mazars

March 2023

Project of a new European taxation system (BEFIT)

The idea of a European common tax base has now come back to the forefront of the international scene through the work initiated by the European Commission.

Initially introduced (and never implemented) ten years ago with the Common Consolidated Corporate Tax Base ("CCCTB"), the "BEFIT" project (Business in Europe Framework for Income Taxation) aims to propose a new framework for corporate taxation in the European Union ("EU") with a single set of rules for corporate income tax, based on a common tax base and a formulary apportionment for its allocation.

On October 13, 2022, the European Commission launched a public consultation on the subject and revealed, for this purpose the framework of "BEFIT".

BEFIT's key objectives are the following:

- Increasing the resilience of businesses by reducing the complexity of tax rules and the compliance costs faced by EU businesses operating across borders;
- Removing obstacles to cross-border investment and make the single market a more attractive location for international investment;
- Creating an environment conducive to fair and sustainable growth by paving the way for administrative simplification; and
- Providing sustainable tax revenue, which is particularly important in the current challenging economic climate.

In this context, Mazars transfer pricing and tax experts shared their comments regarding the BEFIT project with the European Commission as described in this publication.

Our comments follow the questionnaire structure as provided by the European Commission, i.e., the scope, the tax base calculation, the method for allocating taxable profit and the discussion around the benefit for taxpayers and tax authorities.

What should be the scope of BEFIT?

The European Commission stressed that the new obligations should not be burdensome for groups and envisaged to draw inspiration from the Pillar 2 rules.

1. What would be the most appropriate threshold?

Mazars is of the opinion that an approach consistent with the EUR 750 million consolidated group revenue threshold as used in Country-by-Country (CbC) reporting and Pillar Two, would be the most appropriate from a simplification perspective. As a matter of a fact, we consider that a broader scope is not advisable. Nonetheless, an inclusion option on a voluntary basis could be useful as to allow excluded MNEs to immediately benefit from BEFIT application.

2. Should specific sectors be excluded?

We do not envisage an exclusion from BEFIT for certain companies or sectors. The sectorial specificities should be considered in the discussion on formulary apportionment (see below).

What should be the tax base calculation?

As a preliminary remark, we would like to stress out the number of reporting already or shortly in place and a further separate and distinct set of accounts would introduce additional compliance costs and unnecessary complexity.

To date, MNEs and their subsidiaries are required to prepare two sets of accounts (i.e., the statutory accounts under local accounting rules and the consolidated account under IFRS most of the time). In the near future, MNEs with an annual consolidated revenue of EUR 750 million or more (and to which BEFIT is likely to be applicable) will have to prepare a new Pillar 2 reporting which include major differences with the IFRS reporting.

As indicated in the call for evidence for an impact assessment document "*All companies in a group falling under BEFIT would be required to use financial statements as a starting point for the tax base calculation, prepared in accordance with the same accounting standard, authorised for use in the EU*". Thus, we can question the necessity to keep the establishment of statutory accounts under local GAAP and we would suggest the European Commission to add, in this ambitious reform, the option for companies in a group falling under BEFIT to prepare their statutory accounts in accordance with IFRS rules (or under accounting rules used for consolidation purpose) and to drop out local GAAP use.

Furthermore, Mazars is more inclined to apply limited adjustments or use the GloBE calculations rather than a new comprehensive set of tax rules which would in any case increase the compliance burden of EU MNEs and under the option to use limited tax adjustments, data used for preparation of taxable result would be IFRS accounts.

In our opinion, for simplification purposes, statutory reporting (local GAAP accounts) should not be required.

To conclude, if limited adjustments approach is selected, the best approach to ease the compliance for MNE would be:

1. Establish statutory account under IFRS GAAP;
2. Keep the current transfer pricing rules; and
3. Use of pre-existing adjustments based on Pillar 2 data.

A comprehensive set of rules can be created as long as it does not create a number of distortions that require a new set of accounts.

In our opinion this option would in any case increase the compliance burden of EU MNEs.

What should be the method for allocating taxable profits within MNE?

