Proposal for a Council Directive on BEFIT: an Initial Assessment

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Abstract

This study analyses the critical issues of legal interpretation that might arise from the application of the proposed BEFIT Directive and puts forward possible solutions, focusing on four main areas.

The first area (scope) analyses (i) the unequal treatment of companies that the annex may create and the Commission's delegated power to amend it; (ii) the possible conflict with double tax treaties, namely on PE profit attribution and on ownership non-discrimination rules. The second area (preliminary tax result) emphasises the need for greater coordination with other secondary law, especially the GMT directive. The third area (tax base allocation) evaluates: (i) the issues surrounding losses; (ii) the distortions caused by the transitional 'presumptive' transfer pricing rules on the tax base allocation and the conflict with CJEU case law; (iii) and shows how the unlimited power of Member States to adjust their BEFIT base may undermine the fundamental goals of the proposed Directive. Finally, the fourth area (administration and procedures) shows that (i) the two-tier procedural obligations are hard to reconcile with the spirit of the announced one-stop shop compliance mechanism, and that; (ii) legal uncertainty might arise as to the impact of the proposed Directive on domestic procedural rules.

1. Executive summary

Introduction

This study contains a preliminary assessment of the proposed BEFIT Directive from the perspective of legal interpretation and puts forward possible solutions where problems are identified. The authors welcome the proposed Directive, which establishes a common tax base for large corporate entities and thus creates a more neutral tax framework for them to operate in the European Union.

After a historical overview and a review of the main policy objectives, this study focuses on four main areas of the proposed Directive, identified by the authors, namely its (i) scope, (ii) determination of the preliminary tax result, (iii) allocation of the BEFIT base, and (iv) administration and procedures.

Scope

The proposed Directive defines its scope in an annex, listing eligible entities and relevant taxes. While this approach adds legal clarity, it may create unequal treatment for companies in different Member States based on their corporate law. A principle-based scope could have minimized such disparities. Additionally, the EU Commission's unchecked delegated power to update these lists could raise questions about compliance with the essential elements doctrine established by the Court of Justice of the European Union.

Other possible issues might arise from the pragmatic approach regarding permanent establishments, which refers to their definition, but not to existing rules on profit attribution. This might entail a breach of pre-accession treaties, especially when their profit attribution rules are not aligned with the text of the proposed Directive.

The reference to shareholding and other criteria might allow assessment in light of the free movement of capital insofar as the proposed Directive applies to situations that do not produce a “definitive influence” over the company’s decisions. Issues of compatibility with PE and the ownership non-discrimination tax treaty clauses with third countries might also arise.

Determination of the preliminary tax result

A more clearcut fundamental approach based on “limited tax adjustments” vis-à-vis one based on a “comprehensive set of tax rules” should be consistently formulated throughout the proposed Directive. Reliance on undefined criteria, such as the “direct business interest” requirement for deducting expenses would likely garner a series of interpretive uncertainties.

It might be desirable to direct further efforts to achieve or enhance an “as close as possible” alignment of the adjustments of the financial accounting results with the applicable GMT Directive rules. This will help removing the effects of duplication (and triplication, if considering the domestic CIT framework) of the compliance burden of BEFIT group members as to tax base computation that is produced by divergences not justified by other policy considerations.

According to the Explanatory Memorandum, no conflict with the existing body of secondary law in direct taxation should arise, thus preventing the need for ad hoc rules except in the case of interest deductibility. However, the virtual “switching off” of the national corporate tax laws of the Member States implementing ATAD and the Parent-Subsidiary Directive indicates otherwise. Moreover, even though the Impact Assessment regards the proposed BEFIT Directive as prevailing over other secondary law for being lex specialis, this is not so evident from the analysis of the wording of the proposed Directive. Moreover, such precedent might raise a series of further unaddressed questions, which this study has identified.

Allocation of the BEFIT tax base

The study identifies several issues in the aggregation and allocation of the BEFIT tax base, particularly concerning the treatment of losses. The baseline allocation formula fails to perform its function accurately if all BEFIT-group members consistently report losses over three years or if a single member shows an average negative tax result. Moreover, the proposed Directive allows indefinite and unlimited domestic loss-carry forwards for pre-BEFIT losses, diverging from most of the current regimes in the Member States. It also leaves unanswered how to treat such losses if they become final.

During the transitional period, 'presumptive' transfer pricing could result in distorted allocations and potential profit shifting in the 'low-risk' zone. In the 'high-risk' zone, the rules may conflict with CJEU case law on discriminatory transfer pricing. The rules, moreover, offer no solutions for positive income in the high-risk zone or double taxation scenarios. Instead of the current system, the study recommends relying on multilateral advanced pricing agreements alongside adequate dispute resolution mechanisms. Regarding transactions with associated units outside the BEFIT group, the focus on contract manufacturers and limited risk distributors may be misplaced, as any transaction with an associated enterprise can distort baseline allocation.

The unlimited power for Member States to adjust their BEFIT base calls into question the proposed Directive's effectiveness in achieving its goals of simplification, cross-border loss utilization, and tax harmonization.

Administration and procedures

The procedural rules are meant to pursue the goal of establishing the BEFIT regime as a one-stop shop for corporate taxation of large enterprises in the EU, but, in fact, create a two-tier compliance mechanism that is hard to reconcile with such philosophy. The mandatory double filing of tax returns (at the level of the so-called filing entity and each group member) might have been avoided with an integrated fact-finding, with the main reporting obligation for the filing entity, but allowing for supplementary input from the group members. Furthermore, even though the proposed Directive allows for joint audits, it does not prevent the parallel operation of double (and multiple) audits in the Member States involved. Later steps of the procedure also admit double administrative reviews and judicial appeals.

Moreover, even though the proposed Directive introduces a significant degree of harmonisation of procedural rules, its impact on the application of domestic rules raises legal uncertainty in various circumstances. Finally, the authors consider that the absence of rules on the protection of taxpayers’ rights throughout the procedure will not prevent the application of legal remedies based on the general principles of EU law.

2. Introduction

2.1. Preliminary remarks

2.1.1. Aim of the study

This study aims to provide feedback to the European Commission and the European Parliament on the proposal for a Council Directive on Business in Europe: Framework for Income Taxation (BEFIT),[1] which followed the public[2] as well as targeted[3] consultation and the impact assessment[4] on this initiative.

As the title of this contribution suggests, this study is the first version of a comprehensive legal assessment of the proposed BEFIT Directive released on 12 September 2023 by the EU Commission. It identifies its most pressing and critical issues, and dwells on their ramifications with special emphasis on those that arise from the legal interpretation of the provisions contained in the proposed Directive. At the same time, since the technical content of this study does not seek to undermine the adoption of the proposed BEFIT Directive but rather to enhance it with constructive and timeous criticism, where possible, the authors attempt to provide alternative solutions to overcome the identified issues and to support the EU institutions to improve the existing proposal.

The authors trust that such an approach will strengthen the proposed Directive prior to adoption, with particular reference to the need to comply with the general principles of EU law and coordinate with other secondary tax and non-tax legislation, as well as with the international tax framework. A thorough analysis of the relevant legal issues is necessary to ensure that secondary legislation can effectively achieve the desired goals in line with the rule of law and further requirements established by the EU legal system.

2.1.2. Disclaimers

The authors form part of the IBFD Task Force on EU Law, comprising a group of researchers from IBFD Academic who habitually carry out independent research on EU law. All of the members of the Task Force are independent scholars. The IBFD Task Force on EU Law is entirely funded by IBFD and does not receive additional funds from private companies or States that may be, directly or indirectly, impacted by the outcome of the relevant public consultation. This study reflects the joint views of the Task Force as a whole and not necessarily of each member. IBFD is a non-profit foundation, entirely funded through its activities and

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[1] European Commission, Proposal for a Council Directive on Business in Europe: Framework for Income Taxation (BEFIT), COM(2023) 532 final (12 Sept. 2023), available at https://taxation-customs.ec.europa.eu/system/files/2023-09/COM_2023_532_1_EN_ACT_part1_v6.pdf [hereinafter the proposed Directive].

[2] Call for evidence for an impact assessment – Ares(2022)7086603, available at https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/13463-Business-in-Europe-Framework-for-Income-Taxation-BEFIT-_en. This was done in compliance with the Interinstitutional Agreement between the European Parliament, the Council of the European Union and the European Commission on Better Law-Making (OJ L 123, 12.5.2016, p. 1).

[3] European Commission, Staff working Document, Impact Assessment Report, Accompanying the documents Proposal for a Council Directive on Business in Europe: Framework for Income Taxation (BEFIT) and Proposal for a Council Directive on Transfer Pricing, p. 82, SWD(2023) 308 final (12 Sept. 2023), available at eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52023SC0308&qid=1696672544445 [hereinafter the Impact Assessment].

[4] *Ibidem*.

publications, operating in Amsterdam since 1938. More information can be found at www.ibfd.org. The authors have not received any instructions, guidelines or orientations from IBFD or any of its governance boards.

The authors of this study have not intervened in the drafting of the proposed Directive and have not participated in any hearing apart from the written submission made to the public consultation, which the European Commission published on its website.[5]

The present research study is released publicly to encourage further discussion and debate on the questions raised. Only subsequently, and to the extent that this work will be found to adequately contribute to the scholarly debate that will likely emerge from the proposed Directive, may an updated version be published.

IBFD has not relied on external expertise in preparing this study.

2.1.3. Assumptions

This study does not address the determination of whether the BEFIT proposal leads to: i) an effective decrease of the amount of tax to be paid;[6] ii) a reduction of tax compliance costs;[7] iii) stimulating investment and growth; iv) improved competition of the internal market compared to other markets; or v) contributing to ensure more sustainable tax revenues for Member States.

Equally, this study does not comment on the initiative's cost-benefit analysis conducted in the impact assessment, and it will not dwell on the costs of the proposal, namely: i) ongoing operational costs of an administrative nature; ii) short-term (possibly, one-off) adjustment costs, related to updating IT systems, and; iii) the technical training of staff from both the business community and tax administrations to the new system.

2.1.4. Exclusions from the scope of the study

The present study carves out any consideration that does not relate to tax law or tax policy. Accordingly, sociological, economic, econometric or similar considerations are not part of the framework within which the BEFIT proposal is analysed in the present research. Equally, it will not analyse the estimates for budgetary implications of this proposal.

Furthermore, this study does not research either the possible direct or indirect impact of the BEFIT proposal on the European Green Deal or European environmental legislation, nor the interactions between this proposal and the Sustainable Development Goals 8 and 9.

This study does not address the analysis of the effectiveness and efficiency of this initiative or its relevant indicators as set out in the impact assessment: implementation and initial BEFIT running costs; number of groups of companies in the mandatory scope of the

[5] Available at: https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/13463-Business-in-Europe-Framework-for-Income-Taxation-BEFIT-/F3377118_en and https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/13463-Business-in-Europe-Framework-for-Income-Taxation-BEFIT-/public-consultation_en.

[6] Although some identified issues stemming from the allocation rules and the possibility to use them as a tool to shift income and reduce the tax base, are addressed.

[7] Although some identified instances of some duplications of computations for taxpayers falling within the scope of both the proposed BEFIT Directive and the GMT Directive will be pointed out, which may perhaps be regarded as proxy of such a potential increase.

proposal, as well as the number of companies that might voluntarily opt-in; evolution of the compliance costs; and the number of double taxation disputes which might arise as a result of the proposed Directive.

The BEFIT proposal does not exclude any sector from its scope, but rather takes into account sector-specific characteristics relevant to the purposes of the proposal. Accordingly, it only excludes from the scope of the preliminary tax results shipping income covered by a tonnage tax regime. Besides, the proposal excludes from the scope of the BEFIT tax base: i) income and losses from extractive activities, because they are always allocated to their jurisdiction of origin; ii) revenues and expenses from shipping not covered by a tonnage tax regime, or from air transport, which are also not allocated since they are taxed only in the State where the company operating the ships or aircraft is located.

This study does not assess whether the income subject to special tax regimes, such as tonnage taxation, should continue to be excluded or if other tax regimes or income streams should or should not be carved out of the proposal.

While the proposal rests on the assumption that albeit different in their design, the fundamental features of corporate income tax systems are similar as they lay down rules aiming towards the same objective to arrive at a taxable base for businesses,[8] it does also acknowledge that some Member States operate corporate tax systems which are built on principles that differ from the most common approach, such as distribution-based tax systems. Hence, it does set forth specific rules to accommodate distribution-based tax systems. Although acknowledging the relevance of investigating the potential implications of the interactions between the BEFIT and distribution-based systems, such questions fall beyond the scope of investigation of this study.

Together with the BEFIT proposal, the EU Commission has also adopted a separate proposal for transfer pricing.[9] The present study does not address the TP Directive proposal but might refer to it where relevant.

2.2. Historical overview: previous proposals for harmonisation of corporate income taxation

2.2.1. Efforts since the sixties

Since the founding of the European Communities, the idea to develop common rules for company taxation has been viewed as a key element for establishing and completing the Internal Market.

As early as the 1960s, several studies like the Neumark report of 1962,[10] the van den Tempel report of 1970,[11] and one resulting from the works of the Werner Committee,[12] along

[8] See para. 3 of the Preamble to the proposed Directive.

[9] European Commission, Proposal for a Council Directive on Transfer Pricing, COM(2023) 529 final (12 Sept. 2023), [hereinafter Transfer Pricing Directive Proposal].

[10] See the Neumark Report of 1962 and others collected in *The EEC Reports on Tax Harmonization: The Report of the Fiscal and Financial Committee and the Reports of Sub-Groups A, B and C: An Unofficial Translation* (H. Thurston trans., IBFD 1963) [hereinafter *Neumark report*].

[11] A. J. van den Tempel, *Corporation tax and individual income tax in the European Communities* (Brussels: Commission of the European Communities, 1970) 15 Studies Competition: Approximation of legislation Series. [hereinafter *Tempel report*].

[12] Report to the Council and the Commission on the realisation by staged of Economic and Monetary Union in the Community, "Werner Report" (definitive text), 1970 (Luxemburg: Councile-Commission) [hereinafter *Werner Report*].

with several initiatives designed to promote progressive harmonisation of the corporate tax system, base, and rates were held.

In its 22 March 1971 resolution on the attainment by stages of economic and monetary union in the Community, the Council of the European Communities acknowledged that in order to progress in the interpenetration of economies, further harmonization of the taxation of companies and firms was a key measure and ought to be among the first stages.[13]

Following this trend, in 1975, the Commission presented a Proposal for a Council Directive concerning the harmonization of systems of company taxation and withholding taxes on dividends.[14]

Nevertheless, this impetus weakened in the 1980s. Although in 1984 and 1985, the Commission had put forward proposals for directives on loss compensation, these were later withdrawn. In 1988, the reluctance of most Member States prevented the tabling of a draft proposal for the harmonisation of the tax base of enterprises.[15]

Due to the lack of success of these initiatives, in 1990, the Commission entrusted a committee of independent experts to assess the necessity and degree of possible corporate tax harmonization.[16] In March 1992, the Commission released the Report of the committee (also known as the Ruding report from the name of its chairman, Onno Ruding).[17] The Ruding report concluded that the differences in tax regimes among Member States distort the functioning of the internal market and harm economic efficiency.[18] The report observed that taxation has a distortive effect on direct investment decisions as well as on companies' financial and legal structure.[19] Furthermore, tax differences also have administrative implications related to tax enforcement, tax compliance costs and legal certainty.[20]

In December 1998, the ECOFIN Council mandated the Commission to carry out a further analytical study on company taxation in the European Union.[21] Building on this study, in October 2001, the EU Commission issued a communication tabling 'A strategy for providing companies with a consolidated corporate tax base for their EU-wide activities'.[22] With this communication, the Commission outlined the main policy goals underpinning the proposal for

[13] Resolution of the Council and of the Representatives of the Governments of the Member States of 22 March 1971 on the attainment by stages of economic and monetary union in the Community, (OJ C 28, 27.3.1971, p. 1).

[14] Commission of the European Communities, Proposal for a Council Directive concerning the harmonization of systems of company taxation and of withholding taxes on dividends, COM (75) 392 final, (23 July 1975). Bulletin of the European Communities, Supplement 10/75, COM(75) 392 (23 July 1975).

[15] Commission of the European Communities, Communication from the Commission to the Council, the European Parliament and the Economic and Social Committee, Towards an Internal Market without tax obstacles, A strategy for providing companies with a consolidated corporate tax base for their EU-wide activities, p. 4, COM(2001) 582 final (23 Oct. 2001) [hereinafter *COM(2001) 582 final*].

[16] Commission of the European Communities, Communication to Parliament and the Council, Guidelines on Company Taxation, p. 12, para 35, SEC(90) 601 (20 April 1990) [hereinafter *SEC(90) 601*].

[17] A member of this committee was also Professor Frans Vanistendael, former IBFD Academic Chairman.

[18] Commission of the European Communities, Report of the Committee of Independent Experts on Company Taxation, p. 196 (Luxemburg: Office for Official Publications of the European Communities, 1992) [hereinafter *Ruding report*].

[19] *Ruding report*, p. 197.

[20] *Ruding report*, p. 198.

[21] As reported under the heading 'Background and history of the mandate' of the Commission of the European Communities, Commission Staff Working Paper, Company Taxation in the Internal Market, p. 3, SEC(2001) 1681 (23 Oct. 2001).

[22] *COM(2001) 582 final*.

adopting a CCCTB. In the Commission's view, "[o]nly providing multinational companies with a consolidated corporate tax base for their EU-wide activities will really, through a single framework of company taxation, systematically tackle the majority of the tax obstacles to cross-border economic activity in the Single Market".[23]

2.2.2. CCCTB Proposal of 2011

Following consultations and conferences with representatives of Member States, tax advisers, business organizations and academics held during the 2000s,[24] on 16 May 2011, the EU Commission released its first proposal for a Directive on a Common Consolidated Corporate tax base (CCCTB).[25]

The original CCCTB proposal was structured as a system of common rules for the computation of the tax base of companies that were tax residents in the EU and of EU-located branches of third-country companies. This common tax framework tabled rules for computing each company's/branch's individual tax results, for consolidating those results when there were other group members, and for apportioning the consolidated tax base to each eligible Member State based on formulary apportionment.[26]

Several elements are unique to this first attempt. First, although aiming at theoretically benefiting companies of all sizes, this first proposal was expressly addressed to small to medium enterprises (SMEs) since its underlying assumption was that it was this sector that found it more costly to access the Single Market.[27] Hence, the main target of the proposal were SMEs rather than multinational enterprises (MNEs). Second, there was no size requirement since the proposal opted for a non-mandatory approach, making the CCCTB available for all sizes of companies. This choice resulted from the impact assessment revealing that, compared to a mandatory one, an optional CCCTB is preferable because (i) the estimated impact on employment is more favourable and (ii) the enforced change by every single company in the Union to a new method of calculating its tax base (regardless of whether it operates in more than one Member State) is avoided.[28] Third, since the International Accounting Standards and the International Financial Reporting Standards (IAS/IFRS) were examined and disregarded in 2006, the CCCTB system did not refer to the EU Accounting system based on the IAS and IFRS.[29]

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[23] *COM(2001) 582 final,* p. 15.

[24] M. Aujean, *The CCCTB Project and the Future of European Taxation*, in *Common consolidated corporate tax base*, 30-36 (M. Lang, ed. Wien: Linde 2008).

[25] European Commission, Proposal for a Council Directive on a Common Consolidated Corporate Tax base (CCCTB), COM(2011) 121 final (16 March 2011) [hereinafter *COM(2011) 121 final*].

[26] *COM(2011) 121 final*, p. 5.

[27] *COM(2011) 121 final*, p. 6. *See* also European Commission, Communication from the Commission to the European Parliament, the Council, Economic and Social Committee and the Committee of the Regions, Review of the "Small Business Act" for Europe, COM(2011) 78 final (23 Feb. 2011).

[28] *COM(2011) 121 final*, p. 8.

[29] Commission of the European Communities, Communication from the Commission to the Council, the European Parliament and the European Economic and Social Committee, Implementing the Community Lisbon Programme: Progress to date and next steps towards a Common Consolidated Corporate tax base (CCCTB), p. 7, COM(2006) 157 final (5 April 2006), [hereinafter *COM(2006) 157 final*].

Nevertheless, Member States disagreed on two main elements: i) the consolidated tax base; and ii) the formulary apportionment. Failing to reach a compromise solution,[30] the EU Commission withdrew its 2011 proposal,[31] and issued a relaunched C(C)CTB proposal in October 2016.

2.2.3. C(C)CTB Proposal of 2016

In 2016, the European Commission released two proposals, one for a Directive on a Common Consolidated Corporate Tax Base (CCCTB),[32] and one for a Directive on a Common Corporate Tax Base (CCTB).[33]

The 2016 CCTB established a system for a common base for the taxation of certain companies and laid down rules for calculating that base.[34] The 2016 CCCTB proposal built on the CCTB proposal, by providing for the consolidation of the tax bases of companies that are members of a group. It further laid down rules on the consolidated base allocation and administration.[35] Similarly to the 2011 proposal, the allocation to Member States was based on formulary apportionment.

