far-reaching from the outset. Besides affecting financial reporting, BEFIT introduces a fourth accounting system for companies. Its implementation is likely to have far-reaching consequences for the tax authorities of EU Member States, impacting areas like automation, enforcement, service provision, communication, international collaboration, and potentially necessitating capacity expansions. EU and non-EU groups can expect a similar scenario, and it might take time for the new system to solidify in practice. The unanimity requirement for decision-making in the EU could pose challenges in adapting to future developments.
2.4. Aggregation into a single BEFIT tax base	**Aggregation eliminates obstacles to conducting business across various EU Member States**	**Aggregation may result in Pillar Two top-up tax liability**
	The aggregation of results across the borders of the EU Member States brings an advantage to taxpayers compared to the current CIT systems in the EU.The current reality of a netting of CIT basis within national borders, territoriality, or jurisdictional blending in Pillar Two terminology, creates a lock-in effect for company tax purposes. This is the case as such (i.e., a tax-netting of domestic investment returns) favors investments in jurisdictions in which the market operator is already operative over investments across national borders in other jurisdictions (i.e., by not allowing a tax-netting of cross-border investment returns). Within the scope of EU law, this goes against the idea of an internal market without internal borders for groups. Hence the regional blending in BEFIT is a renewed expression of the EC’s long-cherished wish for intra-EU netting of taxable bases.	The aggregation of BEFIT results may be offset by the Pillar Two system. When BEFIT results are combined, the effects could be nullified by the Pillar Two system. Offsetting losses against profits in another EU Member State might reduce the Effective Tax Rate (ETR) of the group in an EU Member State to below 15%, potentially triggering a top-up tax under the Pillar Two rules. For further details, including a numerical example, please refer to the next page (Annex of this publication).

2 According to the EC, however, these compliance costs are estimated to be outweighed by compliance cost savings as well as simplified administrative procedures and in the long run, the improved allocation of resources by businesses and tax administrations. See BEFIT proposal, page 6.

3 This effect has already been observed in practice (see e.g., Stephanie Soong, ‘Slow EU Pillar Two Adoption Is a Challenge, Says EU Official’, Tax Notes International, 19 September 2023).

4 Or even personal income tax system (PIT) when the CIT refers directly to PIT for the definition of certain concepts.

5 Council Directive on Transfer Pricing, COM(2023) 529 final.

6 Council Directive establishing a Head Office Tax system for micro, small and medium sized enterprises, and amending Directive 2011/16/EU, COM(2023) 528 final.

4. BEFIT: Continue Monitoring the Developments

The BEFIT brings a new dynamic to the debate on the taxation of multinational business profits within the internal market. The arguments surrounding BEFIT, much like those in the context of Pillar Two, hold a degree of similarity. While Pillar Two is close to becoming a reality, particularly within the EU, a similar path might unfold for BEFIT in the coming years. We'll maintain a close watch on BEFIT's progress and keep you informed through our monthly EU Gateway newsletter.[7]

Take a look here at our EU Gateway publication with the title "Business and Tax Features of Selected Holding Company Jurisdictions"

7 Subscribe here to the *EU Gateway newsletter*.

Annex: **Numerical example concurrence Pillar Two rules with BEFIT**

Multinational group ABC falls within the scope of both BEFIT and Pillar Two. ABC has three entities (A, B and C) that are established in Member States A, B and C. For the sake of convenience, the differences between BEFIT and Pillar Two have been abstracted for purposes of the income calculations. In Member State A, the income is €200, in Member State B it is €150, and in Member State C there is a loss of €50. The statutory tax rate in Member State A is 20%, and in Member States B and C it is 15%.

Under Pillar Two, a top-up tax should be levied up to 15% if the effective tax rate (ETR) in a jurisdiction is less than 15%. In the situation where BEFIT is not yet applicable, there is no low-tax jurisdiction and no Pillar Two top-up tax will take place. The ETR of the group is 20.8%. In the scenario where BEFIT does apply, Pillar Two seems to result in top-up taxation. This can be illustrated as follows. The BEFIT basis is the aggregate result of the three BEFIT entities and is €300 (€200 + €150 – €50). The results of the three group entities in the three previous years were the same, which means that the basis is distributed equally. €100 will be allocated to each BEFIT group entity. This amount is subject to the BEFIT levy. Based on the above-mentioned statutory tax rates, this means that €20 (20% of 100) will be paid in Member State A. In Member States B and C, €15 is paid.

Pillar Two seems to be based on income and not on the BEFIT allocation. As a result, the ETR in Member States A and B is 10%, i.e., lower than the minimum of 15%. Due to the concurrence with BEFIT, it seems that under Pillar Two in Member States A and B an additional €10 and €7.5 respectively will have to be levied. This is despite the fact that without the application of BEFIT, there is no Pillar Two top-up tax. As a result, the group's ETR increases from 16.7% to 22.5%.

	Member State A	Member State B	Member State C	Total	ETR Group
Income*	200	150	-50	300	
Tax rate	20%	15%	15%		
Pillar Two (without BEFIT)					
National tax	40	22.5	-7.5	55	
Effective rate	20%	15%	0%		
Pillar 2 minimum %	15%	15%	15%		
Pillar Two additional levy %	0%	0%	0%		
Pillar Two additional levy	-	-	-		
	40.0	22.5	-	62.5	20.8%***
Pillar Two (with BEFIT)					
BEFIT attribution **	100	100	100		
BEFIT levy	20	15	15	50	16.7%
Effective rate ***	10%	10%	0%		
Pijler 2 minimum %	15%	15%	15%		
Pillar Two additional levy %	5%	5%	0%		
Pillar Two additional levy	10	7.5	-	17.5	
				67.5	22.5%

* It is assumed that Pillar Two income and BEFIT income (for the application of the formula) are the same.
** It is assumed that countries have contributed equally over the past 3 years.
*** Loss relief rules, and related deferred tax liabilities, have been abstracted under Pillar Two.

Source: Fact sheet 3 Working Group on the Assessment of New Commission Proposals (werkgroep Beoordeling Nieuwe Commissie voorstellen (BNC)): Business in Europe Directive: Framework for income taxation, annex to Letter from the Minister of Foreign Affairs, 6 October 2023 (BZDOC-1953107355-69).

This publication was created by PricewaterhouseCoopers Belastingadviseurs N.V. and concluded on 30 November 2023. Subsequent developments have not been taken into account unless otherwise stated. This publication does not serve as the official input from PwC on the BEFIT consultation.

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