Position Paper for the European Commission's Public Consultation on Business in Europe: Framework for Income Taxation (BEFIT)

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1. About the Irish Tax Institute

The Irish Tax Institute is the leading representative and educational body for Ireland's Chartered Tax Advisers (CTA) and is the country's only professional body exclusively dedicated to tax.

The Chartered Tax Adviser (CTA) qualification is the gold standard in tax and the international mark of excellence in tax advice. We benchmark our education programme against the very best in the world. The continued development of our syllabus, delivery model and assessment methods ensure that our CTAs have the skills and knowledge they need to meet the ever-changing needs of their workplaces.

Our membership of over 5,000 is part of the international CTA network which has more than 30,000 members. It includes the Chartered Institute of Taxation UK, the Tax Institute of Australia, and the Taxation Institute of Hong Kong. The Institute is also a member of the CFE Tax Advisers Europe (CFE), the European umbrella body for tax professionals.

Our members provide tax services and business expertise to thousands of Irish owned and multinational businesses as well as to individuals in Ireland and internationally. Many also hold senior roles in professional service firms, global companies, Government, Revenue, state bodies and in the European Commission.

The Institute is, first and foremost, an educational body but since its foundation in 1967, it has played an active role in the development of tax administration and tax policy in Ireland. We are deeply committed to playing our part in building an efficient and innovative tax system that serves a successful economy and a fair society. We are also committed to the future of the tax profession, our members, and our role in serving the best interests of Ireland's taxpayers in a new international world order.

Irish Tax Institute - Leading through tax education

2. Executive Summary

The Irish Tax Institute welcomes the opportunity to contribute to the European Commission's public consultation on Business in Europe: Framework for Income Taxation (BEFIT).

While the technical detail regarding the BEFIT initiative has not yet been published, we understand from the European Commission that BEFIT will be consistent with, and partially based on, the principles that underpin the OECD/G20 Inclusive Framework Two Pillar Solution to Address the Tax Challenges of Digitalisation[1] (Two-Pillar Solution). The new initiative will also build on the previous proposals by the Commission for a Common Consolidated Corporate Tax Base (CCCTB) and a Common Corporate Tax Base (CCTB).

We do not consider that a common consolidated tax base would benefit businesses or tax authorities across the EU. Our members have raised a number of significant concerns regarding what is being proposed under BEFIT. These concerns, which have been set out in detail in Section 3 of this paper, include the following:

- At a minimum, the European Commission should defer further consideration of BEFIT until the rules for the implementation of the Pillar Two - Minimum Tax Directive[2] have had sufficient time to be put into practice. Only then should the Commission proceed with a process to analyse whether BEFIT would provide a benefit to tax authorities and taxpayers.

- BEFIT which includes "sales by destination" as a core factor in the formula for allocating taxable profits would represent a fundamental move away from the principle that a business should have a physical presence in a country before that country has a right to tax that business.

- It is premature to suggest that a new system of formulary apportionment of a common consolidated tax base within the EU could be designed based on Pillar One, given Pillar One will only apply to the very largest MNEs and a number of its central operational issues remain unresolved, including the identification of the final customer and their location.

- Allocating profits by reference to a formula that would favour countries where customers are located, and which would under attribute value to ownership of critical intangible assets, would adversely impact smaller countries with service-based open economies making them less attractive as destinations for inward investment and thus erode their tax base.

[1] OECD/G20 Inclusive Framework on BEPS, Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy, 8 October 2021.
[2] Council Directive (EU) 2022/2523 of 14 December 2022 on ensuring a global minimum level of taxation for multinational enterprise groups and large-scale domestic groups in the Union.

- The adoption of BEPS measures under the EU Anti-tax Avoidance Directives and the Two-Pillar Solution better serve to address any concerns regarding aggressive tax planning and tax avoidance and the apportionment of residual profits to larger MNEs, without the risk posed by BEFIT to the growth of businesses and the economies of Member States.

- Businesses have invested heavily in systems to ensure that they comply with OECD transfer pricing requirements. The rationale for moving away from existing transfer pricing rules and the arm's length principle in an intra-EU context is not clear.