In addition to the 2011 policy goals – to remove obstacles to facilitate cross-border investments and promote growth – the 2016 Impact Assessment added a further policy goal: enhancing fairness of corporate income tax within the EU, which may be traced to the launch of the OECD BEPS project.[36]

The 2016 initiative was framed as a two-tier strategy. Initially, the CCTB Directive was envisaged to enter into force on the 1st of January 2019, and sought to harmonise the corporate tax bases of the Member States.[37] Two years later, the CCCTB directive would have entered

[30] Compromise Proposal CCCTB of 19 November 2014, doc. no. 15756/14. With explanatory memorandum (doc.no. 15756/14) available at https://data.consilium.europa.eu/doc/document/ST-15756-2014-INIT/en/pdf.

[31] European Commission, Annex to the Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, Commission Work Programme 2017, Delivering a Europe that protects, empowers and defends, Annex IV (Withdrawals), COM(2016) 710 final (25 Oct. 2016).

[32] European Commission, Proposal for a Council Directive on a Common Consolidated Corporate Tax Base, COM(2016) 683 final (25 Oct. 2016) [hereinafter *COM(2016) 683 final*].

[33] European Commission, Proposal for a Council Directive on a Common Corporate Tax Base, COM(2016) 685 final (25 Oct. 2016) [hereinafter *COM(2016) 685 final*].

[34] See Art. 1 *COM(2016) 685 final*.

[35] See Art. 1 *COM(2016) 683 final*.

[36] European Commission, Commission Staff Working Document, Impact Assessment Accompanying the document Proposals for a Council Directive on a Common Corporate Tax Base and a Common Consolidated Corporate Tax Base (CCCTB), p. 23, SWD(2016) 341 final (25 Oct. 2016), [hereinafter *SWD(2016) 341 final*]. B.J.M Terra & P.J. Wattel, *European tax law: volume 1: general topics and direct taxation*, 216 (Alphen aan den Rijn: Kluwer Law International, 7th ed., 2018) [hereinafter *Terra/Wattel, European tax law*] where the authors report that the trade-off between the two pursed policy goals of efficiency and fairness (see *SWD(2016)341 final*, p. 24) has a flipside which is the harm to the EU competitiveness stemming from the "all too ambitious European approach to combat tax planning practices". In particular, the EU would be at a competitive disadvantage if it adopted measures that go beyond what is recommended by the OECD. Under this perspective the EU Commission's stend pursuant to which the EU should serve as a leading example to the world in tackling tax avoidance could backfire.

[37] M.F. de Wilde, *Chapter 2: The CCCTB Relaunch: A Critical Assessment and Some Suggestions for Modification*, in *European Tax Integration: Law, Policy and Politics* (P. Pistone ed., IBFD 2018), Books IBFD.

into force, setting forth the consolidation and the formulary apportionment. The CCCTB was intended to remove the need to rely on the arm's length principle for groups within the EU.

Unlike the 2011 proposal, which introduced a fully optional system, the relaunched CCTB/CCCTB proposals changed this approach, seeking to impose a mandatory system. The relaunched system was to be mandatory for MNEs with a worldwide turnover exceeding EUR 750 million. It would be optional instead only for small and medium-sized businesses. This marked another significant difference between the 2011 and the 2016 proposals: while the former was addressed mainly at SMEs, the latter focussed on large MNEs.

The choice in the 2016 CCTB/CCCTB proposals to include within the scope all MNEs of a certain size, and not to restrict the scope to cross-border activities can be identified as an attempt to avoid the proposals being challenged from a discrimination standpoint.[38]

2.3. The Proposed BEFIT Directive

2.3.1. Background

The BEFIT proposal was announced in the Communication on Business Taxation for the 21st Century in May 2021.[39] The proposal reflects the fact that the context for Union tax policy has changed significantly in recent years.[40] While the context of the relaunched 2016 CCCTB was mainly characterised by the BEPS project and the discussions on taxing the digital economy, the BEFIT proposal instead reveals further nuances. On the one hand, the EU Commission acknowledges the policy objective to build on developments taking place at the international level in the field of corporate taxation. In this sense, the BEFIT proposal intends to capitalize on the international consensus gathered by the OECD Two-Pillar Solution mirrored in the 2021 OECD/G20 Inclusive Framework statement[41] and build on the Member States agreement on the introduction of the EU GMT Directive.[42]

On the other, the Commission noted that although the measures adopted to tackle profit-shifting have been successful, they have also added complexity to tax systems. Hence, the context of the EU Commission BEFIT proposal is also driven by the need to reduce tax complexity when operating in the internal market.[43] Finally, the BEFIT proposal might be seen as a step towards the establishment of a new own resource for the EU, which, as outlined in the 2020 Interinstitutional Agreement, the Commission shall endeavour to propose by June 2024.[44]

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[38] *SWD(2016) 341 final*, p. 42: "relying on a size criterion would better fit the necessity to avoid discrimination since it would not make any difference between a member of a multinational group and a member of a domestic group that, even just potentially, want to grow internationally or do business through permanent establishments."

[39] European Commission, Communication from the Commission to the European Parliament and the Council: Business Taxation for the 21st Century, p. 11, COM(2021) 251 final, (18 May 2021) [hereinafter *COM(2021) 251 final*].

[40] See Explanatory Memorandum of the proposed Directive, p. 1.

[41] Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy – 8 October 2021, OECD/G20 Base Erosion and Profit Shifting Project.

[42] 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 (OJ L 328, 22.12.2022, p. 1).

[43] See the proposed Directive, p. 2.

[44] Interinstitutional Agreement of 16 December 2020 between the European Parliament, the Council of the European Union and the European Commission on budgetary discipline, on cooperation in budgetary matters and

2.3.2. Rationale of the proposal

2.3.2.1. Issues addressed by the proposal

The lack of a common approach to the computation of the taxable base for businesses has led to the existence of 27 different corporate income tax systems in the EU. This obliges businesses to comply with as many different corporate tax systems as the number of EU Member States in which they operate,[45] and gives rise to complexity in tax compliance.[46] This complexity is exacerbated by different tax administration practices.

Increased tax uncertainty and tax compliance costs stemming from the complexity and discrepancies in the interaction of the different tax systems of the Member States undermine the ability of businesses operating in more than one Member State to operate on a level playing field. This negatively affects the functioning of the internal market because it discourages cross-border investments.

Finally, the complexity of multi-jurisdictional operations in the EU internal market is a competitive disadvantage relative to businesses operating in markets of a comparable size elsewhere in the world.[47]

2.3.2.2. Objectives pursued by the proposal

Against the backdrop of the issues outlined above, the Commission presents its BEFIT proposal as an attempt to stimulate growth and promote investment by implementing a common framework of corporate tax rules, replacing the current 27 different tax systems to determine the corporate tax base.[48] The motivation for this proposal is to encourage businesses to operate cross-border, and stimulate investments and growth in the Union, thereby contributing to improving the welfare within the EU.

As seen above, the need to comply with several diverging tax systems, as well as the representations to as many different tax administrations, undermine tax certainty. A single set of common corporate tax rules for regulating corporate taxation would strengthen consistency and enhance tax certainty.[49]

Harmonizing the rules has the potential to reduce or eliminate mismatches between Member States' tax systems that lead to distortions such as double or over-taxation as well as

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on sound financial management, as well as on new own resources, including a roadmap towards the introduction of new own resources, p. 46, (OJ L 433I, 22.12.2020, p. 28). See also European Commission, Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, The next generation of own resources for the EU Budget, COM(2021) 566 final (22 Dec. 2021); *COM(2021) 251 final*; European Commission, Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of Regions on Commission work program 2023 – A Union standing firm and united, COM(2022) 548 final (18 Oct. 2022).

[45] See para. 1 of the Preamble to the the proposed Directive.

[46] See para. 2 of the Preamble to the proposed Directive.

[47] See Explanatory Memorandum of the proposed Directive, p. 1.

[48] See para. 5 of the Preamble to the proposed Directive.

[49] See para. 5 of the Preamble to the proposed Directive.

unintended tax benefits.[50] Harmonisation is also expected to have a positive effect on dispute resolution since it should reduce the reasons driving many tax disputes.[51]

Finally, the Commission's proposal reiterates the role that such a reform may play in contributing to the fair allocation of revenues among Member States.[52]

2.3.3. Overview of the modus operandi

2.3.3.1. Premise

The proposed BEFIT Directive does not prescribe full harmonisation of corporate tax systems. It rather sets out common rules to determine the taxable income of (large) groups of companies in the Union. However, the rules prescribe exhaustive harmonisation for those within the proposal's scope or opt-in. Hence, the proposed Directive attempts to confine Member States's room for manoeuvre within the options already provided under the proposed Directive.

The BEFIT system consists of five building blocks: (i) rules for determining the scope; (ii) rules for calculating the tax base of each BEFIT group member; (iii) rules for the aggregation at the BEFIT group level and for the allocation of the aggregated tax base to the eligible group members; (iv) rules for transactions between BEFIT group members, on the one hand, and associated enterprises outside the BEFIT group, on the other hand; and (v) rules for the administration of the system.[53]

2.3.3.1.1. First building block: the (hybrid) scope

The first building block is set out in Chapter I of the proposed Directive. It sets forth the rules that define the scope of application of the BEFIT system. They introduce a hybrid scope since it is both mandatory and optional. It is mandatory for the same size groups operating within the EU as covered by the GMT Directive, namely groups with annual combined revenues of at least Euro 750 million, while it is optional/voluntary for smaller groups that operate cross-border.

In particular, although the mandatory scope mirrors the scope of the GMT Directive since it is limited to groups with annual combined revenues of at least Euro 750 million, it is further limited to the EU subset of entities that meet the 75% ownership threshold.[54] The rationale for this materiality threshold stems from the aim of ensuring that the proposal's requirements are proportionate to its benefits.

2.3.3.1.2. Second building block: calculation of the preliminary tax result of each BEFIT group member

[50] See Explanatory Memorandum of the proposed Directive, p. 5.
[51] See para. 5 of the Preamble to the proposed Directive.
[52] *Ibidem*.
[53] The Impact Assessment, p. 25.
[54] See Arts 5 and 6 of the proposed Directive.

Chapter II sets out the rules for the second building block. These regulate the calculation of the preliminary tax result of each BEFIT group member using a simplified method. This is achieved by operating limited adjustments pursuant to Sections 2 and 3 and applying the rules of Section 4 on timing and quantification issues to the net income or loss as stated in the financial accounts. In the interest of simplification, rather than setting out a detailed corporate tax framework, the proposal opted for limited adjustments kept to the minimum necessary for the computation of the tax base for the preliminary tax result.

As with the GMT Directive, the starting point is the result from the financial accounts. For the BEFIT groups, this must be determined under one single accounting standard, "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".[55]

For the purposes of the BEFIT proposal, only those accounting standards accepted under EU law may be used. This means that only the national generally accepted accounting principles (GAAP) of one of the Member States or the international financial reporting standards (IFRS) may be used as the starting point under BEFIT.[56]

Finally, this building block also includes rules for entities entering or leaving the BEFIT group, as well as rules concerning business reorganizations.

2.3.3.1.3. Third building block: aggregation and allocation of the BEFIT tax base

Rules for the third building block are set forth in Chapter III. This chapter contains the rules for both the aggregation of the preliminary tax results into a single tax base and the allocation of this aggregated tax base to eligible BEFIT group members.

Accordingly, the BEFIT initiative adopts a two-step methodology. First, the preliminary tax results of the members of the BEFIT group ought to be aggregated at the Union level into a single tax base, namely the 'BEFIT tax base'. Second, the BEFIT tax base is allocated to the members of the BEFIT group based on a transitional allocation rule. Upon allocation, the BEFIT group members must also apply additional adjustments in their national tax assessments.[57]

2.3.3.1.4. Fourth building block: the traffic light system

The fourth building block is still contained in Chapter III and addresses those associated enterprises falling outside the BEFIT group. In this case, the proposal introduces a 'traffic light system' to simplify compliance with transfer pricing for low-risk activities.[58] By allowing the classification of transactions under three risk zones (low, medium and high), the directive would allow Member States' tax administrations to optimise resource utilization by focusing on high-risk transactions.

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[55] See Explanatory Memorandum the proposed Directive, p. 13.
[56] See Art. 7 of the proposed Directive.
[57] See Art. 48, para 1 of the proposed Directive.
[58] See Art. 50 of the proposed Directive.

2.3.3.1.5. Fifth building block: administration

The fifth and last building block is contained in Chapter V and sets forth the rules for the system's administration. The implementation of a common administrative framework in parallel with the introduction of a common legal framework would yield further simplification and free up resources for both taxpayers and tax administrations. In light of this premise, the Commission opted for what it described as a one-stop shop. The latter allows BEFIT group companies to interact with a single tax administration in the Union.

The filing entity will file the BEFIT Information Return, namely the information return for the BEFIT group, with its own tax administration. The latter will have to share such information with the other Member States in which the group operates.[59] Since each BEFIT group member would still be required to file an individual tax return with their local tax administration, this system will allow local tax administration to cross-check the local return against the BEFIT Information Return information relevant to that entity and assess its BEFIT members' tax liability.[60] As in the BEFIT procedure, the filing starts at the level of the ultimate group parent and is passed down to the individual entities of the BEFIT group.

2.3.4. Critical remarks not referring to a specific section of the proposal

2.3.4.1. Reliance on accounting standards for definitions that are normally set by law

2.3.4.1.1. The link to accounting standards

The original CCCTB did not draw a link with or refer to any specific accounting system nor to the EU mandatory accounting system already in place since 2002.[61] While Member States would have maintained their national rules on financial accounting, the CCCTB system would have introduced autonomous rules for computing the tax base of companies.[62]

As such, it did not refer to the EU Accounting system based on the International Accounting Standards and the International Financial Reporting Standards [hereinafter IAS/IFRS]. Whether reference to these standards was to be applied was reconsidered, but dismissed in 2006.[63] However, during the preparatory work of the common tax base, it was agreed that, since IAS/IFRS provide a common (accounting) language and some common definitions, it should be used as a tool to aid the design of the base.[64]

Under this approach, only those elements of these international standards considered useful would be imported into the CCCTB, but there would be no direct formal link with the

[59] See Art. 57 of the proposed Directive.
[60] See Art. 64 of the proposed Directive.
[61] Regulation (EC) No 1606/2002 of the European Parliament and of the Council of 19 July 2002 on the application of international accounting standards, (OJ L 243, 11.0.2022, p. 1).
[62] *COM(2011) 121 final*, p. 5.
[63] *COM(2006) 157 final*, p. 7.
[64] *COM(2006) 157 final*, p. 7. See also *Terra/Wattel, European tax law*, p. 225. T. Neale, *CCCTB: how far have we got and what are the next steps*, in *Common Consolidated Tax Base*, 40-41 (Lang, Pistone, Schuch, Staringer: Linde Verlag Wien, 2008), Series on international tax law 53.

(IAS/IFRS). The rationale for this approach appeared to stem from the purported continuous change of these standards (IAS/IFRS).[65]

The BEFIT approach appears to differ from the CCCTB since the BEFIT tax base would primarily be based on existing financial accounting rules, which are either those already accepted under Union law as the national generally accepted accounting standards (GAAP) of the Member States or the International Financial Reporting Standards (IFRS). Hence, unlike the CCCTB approach, BEFIT provides a direct link to the accounting standards.

2.3.4.1.2. Ramifications relating to the legality principle

In the authors' view, the reliance on financial accounting standards under BEFIT, although constituting an improvement, might still raise some concerns. On the one hand, there might be similar downsides as those already expressed during the deliberations on the original CCCTB proposal with regard to the introduction of a direct formal link to the constantly changing standards. This would be the case where definitions contained in the accounting standard in force were to be subsequently amended. In such a case, the new definition would apply automatically, regardless of any action by the EU legislator. Beyond the more straightforward legitimacy issues, this could create practical problems if an amendment occurs during the fiscal year. It would be beneficial for the BEFIT Directive to provide the relevant timing rule for such eventualities, for example, to require that it would be the relevant standards in force on the last day of the previous tax year that would be applied.

On the other hand, since financial accounting standards like the IFRS are financial accounting rules set forth to regulate goals other than tax legislation, reconciliation between tax rules and financial accounting standards will be needed. The EU Commission acknowledges this as the conditio sine qua non for fostering real simplification.[66] However, it is not clear how this goal would be achieved in practice. This might lead to uncertainty and mismatches between tax and financial accounting standards concepts.

Furthermore, while for the calculation of the preliminary tax result, the proposed Directive clearly relies on the financial accounting standards,[67] the proposed Directive would not do the same for the purposes of defining its terms. On the contrary, from this perspective, the text seems to adopt a case-by-case approach. This would emerge from the fact that when the proposed Directive wishes to define a concept pursuant to the financial accounting standards, it makes express reference to them.[68] A contrario, one could argue that where such an express remand is missing, terms' definitions should not be found in said standards but rather either according to domestic law or as autonomous concepts of EU law.

In the authors' view, the lack of common definitions, clear concepts, and overlaps between divergent definitions might undermine the legality principle and legal certainty, thereby frustrating the simplification objective. Therefore, the authors suggest that the direct link to the financial accounting standards be further clarified to avoid diverging interpretations, conflicting applications and further fragmentation.

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[65] *COM(2006) 157 final*, p. 7. See also *Terra/Wattel, European tax law*, p. 225.
[66] See para. 10 of the Preamble to the proposed Directive.
[67] See Explanatory Memorandum of the proposed Directive, p. 6, Recital 10 and Art. 4.
[68] See Art. 3(1)(a) of the proposed Directive.

2.3.4.1.3. Implications for tax certainty

The most complex challenge faced by the European Commission in introducing a new directive for a common corporate income tax framework is the need for conceptual clarity and consistency with its underlying goals. Failure to do so will create numerous legal interpretation and application problems, which undermine certainty and dramatically reduce the positive impact of the initiative.

Even though the proposed BEFIT Directive's scope, target and nature seem clear in theory, in practice, they are not.[69] For instance, although the proposal defines several key concepts, in some cases, the drafters have failed to provide a clear definition. Examples of undefined concepts include: 'direct business interest',[70] 'corporate tax law',[71] or 'arm's length principle'.[72] With reference to the 'arm's length principle', the Commission seems to rely on the foreseeable adoption of both this proposed Directive and the proposed TP Directive. However, it might happen that while one is adopted, the other is not. Since they are separate pending legislative proposals, they should be able to function autonomously from one another.[73]

Another example is the very notion of 'corporate tax law' to which the proposed Directive refers without including any more precise reference of whether it also comprises procedural matters. This might create legal uncertainty for some interpreters as to the potential implication of this clause for the procedural rules of corporate tax.[74]

The authors understand that the drafting of some of the provisions might have been prompted by the need to reach a compromise on technical content to improve the chance for unanimous approval by the Member States. However, the authors suggest further enhancing the proposed Directive's text with more focused attention to its legal implications before submitting the final version.

2.3.4.2. Inclusion of new (autonomous) concepts with no guidance for interpretation

Although the proposed Directive defines several key concepts, in some cases, the drafters have failed to provide a clear definition. In that regard, it must be noted that the Court has consistently held that it follows from the need for uniform application of EU law, and from the principle of equality that the terms of a provision of EU law which makes no express reference to the law of the Member States for the purpose of determining its meaning and scope must normally be given an autonomous and uniform interpretation throughout the European

[69] Merely as an example, already with regard to the relaunched CCCTB the point was raised that doubt could arise as to the proper interpretation of rules delineating the scope of the directive. In particular, it has been outlined that while the directive stipulates that it applies "in respect of all matters regulated by this Directive" (see Art. 1(2) *COM(2016) 683 final*, now Art. 1(3) *COM(2023) 523 final*). *A contrario* this would mean that the national corporate income tax would still be relevant for issues not regulated by the directive. Hence, the use of the expression 'matters regulated' leaves space to ambiguity when determining whether a certain matter is to be considered as regulated or not. (see *Terra/Wattel, European tax law*, p.224).

[70] See sec. 4.1.3. of this study.

[71] See sec. 5.4.2.3. of this study.

[72] See sec. 6. of this study.

[73] Further examples on definition matters in sec. 5.4.2.3. of this study.

[74] Further examples on procedural matters in sec. 6. of this study.

Union, having regard to the context of the provision and the objective pursued by the legislation in question.[75]

However, autonomous concepts alone would not entirely resolve the problems related to the lack of legal definitions and the ambiguity and conflicting interpretations that follow. Ensuring consistency in such a framework requires constant intervention by the CJEU that needs to be prompted by domestic courts and, in any event, would lead to a lag of years, if not decades, before a somewhat consistent interpretation is achieved.