BEFIT does not mean that the arm's length principle should be disregarded as part of international intercompany transactions. Indeed, the arm's length principle will still apply to intercompany transactions between companies of the BEFIT Group and affiliated companies that are tax-resident in a non-EU Member State. In addition, the questionnaire suggests that the initiative could simplify the methods for applying transfer pricing rules, to give taxpayers greater legal certainty but without deviating from the arm's length principle. It also suggests that to enhance tax certainty, a system based on industry benchmarking studies could be used to determine whether a tax authority would be likely to investigate transactions. Consequently, BEFIT would not replace the arm's length principle, and companies would still need to carry out appropriate transfer pricing analyses. However, it would provide guidance on how tax authorities would assess the tax risk of certain intercompany transactions without deviating from the OECD Guidelines.

This being said, the following sections aim to provide our point of view on the different possibilities and methods for allocating taxable profit.

1. Analysis of the suggested allocation through a formulary apportionment across EU countries

When defining an apportionment formula, there is a trade-off between accuracy and simplicity. In general, the more accurate the measure, the more complex the system. And, as complexity rises, compliance costs increase.

Settling on the three-factor formula, would not be the "right" formula in all cases, but it would be the simpler formula that fairly reflect the factors that generated income for most manufacturing and mercantile companies. The three-factor formula has become an approved benchmark because it reflects a very large share of the value-generating activities while retaining a simplicity that is lacking in formulae that attempt to measure income more precisely.

However, from a US perspective we have learned that three-factor formula has been, with the time, substituted by a sales-based allocation approach. Mainly because the latter would give less opportunities to groups to move assets and labour form one State to another.

For certain lines of business, the inclusion of industry-specific factors in the allocation formula may be justified. For example, natural resource assets could be used as a key allocation factor for the extractives sector. This would likely benefit commodity-exporting developing countries. Although intangible assets are an important production input for several industries, such as pharmaceuticals and information technology, their manipulability (due to ease of "relocation" and current lack of accounting measurability in the case of self- developed intellectual property) has thus far excluded intangible assets from consideration as an apportionment factor. Nonetheless, to the extent that the value of intangible assets is

derived from employment (research and development workers) or tangible investments (such as laboratories), they are arguably at least partially captured by those other factors.

In order to assess the tax and financial effects of BEFIT, we have carried out a simulation using the following two options on the financial data of one of our clientswhose transfer pricing is in line with the arm's length principle.

Option 1: Formula without incorporating intangible assets

The first formula weighted by:

- 1/3 for tangible assets;
- 1/3 for labor, equally shared between number of employees and personnel expenses; and
- 1/3 for sales by destination.

results in a reallocation of profit to France and Germany, which share:

- 96% of the group's tangible assets; and
- 77% of the personnel expenses.

Consequently, Norway and Spain have respectively lost 25% and 2% of their taxable base calculated according to the regulations currently existing.

Option 2: Formula incorporating intangible assets

The second formula is weighted by:

- 25% for tangible assets;
- 25% for intangible assets;
- 25% for labor, equally shared between number of employees and personnel expenses; and
- 25% for sale by destination.

The application of this profit allocation formula results in a massive reallocation of profit to France. It is explained by the fact that, 97% of the group's intangible assets (trademark, patents, etc.) are located in France.

Consequently, for the other countries, the losses of taxable base are as follows:

- - 44% for Norway;
- - 18% for Spain; and
- - 12% for Germany.

In the case, intangible assets could lead to a reallocation of profits by default. In fact, the internal accounting standards of some countries such as France or the IAS/IFRS[1] accounting standards (legally recognized by the EU) do not allow an internally developed brand to be recognized as an asset in the balance sheet. In such a situation, the reallocation of profits will not be to the country that developed and created the trademark but rather to the country that holds intangible assets that may not be essential to the business. The same issue arises for subsidiaries in some countries where the customer database would not be on the balance sheet. However, the tax impact would be less as the profit allocation formula takes into account sales by destination.

Option 3: Formula with a single allocation factor (without weighting)

The third formula aims to allocate the profit by a single allocation factor among:

- Tangible assets;
- Intangible assets;
- Labor, equally shared between number of employees and personnel expenses; or
- Sale by destination.