- BEFIT would only eliminate existing transfer pricing rules within the EU for those companies within scope, meaning MNEs would remain subject to the current arm's length principle on transactions outside of the EU. Therefore, such companies would be unlikely to realise a meaningful transfer pricing simplification benefit.

- Introducing and complying with a new tax system would involve significant additional implementation cost for all businesses and could act as a barrier for SMEs seeking to scale up and operate cross-border in the Single Market.

- Regarding a common tax base, it should be a matter for individual Member States to determine the most efficient and cost-effective way of incentivising research and development (R&D) in their jurisdiction.

- Ignoring the existence and location of intangible assets, which are a major part of modern global business is not a realistic way of allocating profits to locations where economic value is created.

- Using research and development expenses and costs for marketing and advertising as a proxy value for intangibles assets would be wholly inadequate and inconsistent with the issues BEFIT aims to address, as it does not reflect the investment made by businesses in both developing and acquiring intangibles.

- BEFIT would create a further layer of uncertainty for business, which could create a disincentive for investment within the EU Single Market at a time when it is needed to support the recovery of the economies of Member States.

- In line with the principle of subsidiarity, should the European Commission decide to proceed with the BEFIT proposal, a detailed statement with the necessary quantitative and qualitative indicators would need to be provided to allow Member States to fully assess all the implications of a cross-border proposal of this magnitude.

3. Key Issues with the Proposed BEFIT Initiative

3.1 Represents a fundamental change in the international tax landscape

The BEFIT initiative puts forwards two options for consideration for the formula to be used to apportion consolidated profits. Both options include the three factors - tangible assets, labour and sales by destination. These factors do not fully reflect the activities to which profits are currently allocated. We consider that a key principle must be that profits should be taxed where value is created.

The inclusion of “sales by destination” as a core factor in the formula for allocating taxable profits would represent a fundamental swing away from the principle that a business should have a physical presence in a country before that country has a right to tax that business.

In justification of this fundamental change in approach to taxation, the Commission’s Call for Evidence for an Impact Assessment suggests that the formula for allocating profits under Pillar One and the rules developed for Pillar Two will be a source of inspiration for the design of BEFIT.

Critically, however, the scope of the new Amount A taxing right under Pillar One which provides for an element of formulary apportionment that countries signed up to in October 2021, will only apply to the very largest of multinational enterprises (MNEs) with global turnover above €20 billion and profitability above a 10% margin.

Moreover, a number of central issues remain to be resolved with respect to the practical implementation of Pillar One including, in particular, the identification of the final customer and their location. It is therefore premature to suggest that a new system of formulary apportionment of a common consolidated tax base within the EU could be designed based on Pillar One, which could potentially apply to all businesses operating in the EU, regardless of size.

In our view, a formulary apportionment system cannot result in fair treatment for all. A sales element in an allocation formula will always reduce the profits attributable to small open economies which are export focused and have less domestic consumers and is contrary to the principles of the Single Market.

3.2 Disproportionate impact on small open economies

The tax regimes of EU Member States evolve over time as individual governments make tax policy choices to adapt their domestic tax systems to fit their economy, their resources and the type of businesses that can prosper in their country.

Corporate tax regimes and policy choices do not exist in isolation. Indeed, corporate taxation fits within the overall mix of taxes collected from individuals, from the consumption of goods and services and from property to meet a country’s expenditure needs in areas such as infrastructure, education, health, welfare, etc.

Tax is a national competence and sovereignty in tax matters is a fundamental principle of EU law. We believe EU Member States need to retain flexibility to set their tax base to suit their economic policies, whether this is to stimulate growth in certain industries, alter their tax revenue mix, or fund capital investment, as individual countries are better placed to be nimble and responsive to a changing economic environment.

This is particularly important for countries with small open economies. Removing this flexibility would be an erosion of tax sovereignty which would likely result in damaging the economies of some Member States and risk de-stabilising their tax revenues.

We believe the current BEFIT proposal would disproportionally impact EU Member States with smaller open economies, including Ireland. After all, the design criteria of a corporate tax system for a large economy with a strong manufacturing base are not the same for a small service-based open economy.