If a term lacks a clear (or any) definition, the interpretative uncertainty will lead to fragmentation in the approaches of domestic administrative authorities and courts. If terms are not properly defined, disagreements between taxpayers and tax authorities might result in national court decisions. This could lead to several contradictory decisions among different courts of different Member States, which will be challenging to identify and apply in a framework aiming at consistent application.[76] Since this might lead to the directive having a different meaning and effect in the different Member States (at least until the CJEU intervenes), the tax base might end up being determined according to several different rules, thereby failing to enhance homogeneity and clarity.

Finally, the question might be raised as to whether, although not defined or making any express reference to the law of the Member States for the purpose of determining the meaning and scope of a certain expression, a term must be given an autonomous and uniform interpretation throughout the Union or not, in the first place.[77]

The inclusion of new autonomous concepts with no guidance for interpretation might raise fundamental concerns that should be solved before adoption. Therefore, it would be advisable to update the proposed Directive with definitions of those concepts which might be subject to divergent interpretation and give rise to fragmentation, thereby frustrating the directive's aim to simplify access to the internal market by creating a clearer and simpler legal framework.

2.3.4.3. Ambiguity as to the competent central tax authority or organ

The approach of the fifth building block is that in order to achieve real simplification and enhance tax certainty, the common legal framework for corporate taxation would need to be accompanied by a parallel administration system which, by operating in a centralised

[75] See GR: ECJ, 12 Dec. 2013, Case C-116/12, Ioannis Khristodoulou, Nikolaos Khristodoulou, AFI N. Khristodoulou SA v. Greek State, Case Law IBFD, para. 34 and the case-law cited. One of the most renowned examples of the autonomous concepts can be found also in the European Court of Human Rights (ECtHR) jurisprudence and it relates to the notion of 'criminal charge'. In the landmark *Engel* judgment (NL: ECHR, 8 June 1976, Joined Cases 5100/71, 5101/71, 5102/71, 5354/72 and 5370/72, *Engel and others v. The Netherlands*), the ECtHR uphold the view that the meaning of 'criminal charge' under Article 6 ECHR is autonomous from domestic classifications (L. Mancano, *Judicial Harmonisation Through Autonomous Concepts of European Union Law: The Example of the European Arrest Warrant Framework Decision*, 43 European Law Review, pp. 69-88 (2018)). This often leads to controversies as to whether a measure would be criminal or not.

[76] R. Russo, *Ch. 5: CCCTB: General Principles and Characteristics*, in *CCCTB: selected issues*, 70 (D. Weber, Alphen aan den Rijn: Wolters Kluwer Law & Business ed., 2012).

[77] See also NL: ECJ, 10 November 2016, Case C-453/16, *Özçelik*, Case Law IBFD, para. 15; DE: ECJ, 10 Dec. 2020, Case C-488/18, Finanzamt Kaufbeuren mit Außenstelle Füssen v. Golfclub Schloss Igling e.V., Case Law IBFD, para. 23.

manner, would deal with several common issues otherwise spread among Member States. This is also pursued by promoting adequate cooperation and collaboration amongst the national tax administrations. This is pursued through the one-stop shop approach, which would allow the administration of common substantive rules through a common framework in the Union. Pursuant to the rationale of the proposed Directive, the simplification derives from a reduction in compliance obligations since the OSS would allow groups of companies to comply with the tax requirements of the proposed Directive through one single entity rather than obliging to filing in each Member State.[78]

Since cross-border issues usually require agreement between different Member States, they may often result in lengthy disputes or procedures. A common administrative framework would enhance legal certainty for businesses by allowing them to obtain certainty in advance on certain items.[79] That being said, such a centralised approach must be reconciled with the need to take into account the powers of Member States to intervene on matters that concern group entities situated in their territory, for example, with respect to (ideally multilateral) transfer pricing adjustments.[80]

Furthermore, questions would arise in practice as to the absence of a central organ at the EU level with clear competencies, especially regarding standard setting and coordination amongst the tax authorities of the EU Member States. Similarly, the authors underline that further clarity would be needed on the question of which tax authority would be competent to issue administrative guidance (such as orders, circulars, etc.) that relates to the functioning of the whole BEFIT group.

Finally, the proposed Directive clearly states that the “accounting standard to be used by the BEFIT group members for the purposes of calculating the primary tax result “shall be the acceptable accounting standard in the Union which is used in the preparation of the consolidated financial statements of the ultimate parent entity where the latter is resident for tax purposes in a Member State”.[81] If, on the one hand, this enhances centralization of administration, on the other, it would entail that BEFIT group members would be required to draw up accounts based on an additional set of rules. In the original 2011 CCCTB proposal, the Commission found this (so-called double) ‘bridge’ undesirable since it would have been unfriendly for SMEs, to which the original proposal was addressed. Although differing in context and the subjective scope of the proposed BEFIT Directive, administrative simplification might still raise similar concerns since, to channel centralization, businesses would need to afford additional compliance burdens at the level of the BEFIT group member.

[78] See Explanatory Memorandum of the proposed Directive, p. 5.
[79] See Explanatory Memorandum of the proposed Directive p. 5. While this is the overal intent of the proposed Directive, cfr. Sec. 6.
[80] See sec. 5.6.2. of this study.
[81] See Art. 7(2) of the proposed Directive.

3. Scope

3.1. Overview of the rules regarding the scope

The new common framework for corporate income taxation only applies to companies which, besides forming part of a group, meet strict requirements. They will be the so-called BEFIT group.[82] These requirements are spread across several articles of the proposed Directive and refer to elements of differing natures. The following paragraphs address each of the requirements in a more structured manner.

First, there are the requirements regarding each in-scope entity, which may be either a company or a permanent establishment. In respect of a company, it has to: i) be resident for tax purposes in a Member State;[83] ii) take one of the forms mentioned in annex I;[84] iii) be subject to one of the corporate taxes listed in annex II (or to a similar tax).[85] For permanent establishments, the proposed Directive only requires their location within the territory of one of the Member States. In defining a permanent establishment, the proposed Directive relies on existing double tax treaties and national rules.[86]

Second, there are requirements regarding the existence of a group, which requires a company to exercise control over another company or companies. The proposed Directive restricts the scope to: i) companies that are part of the same group, as defined in the applicable financial accounting standards (defined by reference to the control exercised by the ultimate parent);[87] ii) permanent establishments whose income or loss is included in the financial statements of one of the entities in-scope, excluding those that form part of more than one group in accordance with the applicable financial accounting standards.

Third, we find requirements regarding the revenue of the group. The Commission has opted for the so-called hybrid approach,[88] with BEFIT being: i) mandatory for (domestic or MNE) groups whose threshold exceeds 750 million EUR in at least two of the previous four tax years;[89] ii) optional for groups which prepare consolidated financial statements but do not meet such threshold.[90] There are specific rules for the threshold computation in specific scenarios.[91] The revenue threshold is also used to carve out from the mandatory scope groups with limited activity in the Union (less than 750 million EUR or EU revenue less than 5% of

[82] See Arts. 4 et seq. of the proposed Directive. However, it should be noted that, unlike the proposed CCCTB, the proposed BEFIT does not introduce taxation at group level.
[83] See Art. 2(1) first line, of the BEFIT proposed Directive, see supra n. 1.
[84] See Art. 2(1)(b)(i) of the proposed Directive.
[85] See Art. 2(1)(b)(ii) of the proposed Directive.
[86] See Recital 7 of the proposed Directive.
[87] Such requirement, although not explicitly mentioned as such, can be extracted from several provisions of the proposed Directive. It appears implicitly Art. 2(1)(b)(iii) as it lays down requirements regarding the Ultimate Parent Entity and the other companies of the group. It also results from the conjugation of art. 2(1)(a) which restricts the proposed Directive to domestic groups and MNE groups and art. 3(2) and 3(3) which define what such groups are, requiring companies to be part of a group, and art. 3(1)(a) which defines group as "a collection of entities which are related through ownership or control as defined by the acceptable financial accounting standard for the preparation of consolidated financial statements by the ultimate parent entity".
[88] See European Commission, Commission Staff Working Document, Impact Assessment Report accompanying the documents – Proposal for a Council Directive on Business in Europe: Framework for Income Taxation (BEFIT) and Proposal for a Council Directive on Transfer Pricing, Com(2023) 532 final, SWD(2023), 308 final, 12.09.2023, p. 12.
[89] See Art. 2(1)(a) of the proposed Directive.
[90] See Art. 2(7) of the proposed Directive.
[91] See Art.2(3) to (6) of the proposed Directive.

the overall revenue), insofar as their ultimate parent entity is resident in a third country. Finally, there is also the materiality threshold. The proposed Directive only applies to groups that consolidate for financial accounting purposes and, in case the ultimate parent entity, directly or indirectly, holds: i) 75% of the ownership rights; or ii) 75% of the rights giving an entitlement to profit[92] in the other companies in the group. Permanent establishments of in-scope companies will always qualify insofar as they belong to the parent company or any group company located in the EU.[93] This control must be held for at least two of the last four tax years.

The following sections are devoted to a critical assessment of the different requirements. The sections follow the pattern as above, namely section 3.2. will address the in-scope entities, 3.3. will address the aspect of control, and 3.4. will address the revenue threshold. The analysis in these sections is not considered comprehensive and aims to address only the regime's most critical features.

3.2. Requirements identifying the in-scope entities of the BEFIT group

3.2.1. Introduction

The BEFIT group may be comprised of either companies or permanent establishments. The authors will start by addressing requirements regarding companies (section 3.2.2.) and will only then focus on requirements regarding permanent establishments (section 3.2.3.).

3.2.2. Requirements regarding companies

3.2.2.1. Corporate tax form

Only companies following one of the corporate forms listed in the annex may be included in the BEFIT group.[94] This legislative option is not new and mirrors those already adopted in other corporate tax directives (i.e. the Parent-Subsidiary Directive,[95] the Interest and Royalty Directive [96] and the Merger Directive [97]).

However, the proposed Directive introduces a drastic change in what concerns the update of the annexes. It empowers the Commission to adopt delegated acts to amend the list of corporate forms. In the exercise of such power, the Commission must take account "of changes to the laws of the Member States concerning company forms".[98] This empowerment is not accompanied by any further guidance. This may lead to several issues.

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[92] See Art. 5(1)(a) of the proposed Directive.
[93] See Art. 5(1)(b) of the proposed Directive.
[94] See Art. 2(1)(b)(i) of the proposed Directive.
[95] Council Directive 2011/96/EU of 30 November 2011 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States (recast), OJ L 345, 29.12.2011, p. 8–16.
[96] Council Directive 2003/49/EC of 3 June 2003 on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States, OJ L 157, 26.6.2003, p. 49–54.
[97] Council Directive 2009/133/EC of 19 October 2009 on the common system of taxation applicable to mergers, divisions, partial divisions, transfers of assets and exchanges of shares concerning companies of different Member States and to the transfer of the registered office of an SE or SCE between Member States (Codified version), OJ L 310, 25.11.2009, p. 34–46.
[98] See Art. 2(8) of the proposed Directive.

First, the proposal merely "empowers" the Commission. An omission of action by the Commission (even after radical changes regarding corporate forms of a Member State are brought before it) will likely never amount to unlawful behaviour by the Commission and may never be scrutinised by the Court. One could wonder if the Court would take a different view if it was asked to ascertain the omissive behaviour of the Commission in light of the good management duty, as regulated by Article 41 of the EU Charter, which also contains an obligation to provide motivation in respect of all acts of EU institutions.

Second, neither the provision nor the annex list follows a principle-based approach as regards the inclusion of the selected corporate forms (nor is the empowerment to amend the list of corporate forms linked with any such approach). Accordingly, the meaning of "to take account of changes to the laws of the Member States concerning company forms" is uncertain and unclear, as is the direction the Commission must follow in exercising such power beyond mere discretion.

Third, the Court may be requested to scrutinise the validity and legitimacy of such delegation in view of its "essential elements" doctrine. The Court may check whether: i) the definition of the scope[99] may amount to an "essential element" of the act;[100] ii) there is a lack of determinacy regarding "not only the objectives but also the content, scope and duration of the delegation of power";[101] iii) the delegation enables "the Commission's use of the power to be reviewed [by the Court] by reference to objective criteria fixed by the EU legislature".[102] These components of the "essential elements doctrine" aim "to guard against the danger of the Union legislator abandoning its legislative function in favour of administrative rule making" and "protects the principle of democracy and the rule of law, in particular, the horizontal and vertical allocation of powers within the Union legal system".[103]

Fourth, the only meaningful result of the delegation appears to be to allow the Commission to force a Member State to enlarge the scope of BEFIT against its will. As this is a proposed Directive, it requires implementation by Member States who can implement the directive on its own terms or overimplement it, enlarging the scope of its application. Accordingly, both on implementation or at any later moment, any Member State may (domestically) enlarge the scope, covering corporate forms not (yet) listed in the annex. Other Member States and the Commission could object to the expanded scope and decide not to apply BEFIT to such companies. However, Member States would always be free to, alternatively, change their corporate law and adopt a new corporate form as an expansion of one of the forms currently mentioned in the annex, circumventing the ambit of the original scope. Therefore, the delegated power would only have *effect utile* if the Commission wants to change the scope of corporate forms in a Member State against the Member State's will. Such erosion of a Member State's sovereignty is something that is currently not admissible, as unanimity is still required for the adoption of any secondary acts in direct taxation.

[99] The definition of the corporate forms as a direct impact on ascertaining which companies fall (mandatorily) within the scope of the proposed Directive.

[100] Condition required in art. 290(1) TFEU for all delegated acts.

[101] See Judgment of 26 July 2017, *République Tchèque / Commission* (C-696/15 P) ECLI:EU:C:2017:595, para. 48.

[102] See Judgment of 26 July 2017, *République Tchèque*, supra n. 101, para. 49.

[103] See Turk, A. H. (2020). Legislative, Delegated Acts, Comitology and Interinstitutional Conundrum in EU Law - Configuring EU Normative Spaces. European Law Journal, 26(5–6), p. 419.

The list in Annex I introduces further elements that go beyond a mere reference to the corporate form. This raises some questions about the consistency of the adopted legislative technique, as it seems to contradict the main legislative text provision and the purpose of the annex.[104] Namely, the list in annex I includes: i) the form of computation of the domestic tax base;[105] ii) the company's activity;[106] iii) further requirements laid down in domestic law,[107] and; iv) whether the entity is subject to tax.[108] The latter, besides the potential overlap with the requirement enshrined in Art. 2(b)(ii) of the proposed Directive, may lead to additional uncertainty as the references to the tax are in English, whereas symmetrical references in the annex list to which 2(b)(ii) refers (i.e. Annex II) are in the national language.[109] Mismatches in future updates of either Annex I may also occur. This may raise the question of whether the Commission is empowered to change the annex not only by reference to a company form but also in what concerns those additional elements (even in what concerns the Member States whose forms currently do not include those elements).

The current shape of the content of annex I shows that the Commission likely left the Member States free to decide, on a casuistic basis and without the need to follow (intelligible) pre-determined criteria, which corporate forms would be admissible. Accordingly, certain company forms may qualify when incorporated and resident in one Member State, but not qualify in cases when being resident in another. Such a situation might produce a more significant impact on the exercise of fundamental rights and fundamental freedoms than the one that might prima facie appear based on the tax case law of the CJEU. That may amount to a breach of the prohibition of discrimination on the "grounds of nationality" and of the principle of equality, as enshrined in the EU Charter.[110]

The casuistic approach to delimitate the subjective scope, chosen by the proposed Directive, provides more certainty in what concerns the forms that qualify. That would not be the case of a principle-based approach, based on abstract criteria. In any case, nothing prevented combining a principle-based approach, with an annex with a white-list, with an inclusion of the corporate forms that would immediately qualify (i.e. a clarification of that principle-based approach).

In Gaz de France,[111] the Court noted that the exclusion from the scope of a directive (in that case, of the PSD) of a company not explicitly listed in an annex does not amount to an

[104] See Art. 2(b)(i) which clearly only refers to "forms".
[105] For instance, other Danish companies may also qualify insofar as "their taxable income is calculated and taxed in accordance with the general tax legislation rules applicable to 'aktieselskaber'" – see letter d) of Annex I of the BEFIT proposed Directive.
[106] For instance, Bulgarian companies will only qualify if, in addition to the form, carry on "commercial activities" – see letter c) of Annex I of the BEFIT proposed Directive. Other Italian companies may qualify whenever their activity is "wholly or principally commercial". One could question what companies would be cover in one State that would not be in the other and whether this would be fair in terms of the construction of a real internal market.
[107] See letters h) and m) of Annex I of the BEFIT proposed Directive.
[108] For instance, see letters f), i), j), k), p), s) t), and ab) of Annex I of the BEFIT proposed Directive.
[109] To ensure consistency, one would expect that either annexes followed the same approach, i.e. either translating in both or keeping the original names.
[110] See Art. 20 and 21(2) of the Charter of Fundamental Rights of the European Union, OJ C 326, 26.10.2012, p. 391–407 (BG, ES, CS, DA, DE, ET, EL, EN, FR, IT, LV, LT, HU, MT, NL, PL, PT, RO, SK, SL, FI, SV) and OJ C 326, 26.10.2012, p. 391–407 (GA).
[111] DE: ECJ, 1 Oct. 2009, Case C-247/08, *Gaz de France - Berliner Investissement SA v. Bundeszentralamt für Steuern*, Case Law IBFD.

infringement of the freedom of establishment[112] or of capital.[113] In such judgment, the Court further indicated that it would still be a task of Member States "to determine whether, and to what extent, economic double taxation of dividends is to be avoided and, for that purpose, to establish either unilaterally or through conventions concluded with other Member States, procedures intended to prevent or mitigate such economic double taxation".[114] This brought the Court to conclude that legal certainty prevents the interpretation of the annex as a mere indicative list (as such interpretation is not allowed in accordance with the wording).[115]

It is fully understandable that the Court might have been concerned with the potential implications for legal certainty of an open-ended judicial, which would enlarge the list of corporate forms in the absence of intelligible criteria in the annex. Nevertheless, this conclusion does not imply a general acceptance of the list-based casuistic approach, and should not prevent asking whether the Court would maintain its position under the current proposal.

Whereas in the previous corporate tax directives, Member States were in a position of, unilaterally, solve the discrimination issues raised by the list of the Annex (by applying to entities not covered in the Annex the regime foreseen in the Directive, as indicated by the Court) this is no longer the case under BEFIT since the filling Member State is not in a position of ascertaining what is a comparable corporate form under the laws of another Member State and, accordingly, unilaterally extend the regime of the proposed Directive. That fundamental difference may lead the Court to a different outcome from Gaz de France.

A principle-based approach, establishing criteria to define the features that a large enterprise must meet in order to be entitled to the application of the proposed Directive regardless of the country of its incorporation/seat or residence, would also be a better policy option from an equality perspective. Amending the proposed Directive in this direction would not necessarily require abolishing the annex, which could beget a mere declaratory function. In such context, the annex would only clarify the list of entities considered to meet those requirements, enhancing legal certainty as to the application of the BEFIT regime. Among others, the different function of the Annex I would also confine the EU Commission's power of amending the list within the boundaries of good management. Such function would be more consonant with the object and purpose of comitology and remove the strong power of affecting the entitlement to the application of the BEFIT regime that the EU Commission currently enjoys based on the current wording of the proposed Directive.

3.2.2.2. Being subject to a corporate income tax

The proposed Directive requires all BEFIT group members to be "subject to one of the corporate taxes listed in Annex II, or to a similar tax subsequently introduced".[116]

Such reference to a listing is similar to the legislative technique used in the supra-mentioned corporate tax directives.[117] However, there are two meaningful deviations in this

[112] See *Gaz de France*, supra n. 111, para. 61.
[113] See *Gaz de France*, supra n. 111, para. 62.
[114] See *Gaz de France*, supra n. 111, para. 37.
[115] See *Gaz de France*, supra n. 111, para. 38.
[116] See Art. 2(1)(b)(ii) of the proposed Directive.
[117] See supra, n. 95, 96 and 97.

proposed Directive, which give cause to question whether the legislator intended a different interpretative outcome.

The first deviation regards a possible exemption applying to companies. The other corporate tax directives only applied to companies with "no option of being exempt" from tax[118] or that were not "exempt".[119] In the authors' view, that should not lead to a different interpretation since the expression "subject to tax" (as opposed to "liable to tax") already excludes (subjectively) exempted companies. By contrast, and just to clarify, that does not exclude companies that, namely, due to losses, end up not paying tax in a given tax year.

The second deviation is with reference to the "update provision", namely that BEFIT applies immediately to any "similar tax" as subsequently introduced. The PSD and the Merger directive apply to "any other tax which may be substituted for any of those taxes"[120] without requiring similarity. The Interest and Royalty Directive requires the new tax to be "identical or substantially similar".[121] It would have been better to introduce the same standard for all directives, which, in the authors' view, should be aligned with the standard provided by the Interest and Royalty Directive. The latter uses the same wording as appearing in the OECD Model Convention[122] to address the same issue. Standard language would allow for a consistent and parallel interpretation of treaties and directives. It would also allow Member States to draw inspiration from the (foreign) case law regarding the interpretation of the treaty provision (which is far more abundant than the case law on the directives' provisions).