The application of the profit allocation formula with a single allocation factor resulted in a reallocation of profit mainly in France for each possibility. In fact, as France is the place

[1] IAS 38 – Intangible assets

where the group mainly operates, we observe a reallocation of the profit in France:

- 82% of the profit before tax using tangible assets as allocation factor;
- 97% of the profit before tax using intangible assets as allocation factor;
- 76% of the profit before tax using the number of employees as allocation factor;
- 67% of the profit before tax using personnel expenses as allocation factor; and
- 56% of the profit before tax using sales by destination as allocation factor

As a conclusion we believe that the use of allocation keys to allocate the profit of MNEs within the EU would lead to inaccurate results. This is all the more an issue that the Tax systems and the Corporate Income Tax rates are not yet harmonized.

2. The allocation to related entities outside the BEFIT group

The BEFIT rules may lead to a mismatch in the assessment of transfer prices and the allocation of profits between entities within the BEFIT group and those outside the BEFIT group. Our views on the EU proposed approaches are set out below.

Option 1: Simplified approach to transfer pricing

The use of standard benchmarking studies to test transactions outside the Group could be limitative in scope. In fact, standard benchmarking studies may not consider functions that nowadays businesses are made up of. For instance, as a simple example, a standard benchmarking analysis on the wholesale, will not consider companies with an online sales shop, however, more often than not such a feature is present in today's business model. Those (and more complex) types of differentiations can be addressed only if ad hoc benchmarking analysis are performed after having performed a through functional analysis of the multinational groups and the local entities in particular.

Option 2: Maintain current transfer pricing rules

We recommend maintaining transfer pricing rules for the intragroup transactions within the BEFIT Group. Thus, the TP rules and the arm's length principle have proven to be the most accurate way to allocate profit within MNEs. Thus, unlike allocation keys, transfer pricing rules are based upon the actual functions, risks and assets of the companies involved in intragroup transactions. For all these reasons, we believe that current transfer pricing rules should be maintained for intragroup transactions among companies belonging to multinational groups based in EU.

What should be the benefit for tax authorities?

The administration of today's corporate tax systems is primarily the responsibility of national tax authorities that can audit groups' operations in their jurisdictions by reviewing the tax accounts of the local entities and the PEs of any non-resident entities. However, if formulary apportionment were adopted, a national tax authority would need both the power and resources to review a multinational's entire international operations.

In addition, countries may need to renegotiate or reinterpret their network of bilateral income tax treaties to incorporate the apportionment method or, alternatively, to adopt a treaty standard and develop guidelines for the uniform application of that standard and to adapt the CFC rules.

Conclusion

The BEFIT project has many drawbacks. The approach taken by the European Commission leads to increasing the compliance burden on groups which eliminates the benefits of the R&D credits

regulations and add one layer of complexity from the perspective of Pillar 2. The difference in treatment between companies in the BEFIT group and those outside does not allow for standardisation of reporting (that today, MNEs care about) and increases the risk of inaccuracy, should the ***current transfer pricing rules not be maintained.*** Thus, if the European Commission wishes to pursue this ambitious project, it will have to make significant changes.

Contributors

Frédéric Barat – Partner, Transfer pricing France
Frederic.barat@avocats-mazars.com

Marcus von Goldacker - Partner, Global Head of PIE Tax, Germany
Marcus.von.goldacker@mazars.de

Matteo Mussi - Partner, Transfer pricing, Italy
Matteo.musi@mazars.it

Vesko Petkov – Partner, Global PIE Tax Group Executive, UK
Vesko.petkov@mazars.co.uk

Roberta D'Angelo – Senior Manager, Transfer Pricing, Italy
Roberta.dangelo@mazars.it

Ramy Boualam – Manager, Tax accounting and reporting, France
Ramy.Boualam@avocats-mazars.com

Coralie Crespin – Manager, Transfer Pricing, France
Coralie.crespin@avocats-mazars.com

Guillaume Mélot – Manager, Transfer Pricing, France
Guillaume.melot@avocats-mazars.com

Laura Schoumacher – Senior, International direct tax, France
Laura.schoumacher@avocats-mazars.com