Allocating profits by reference to a formula that would favour countries where customers are located, and which would under reward ownership of critical intangible assets, would make smaller countries with service-based open economies less attractive as destinations for inward investment and erode their tax base.

In our view, it would be fundamentally unfair to impose a system of taxation that would be designed to suit countries with larger domestic economies at the expense of smaller countries with open economies.

3.3 Objectives which overlap with existing tax reform measures

The consultation questionnaire identifies aggressive tax planning as a potential problem that BEFIT could address and proposes that a more robust corporate tax system that can withstand tax avoidance by businesses could be one of the ultimate aims of a new EU corporate tax framework.

However, the primary objective of recent EU and international tax reforms, including the EU Anti-tax Avoidance Directives (ATAD1[3] and ATAD2[4]), the seven iterations of the Directive on Administrative Co-operation[5] (DAC) has been to combat tax avoidance and tax evasion. These reforms have resulted in the implementation of a range of measures including:

- CFC rules,
- exit tax rules,
- anti-hybrid rules,
- interest limitation rules,
- general anti-avoidance rules,
- transfer pricing,

[3] Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market.
[4] Council Directive (EU) 2017/952 of 29 May 2017 amending Directive (EU) 2016/1164 as regards hybrid mismatches with third countries.
[5] Council Directive 2011/16/EU of 15 February 2011 on administrative cooperation in the field of taxation and amending Directives

- transparency measures comprising the automatic exchange of financial account information, tax rulings and country-by-country reports within the EU,
- the mandatory reporting of cross-border arrangements that could potentially be used for aggressive tax planning and
- reporting obligations for digital platforms to collect and report the income realised by sellers offering certain services.

Alongside these significant legislative changes, businesses are striving to comprehend the likely impact of the corporate tax reforms agreed as part of the Two-Pillar Solution and within the EU, the implementation of the Minimum Tax Directive.[6]

In our view, the impact and effectiveness of these extensive tax reforms, which have recently been implemented, and the global minimum tax rate which will shortly be transposed into the domestic legislation of Member States, have not yet been sufficiently evaluated. We believe that the adoption of these recent reforms should adequately address any concerns regarding aggressive tax planning and tax avoidance, without the risk posed by BEFIT to the growth of businesses and the economies of Member States.

We believe, at a minimum, that the European Commission should defer further consideration of BEFIT until the rules for the implementation of the Pillar Two global minimum tax rate have had sufficient time to be put into practice. Only then should the Commission proceed with a process to analyse whether BEFIT would provide a benefit to tax authorities and MNEs. We do not consider it is appropriate to add another layer of complexity at this time.

3.4 Increased complexity and costs for tax authorities and businesses

One of the key objectives of BEFIT is to increase the resilience of EU businesses by reducing the complexity of tax rules and the compliance costs they face when operating cross-border. As outlined above, businesses are already burdened by the level of effort required to comprehend and comply with the plethora of recent BEPS reforms.

Indeed, a stated aim of the BEFIT initiative is to address the complexity and high costs for businesses having to comply with 27 different corporate tax systems when doing business across the EU. However, while many businesses may have customers in several EU Member States, often they do not have a taxable presence in each of the Member States. Under BEFIT, such businesses would have increased compliance obligations in more jurisdictions than currently is the case, resulting in a greater administrative burden.

The implementation of BEFIT would involve a transition from 27 different corporate tax systems to one common framework. Therefore, we believe the Commission would need to consider developing rules to deal with the transition between regimes and the

[6] Council Directive (EU) 2022/2523 of 14 December 2022 on ensuring a global minimum level of taxation for multinational enterprise groups and large-scale domestic groups in the Union.

associated complexities. In our view, the multifaceted transition issues that would arise would likely undermine the stated aim of BEFIT.

The practical implications arising from the interconnectedness of the tax returns which would be submitted by a business under the BEFIT framework would also need to be considered. For example, how would audits be conducted and how would tax assessments be amended?