Under this delegated authority, the Commission is also empowered to amend the corporate tax list.[123] The remarks made in the previous section are, mutatis mutandis, applicable to such powers. Moreover, and in the presence of the "update provision", it is difficult to understand the effect utile of the power granted to the Commission beyond the clarification that a tax adopted by a Member State is "similar" to a previous tax. The provision's wording could be interpreted as meaning that the Commission is not bound by the requirement of "similarity", being thus able to enlarge[124] the objective scope by including in the BEFIT mechanism (existing) taxes, which are not currently listed, (further) eroding the sovereignty of Member States in direct taxation beyond what was unanimously agreed in the Council. One might argue that the objective scope (list of taxes) is one of the "essential elements" which would not allow modification through delegated acts.

The inclusion or exclusion of a corporate tax in the scope of the proposed Directive impacts not only the Member State in question but also the other Member States, at least during the transitional period.[125] Thus, one could argue that any list change, beyond the mere update

[118] See Art. 2(a)(iii) of the Parent-Subsidiary Directive, supra n. 95, Art. 3(c) of the Merger Directive, supra n. 97.
[119] Art. 3(2)(iii) of the Interest and Royalty Directive, supra n. 96.
[120] See Art. 2(a)(iii) of the Parent-Subsidiary Directive, supra n. 95, Art. 3(c) of the Merger Directive, supra n. 97.
[121] See Art. 3(2)(iii) of the Interest and Royalty Directive, supra n. 96.
[122] See OECD Model Tax Convention on Income and on Capital, art. 2(4) (21 Nov. 2017), Treaties & Models IBFD.
[123] See Art. 2(7) of the proposed Directive.
[124] Enlarge but not to restrict, since Member States could always over-implement the directive, including other taxes or change the existing corporate income tax acts to include new features or levies.
[125] In fact, the inclusion of another tax would enlarge the amount of taxes paid in the previous years and, accordingly, the share to be allocated to a Member State under Art. 45 of the proposed Directive.

to similar taxes, would require unanimity (at least, insofar unanimity remains the rule for adopting normative instruments in direct taxation).

3.2.2.3. Corporate residence

The proposed Directive applies only to "companies resident for tax purposes in a Member State".[126] Unlike the other corporate tax directives, BEFIT does not exclude companies which, in accordance with a tax treaty concluded with a third country, are considered residents in a third country.

The misalignment with such wording is welcomed. In fact, the references to bilateral tax treaties, particularly to those that adopted the two-tiered mutual agreement procedure (procedural approach) as recommended by the 2017 version of the OECD Model Convention[127] and the MLI[128] create additional interpretative issues which were comprehensively addressed by one of the authors of this study, in an autonomous contribution.[129]

The proposed Directive does not include any reference to tax treaties regarding company residency. According to the authors, tax treaties determine residency only for the purposes of tax treaty benefits between the bilateral pair that concluded the tax treaty. Therefore, the residence for tax treaty purposes does not affect the tax residence under domestic law for all other purposes, or potentially with respect to residency conflicts with other treaty partners over the same company. Thus, in the absence of an explicit exclusion of companies that, in accordance with a tax treaty, are considered residents in a third country, such companies will remain covered by the BEFIT regime.

Some issues may arise concerning the determination of a company's residency. The proposed Directive contains no criteria, making an (implicit) *renvoi* to domestic law. In many Member States, residence of companies is defined in the domestic corporate income tax act. However, the same proposed Directive determines that in-scope companies "shall cease to be subject to the national corporate tax law in all Member States where it is established in respect of all matters regulated by the Directive".[130] The most logical conclusion is that, insofar as the proposed Directive is silent as regards corporate residence, domestic corporate income tax rules are still applicable and in force. Moreover, Member States are free to amend such rules, regardless of the impact they may have in the application of this proposed Directive. Members States may, therefore, also continue to apply rules that are based on cumulative criteria.

Following such reading, a company may be considered a resident in more than one Member State. Even if that does not hamper the determination of the scope, it may raise difficulties in the application of many features of the regime, namely the allocation of the

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[126] See Art. 2(1) of the proposed Directive.
[127] See Art. 4(3) of the 2017 OECD Model Convention, supra n. 122.
[128] See Art. 4 of the OECD, Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base and Profit Shifting, 2017, OECD Publishing (hereinafter MLI).
[129] J.F.P. Nogueira, Dual residency of companies and EU law: accessing directive benefits with the post-2017 OECD Model Tax Convention wording, forthcoming.
[130] See Art. 1(3) of the proposed Directive.

BEFIT tax base.[131] In the absence of a tax treaty tie-breaker with a substantive rule between the Member States in question,[132] the issue may be left to a treaty's mutual agreement procedure[133] or to the Dispute Resolution Directive's procedure.[134] However, the issue may not receive an unequivocal or consensual answer in this case, even in comparable situations.

3.2.3. Requirements regarding permanent establishments

Permanent establishments will be part of the BEFIT group insofar as they: i) are located in a Member State;[135] ii) "belong to" one of the companies forming part of the "multinational enterprise group";[136] iii) are subject to one of the corporate taxes listed in the annex;[137] iv) are the PE of the ultimate parent entity as well as of any entity "whose assets, liabilities, income, expenses and cash flows shall be consolidated on a line-by-line basis by the ultimate parent entity".[138]

The proposed Directive aims at including within the scope all "taxable entities" of a group insofar as they are located in the EU, avoiding that the choice between exercising an economic activity through a subsidiary or a permanent establishment impacts its application. Such a proposal is aligned with the PE non-discrimination provision as enshrined in treaties[139] and with CJEU's case law.[140]

The definition of permanent establishment does not raise any added difficulties since the potentially applicable accounting standards tend to focus on the idea of a reporting entity. For instance, and merely for illustration, the International Financial Reporting Standards (hereinafter IFRS) consider that a permanent establishment can always be considered as a reporting entity, under paragraphs 3.10 to 3.14 of its Conceptual Framework.[141]

The Commission opted for the "pragmatic approach" of not defining permanent establishment, leaving such definition to domestic and tax treaty law.[142] The proposed lack of "full harmonisation through secondary Union law",[143] despite its numerous advantages, has the disadvantage of providing a different treatment of similar or comparable realities, even within the same Member State, for the mere fact that those realities are covered by different tax

[131] Under section 2 of chapter III of the proposed Directive, both during the transitional period as in period thereafter.
[132] Such as the "place of effective management", as recommended by the OECD until 2017.
[133] As regards those provisions following Art. 25 of the 2017 OECD Model Convention, supra n. 122.
[134] Council Directive (EU) 2017/1852 of 10 October 2017 on tax dispute resolution mechanisms in the European Union, OJ L 265, 14.10.2017, p. 1–14.
[135] See Art. 2(1) of the proposed Directive.
[136] Idem.
[137] See Art. 2(c)(i) of the proposed Directive.
[138] See Art. 2(c)(ii) of the proposed Directive.
[139] Following the pattern of Art. 24(3) of the 2017 OECD Model Convention, see supra n. 122.
[140] Namely cases requiring equal treatment between subsidiaries and permanent establishments, as decided by the Court in "*Avoir Fiscal*", *Saint Gobain* and subsequent cases. See FR: ECJ, 28 Jan. 1986, Case 270/83, *European Commission v. French Republic*, Case Law IBFD and DE: ECJ, 21 Sept. 1999, Case C-307/97, *Compagnie de Saint-Gobain, Zweigniederlassung Deutschland v. Finanzamt Aachen-Innenstadt*, Case Law IBFD.
[141] See the Conceptual Framework for Financial Reporting, as issued by the International Accounting Standards Board in September 2010 and revised in March 2018.
[142] See para. 7 of the Preamble of this proposed Directive.
[143] Idem.

treaties. This breach of equality may be considered permissible by the Court.[144] In fact, the different tax treatment of comparable realities (one being considered a PE and the other not) may deem those realities as non-comparable to ascertain the compatibility of the domestic provision with fundamental freedoms. However, it may not be the best solution to ensure equal (tax) treatment within the internal market.

Bilateral tax treaties still differ significantly as regards the attribution of profits to permanent establishments. Nevertheless, the proposed Directive appears to unify the determination of the PE's taxable base, considering it either the income or loss "reflected on its own separate financial accounts" or, in their absence, "the net income or loss that would have been reflected in its separate financial accounts, if they had been prepared on a standalone basis"[145]. In both cases, the applicable acceptable accounting standard rules would apply.[146] This determination appears to be aligned with the so-called OECD-authorised approach.[147] However, this may lead to mismatches with the profit (or loss) attributable to the permanent establishment under the applicable bilateral tax treaty (many of which do not follow the abovementioned approach).[148]

This conflict between EU law and tax treaties needs to be addressed carefully. The authors will start by addressing intra-EU scenarios (i.e. cases in which the conflict is with a treaty signed between the Member States) and instances with third countries (i.e. cases in which the applicable bilateral treaty is signed between an EU country and a third country).

For intra-EU bilateral tax treaties, the Directive[149] will have primacy over domestic law (including such bilateral tax treaties)[150] even in respect of treaties concluded before 1 January 1958 or before the State's accession.[151] This means that Member States must apply the BEFIT approach and disregard the approach under existing intra-EU tax treaties. While Member States would be under the obligation to amend their tax treaties to align them with the Directive, even those whose constitutional normative framework prevents "treaty overrides"[152] will need to comply with Union law, including during the interim period prior to the renegotiation. On the one hand, this follows from the fact that EU law also has primacy over the constitutional laws of its Member States.[153] On the other hand, the authors argue that, in intra-EU instances, there can never be a 'treaty override' since both Member States that are parties to the tax treaty are

[144] See NL: ECJ, 5 July 2005, Case C-376/03, *D. v. Inspecteur van de Belastingdienst/Particulieren/Ondernemingen buitenland te Heerlen*, Case Law IBFD and AT: ECJ, 10 Feb. 2011, Case C-436/08, *Haribo Lakritzen Hans Riegel BetriebsgmbH and Österreichische Salinen AG v. Finanzamt Linz*, Case Law IBFD.
[145] See Art. 7(3)(a) and (b) of the proposed Directive.
[146] See Art. 7(1) and (2) ex vi art. 7(3).
[147] See OECD (Centre for Tax Policy and Administration), Report on the Attribution of Profits to Permanent Establishments, 17 July 2008 and See OECD (Centre for Tax Policy and Administration), Report on the Attribution of Profits to Permanent Establishments, 22 July 2010.
[148] See the treaty provisions following Art. 7 of the 2017 OECD Model Convention, see supra n. 122 or of a prior version.
[149] One of the instruments of secondary law, under Art. 288(3) of the TFEU.
[150] See Judgment of 5 February 1963, *Van Gend en Loos / Administratie der Belastingen* (26/62, ECR 1963 p. 1) ECLI:EU:C:1963:1, DE: ECJ, 17 Dec. 1970, Case 11/70, Internationale Handelsgesellschaft mbH v. Einfuhr- und Vorratsstelle für Getreide und Futtermittel, Case Law IBFD.
[151] See Judgment of 27 September 1988, *Matteucci / Communauté française de Belgique* (235/87, ECR 1988 p. 5589) ECLI:EU:C:1988:460, para. 21.
[152] See E. Kemmeren, Principle of Origin in Tax Conventions – A Rethinking of Models, 2001, pp. 233-234.
[153] See Judgment of 17 December 1970, *International Handelsgesellschaft*, 11/80, EU:C:1970:114, para. 3.

‘under a duty to facilitate the application of the [EU law] provision and, to that end, to assist every other Member State which is under an obligation under Community law.’[154]

With reference to treaties with third countries, the situation requires further analysis. In this case, the EU Member States would be under the obligation of amending the treaty to bring them in line with EU law. In any case, and from the taxpayer's perspective, we would have to distinguish between treaties concluded before 1 January 1958 or, for non-founding Member States, between treaties concluded before and after their accession. Only the former treaties are not affected by the provisions of EU law,[155] including supervenient secondary law.[156]

Accordingly, a pre-1958 or pre-accession bilateral tax treaty with a third country may be invoked (and claimed under a domestic court) to prevent the functioning of Art. 7 of the BEFIT proposed Directive as envisaged since the only taxable base that BEFIT could capture would be the profit that, under the treaty’s provisions, would be attributable to the Member State under the rules of the tax treaty. It would be doubtful whether the domestic court would have the possibility of submitting a preliminary question to the CJEU, since the only legal provision that would require assessment would be a tax treaty provision. In any event, domestic courts would be positioned to submit preliminary questions on the correct interpretation of the scope under Article 351 TFEU.

In contrast, as regards treaties concluded after the accession, EU law (including supervenient EU law) prevails.[157] Regarding such treaties, Member States are obliged to “take all appropriate steps to eliminate the incompatibilities established”,[158] which, in this case, would be to re-negotiate or to terminate the treaty. However, before such alignment occurs (should a new treaty be negotiated or a protocol to amend the old treaty be concluded), the situation may lead to double taxation (which could also occur if the treaty were to be terminated) and double non-taxation. If the allocation of profits to PEs differs from the one resulting from Art. 7 of the proposed Directive, the third-country contracting state (where the Head Office is resident) will only consider the profit attributed to the Permanent Establishment (in the EU Member State) as foreseen in the treaty. Any other computation will not be considered as an amount that “may be taxed in the Other Member State in accordance with the provisions of th[e] Convention”,[159] and, accordingly, relief (by means of exemption or credit) does not need to be provided by that third-country.

3.3. Requirements regarding control

3.3.1. Introduction

[154] See by analogy the findings of the Court in Judgment of 27 September 1988, *Matteucci / Communauté française de Belgique* (235/87, ECR 1988 p. 5589) ECLI:EU:C:1988:460, para. 19.
[155] According to Art. 351(1) TFEU.
[156] See Judgment of 2 August 1993, *Ministère public and Direction du travail et de l'emploi / Levy* (C-158/91, ECR 1993 p. I-4287), (SVXIV/I-295 FIXIV/I-329) ECLI:EU:C:1993:332, para. 16 to 19.
[157] According to the Court “If, therefore, the application of a provision of Community law is liable to be impeded by a measure adopted pursuant to the implementation of a bilateral agreement, even where that agreement falls outside the field of application of the Treaty, every Member State is under a duty to facilitate the application of that provision and, to that end, to assist every other Member State which is under an obligation under Community law.” – See *Matteucci*, supra n. 68, para. 19.
[158] See Art. 351 TFEU.
[159] See Art. 23-A(1) and 23-B(1) of the 2017 OECD Model Convention, supra n. 122.

The second cluster of requirements refers to the control of an entity over other entities, which enables the plurality of entities to be considered a group.[160] Such a group covers both the ultimate parent entity[161] and the companies whose "assets, liabilities, income, expenses, and cash flows shall be consolidated on a line-by-line basis by the ultimate parent entity".[162] It also covers the permanent establishments of both.[163]

There is a two-tiered definition of control. Initially, the proposed Directive refers to control under the applicable financial accounting standards. At a later stage, it adds qualified control with reference to ownership or profits. The following two sections will deal with each one of those tiers separately.

3.3.2. Control according to the applicable financial accounting standard

To define the scope, one has to start by identifying the entities that are part of a group according to the applicable financial accounting standard.

A group is loosely described as a collection of entities "as defined by the acceptable financial accounting standard for preparing the consolidated financial statements".[164] There is a clear renvoi to the applicable "acceptable accounting standard in the Union"[165] with the sole limitation that entities (in this case controlled entities - subsidiaries and permanent establishments) excluded solely on their "small size, on materiality grounds or on the grounds that [they are] held for sale" shall be again included. Such limitation reaffirms the traditional rejection, in tax law, of the materiality standards adopted by accounting standards. For the purposes of the proposed Directive, both domestic[166] and MNE groups[167] qualify.

The level of control that the ultimate parent entity[168] exercises over the other group entities[169] for them to be captured under BEFIT must be found in the applicable financial accounting standard. In respect of the IFRS, this is found in IFRS 10 on Consolidated Financial Statements[170] and requires the following steps: i) determining the power over the relevant activities which may be achieved through voting rights or otherwise; ii) assessing whether the investor is exposed to variability of returns from its involvement with the investee, comprising debt/equity interests and other interests, and; iii) assessing the linkage between power and returns, comprising both the "fund managers" and decision-makers other than "fund managers".[171]

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[160] See Art. 2(1)(b)(iii) in what concerns companies and Art. 2(1)(c)(ii) in what concerns permanent establishments, both from the proposed Directive.
[161] See Art. 2(1)(b)(iii) and Art. 2(7) of the proposed Directive.
[162] See Art. 2(1)(b)(iii), of the proposed Directive, last segment.
[163] I.e. the permanent establishments of the Ultimate Parent Enterprise and of the companies forming part of the group.
[164] See Art. 3(1)(a) of the proposed Directive.
[165] See Art. 3(11) of the proposed Directive.
[166] See Art. 3(2) of the proposed Directive.
[167] See Art. 3(3) of the proposed Directive.
[168] Which needs to be a company listed in the annex if resident in the European Union and may be any entity if resident in a third country.
[169] Which can only become BEFIT group members in case they are companies (subsidiaries of the ultimate parent or of one of the entities controlled by the ultimate parent) or permanent establishments.
[170] More precisely on paragraphs 10.6 to 10.9 of the IFRS 10 on Consolidated Statements.
[171] Idem.

3.3.3. Qualified control regarding ownership or profits

Subsequent to the application of tier 1 (described above), the proposed Directive restricts the scope to cases in which the ultimate parent enterprise exercises “qualified control”, which is defined, disjunctively, as the direct or indirect holding of: i) 75% of the ownership rights, or; ii) 75% of the rights giving entitlement to profit. Permanent establishments will only qualify insofar as they belong to the ultimate parent or an entity controlled by the ultimate parent at that level of qualified control.

The computation of the right to profit of the ultimate parent entity in multi-tiered group structures[172] raises interpretative issues. The proposed Directive states that the computation of “the ownership rights and the rights giving entitlement to profit in a company (…) shall be calculated by multiplying the interests held, directly and indirectly, at each tier”.[173] The concept of “interests” is not defined by the proposed Directive, and it is not clear whether it refers solely to “ownership interest”[174] (in which case only ownership percentages would be computed) or if it also refers to an “interest” on the “rights giving entitlement to profit”. In the latter case, the underlying computation could be questioned. If all of the group members are the beneficial owners of the right to profit,[175] each one would have the freedom to decide whether or not such profit would be distributed to the higher tier.[176] The authors consider that the Commission should further clarify if the concept of “interests”, as used in the last segment of Art. 5(2), refers only to ownership interests or also to interests in the rights giving entitlement to profit.

Neither the proposed Directive nor the impact assessment report offer an explanation for this qualified control requirement, which hampers the assessment of whether such threshold is in accordance with the pursued rationale. The threshold was not included in the GMT Directive,[177] which makes it harder to achieve the envisaged goal of ensuring that the application of BEFIT is “aligned as closely as possible with the Two Pillar approach” and, in particular, to “ensure coherence with the Pillar II directive”.[178]

It is difficult to understand the reasons for excluding, from the BEFIT scope, companies falling below one of the two thresholds. Accordingly, and following the wording, a company would be a BEFIT group member if the ultimate parent has 75% of the rights giving entitlement to profit, regardless of any shareholding (which is relatively easy to achieve through a shareholders agreement between the group and non-group shareholders). In contrast, a company would never be included even if the ultimate parent held, cumulatively, 74% of the ownership rights and 74% of the rights giving entitlement to profit. The latter appears to be more closely integrated into the economic ability of the overall group than the former, which

[172] Under Art. 5(2) of the proposed Directive.
[173] Idem.
[174] As defined by Art. 2(8) of the proposed Directive.
[175] In the sense that this concept is used in the 2017 OECD Model Convention on Income and Capital and as (loosely) defined in the commentaries to Art. 10, see supra n. 122.
[176] Of course, the majority shareholder can always dismiss the members of the managing body in a general assembly. Notwithstanding, the power to decide whether or not to distribute profits remains at the level of the managing body.
[177] 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, ST/8778/2022/INIT, OJ L 328, 22.12.2022, p. 1–58.
[178] See Explanatory Memorandum of the proposed Directive, p. 6.

could be one of the underlying reasons for the application of the common framework for corporate income taxation. Moreover, the high threshold leaves many associated enterprises outside the scope of the BEFIT group, thereby creating significant potential for profit shifting for the purposes of manipulating the relative weight of units in the application of the allocation formula, a matter further discussed hereinafter in this study.