The proposed interaction of BEFIT with foreign tax credit rules is unclear and would likely lead to further complexity for both tax authorities and businesses. Where a taxpayer located in a Member State derives income that has been taxed in another Member State or in a third country, double taxation agreements or domestic legislation generally require the residence state to grant a credit for the tax withheld abroad from the taxpayer's domestic tax liability. It is unclear how the tax credit system would operate where there is a misalignment between the EU jurisdiction where the corporate income tax would actually be paid (due to a reallocation under BEFIT) and the EU jurisdiction providing the credit under the double taxation agreement.

One of the options under consideration envisages tax authorities operating two different tax systems in parallel. Tax authorities would have to operate their domestic corporate tax regime for companies that do not fall within the scope of BEFIT, and a new separate regime under BEFIT. This would appear to be contrary to the stated objective of simplifying tax administration as operating two tax systems would inevitably increase the complexity and costs of administration for both tax authorities and taxpayers.

As BEFIT would not eliminate existing transfer pricing rules for all transactions but only within the EU for those companies within scope, MNEs would remain subject to the current arm's length principle on transactions outside of the EU. Therefore, such companies would be unlikely to realise a meaningful transfer pricing simplification benefit.

In recent years, businesses have invested heavily in systems to ensure that they comply with OECD transfer pricing requirements. The rationale for moving away from existing transfer pricing rules and the arm's length principle in an intra-EU context is not clear.

Introducing and complying with a new tax system would involve significant cost for all businesses operating in the EU, which could in fact act as a barrier for some SMEs seeking to scale up and commence operating cross-border within the EU.

3.5 Adjustments to the common tax base

If BEFIT were implemented within the EU, it is likely that adjustments made to the taxable base that have been developed by Members States to attract inward investment in certain sectors in their countries would be lost, which could negatively impact economic growth in those Member States.

For instance, we firmly believe it should be a matter for individual Member States to determine the most efficient and cost-effective way of incentivising research and development (R&D) in their jurisdiction, whether this is by means of grant aid, provision of other business supports or tax related measures. In our view, allowing for local adjustments after the initial set of common adjustments would diminish the impact of a local tax measure which is intended, for example, to incentivise R&D investment in a country.

The impact of the use of a single rate of tax in Member States would also need to be examined, if that is the policy choice. For example, Ireland currently has three rates applying to corporate profits – a 12.5% tax rate which applies to trading profits, a 25% tax rate for passive income and a 33% rate is imposed on capital gains. The creation of a single tax base which is subject to tax at a single rate could result in reduced revenues for Member States.

Furthermore, the adoption of a common tax base would make it very difficult for Members States to make subsequent adjustments, which might be needed, should economic circumstances change.

3.6 The importance of recognising intangible assets

In describing the problem the BEFIT initiative proposes to confront, the Commission's *Call for Evidence for an Impact Assessment* states that: *"the current corporate tax systems do not fully reflect the realities of today's economy and global developments as they are still mainly based on the principles of local brick-and-mortar production. These principles are believed to be outdated since globalisation, digitalisation and the intensified use of intangibles have substantially changed how companies do business. These changes should also be reflected in how they are taxed."*

Having noted the importance of intangibles in how companies do business, it is perplexing that one of the options under consideration by the Commission proposes to exclude intangible assets as a factor in the formula for the apportionment of consolidated profits. Ignoring the existence of intangible assets, which are a major part of modern global business is simply not a realistic way of allocating profits.

Under the second option for consideration, it is proposed that intangible assets would be included as a "*proxy value, which could consist of aspects such as research and development expenses and costs for marketing and advertising*". We consider such an approach to intangible assets would be wholly inadequate as it would not reflect the investment made by businesses in both developing and acquiring intangibles.

3.7 Legal and tax certainty for businesses

Legal and tax certainty in the international taxation framework is of the utmost importance and must be a priority for policymakers. Tax certainty is recognised by the OECD and the IMF as a key factor that influences investment and other commercial decisions and therefore has a significant impact on economic growth.[7] The European Commission has noted that uncertainty may have negative effects on investment, trade, and compliance.[8]

We believe the introduction of BEFIT would create more uncertainty for companies operating in the EU at a time when businesses are already grappling with the level of effort required to understand and comply with the substantial tax reforms which have taken place within the EU over the last five years.