One may wonder whether this disjunction between ownership and profit participation may lead to claiming protection under the free movement of capital and payments, which, according to the TFEU, also applies to relations with third countries.[179] In fact, it would lead to integrating, as a BEFIT group member, a company insofar as 75% or more of the rights giving entitlement to profit were held (directly or not) by the ultimate parent enterprise. In case such 75% entitlement is not accompanied by a shareholding, allowing the exercise of a "definite influence" over the company's decisions and to determine its activities, in the sense as this expression received in Baars[180] and subsequent case law. That being the case, and following the "purpose of the national legislation" approach,[181] BEFIT would not only apply to "definite influence" cases but also to other situations.[182]

The answer to this question is not straightforward, since the Court has never defined a threshold according to which a (share)holding is considered as granting "definitive influence". In fact, "while investment in a branch generally triggers article 49 of the TFEU[183] and the Court's case law seems to imply that holding requirements of 100%,[184] 90%,[185] 75%,[186] 66.66%,[187] 65%,[188] more than 50%,[189] exactly 50%,[190] 34%[191] or even 25%[192] will also trigger

[179] See Art. 63 of the TFEU.
[180] NL: ECJ, 13 Apr. 2000, Case C-251/98, *C. Baars v. Inspecteur der Belastingen Particulieren/Ondernemingen Gorinchem*, Case Law IBFD.
[181] See, for instance, PT: ECJ, 3 Oct. 2013, Case C-282/12, *Fazenda Pública v. Itelcar - Automóveis de Aluguer*, Lda, Case Law IBFD, paras. 16 to 18.
[182] For a similar argument regarding the free movement of capital and its application to ATAD's CFC rule see I. Lazarov, Chapter 5: Harmonization of Anti-Avoidance Measures: Compatibility with the General Principle in Anti-Tax Avoidance in Corporate Taxation under EU Law: The Internal Market Narrative (IBFD 2022), Books IBFD.
[183] *Stahlwerk Ergste Westig* (C-415/06), para. 14 et seq. However, investments in partnerships may also be covered by art. 63 TFEU; see for intra-EU situations, for example, DE: ECJ, 6 Dec. 2007, Case C-298/05, *Columbus Container Services BVBA & Co. v. Finanzamt Bielefeld-Innenstadt*, ECJ Case Law IBFD and AT: ECJ, 23. Jan. 2014, Case C-164/12, *DMC Beteiligungsgesellschaft mbH v. Finanzamt Hamburg-Mitte*, ECJ Case Law IBFD.
[184] NL: ECJ, 13 Apr. 2000, Case C-251/98, *C. Baars v. Inspecteur der Belastingdienst Particulieren/Ondernemingen Gorinchem*, para. 21, ECJ Case Law IBFD; DE: ECJ, 5 Nov. 2002, Case C-208/00, *Überseering BV v. Nordic Construction Company Baumanagement GmbH (NCC)*, para. 70, ECJ Case Law IBFD; NL: ECJ, 7 Sept. 2006, Case C-470/04, N *v. Inspecteur van de Belastingdienst Oost/kantoor Almelo*, para. 24 et seq., ECJ Case Law IBFD; *ACT Group Litigation (*C-374/04), para. 39; *Test Claimants in the FII Group Litigation* (C-446/04), para. 37; *Aberdeen* (C-303/07), para. 33 et seq.; see also DE: ECJ, 6 Dec. 2007, Case C-298/05, *Columbus Container Services BVBA & Co. v. Finanzamt Bielefeld-Innenstadt*, para. 30, ECJ Case Law IBFD (concerning holdings in a partnership).
[185] *Oy AA* (C-231/05), para. 21 et seq.
[186] *Test Claimants in the Thin Cap Group Litigation* (C-524/04), para. 32 et seq.
[187] *Lasertec* (C-492/04), para. 23.
[188] *SGI* (C-311/08), para. 34 et seq.
[189] *Cadbury Schweppes* (C-196/04), paras. 6 and 32.
[190] *Burda GmbH* (C-284/06), para. 70.
[191] *SGI* (C-311/08), para. 34 et seq.
[192] *Lasertec* (C-492/04), para. 21 and *Scheunemann* (C-31/11), para. 25 et seq.

the exclusive application of article 49 of the TFEU, a holding requirement of 10% is not enough to exclude the application of article 63 of the TFEU".[193]

The Court may also follow a different approach and consider that control, as defined in the applicable financial accounting standards, is enough.[194] In that case, and per definition, there would be control in all BEFIT groups. However, that may not be the case, as the Court consistently refers specifically to the company's decisions and activities and takes into account the control over the company's corporate rights (shareholding).

In the authors' view, with its current wording, the BEFIT proposed Directive may risk being assessed in the framework of the free movement of capital[195] since it applies to situations other than those granting, necessarily, definite influence. This may lead to the risk of an enlargement of its scope (much beyond its object and purpose) to third-country scenarios.

3.4. Requirements regarding the revenue of the group

3.4.1. Introduction

The proposed Directive also refers to the revenue of the group. First, to limit the mandatory scope to those companies earning above a certain threshold. Second, to limit the mandatory scope of groups controlled by a non-EU parent to those whose revenue in the Union falls below certain thresholds. The following two sections address each one of these revenue-related requirements.

3.4.2. Combined revenue above a certain threshold

The proposed Directive only applies mandatorily to groups whose annual combined revenues are equal to or exceed 750 million EUR in at least two of the last four tax years.[196] There are also specific rules for cases of mergers,[197] acquisitions,[198] demergers,[199] and for tax years not matching with a 12-month period.[200]

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[193] See CFE ECJ Task Force, Opinion Statement ECJ-TF 1/2017 on the Decision of the Court of Justice of the European Union in SECIL (Case C-464/14) Concerning the Free Movement of Capital and Third Countries, 57 Eur. Taxn. 4 (2017), Journal Articles & Opinion Pieces IBFD which refers, in what concerns 10% shareholdings the the CJEU rulings in AT: ECJ, 10 Feb. 2011, Case C-436/08, *Haribo Lakritzen Hans Riegel BetriebsgmbH and Österreichische Salinen AG v. Finanzamt Linz*, Case Law IBFD, para 36, PT: ECJ, 3 Oct. 2013, Case C-282/12, Fazenda Pública v. Itelcar - Automóveis de Aluguer, Lda, Case Law IBFD, para. 22, DE: ECJ, 11 Sept. 2014, Case C-47/12, *Kronos International Inc. v. Finanzamt Leverkusen*, Case Law IBFD, para. 35 and PT: ECJ, 3 Oct. 2013, Case C-282/12, *Fazenda Pública v. Itelcar - Automóveis de Aluguer, Lda*, Case Law IBFD, para. 40.

[194] And, in what concerns the IFRS is further defined in IFRS 10, see supra n. 170.

[195] See Art. 63 TFEU.

[196] See Art. 2(1)(a) of the proposed Directive.

[197] See Art. 2(3) of the proposed Directive.

[198] See Art. 2(4) of the proposed Directive.

[199] See Art. 2(5) of the proposed Directive.

[200] See Art. 2(6) of the proposed Directive.

The threshold used for this proposed Directive is the same used in the framework of the GMT Directive and in the framework of both "private"[201] and "public"[202] Country-by-Country reporting. Such threshold became the consensual threshold, at least for direct taxation, for the delimitation of a Multinational Enterprise (group).

The discussion on the compatibility of such thresholds with European Union Law has already taken place in the context of the proposals for the EU Digital Services Tax[203] and of the proposal for a GMT Directive (i.e. the preceding text).[204]

The proposed Directive does not amount to direct discrimination since it applies not on the basis of nationality but on the basis of residence, and not only to cross-border groups but also to domestic groups, unrestrictedly.[205] It could amount to indirect discrimination since the effect of the application of the revenue-based threshold would be to factually limit the application to non-residents or to cross-border cases.

First of all, indirect discrimination would require evidence that BEFIT would lead (always or systematically) to a less favourable tax treatment of companies falling within its scope, which would be a tricky task. One could also try to argue on a "per-element" approach, examining a specific feature and deciding solely on the basis of such features. However, it is not clear whether the Court would adopt such an approach.

Secondly, the Court would have to accept a fact-based assessment of indirect discrimination. However, such an approach was explicitly rejected by the Court, namely in Vodafone,[206] where it concluded that a turnover-based threshold could be validly relied upon as a criterion for determining the scope of a tax measure since "on the one hand, the amount of turnover constitutes a criterion of differentiation that is neutral and, on the other, turnover constitutes a relevant indicator of a taxable person's ability to pay".[207] This was still the case if the effect of employing such a criterion was that "the actual burden of [the tax] is mainly borne by undertakings controlled directly or indirectly by nationals of other Member States or by companies that have their registered office in another Member State, due to the fact that

[201] See para. 4 of the section I of Annex III of Council Directive 2011/16/EU of 15 February 2011 on administrative cooperation in the field of taxation and repealing Directive 77/799/EEC, OJ L 64, 11.3.2011, p. 1–12, in this regard as amended by Council Directive (EU) 2016/881 of 25 May 2016 amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation, OJ L 146, 3.6.2016, p. 8–21.

[202] See Art. 48b of Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EEC and 83/349/EEC (Text with EEA relevance), OJ L 182, 29.6.2013, p. 19–76, as amended by Directive (EU) 2021/2101 of the European Parliament and of the Council of 24 November 2021 amending Directive 2013/34/EU as regards disclosure of income tax information by certain undertakings and branches (Text with EEA relevance), PE/74/2021/INIT, OJ L 429, 1.12.2021, p. 1–14.

[203] See, for instance, J.F.P. Nogueira, The Compatibility of the EU Digital Services Tax with EU and WTO Law: Requiem Aeternam Donate Nascenti Tributo, 2 Intl. Tax Stud. 1, sec. 4.3.2.2 (2019), Journal Articles & Opinion Pieces IBFD.

[204] See, from one of the authors of this study, J.F.P. Nogueira, GloBE and EU Law: Assessing the Compatibility of the OECD's Pillar II Initiative on a Minimum Effective Tax Rate with EU Law and Implementing It within the Internal Market, 12 World Tax J. 3, sec. 4.3.6, (2020), Journal Articles & Opinion Pieces IBFD.

[205] See Art. 2(1)(a) and Art. 3(2) of the proposed Directive.

[206] HU: ECJ, 3 Mar. 2020, Case C-75/18, *Vodafone Magyarország Mobil Távközlési Zrt. v. Nemzeti Adó- és Vámhivatal Fellebbviteli Igazgatósága*, Case Law IBFD.

[207] See *Vodafone*, supra n. 206, para. 50.

those undertakings achieve the highest turnover in the market concerned"[208] particularly when that is the result of the way in which the "market is dominated by such taxable persons".[209] The Court held that turnover does "not, inherently, create any discrimination, based on where companies have their registered office".[210]

One should note that the opt-in clause provided to companies that are not in-scope would not be sufficient to exclude a potential breach of EU law, under a fact-based approach to indirect discrimination. First, if BEFIT leads to a worse treatment, companies outside the scope would, despite being entitled, likely not opt for such a regime. Second, the Court appears not to grant relevance to the existence of optional regimes when assessing the compatibility of a certain measure with the EU. As it concluded in M.K.,[211] "a choice between a discriminatory tax regime (…) and another which would not be discriminatory (…) is not capable of excluding the discriminatory effects of the first of those two taxation regimes".[212] This also means that Member States must ensure that their domestic corporate income tax systems for groups non-eligible for BEFIT remain compatible with the Fundamental Freedoms. The option provided for such groups to opt for an EU-compliant system such as BEFIT would not mitigate the domestic regime's compatibility issues.

There are no indications regarding the reasons for the inclusion of an opt-in clause instead of the inclusion of an opt-out clause. If BEFIT is expected to "result in enhanced tax certainty and less tax disputes, as it would tackle distortions and decrease the number of cases of double and over-taxation", one can only wonder why this is not the default tax system for all consolidated groups, accompanied rather by an opt-out clause for companies below a revenue threshold. On the one hand, one could argue that the system makes more sense for companies that are already subject to other reporting obligations, namely under the previously mentioned GMT Directive and Private and Public Country-by-Country Reporting Directives. However, on the other hand, the data-gathering activities taking place in the framework of such directives are not that relevant for the purposes of BEFIT, which is mainly based on the consolidated financial accounts that have to be prepared by some companies. If the purpose is to avoid creating an extra procedural burden for groups, then it would be sufficient to exclude from the mandatory scope those companies which are not already under the obligation of preparing consolidated financial accounting reports. Such a step would ensure a more level playing field for competing businesses[213] and strengthen the internal market.

One should note that there is a mismatch between the scope of companies which are relevant for the purposes of the determination of the threshold (all group entities) and those to whom the regime will be applied (only group companies with residence in one of the Member States). This means that BEFIT, according to this rule alone, could be applied to groups with quite limited revenue in the European Union. For such reason, the proposed Directive includes an additional threshold, limiting its (mandatory) application to groups with EU presence below certain thresholds.[214] Regardless of the effectiveness of such limitations, one can immediately

[208] See *Vodafone*, supra n. 206, para. 56.
[209] Idem.
[210] See Vodafone, supra n. 206, para. 54.
[211] PT: ECJ, 18 Mar. 2021, Case C-388/19, *MK v. Autoridade Tributária e Aduaneira*, Case Law IBFD.
[212] See *MK v. Autoridade Tributária e Aduaneira*, supra n. 211, para. 42 and 43.
[213] As nothing prevents a MNE group to be in direct competition with a non-MNE group.
[214] Addressed in the next section.

question if, for the purposes of an EU law regime, relevance should be attributed to revenues obtained outside of the Union by companies not governed by EU law under accounting standards other than those applicable within the EU Member States, that is what happens outside of the EU should have relevance for the purposes of the normative tax framework for what happens (solely) inside the EU.

3.4.3. Revenue in the Union below a certain threshold: the materiality threshold

3.4.3.1. Introduction

The proposed Directive shall not apply mandatorily to a group whose combined revenues in the European Union "either do not exceed 5% of the total revenues for the group based on its consolidated financial statements or the amount of EUR 50 million in at least two of the last four fiscal years".[215] This is labelled in the preamble as the "materiality threshold".[216] The EU subset of such a group, if under the thresholds, would always have the possibility of opting in.[217]

Even if mostly theoretical, one should start by addressing the ability of Member States to obtain this information. Member States could always request the information from one of the group constituents that has residence in the European Union, which could claim that it has neither access to it nor the ability to force its ultimate parent to provide them access to the information. Secondly, and assuming that it is possible to get access to the information about the identity of the ultimate parent,[218] Members States may still not be able to obtain the information, as the parent could be located in a jurisdiction with which there is no mutual assistance.

The proposed Directive does not provide any guidance on the reasons for selecting each of the two thresholds, making it more difficult to assess the adequacy of the measure to pursue the underlying rationale.

3.4.3.2. Compatibility with the ownership non-discrimination clause in bilateral tax treaties and different treatment of third-country situations

The "EU materiality" requirements are set on a disjunctive basis, meaning that BEFIT does not apply, mandatorily, to companies not reaching either of the thresholds. Accordingly, and merely for the sake of illustration, if the combined revenues of the EU-subset are higher than 750 million EUR in the relevant years, but such revenues amount to less than 5% of the overall group revenue, then such EU-subset is not mandatorily covered. Taking into account the available economic data, that may not be a mere theoretical hypothesis. Therefore, the 5% revenue threshold appears to introduce a difference in treatment between comparable EU

[215] See Art. 2(2) of the proposed Directive.
[216] See paragraph 8 of the preamble of the proposed Directive.
[217] See Art. 2(2) last sentence and Art. 2(7) of the proposed Directive.
[218] Namely with the support of the registry of (ultimate) beneficial owners and with the entitlements provided to tax authorities in the framework of the Directive on Administrative Cooperation, supra n. 201, as amended by Directive Council Directive (EU) 2016/2258 of 6 December 2016 amending Directive 2011/16/EU as regards access to anti-money-laundering information by tax authorities, OJ L 342, 16.12.2016, p. 1–3.

subsets of groups (with the exact same revenue), depending on whether they are owned by an EU or by a third-country parent.

In addition, the second threshold (i.e. revenue above 50 million EUR in the relevant years) may also lead to a different treatment. In fact, the EU subset of EU groups will be mandatorily covered whenever their EU revenue is equal to or higher than 750 million EUR (in the relevant years), whereas the EU subset of non-EU parented groups would be mandatorily covered whenever their EU revenue is equal or higher than 50 Million (assuming that the overall group is above).[219] If one takes into account the EU subset as the benchmark for comparison (i.e. the BEFIT group, to which BEFIT will apply), then they will be treated differently depending on where the parent is located. This also means that, in certain cases, one is entitled to switch on and off the applicability of BEFIT by means of a reverse merger, placing a newly created parent inside or outside of the Union.

This may raise questions regarding the compatibility of the materiality provisions with bilateral tax treaties with third countries,[220] which include the so-called ownership non-discrimination clause[221] requiring equal treatment not only of the tax to be paid but also of "any requirement connected therewith which is other or more burdensome".[222] It is important already to stress that, for the purposes of this provision, the connected requirements (namely informational or tax returns) do not need to be more burdensome: there is discrimination insofar as they are different, provided that they lead to less favourable treatment.[223]

One could trigger the application of such a clause in many scenarios, which cannot be detailed at length in this study. To illustrate our reasoning in a fact pattern that is easier to understand, let us assume two companies (Co1 and Co2), both with a wholly owned subsidiary in the same Member State (Co3 and Co4, respectively), resident in the same Member State (MS1) that are entirely comparable as regards their revenue (which is 40 million EUR each, in the each of relevant years). The revenue of the subsidiaries is one million EUR each, in each of the relevant years.[224] Let us also assume that Co1 and Co2 are wholly owned by separate parent companies (Co5 and Co6, respectively), which are also comparable as regards their revenue (in both cases, higher than 750 million EUR in the relevant years), but are distinguishable as regards their residence. While Co1 is owned by Co5, resident in the same Member State (MS1), Co2 is owned by Co6, resident in a third country. In both cases, the group's overall revenue would meet the threshold. However, only in the first scenario would BEFIT be mandatorily applied. The default corporate tax system of the second group, in the

[219] Of course, provided that the other disjunctively applicable criterion does not apply, i.e. that the EU-revenue is exceeds 5% of the overall group revenue.
[220] As mentioned earlier, and following the TFEU, this would apply to treaties concluded after 1 January 1958 of post-accession treaties. See Art. 351 TFEU and the already cited case-law.
[221] Namely following Art. 24(5) of the 2017 OECD Model Convention, supra n. 122, or under Art. 24(5) of the 2016 US Model Convention.
[222] The provision, referred supra n. 221, states that "enterprises of a Contracting State, the capital of which is wholly or partly owned or controlled, directly or indirectly, by one or more residents of the other Contracting State, shall not be subject in the first mentioned State to any taxation or any requirement connected therewith which is other or more burdensome than the taxation and connected requirements to which other similar enterprises of the first-mentioned State are or may be subjected". One should note that in the treaties with the US, the provision refers only to a requirement is more burdensome.
[223] OECD Comm. 2017 to Article 24(5) of the Model Convention, para. 76.
[224] And that all other requirements of the proposed Directive are met.

absence of the exercise of any option, would not be BEFIT but the corporate income tax system of that Member state.

Similar issues may arise from the application of the 5% threshold. Again, let us assume two companies (Co1 and Co2), both with a wholly owned subsidiary in the same Member State (Co3 and Co4, respectively), resident in the same Member State (MS1) that are entirely comparable, as regards their revenue (which is 751 million EUR in the relevant years).[225] Let us assume that these companies are wholly owned by two separate parent companies (Co5 and Co6, respectively), which are completely comparable (as regards their revenue.

Regardless of whether BEFIT is more (or less) beneficial than the domestic corporate income tax regime applicable by default, in both cases, it would still introduce a requirement connected with taxation that is "other or more burdensome" than the requirement applicable to domestic groups: the option. The default regime, in the absence of an option, is different. This raises the issue of whether the exclusion of the mandatory scope foreseen for non-EU-owned groups is compatible with the ownership non-discrimination clause of the treaties and, subsequently, the consequences of such incompatibility.

One should start by acknowledging that the OECD Model Commentary clearly excludes from the scope of the provision "rules that take account of the relationship between a resident enterprise and other resident enterprises (e.g. rules that allow consolidation, transfer of losses or tax-free transfer of property between companies under common ownership)".[226] Thus, the treaty rule "cannot have the effect to force the State to allow such consolidation between a resident company and a non-resident parent company".[227] However, what is at stake is not the consolidation between a third-country parent and its subsidiaries resident in a Member State but merely the ability of the domestic subsidiaries to form a BEFIT group when they are fully owned by a third-country resident and not by a company resident of the same Member State.

In the latter scenario, the ownership non-discrimination provision comes into play. In fact, "in accordance with the text of article 24(5) of the OECD Model, it applies in all instances where a tax benefit is denied to foreign-owned resident enterprises on the basis of their foreign ownership. If those conditions are met, the provision should apply, even if the domestic measure at issue serves to take account of the resident enterprise's group status".[228] Accordingly, a company cannot fall under one default system solely due to the fact that it is owned by a third-country resident, whereas it would have a different default system if it was owned by a resident of the same country.

Assuming that the difference in treatment is incompatible with the treaty provision, one has to ascertain the consequences of such infringement. The conclusions are similar to those

[225] And that all other requirements of the proposed Directive are met.
[226] See Para. 77 of the OECD Model: Commentary on Article 24 (2017), see supra n. 122.
[227] Idem.
[228] N. Bammens & F.J.G.M. Vanistendael, Article 24: Non-Discrimination - Global Tax Treaty Commentaries, Global Topics IBFD, section. 2.5.1.2.2. See also J.F. Avery Jones et al., Art. 24(5) of the OECD Model in Relation to Intra-Group Transfers of Assets and Profits and Losses, 3 World Tax J. 2 (2011), Journal Articles & Opinion Pieces IBFD, G.F. Boulogne, Group Taxation within the European Union: Did Papillon and Art. 24(5) of the OECD Model Tax Convention Create a Butterfly Effect? 51 Eur. Taxn. 5, sec. 4.2. (2011), Journal Articles & Opinion Pieces IBFD. and A. Rust, Non-discrimination in: E. Reimer and A. Rust, Kaus Vogel on Double Taxation Conventions, Vol. II, fifth edition, Wolter Kluwer, 2022, p. 1953 and 1954.

mentioned above concerning the potential clash between the BEFIT provisions on the attribution of profits to permanent establishments and similar rules of bilateral tax treaties. It suffices to refer to what was already written above, which applies mutatis mutandis.

In addition, and given the considerable number of parent companies resident in the EU, one should particularly take account of pre-accession tax treaties concluded with the United States of America. Issues could arise, namely in the bilateral tax treaties with Cyprus,[229] Czechia,[230] Estonia,[231] Finland,[232] Latvia,[233] Lithuania, [234] Poland,[235] Romania,[236] the Slovak Republic[237] and Slovenia.[238]

If the Commission wants to move forward, there are several alternatives. One of them is to create a framework (multilateral) tax treaty specifically devoted to changing this clause and allowing the application of BEFIT as an exception to the ownership non-discrimination clause. For the above-mentioned reasons, it would be crucial to ensure that the United States is willing to enter into such an agreement. The second option (which, in the authors' view, is preferable) is to consider the EU subset as the benchmark. Accordingly, only the revenues allocated to the constituent entities resident or located within the European Union (the so-called EU subset) are taken into account. Application is triggered whenever such revenues exceed the pre-defined threshold (which could either be 750 million EUR or a lower threshold, for the reasons mentioned above). This would not be less aligned with the GMT Directive but more aligned with the regulations requiring consolidated financial accounts, which is the main procedural burden required of companies, in order to fall within the scope of BEFIT.

3.4.3.3. Materiality threshold and groups headquartered in the Union - worse treatment of EU situations

According to the Preamble of the proposed Directive, the materiality threshold aims at excluding from the scope cases "with limited activity in the internal market".[239] However, such

[229] See Art. 7(4) of the Cyprus-United States tax treaty signed in 9 March 1984 which refers to an "other or more burdensome requirement". The EU accession took place on 1 May 2004.
[230] See Art. 25(6) of the Czechia-United States tax treaty signed in 16 September 1993 which refers to an "other or more burdensome requirement". The EU accession took place on 1 May 2004.
[231] See Art. 24(4) of the Estonia-United States tax treaty signed in 15 January 1998 which refers to an "other or more burdensome requirement". The EU accession took place on 1 May 2004.
[232] See Art. 24(4) of the Finland-United States tax treaty signed in 21 September 1989 which refers to an "other or more burdensome requirement". The EU accession took place on 1 January 1995.
[233] See Art. 25(5) of the Latvia-United States tax treaty signed in 15 January 1998 which refers to an "other or more burdensome requirement". The EU accession took place on 1 May 2004.
[234] See Art. 25(4) of the Lithuania-United States tax treaty signed in 15 January 1998 which refers to an "other or more burdensome requirement". The EU accession took place on 1 May 2004.
[235] See Art. 21(3) of the Poland-United States tax treaty signed in 8 October 1974 which refers to an "other or more burdensome requirement". The EU accession took place on 1 May 2004.
[236] See Art. 22(3) of the Romania- United States bilateral tax treaty signed in 4 December 1973. The EU accession took place on 1 January 2007. The provisions refers to "other or more burdensome" requirements.
[237] See Art. 25(6) of the Slovak Republic-United States tax treaty signed in 8 October 1993 which refers to an "other or more burdensome requirement" which, unlike previously cited treaties, only refers to an "more burdensome requirement" requiring accessing if the treatment granted to capitals owned by enterprises of the other Contracting State are worse treated. The EU accession took place on 1 May 2004.
[238] See Art. 7(4) of the Slovenia-United States tax treaty signed in 21 June 1999. The accession took place on 1 May 2004.
[239] See para. 8 of the Preamble of the proposed Directive.

exclusion is only provided to groups whose parent company is resident outside of the Union, being denied to groups whose parent is headquartered in the Union.

One fails to understand the reasons justifying such different treatment, particularly taking into account that, in both cases (i.e. in cases where the parent is an EU resident and cases in which the parent is a third-country resident): i) only the EU-subset is going to be considered a BEFIT group member; ii) the chain of ownership of the EU-subset may, in both cases, include one or several entities which are non-resident in the Union.

Groups with limited presence in the Union, namely not meeting either of the thresholds foreseen in the proposed Directive, may still be covered even if they undeniably meet the preamble rationale for exclusion, i.e. "limited activity in the internal market".[240] This would be the case of a group with: i) a parent resident in one of the EU-Member States; ii) with the overwhelming majority of its activity taking place outside of the European Union through subsidiaries; iii) insofar as one of those subsidiaries has an (even if residual activity) subsidiary or PE in one of the EU Member States. Insofar as the combined revenue of the group outside of the Union is equal to or exceeds 750 million EUR, BEFIT would be mandatorily applicable to that EU parent company and that single non-EU subsidiary's EU subsidiary (or non-EU subsidiary's EU permanent establishment) even if their revenue (due to the correct application of transfer pricing regulations) is reduced or insignificant.

If the goal was to provide a materiality threshold, then this should be provided to all groups, taking into account their activity or revenues in the Union, without discriminating (and treating differently) groups whose parent entities are resident in one of the Member States that will never have the possibility of opting out even if the group activity or revenue in the Union is almost insignificant.

3.4.4. Extension of the scope to groups excluded from the mandatory scope

Groups excluded from the mandatory scope due to failure to meet one of the two thresholds mentioned in the previous sections can still opt for the application of BEFIT.[241]

Member States must provide such an option (which amounts to an EU entitlement as it will be foreseen in a Directive), following the principle of sincere cooperation, with limitations derived from the subprinciples of equivalence and effectiveness.[242] As interpreted by the Court, such a principle means that Member States will have a limited (and quite reduced) leeway in setting any conditions more than those that are needed for the proper functioning of the option from a procedural perspective.

It would have been better if the proposed Directive provided further regulation on such an option and on the automatic exchange of information with other Member States that may be affected by the exercise of such an option.

[240] Idem.
[241] See Art. 2(7) of the proposed Directive.
[242] See Art. 4(3) of the TEU.

4. Determination of the preliminary tax result

4.1. Determination of the “preliminary tax results”: a survey of notable issues

4.1.1. Preliminary remarks

The mandatory scope of the proposed Directive is limited to the Union sub-set of the large groups that are also within the scope of the GMT Directive, unless such large group is headquartered outside of the Union and has limited activity in the internal market (so-called “materiality threshold”).[243] Moreover, it is indicated that the new rules are “aligned as closely as possible with the Two-Pillar Approach”[244] so that, by uniformly applying BEFIT rules to in-scope groups, coherence with the GMT Directive would be ensured.

In light of the stated alignment, one of the fundamental goals of the proposed Directive is to leverage interaction with the GMT Directive framework and to minimise implementation costs.[245] In the view of the Commission, this goal would be best achieved by applying both the “BEFIT tax base”[246] and the “Pillar 2 minimum effective tax rate”[247] “at the same level, i.e. the Union group level”.[248] This alignment would also be facilitated with respect to compliance as both regimes “rely on financial accounting statements as a starting point” and “companies must apply the Union-wide tax adjustments for both”.[249]

In this respect, a parallel is made with Chapter III of the GMT Directive, which contains rules for the determination of ‘qualifying income’, i.e. the adjusted income that is taken into account for computing the effective tax rate for the purposes of the Income Inclusion Rule and the Undertaxed Profits Rule. Within the GMT Directive framework, the starting point is the financial accounting net income or loss of the constituent entity for the fiscal year as determined for preparing consolidated financial statements, to which adjustments are then introduced.

BEFIT adopts the same starting point and similarly operates on the basis of adjustments. These adjustments are similar in rationale to those envisaged within the GMT Directive framework. In this respect, Recital 9 of the Preamble to the proposed Directive stresses that the objective of simplifying the current rules underscores the envisaged initiative and envisages that the rules on the computation of the tax base should be built by applying a “limited series of tax adjustments”[250] to the financial statements of each group member. These limited

[243] As per Art. 2, Para. 4 of the Directive.
[244] See Section 2, p. 5 of the Explanatory Memorandum. In this respect Recital 6 of the Preamble to the proposed Directive states that: “considering the efforts that both tax administrations and businesses have made in order to implement the framework of a global minimum level of taxation, it would be important to capitalise on this achievement and design rules that remain as close as possible to the OECD/G20 Model Rules and Directive (EU) 2022/2523”.
[245] See Section 2, p. 6 of the Explanatory Memorandum.
[246] See Section 2, p. 5 of the Explanatory Memorandum.
[247] Ibidem.
[248] Ibidem.
[249] Ibidem.
[250] Compare Recital 9 of the Preamble to the Proposed Directive. It may be observed that the envisaged adjustments, although, on average, surely less pervasive than the adjustments required by the corporate tax laws of the Member States that rely on the so-called derivation principle for the determination of the corporate tax base are, nonetheless, rather impactful in their bearing on the resulting tax base. In this respect, the Impact Assessment observes that “[t]he list of such adjustments (e.g. tax depreciation, treatment of profit distributions, deductibility

adjustments would represent common adjustments necessary to convert the financial accounting statements into a tax base. In this respect, the same Recital expressly considers "the need for alignment with Directive (EU) 2022/2523" so that "the adjustments should resonate with that framework, which should also facilitate implementation for Member States and businesses that would already be familiar with the general principles".

As it will be illustrated further in the following subsections, while the proposed Directive appears to be inspired by this stated goal, the concrete implementation thereof seems to leave room, in more than one instance, for potential misalignments between the GMT Directive and the proposed BEFIT Directive's base determination rules which would have at least two broad issues:

i) on the procedural level, potentially duplicating the compliance burden for groups that would fall within the mandatory scope of application of both the GMT Directive and proposed BEFIT Directive regimes;
ii) on the substantive level, generate potential misalignments between BEFIT and Pillar II results that would need to be reconciled at some level.

The proposed Directive does not seem to address either in the form of the inclusion of rules of hierarchy, by which one of the two regimes should ultimately prevail, or in the form of ex post reconciliatory mechanisms in case of conflict.

Yet, Recital 9 of the Preamble considers "the need for alignment with Directive (EU) 2022/2523". Thus, there would seem to be an implicit deference to the GMT Directive framework as regards the formulation of policy (i.e., designing a set of rules that may coexist with the GMT Directive rules) rather than an explicit rule of hierarchy or, alternatively, a reliance on the GMT Directive rules for the determination of the preliminary tax result.

4.1.2. Financial accounts as a basis for computing the preliminary tax results

The acceptable accounting standard in the Union to be used by the BEFIT group members shall be the acceptable accounting standard in the Union, which is adopted when preparing the consolidated financial statements of the ultimate parent entity where the latter is resident for tax purposes in a Member State.[251] In concrete terms, this would either consist of the national generally accepted accounting principles (GAAP) of one of the Member States or the international financing reporting standards (IFRS).

In those cases where the ultimate parent entity is not resident for tax purposes in a Member State, the acceptable accounting standard in the Union shall be the standard in force in the Member State where the filing entity is resident for tax purposes.[252]

By way of derogation to the above general rule, where a Member State applies national law which allows groups to prepare, audit, and publish financial statements on a jurisdictional basis, the preliminary tax result and the allocation of the BEFIT tax base of the BEFIT group

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of business expenses, long-term contracts, bad debt, provisions, taxes paid) would consist of certain items that represent a significant part of the current corporate tax base of a BEFIT group member (around 90%)." Compare Impact Assessment, Para. 5.2.1.2.

[251] See Article 7 of the proposed Directive.

[252] See Article 7, Para. 2 of the proposed Directive.

members that are resident for tax purposes in that Member State may also be computed on a jurisdictional basis, provided that the group can identify separately, for each BEFIT group member, the data necessary to calculate such preliminary tax result and post-allocation adjustments in accordance with the Proposed Directive.[253]

While the general rule largely reflects the starting point also adopted for the determination of the qualifying income or loss for the purposes of the GMT Directive, the possibility of relying on the consolidated financial statements as a starting point rather than those of the single entities appears as a significant deviation from the per entity approach which otherwise constitutes the backbone of the BEFIT proposal when it comes to the determination of the preliminary tax result and which in turn is integral to the GMT Directive framework, the latter framework not contemplating possible deviations from "per entity" approach.[254]

Article 15(2) of the GMT Directive provides that the financial accounting net income or loss of the constituent entity for the fiscal year may be determined using another acceptable financial accounting standard or an authorised financial accounting standard. In other words, the GMT Directive framework appears more "flexible" than the BEFIT Proposal in identifying the accounting results to which the adjustments would later be applied. The flexibility of the GMT Directive may reflect the intention of reaching a compromise in the negotiations that led to the adoption of the Pillar Two Model Rules by a broader (and more diverse) constituency of States as those participating in the works of the Inclusive Framework. If one of the underlying goals of the BEFIT proposals is the pursuit of simplification (outlined in the Preamble and Explanatory Memorandum), then such a significant deviation from the GMT Directive framework, where both would apply, raises some questions. In particular, this deviation may generate divergences based on the starting point of the determination of the preliminary tax results.

4.1.3. Between standards and rules?

In addition to explicitly indicating the required adjustments for the determination of the tax base at the entity level, the BEFIT proposal lays down some general principles, under Article 4, on the computation of the tax result of each BEFIT group member, which should be determined, for each fiscal year, based on its financial accounting net income or loss following the adjustments envisaged by Articles 8 to 41 of the proposed Directive.

However, the second paragraph of Article 4 expressly foresees a sort of backstop requirement in that expenses included in the financial accounting net income or loss of a BEFIT group member shall be deductible from its preliminary tax result only to the extent that they are incurred in its direct business interest.

The notion of "direct business interest" thus acquires pivotal relevance as the fundamental precondition for the deductibility of any expense by a BEFIT group member. This overarching autonomous notion appears novel with respect to existing secondary EU legislation, including the GMT Directive.

[253] Compare Art. 7, Para. 4 of the proposed Directive.

[254] With regard to further issues with permitting the consolidated financial statements for a jurisdiction as the base, see also the considerations set forth in section 5.4.2.

This is already in itself a major deviation from the GMT Directive framework, which is primarily rule-based, while BEFIT would seem to try to combine a rule-based approach with a standard-based one.[255] While, as will be illustrated later,[256] most other adjustments operate somewhat mechanically (e.g., disregarding a certain percentage of an income component or calculating depreciation based on set criteria), the business interest requirement implies an ex post assessment that may generate a series of interpretive uncertainties.[257] This is especially relevant in the absence of an explicit definition in the proposed Directive as to what constitutes a "direct business interest" and how this will be interpreted under the longstanding and divergent national practices to date.

4.1.4. Overview of the required adjustments

In addition to the above fundamental divergence[258] with respect to the GMT Directive approach, which appears to be primarily rule-based, numerous granular and operational misalignments between the two initiatives arise.

The BEFIT adjustments under Section 2. require firstly either inclusion in the base or disallowance of prior deductions for some specifically identified items, namely: i) financial assets held for trading;[259] ii) borrowing costs that are paid to parties outside the BEFIT group in excess of the interest limitation rule of the ATAD;[260] iii) fair value adjustments and capital gains received by life insurance undertakings in the context of unit-linked/index-linked contracts;[261] iv) fines, penalties and illegal payments such as bribes;[262] v) corporate taxes that were already paid or top-up taxes in the application of the GMT Directive, thereby including a Qualified Domestic Top-up Tax as referred to in Article 11 of the same Directive.[263]

[255] The fundamental difference between rules and standards is the point at which each is given content, see in this sense S. Dean, *Neither Rules nor Standards*, 87 Notre Dame L. Rev. 2, p. 543 (2012). In particular, a standard is provided with ex post normative content, through a deferral of the specification of its content, see L. Kaplow, *Rules Versus Standards: An Economic Analysis*, 42 Duke L. J. 3, p. 567 (1992). On the other hand, a rule is already drafted with an *ex ante* normative content. An intuitive example in this respect is the distinction between a "reasonable speed" requirement (a standard) and a "numerical speed limit" (a rule). On the merits of these approaches, see more generally R.E. King & C.R. Sunstein, *Doing Without Speed Limits*, 79 Boston U. L. Rev. 1, p. 155 (1999) and C.R. Sunstein, *Problems with Rules*, 83 Calif. L. Rev. 4, p. 953 (1995). It is not uncommon for normative systems to encompass both approaches but in the concerned piece of legislation the two planes would seem to be intertwined, which may raise various uncertainties on the interpretive plane. On the possible issues arising from the interactions of the two approaches in a cognate area of international taxation, namely transfer pricing, see further A. Turina, *Back to Grass Roots: The Arm's Length Standard, Comparability and Transparency – Some Perspectives from the Emerging World*, 10 World Tax J. 2 (2018), at 335.

[256] See Section 4.1.4.

[257] See further section 2.3.4.2 on this point. Overall, it will take years until the Court of Justice releases rulings on this matter. Until then, businesses will have to face the fundamental uncertainty of not knowing whether their deductions comply with the "direct business interest" requirement.

[258] As discussed in Section 4.1.3.

[259] See Art. 11 of the proposed Directive.

[260] See Art. 13 of the proposed Directive.

[261] See Art. 14 of the proposed Directive. In this respect, a special regime is envisaged for insurance undertakings and Para. 3 of the same provision foresees that "The Commission may adopt delegated acts in accordance with Article 74 to supplement this Directive laying down more detailed rules on the adaptation of the preliminary tax result for insurance undertakings, in the context of the impact of the new International Financial Reporting Standard (IFRS) 17 on insurance contracts." In this respect, analogous issues to those addressed in section 3.2.2.1. with regard to reliance on delegation should be further considered.

[262] See Art. 16 of the proposed Directive.

[263] See Art. 17 of the proposed Directive.

Secondly, the proposed Directive in Section 2. also mandates the exclusion of certain financial net income or losses for the following items: i) dividends and capital gains or losses on shares or ownership interests, in the case of significant ownership and unless they are held for trading or by a life insurance undertaking;[264] ii) the profit or losses from permanent establishments;[265] iii) shipping income subject to a national tonnage tax regime;[266] iv) rollover relief for gains on assets that are replaced;[267] v) acquisition, construction and improvement costs of depreciable assets, because these costs will already be part of the depreciation base, as well as subsidies directly linked to this, because subsidies should neither be in the depreciation nor tax base;[268] vi) unrealised gains or losses from currency exchange fluctuations on fixed assets.[269]

In addition, the exclusion is foreseen also for any amount relating to the post-allocation adjustments listed in Article 48[270] of the proposed Directive.

The above adjustments required by Section 2. of the proposed Directive are followed by further adjustments in Section 3. (concerning specific depreciation rules),[271] and timing and quantification aspects of certain transactions, such as hedging ones in Section 4.[272]

Lastly, the tax base is also affected by Section 5. of the proposed Directive, which addresses the consequences for entities leaving or joining the BEFIT group, as well as, rules governing reorganisations.[273] As further illustrated in the next section, these adjustments reflect departures from the GMT Directive, and so bring into question the aim of alignment between the directives in the interests of simplicity and certainty.

4.1.5. A Comparison with the parallel GMT Directive framework of adjustments (selected issues)

A high-level comparison suggests that the required adjustments for the purposes of the GMT Directive may be more complex in some instances (such as, for instance, with regard to the treatment of deferred tax assets), but are fewer, encompassing the following items:[274] i) "net taxes expenses"; ii) "excluded dividends"; iii) "excluded equity gains or losses"; iv) "included revaluation method gains or losses"; v) "gains or losses from the disposal of assets and liabilities within the context of a reorganization"; vi) "gains or losses from the disposal of assets and liabilities within the context of a reorganization"; vii) "asymmetric foreign currency gains or losses"; viii) "policy disallowed expenses"; ix) "prior period errors and changes in accounting principles"; and x) "accrued pension expenses".