The corporate tax regimes of Member States are based on detailed legislation, guidance notes and case law spanning thousands of pages which both Member States and taxpayers rely on to gain certainty regarding the operation of their tax systems. Much of the legislation and case law that has evolved over time could become redundant with the introduction of a regime with new rules and new definitions, which would create enormous uncertainty for both business and tax authorities.

It is important to consider that harmonisation of tax law does not necessarily create legal certainty. For instance, the Court of Justice of the European Union (CJEU) already considers harmonised areas of tax law within the EU in the context of VAT. It is evident from the volume of VAT cases heard by the CJEU that despite harmonisation of the rules, Member States have interpreted the provisions differently in transposing the VAT Directive, causing conflicting approaches.

It may be the case that the CJEU would become the legal forum for the resolution of disputes regarding a new harmonised corporate tax system. In order to avoid legal uncertainty, tax disputes would need to be resolved within a short timeframe. However, given the length of procedures at the CJEU at present, it would not be a time efficient or effective forum for dispute resolution under a common tax base. Undoubtedly, it would take years, most likely decades, to replicate the existing considerable catalogue of case law for a new EU wide tax system.

In our view, the BEFIT proposal would create a further layer of uncertainty for business at a time when the economic outlook has never been so uncertain. We believe that causing further economic uncertainty could create a disincentive for investment within the EU Single Market when it is needed most to support the recovery of the economies of Member States.

3.8 Detailed analysis essential to demonstrate the need for BEFIT

Article 5(3) of the Treaty on European Union (TEU) provides as follows: "*3. Under the principle of subsidiarity, in areas which do not fall within its exclusive competence, the Union shall act only if and in so far as the objectives of the proposed action cannot be sufficiently achieved by the Member States, either at central level or at regional and local*

[7] IMF/OECD (2019), 2019 Progress Report on Tax Certainty, Paris. www.oecd.org/tax/tax-policy/g20-report-on-tax-certainty.htm
[8] European Commission Working Paper No. 67 – 2017: 'Tax Uncertainty: Economic Evidence and Policy Responses', March 2017

level, but can rather, by reason of the scale or effects of the proposed action, be better achieved at Union level."

To assist national parliaments in their evaluation of subsidiarity compliance, Article 5 of Protocol (No 2) of the TEU on the application of the principles of subsidiarity and proportionality states: "*Any draft legislative act should contain a detailed statement making it possible to appraise compliance with the principles of subsidiarity and proportionality. This statement should contain some assessment of the proposal's financial impact and, in the case of a directive, of its implications for the rules to be put in place by Member States…"*

In the event that the European Commission decides to proceed with the BEFIT proposal, we believe a detailed statement, with the necessary quantitative and qualitative indicators, would be essential to allow Member States to fully assess all the implications of a cross-border proposal of this magnitude with a sufficient period of time afforded for consultation and engagement.

We firmly believe it would be important for the European Commission to be able to demonstrate that the aims of BEFIT cannot be sufficiently addressed by individual Member States and that action at the EU level would provide additional benefits.

To do this, we would suggest the following analysis must be undertaken:

- An analysis on whether costs would be reduced for businesses due to BEFIT considering the wider impact of the proposal.
- An analysis of the impact of BEFIT on foreign investment in individual Member States, with particular consideration given to small open economies.
- An analysis of the impact of the requirement for tax authorities to run two different tax systems in parallel because of BEFIT.
- An analysis demonstrating why BEFIT would provide a better solution than current transfer pricing rules.
- An analysis of the impact of the proposals on small open economies. The BEFIT initiative must provide for sustainable tax revenues for individual Member States as well as the EU as a whole.
- An analysis of the impact of the imposition of a single rate of tax on a consolidated tax base would have on the tax revenues of Member States.

Undertaking such detailed analysis and impact assessment would be in keeping with the Commission's better regulation agenda and its commitment to ensure any proposals to change existing EU laws would provide simplification and reduce unnecessary regulatory costs.