[264] See Arts. 8 – 11 and Art. 14 of the proposed Directive.
[265] See Art. 12 of the proposed Directive.
[266] See Art. 15 of the proposed Directive.
[267] See Art. 18 of the proposed Directive.
[268] See Art. 19 of the proposed Directive.
[269] See Art. 20 of the proposed Directive.
[270] Compare Art. 21 of the proposed Directive. On post-allocation adjustments, see further section 5.1.3. of this study.
[271] See, in particular, Art. 19 and then Art. 22 to 28 of the Proposal.
[272] See, in particular, Art. 33 on hedging and Arts. 29 to 33 of the Proposal.
[273] See Arts 35 to 36 and then, in particular, Art. 37 on "Provisions, revenues and deductions when entering a BEFIT Group", Art. 38 on pre-entry losses, Art. 39 on termination of the group, Art. 40 on business reorganisations, Art. 41 on disallowances of exempt share dispositions.
[274] As opposed to the more than thirty items mandated as per the BEFIT Proposal.

While a granular analysis of the aforementioned adjustments in the context of the GMT Directive exceeds the scope and purpose of the present study, it is worthwhile for the specific purposes of this section to highlight some key divergences between the BEFIT and the GMT Directive adjustments for the determination of the tax base.

When it comes to a crucial item such as remuneration arising from ownership interests in an entity (namely, dividends and capital gains), some asymmetries either between the two types of income as well as between GMT rules and the BEFIT rules come to the fore.

Article 8 of the BEFIT proposal foresees an adjustment in relation to ownership interests in order to exclude 95% of dividend distributions, subject to the condition that the ownership interest from which the distribution derives meets a minimum threshold of 10% of either profits, capital, reserves or voting rights, with a minimum holding period of one year. Here, the structure of the rules and the requirements concerning the minimum participation threshold and the holding period match those applying to excluded dividends as per Article 16(1)(b) of the GMT Directive,[275] but the exclusion for GMT Directive purposes is provided in full (i.e., 100%) if the conditions are met.

The partial (at 95%) rather than full exclusion of the dividends also seems to mark a tension with potential subsequent cascading effects on groups that would also fall within the scope of application of the Parent-Subsidiary Directive.[276]

Even more noticeable divergences can be appreciated in relation to capital gains, in relation to which a bifurcated treatment is foreseen: a 95% adjustment for gains (or losses) deriving from disposition[277] and a 100% adjustment (thus marking an asymmetry) for fair value gains or losses,[278] always subject to the same threshold and holding period conditions mentioned in relation to dividends. Regarding these items of income, within the GMT Directive framework, an adjustment in full (i.e., 100%) is foreseen in either case with regard to "excluded equity gains or losses",[279] regardless of the nature of the gain, and the holding period requirement does not appear to be contemplated.

A further rather significant point of departure from the adjustments foreseen for determining the qualifying income or loss for the purposes of the GMT Directive concerns the treatment of the income or loss of permanent establishments belonging to a group. Article 12, the BEFIT Proposal disregards (excludes), by means of an ad hoc adjustment, the amount of profit or loss attributable to the Permanent Establishment(s) of a BEFIT group member. This approach is mirrored by the general rule contained in Article 18(4) of the GMT Directive. However, a specific deviation from the general rule is laid down by Article 18(5) of the GMT Directive, according to which the loss of a permanent establishment shall be treated as an

[275] According to which 'excluded dividend' means a dividend or other distribution received or accrued in respect of an ownership interest, except a dividend or other distribution received or accrued in respect of either: - an ownership interest which is held by the group in an entity, that carries rights to less than 10 % of the profits, capital or reserves, or voting rights of that entity at the date of the distribution or disposition (a 'portfolio shareholding'); and that is economically owned by the constituent entity that receives or accrues the dividend or other distribution for less than one year at the date of the distribution; or - an ownership interest in an investment entity that is subject to an election pursuant to an election to apply a taxable distribution method.

[276] With regard to specific issues concerning withholding taxes, see further section 4.2.2. of this study.

[277] See Art. 9 of the proposed Directive.

[278] See Art. 10 of the proposed Directive.

[279] See Art. 16(1)(c) of the GMT Directive.

expense of the main entity for the computation of its qualifying income or loss to the extent that the loss of the permanent establishment is treated as an expense in the computation of domestic taxable income of such main entity, and is not set off against an item of the domestic taxable income that is subject to tax under the laws of both the jurisdiction of the main entity and the jurisdiction of the permanent establishment. Not foreseeing similar treatment of the losses of a permanent establishment in similar circumstances for the purposes of the determination of the preliminary tax result of a BEFIT group member may create a significant misalignment with GMT Directive computations that may be particularly difficult to reconcile[280] and does not appear immediately justifiable on a policy level.

Another area which may trigger potential misalignments concerns the treatment of foreign exchange gains or losses. Under Article 20 of the proposed Directive, the financial accounting net income or loss of a BEFIT group member shall be adjusted to exclude: i) the amount of any unrealised foreign currency exchange gain or loss in relation to fixed assets and liabilities; ii) the amount of any provision recorded for an unrealised foreign currency exchange loss. Under the GMT Directive framework, Article 16(e) adjustments only address an "asymmetric foreign currency gain or loss", defined as a foreign currency gain or loss of an entity whose accounting[281] and tax functional currencies are different. In this respect, the impact of the adjustments required by the GMT Directive framework appears narrower than under BEFIT. In essence, for the GMT Directive rules, adjustments would be introduced only in order to avoid distortions that could arise when the functional currencies used for accounting and tax differ, while no adjustments would be mandated under GMT Directive rules when the functional currencies are the same.[282] As a result, in such circumstances, any foreign exchange gain or loss reflected in the financial accounts would be included in the qualifying income or loss for GMT Directive purposes, irrespective of the local tax rules,[283] so that, ultimately, the treatment for accounting purposes would prevail unless there is a fundamental discrepancy in the functional currency used for accounting and tax purposes.

In the authors' view, it would be preferable to keep the GMT Directive's "minimalistic" approach to foreign exchange gains or losses for the BEFIT tax base determination. Minimizing adjustments related to exchange rate gains or losses would also facilitate the aggregation of the preliminary results and address potential timing mismatches that may affect the conversion at the aggregation stage, as per Article 42 (3) of the proposed Directive.[284]

As it can be appreciated by a simple comparison of the list of adjustments to be introduced in pursuance of BEFIT versus those under the GMT Directive, the proposed BEFIT rules also encompass adjustments that are not contemplated in the GMT Directive. These adjustments appear to be perhaps a direct legacy of the original C(C)CTB framework or, at

[280] In particular when considering the recapture rule also envisaged by Art. 18, Para. 5 GMT Directive, according to which the qualifying income that is subsequently earned by the permanent establishment shall be treated as qualifying income of the main entity up to the amount of the qualifying loss that was previously treated as an expense of the main entity.
[281] Defined as per Art. 16(1)(e) as the functional currency used to determine the constituent entity's financial accounting net income or loss.
[282] See in this regard the clarifications provided under Para. 67 and 68 of the *Commentary to the Global Anti-Base Erosion Model Rules (Pillar Two)*, First Edition (2022).
[283] Ibidem.
[284] According to which the preliminary tax result of each BEFIT group member shall be converted to Euro at the exchange rate issued by the European Central Bank as it stood on the last day of the calendar year or, if the fiscal year does not coincide with the calendar year, on the last day of the fiscal year.

least, closer in its ambitions to the "comprehensive set of tax rules" approach ("option 2", as per the Impact Assessment).[285] This approach stands in contrast to the "Limited Tax Adjustments Approach" ("option 1", as per the Impact Assessment).[286] This choice perhaps marks a fundamental methodological ambiguity in some crucial areas of base determination. The concrete risk deriving from this fundamental ambiguity would be that taxpayers included at once within the scope of the BEFIT and the GMT Directive regime would have, in fact, to compute three tax bases: one for the GMT Directive, one for the proposed BEFIT Directive and one for CIT due to the individual assessment under the proposal.[287] Some examples in this respect are illustrated below.

The Explanatory Memorandum states that Section 3. of the proposed Directive consists of a common set of tax depreciation rules.[288] The goal is to ensure that "the proposal remains closer to financial accounting than national tax depreciation rules".[289] The order of magnitude of the matter is, of course, very considerable, as it is acknowledged in the Impact Assessment that "among(…) deductible expenses, tax depreciation and amortisation of fixed assets generally have the largest impact".[290] In this respect, some specific rules are introduced that depart quite substantively from what may be envisaged by either the IFRS or the GAAPs of the Member States and appear more closely inspired by systems relying on a "dual track" of independent tax and financial accounting. Firstly, this outcome would seem to be illustrated by certain predeterminations on fixed assets, requiring that low-valued (below 5,000 EUR) fixed assets be immediately expensed or that, for some types of assets, only straight-line depreciation would be applied. Secondly, some predeterminations as to the useful life of certain assets of key importance are envisaged, most notably for immovable property.[291] Similarly, predeterminations are applied to fixed intangible assets,[292] including acquired goodwill: in relation to these assets, a five-year time frame is assumed in case the period for which the asset enjoys legal protection or for which the right has been granted cannot be determined. While the proposed Directive rules might be considered simpler than the tax accounting rules applied by domestic systems in this area, it may be questioned whether, on the whole, the rules governing depreciation may have simply operated with reference to the acceptable accounting

[285] See Section 5.2.1.2 of the Impact Assessment.
[286] Ibidem.
[287] On which see further Section 5.3 of this study.
[288] See in particular p. 14 of the Explanatory Memorandum.
[289] Ibidem.
[290] See, in particular, Section 2.2 of the Impact Assessment.
[291] In particular, as per Art. 22, Para. 2(a), all buildings as well as any other type of immovable property and structure in use for the business would have a useful life of 28 years.
[292] In the case of fixed intangible assets that enjoy intellectual property protection, the useful life will extend to the span for which the right has been granted.

standards[293] rather than attempting a partial (stricter) harmonisation of depreciation rules in the EU.[294]

The analysis so far has concentrated either on misalignments between the two sets of base determination rules (as it would be the case, mutatis mutandis, with regard to dividends and capital gains) or on the adjustments not contemplated by the GMT Directive, whose added value to the overall BEFIT framework may perhaps deserve further thought. It seems appropriate to conclude this section by highlighting some adjustments that, while contemplated by the GMT Directive framework, do not seem to find an immediate equivalent within BEFIT. Of particular relevance here is the absence of a specific set of rules to address prior period errors and changes in accounting principles.

Similarly, an issue of significant practical relevance concerns the potential differences that may arise between the amount of pension liability expenses included in the income (or loss) for financial accounting purposes, and the amounts contributed to pension funds in a given fiscal year. While the GMT Directive framework foresees specific adjustments in this respect, the proposed BEFIT rules do not seem to consider the issue at the level of the determination of the preliminary tax result. Interestingly, the matter is addressed in the post-allocation phase[295] while, overall, no specific base determination rules are introduced. Accordingly, the matter is deferred to the corporate tax law of the Member State in which the BEFIT group member is resident or located, depending on whether the Member State concerned envisages the deductibility of pension liability expenses.[296]

4.1.6. On the perils of dealing with the two regimes "at the same level" and the possible way forward

While it can be appreciated that the misalignments between the BEFIT and the GMT Directive initiatives have been introduced by design in light of the different goals pursued by their rules, one may question whether such asymmetries and misalignments run counter to one of the core policy objectives of the BEFIT Proposal, namely, the pursuit of simplification. The likely duplication of calculations and adjustments for GMT Directive and BEFIT purposes (requiring possibly dual tracking) would seem to defy the simplification rationale. This is particularly true if one considers that those that fall within the scope of the BEFIT rules will not exceed those targeted by the GMT Directive. Such dual tracking may end up being systematically more burdensome with regard to compliance obligations for groups that fall

[293] See Art. 7 of the proposed Directive. On the other hand, it may perhaps be acknowledged that, in those situations were the consolidated financial statements are redacted in compliance with the US GAAP as opposed to the IFRS, some significant discrepancies in the treatment of assets may emerge. A fundamental divergence in this regard concerns the relevance of the "fair market value". In particular, under IFRS, the value is first recorded at cost and can be revaluated later on up to market value while under US GAAP, the property is valued and depreciated at historical cost. Furthermore, with specific regard to intangible assets, the IFRS allow tangible assets to be revalued (except for goodwill) while the US GAAP prohibit taking impairment into account. With specific reference to Research and Development expenses, under IFRS, the costs can be capitalised (and thus depreciated over time) while under the US GAAP, development costs are immediately expensed. Also compare on this point the Appendix to the Impact Assessment: Key Takeaways from the BEFIT Building Blocks Interview 24/05/2022 #9.

[294] With regard to the finding that BEFIT would substantively bring about an analogous outcome, compare Section 6.3.3.2. of the Impact Assessment.

[295] Compare Art. 48 (e) of the proposed Directive.

[296] Compare 48, Para. 1 (i) of the proposed Directive.

within the scope of both the GMT Directive and the proposed BEFIT Directive, compared to groups that would not be included in either regime.[297]

This misalignment hurdle may stem from the stated goal in the proposed Directive of "dealing with both the "BEFIT tax base" and the "Pillar 2 minimum effective tax rate" "at the same level". This may be inasmuch a source of the problem as it is a pursued objective. Treating the two initiatives at the same level while foreseeing the application of rules that, while converging in part, such as the introduction of adjustments to the accounting results instead of foreseeing an autonomous "detailed corporate tax framework", entails several differences in the adjustments to be applied to the accounting results which may trigger duplication of compliance requirements.

If these differences and misalignments are to be justified by diverging policy goals underlying the two initiatives and thus cannot be reconciled, a possible (although somewhat radical) approach to address the potentially underlying conflicts between the two regimes could be to embed in the BEFIT framework a set of clear hierarchy rules that would state those situations in which the GMT Directive framework would take precedence (or be overridden[298]) by the BEFIT framework. Such rules would be of benefit to all groups that would be simultaneously subject to both regimes.

It may be argued, in the alternative, that the two initiatives simply address different concerns: the BEFIT acting as a domestic CIT system, complemented by some elements of the domestic CIT such as rates and post allocation adjustments; and, on the other hand, the GMT Directive providing a minimum floor for the BEFIT system's results. An actual hierarchy may be hard to establish and may defeat the aim for these two initiatives to be complementary.

Whatever approach is to be adopted, it is suggested that further efforts be devoted to bridge the gaps between the rules for the determination of the qualifying income or loss under the GMT Directive and the adjustments to the financial accounting net income or loss under the proposed BEFIT Directive.

4.1.7. Impact of the pre-existing EU secondary law framework on the determination of the taxable base

A fundamental question that has remained unaddressed so far concerns the interaction between the proposed Directive and the pre-existing EU secondary law in the area of direct taxation: to what extent the existing Directives would be applicable, through the filter of the implementing legislation of the Member States, to the determination of the taxable base of each BEFIT group member?

A granular analysis of the considerably vast body of secondary law that may impact the determination of the taxable base of the entities belonging to BEFIT Group extends far beyond the scope and objectives of this study.

[297] On which further see section 3.1. of this study.
[298] This scenario however appears less likely as it may entail instances of heightened scrutiny for EU Member States within the context of the Pillar Two peer review monitoring to be conducted within the Inclusive Framework.

Nevertheless, in addition to some of the specific points raised so far, as regards interaction with the Parent Subsidiary Directive, some further preliminary considerations are presented also with reference to the ATAD framework.[299] The Explanatory Memorandum to the proposed Directive seems to adopt a fairly simple compatibility approach. The proposed Directive simply states that it is compatible with the ATAD and that BEFIT does not contradict those rules.[300] However, the question arises as to what extent the existing body of secondary law in the area of direct taxation (and implemented under domestic law) is substantively switched off for BEFIT purposes. Alternatively, to what extent will such secondary law remain applicable to the determination of the taxable base of each BEFIT group member? The answer to this question seems to be twofold when examining the explanatory documentation that accompanies the proposed Directive.

Firstly, the overlap with (or override of) existing secondary law seems to be qualified as a non-issue. The only provision where a potential issue of consistency with the ATAD framework has been expressly identified and addressed[301] is in the area of interest limitation rules as laid down in Article 4 of the ATAD. In this respect, Article 13 of the proposed Directive expressly requires the BEFIT group member to adjust their financial accounting net income or loss to include the amount of excessive borrowing costs[302] which are not deductible for tax purposes in accordance with the interest limitation rules laid down (by means of implementing the ATAD) in the national corporate tax law of the Member State where it is resident for tax purposes. Article 13(2) then carves out from this ATAD override rule those excessive borrowing costs arising from transactions within BEFIT group members. Such carve out for the BEFIT group raises issues when comparing the treatment of entities that belong to a BEFIT group, that would essentially be entitled to disapply the ATAD interest limitation rules, with other corporate groups.[303] The policy rationale for this carve out does not appear entirely clear but is perhaps directed at nudging corporate groups to voluntarily opt into the BEFIT regime.[304]

However, Article 45(5) then substantially restricts the application of Article 13(2) by providing that the excessive borrowing costs shall not be recognized for the purpose of computing the baseline allocation percentage of the BEFIT group members. Given that there is internal group consolidation of the BEFIT group, it is unclear which of the excessive borrowing costs within the BEFIT group may be taken into account under Article 13(2). If the understanding above is correct, the answer would appear to be none of the excessive borrowing costs, leaving the question as to the purpose of Article 13(2).

Secondly, at a deeper level, it seems that the BEFIT regime would seem to trump the pre-existing secondary law framework for those taxpayers that fall within its scope of its application: "BEFIT would be specific to groups. Where there is an overlap in scope with, for

[299] Council Directive (EU) 2016/1164 of 12 July 2016 and Council Directive (EU) 2017/952 of 29 May 2017 amending Directive (EU) 2016/1164 as regards hybrid mismatches with third countries.
[300] See Explanatory Memorandum, Section 6, p. 3.
[301] Compare Explanatory Memorandum, Section 1, p. 3.
[302] Defined by Art. 2(2) of the ATAD as "the amount by which the deductible borrowing costs of a taxpayer exceed taxable interest revenues and other economically equivalent taxable revenues that the taxpayer receives according to national law".
[303] Moreover, as it will be further addressed in section 5.4. of this study, the allocation formula takes into account intra-group transactions, which raises some questions on the possibility to use excessive debt to influence relative weights over the years.
[304] Another example in this respect would be the regime concerning the disapplication of withholding taxes on intra-BEFIT Group transactions as envisaged by Art. 43 of the proposed Directive.

instance, the Parent-Subsidiary Directive, BEFIT would prevail as lex specialis".[305] This broad override appears tempered on the issues of the prevention of tax avoidance, as "other policies such as the ATAD would act as a complement to BEFIT for anti-tax abuse, which can be clarified in the proposal".[306] This understanding seems to be reflected in the Explanatory Memorandum, where it is mentioned that for BEFIT group members, the "tax situation will be more transparent and clearer, compared to having to structure their operations in accordance with multiple national legal frameworks while also making sure that they respect the main purpose of each framework and avoid mismatches".[307] When it comes to the actual wording of the proposed Directive, whether there is a general override or a complex coexistence of the BEFIT regime with the significant body of secondary law and the case law elaborated by the Court of Justice in this area, does not appear to be formulated as clearly and would indeed need to be further circumstantiated in the proposed Directive's wording.

4.2. Computation of the BEFIT tax base

4.2.1. General issues

The determination of the tax results of each BEFIT group member is the first step in the computation of the actual BEFIT group, which is obtained by aggregating[308] the individual BEFIT group member tax results.

Aggregation implies that losses within the group may be annually absorbed by profits within the group. Should the aggregated result be negative, Article 42(2) provides that the aggregated losses shall then be carried forward and offset against the next (i.e., of a subsequent year) positive BEFIT tax base.

Such a year-on-year aggregation, with the possibility for groups to offset losses across (EU) borders, is a legacy of the original CCCTB proposal and one of the desirable effects which would result from the adoption of the proposal.[309] While this is understandable, this position seems juxtaposed to that adopted for GMT Directive purposes (which relies substantively on a carry forward of qualifying losses through the operation of deferred tax accounting rules).

Fundamentally, the BEFIT cross-border loss relief mechanism would effectively amount to a regional blending (through aggregation) of various profits and losses, while the GMT Directive essentially maintains a jurisdictional perspective.

Two further provisions concerning the determination of the BEFIT tax base require further scrutiny, namely withholding taxes and other source taxation, and tax credits. These are addressed below.

4.2.2. Withholding taxes and other source taxation

[305] Compare Section 7.4.2 of the *Impact Assessment*, at p. 57.
[306] Ibidem.
[307] See Explanatory Memorandum of the proposed Directive, Section 6, p. 3.
[308] Following the earlier recalled criteria laid down by Art. 42, Para. 3, with regard to currency conversions, where applicable.
[309] Compare Section 5, p. 15 of the Explanatory Memorandum of the proposed Directive.

Article 43 of the proposed Directive foresees that Member States shall not impose withholding taxes or any other source taxation on intra-BEFIT group transactions unless the beneficial owner of the payment is not a BEFIT group member.

In this respect, the Explanatory Memorandum elaborates on the possible rationale of the measure, observing that within the BEFIT group, there is, in principle, no need to tax these transactions individually as they will be included in the aggregated BEFIT tax base, but it is also critical to ensure that such payments are not used to shift profits out of the group at low tax.[310]

However, the formulation of the proposed provision raises some questions.

The most obvious question relates to the interpretation of the "beneficial ownership" requirement. This is crucial to define the scope of application of the rule. However, neither the proposed Directive, nor the Explanatory Memorandum elaborate further. It is, therefore, unclear whether national competent authorities will retain the right to review whether the recipient complies with the requirement.[311]

The anti-avoidance rationale envisaged in the Explanatory Memorandum on this point seems to be at odds with Article 43 in the proposed Directive, which does not provide for this anti-avoidance purpose. Further, in the absence of an explicit definition in the proposed Directive, the devolution of the meaning of "beneficial ownership" to national corporate tax law seems to contradict the effective carve-out of BEFIT group members from the national corporate tax law of the Member States "in respect to all matters regulated by this Directive, unless otherwise stated by this Directive".[312] Failure to define "beneficial ownership" and implicitly leaving the matter to national tax law will result in fragmentation of interpretation. The authors suggest that an explicit definition be included in the proposed Directive. This definition may build upon the existing interpretations of the CJEU on the term in the context of the Interest and Royalties Directive.[313] It may further provide an opportunity to ensure harmonisation of this concept in EU secondary law.

The scope of the "withholding taxes" contemplated under Article 43 is unclear, and made all the more murky with the combination of "source taxation" in the article. This combination of terms could infer that a broader scope than the notion of "withholding tax" as envisaged within the framework of the Parent Subsidiary Directive[314] is envisaged. It is noted that the Parent Subsidiary Directive's concept of withholding tax was broad enough to encompass, for example, advance payments or prepayments of corporation tax to the Member State of the subsidiary, which is made in connection with a distribution of profits to its parent company. Further, the notion of withholding tax under the Parent Subsidiary Directive was found to be so broad as to include taxes levied at source in connection with inheritance tax.[315] However, the broad nature of the notion of withholding tax in the Parent Subsidiary Directive was not without limits. It should be recalled, inter alia, that a carve-out was observed in

[310] Compare Section 5, p. 15 of the Explanatory Memorandum of the proposed Directive.
[311] Ibidem.
[312] Compare section Art. 1, Para. 3 of the proposed Directive.
[313] LU: CJEU, 26 Febraury 2019, Case C-115/16, N Luxembourg 1, EU:C:2019:134, paras. 84-94.
[314] As per Art. 7, Para. 1 of the Parent Subsidiary Directive. Consider in this respect the interpretation provided by the Court, inter alia, in GR: ECJ, 4 October 2001, Case C-294/99, *Athinaiki Zithopiia*.
[315] Compare PT: ECJ, 17 February 2000, Case C-375/98 *EPSON Europe*, in particular, paras. 22 – 25.

connection with the Advance Corporation Tax[316] and that taxes levied on profits in the hands of the recipient were found not to fall within the scope.[317] Thus, within the proposed Directive, the use of the expression "withholding tax" should be further circumstantiated.

The expression "any source taxation" in the proposed Directive may have been intended to expand the scope of the carve-out *ad libitum* as any form of taxation by a Member State in pursuance of its sourcing rules. If so, such expanded meaning would seemingly open the door to significant planning opportunities on the one hand and significant uncertainties on the other. For example, under such a broad meaning, the taxation of income derived from immovable property (that, under domestic and tax treaty law, may be unrestrictedly taxed at source) would no longer be possible, with such income being solely taxed at the residence of the beneficiary. In such a case, it could be easy to move such profits to the lowest taxed jurisdiction by ensuring the owner of the property is resident in the low tax jurisdiction.

It is again suggested that the intended scope of the expression "any source taxation" be defined in the proposed Directive.

4.2.3. Tax credits

Article 44 embeds a special rule for the elimination of double taxation with regard to income that has been taxed in another Member State or a third country. In these cases, a tax credit shall be granted in line with the applicable double taxation convention or national law and shared among the BEFIT group members using the baseline allocation method referred to in Article 45.

Per Article 44(2), no tax credit would be granted where the income derived by a BEFIT group member is not included in its financial accounting net income or loss, with specific reference to Articles 8, 9 or 12 of the proposed Directive.[318] Where the tax credit may not be allocated to the BEFIT group members, the proposed wording does not specify how such denied tax credits must then be treated. This issue should be addressed in the proposed Directive.

In terms of Article 44(3), the tax credit shall be calculated separately for each Member State or third country as well as for each type of income (reduced first by the amount of deductible expenses related to such income). The tax credit shall not exceed the amount which results from subjecting the income attributed to a BEFIT group member to the corporate tax rate of the Member State where this BEFIT group member is resident for tax purposes or situated in the form of a permanent establishment.

[316] Compare UK: ECJ, 25 September 2003, Case C-58/01, *Océ van der Grinten*, para. 59 et seq.

[317] Compare DE: ECJ, 26 June 2008, Case C- 284/06 *Burda*, Para. 56 et seq. In this case the reasoning of the Court was based on a three-pronged test for identifying a withholding tax prohibited by the Parent Subsidiary Directive, according to which, the following requirements are meant to be met: i) the chargeable event for the tax is the payment of dividends or of any other income from shares; ii) the taxable amount is the income from those shares; and iii) the taxable person is the holder of the shares.

[318] Dealing respectively with dividends and other distributions, gains or losses from the disposition of shares, and, income or loss of a Permanent Establishment.

It is questioned whether these rules concerning the quantification of the tax credit would not constitute a potential instance of override of the measures for the elimination of double taxation contained in pre-accession double tax conventions.

From a planning and avoidance perspective, it is further questioned whether such quantification and allocation of the tax credits may lead to the use of triangular structures conducive to non-residents of a contracting State effectively benefitting from a double taxation convention. Further, it would seem that tax credits become portable within the BEFIT group. This portability may be a particularly sensitive matter with regard to treaties that rely on the ordinary tax credit, which operates on a net basis. All these issues should be considered in further depth and may warrant a more analytical wording in the formulation of the proposed Directive.

5. Aggregation, allocation, and simplified transfer pricing compliance

5.1. Overview of the rules

5.1.1. Computation of the base

The previous section (section 4.) has demonstrated how the tax result of each individual BEFIT group member is computed. Here, the authors will further address how the BEFIT group taxable base is determined, as well as the methods for attributing the common base to each individual BEFIT member.

According to Article 41(1), the common BEFIT tax base is achieved by aggregating the individual tax results of the BEFIT group members. This leads to a significant potential benefit of the proposal, namely cross-border loss utilization.[319] Moreover, if the overall BEFIT tax base is negative, the possibility exists for an indefinite loss-carry forward.[320] If the aggregation of the BEFIT tax base leads to a positive tax result (and with insufficient prior losses carried forward to offset such a result), the group tax base must then be allocated among the different BEFIT group members.

5.1.2. Allocation of the base

The allocation of the base is subject to an initial transitional regime that is to be substituted by formulary apportionment by 2035.[321] However, if no agreement on a formula is reached by then, the 'transitional' allocation rules might very well apply indefinitely.[322] In the absence of any information concerning the 2035 formulary apportionment, this study necessarily focuses on the transitional regime.

During this transitional regime, and with some modifications, transfer pricing will be used for determining the outcome of intra-BEFIT transactions and, as a consequence, will have an impact on the relative weight of individual BEFIT group members in the overall base. The transfer pricing rules are subject to simplifications, with transactions presumed to be in accordance with the arm's length principle if the income/expenses arising from the intra-BEFIT transactions of a group member in a fiscal year do not exceed 10% of the average of its intra-BEFIT transactions in the previous three fiscal years. The proposed Directive applies the 10% threshold separately to the expenses and the income.[323] If any of the two exceeds 10%, the difference must not be taken into account for the purposes of the BEFIT allocation computation. In the latter scenario, the taxpayer may rebut the presumption of non-compliance

[319] It must be noted that the Netherlands has already expressed reservation as to whether such solution would be proportionate, see Beoordeling Richtlijn Business in Europe: Framework for income taxation, p. 12, available at https://open.overheid.nl/documenten/dc837b31-4319-4913-b8cb-4e74e158c024/file.

[320] See Art. 42(2)(b) of the proposed Directive. It is important to differentiate such BEFIT losses from any potential losses that a BEFIT group member may carry from the time before entering the BEFIT group, which remain domestic and can be deducted only from the respective share of the BEFIT tax base that is attributable to this group member in its respective Member State of residence (Article 38 in conjunction with Article 48(1)(a)).

[321] The specific factors to be taken into account for the formulary apportionment are to be agreed upon at a later date (Art. 45(9)).

[322] See Art. 45(10) of the proposed Directive. A similar development has occurred in the field of VAT where the 'transitional' regime still applies many decades after its inception: see for example the recitals to Council Directive 91/680/EEC of 16 December 1991 supplementing the common system of value added tax and amending Directive 77/388/EEC with a view to the abolition of fiscal frontiers, OJ L 376, 31.12.1991 which envisaged a 'transitional' regime until 1996.

[323] See Art. 45(3) that speaks of expenses *or* income.

with the arm's length standard before the tax authorities of its Member State of residence, and, if successful, the claimed amount of the intra-BEFIT transaction shall be taken into account for the BEFIT allocation.

Transactions between BEFIT group members and associated units that are not members of the BEFIT group are subject to a simplified approach to transfer pricing where such transaction pertains to the associated unit's activity as a 'low-risk distributor' or a 'contract manufacturer'. All other transactions with associated units outside of the BEFIT group are not covered by the proposed Directive.

Once the taxable result of each individual BEFIT group member has been determined, the allocation to each individual member is calculated as a percentage of the common BEFIT base. The allocation is determined by multiplying the current common BEFIT base by the average taxable result for the individual BEFIT member for the past three fiscal years over the common base averaged for the previous three fiscal years. If a BEFIT group member has a negative average tax result for this period, then the allocation percentage for this group member is zero.

In the first year in which the BEFIT directive applies to a group, there is no three-year history of taxable results calculated in accordance with the BEFIT rules for the tax base. Therefore, in determining the average weight of each BEFIT group member, reference is made to the national corporate tax determined in accordance with domestic CIT rules in these prior years. In each subsequent year, the national corporate tax history is substituted by the past BEFIT computations until, from the fourth year onwards, only the BEFIT computation is taken into account. Interestingly, it seems that the current year of assessment has no impact on the computation of the relative allocation weight. For instance, if the year of BEFIT assessment is y0, the allocation percentage will depend solely on the previous three years: y-3, y-2, and y-1, but not on the units' performance in y0.[324] This would seem to generate some form of smoothing effect in the allocation between BEFIT group members but generates a number of issues in its own right.

5.1.3. Domestic adjustments

Once the allocation of the common base has been made to a BEFIT group member, the Member State in which this group member is resident may make additional domestic adjustments. These include adjusting for timing issues related to the interaction of the previously applicable domestic CIT regime with the newly applicable BEFIT regime; some rules of domestic CIT that 'survive' the BEFIT system (such as deductibility of certain donations, pension provisions, and local taxes); as well as an open-ended provision allowing Member States a wide discretion to introduce further adjustments to their allocated base.

From this brief overview of the functioning of the relevant provisions to determine the tax base, a number of key issues are now examined with respect to their potential application.

[324] See for example Art. 45(2)(a), para 2: *In the first fiscal year in which a BEFIT group is subject to this Directive, those taxable results shall be determined in accordance with the national corporate tax rules of the Member State in which the BEFIT group member is resident for tax purposes or is situated in the form of a permanent establishment.*
This wording excludes the first year of assessment under the directive.

5.2. The treatment of losses

5.2.1. Indefinite loss-carry forward

Providing an indefinite and unconditional loss-carry forward such as the one under BEFIT is highly unusual in the context of EU Member States' domestic CIT regimes. Only three Member States have unlimited loss-carry forwards similar to the one under the BEFIT proposal.[325] 11 of the EU Member States currently provide for a limited number of years for loss-carry forward.[326] Another 11 Member States have unlimited loss-carry forward, but provide for a minimum level of taxation in future periods of profit (e.g. by allowing only a certain percentage of the current profit to be offset against past losses).[327] Two Member States have distribution-based systems and loss carry-forward.[328]

This comparative overview demonstrates that Article 42(2)(b) and its unlimited loss-carry forward option is a peculiar policy choice that deviates from the vast majority of existing EU domestic CIT systems. While cross-border loss offsetting reduces the carry-forward of losses,[329] losses will still occur in specific situations. For example, when a third-country multinational enterprise (MNE) newly enters the EU market or has limited operations, options for cross-border loss utilization may be scarce. The same would hold true for extraordinary circumstances such as the Covid-19 pandemic affecting specific sectors or the whole economy.

Therefore, it might be a sound policy choice to consider either introducing a limitation to the losses that can be carried-forward in terms of years (the preferred policy option in Central and East European Member States) or putting a cap on the maximum percentage of current profits that may be offset against past losses (the preferred policy option in West European

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[325] Belgium [G. Cruysmans, Belgium - Corporate Taxation sec. 1., Country Tax Guides IBFD], Sweden [F.M. van der Zeijden, Sweden - Corporate Taxation sec. 1., Country Tax Guides IBFD], and Malta [C. Cassar Torregiani, Malta - Corporate Taxation sec. 1., Country Tax Guides IBFD].

[326] Bulgaria (5 years) [D. Shishkova & G. Ahtchieva, Bulgaria - Corporate Taxation sec. 1., Country Tax Guides IBFD], Croatia (5 years) [P. Suchar, B. Đukić & J. Žgela, Croatia - Corporate Taxation sec. 1., Country Tax Guides IBFD], Cyprus (5 years) [N. Papapanayiotou, Cyprus - Corporate Taxation sec. 1., Country Tax Guides IBFD, Czech Republic (5 years) [F. Krajcuska, Czech Republic - Corporate Taxation sec. 1., Country Tax Guides IBFD], Finland (10 years) [K. Hiltunen, Finland - Corporate Taxation sec. 1., Country Tax Guides IBFD], Greece (5 years) [S. Papademetriou & G. Kerameus, Greece - Corporate Taxation sec. 1., Country Tax Guides IBFD], Hungary (5 years) [G. Erdős, Hungary - Corporate Taxation sec. 1., Country Tax Guides IBFD], Luxembourg (17 years) [C. Bardini & M. Lambion, Luxembourg - Corporate Taxation sec. 1., Country Tax Guides IBFD], Poland (5 years) [M. Olejnicka, Poland - Corporate Taxation sec. 1., Country Tax Guides IBFD], Romania (7 years) [R. Rusu, Romania - Corporate Taxation sec. 1., Country Tax Guides IBFD], Slovak Republic (5 years) [L. Dumitrescu et al., Slovak Republic - Corporate Taxation sec. 1., Country Tax Guides IBFD].

[327] Austria [Y. Schuchter & A. Kras, Austria - Corporate Taxation sec. 1., Country Tax Guides IBFD], Denmark [A. Riis, Denmark - Corporate Taxation sec. 1., Country Tax Guides IBFD], France [P. Burg, France - Corporate Taxation sec. 1., Country Tax Guides IBFD], Germany [A. Perdelwitz, Germany - Corporate Taxation sec. 1., Country Tax Guides IBFD], Ireland [S. Ruane, Ireland - Corporate Taxation sec. 1., Country Tax Guides IBFD], Italy [C. (Cesare) Silvani, Italy - Corporate Taxation sec. 1., Country Tax Guides IBFD], Lithuania [T. Vaiciuliene, Lithuania - Corporate Taxation sec. 1., Country Tax Guides IBFD], Netherlands [H-J. van Duijn & K. Sinnige, Netherlands - Corporate Taxation sec. 1., Country Tax Guides IBFD], Portugal [A. Valente Vieira, Portugal - Corporate Taxation sec. 1., Country Tax Guides IBFD], Slovenia [A. Maher, Slovenia - Corporate Taxation sec. 1., Country Tax Guides IBFD], Spain [Á. de la Cueva González-Cotera & R. Saura Martínez, Spain - Corporate Taxation sec. 1., Country Tax Guides IBFD].

[328] Estonia [M. Herm, Estonia - Corporate Taxation sec. 1., Country Tax Guides IBFD] and Latvia [L. Gerzova, Latvia - Corporate Taxation sec. 1., Country Tax Guides IBFD].

[329] Impact assessment, supra n. 3, p. 43.

Member States). Also, a combination of the two is possible. Such an approach would be more in line with what exists under the domestic CIT systems and will not only make consensus on the proposed Directive more likely but would also decrease the distortion of competition between the taxpayers who are subject to the BEFIT regime and those who are not.

5.2.2. Loss-making and the baseline allocation formula

According to the BEFIT rules, losses generated before the proposed Directive starts applying to a given group remain at the national level and during the first three years of application of the proposed Directive, the national CIT systems (in whole during the first year, and in part for the remaining two years) would be the framework of reference for computing the taxable result: i) of a BEFIT group member (numerator); and ii) of the group as a whole (denominator). Such a fraction is used to compute the baseline allocation of income. The main issue with the baseline allocation formula is that the application of the formula remains unclear if every group unit was at an average loss during the past three years. The problem stands out when the loss was incurred under the domestic CIT regime prior to the application of the proposed Directive and is, therefore, subject to the regime of Article 38 of the proposed Directive (can be offset only against the individual member allocated base, if any, and never against the BEFIT base).

The problem becomes clearer with an example, represented numerically in *Table 1* below. Imagine that a third country MNE enters the European market four years before the BEFIT directive starts being applicable to it. Y0 is the year when the BEFIT directive starts applying. Y1 is the year when the BEFIT information return with the computation must be submitted covering the previous fiscal year – y0. According to the information return, the filing entity must provide the computation under the baseline allocation percentage. For instances such as the one described in our example, the following provision of Article 45 applies:

"the taxable result of a BEFIT group member shall be the average of the taxable results in the three previous fiscal years.

In the first fiscal year in which a BEFIT group is subject to this Directive, those taxable results [of the BEFIT group members] shall be determined in accordance with the national corporate tax rules of the Member State in which the BEFIT group member is resident for tax purposes or is situated in the form of a permanent establishment".[330]

With respect to the taxable income in y0 – the first year when the proposed Directive applies to the MNE, the MNE in our example must compute the baseline allocation by looking at the domestic tax CIT results in years -3, -2, and -1. It is not unusual that the units of a group that enter a new market are at a loss for a certain amount of time at the beginning. In such cases, the average taxable result of the units of the MNE for years -3 to -1 might be negative under the CIT rules of all EU jurisdictions involved. According to Article 45(2), last paragraph, in such a case, the baseline allocation percentage of all these group members is set at zero. Assume, however, also that y0 – the first year of application of BEFIT – is also the first year when the MNE turns profitable, and there is a positive amount under Article 42(2)(a) that needs to be allocated. None of the past domestic losses can be offset against this profit (Article 38),

[330] See Art. 45(2)(a) of the proposed Directive.

and it cannot be attributed to anyone since all BEFIT group members have a baseline percentage of zero, bringing us into a dead-end situation. Does this profit remain untaxed since no jurisdiction has taxing rights over it in accordance with the BEFIT rules? The proposed Directive does not seem to answer this question.

Table 1

	MNE Unit 1	**MNE Unit 2**	**MNE Unit 3**
Y -3 taxable result	-50	-100	-10
Y -2 taxable result	-30	-50	-5
Y -1 taxable result	-10	-20	-2
Average tax result (ATR) and baseline allocation percentage (BAP)	ATR: negative BAP: *zero*	ATR: negative BAP: *zero*	ATR: negative BAP: *zero*
Y 0 BEFIT tax base	+100 [cannot be allocated under the baseline allocation formula as all MNE units have a baseline allocation percentage of *zero*]		

Under a pure BEFIT regime (after the first three years of application of the Directive to a group), this outcome is less likely due to the loss-carry forward. However, it is not impossible if, for instance, the group is faced with a number of years of consistent losses across the board and then a sudden sharp profit spike that outweighs all the losses carried forward from prior years. An example of such a circumstance could be where an EU R&D unit of a global MNE has a significant breakthrough.

There are two potential solutions to this issue. In the first instance, for pure BEFIT regime situations, the solution is to explicitly include the year of assessment in the calculation of the average: thereby including in it the taxable result of the reported year and the ones for each of the previous two years. This, alongside loss-carry forward, will solve the problem in pure BEFIT situations because then either the profits of today will be fully absorbed by past losses (if the losses outweigh the profits) (Scenario 1 in Table 2 below) or the profits of today will fully absorb the past losses and leave something that can be attributed under the formula because it will be sufficient for performing the averaging and having a positive result in some group members (Scenario 2 in Table 2 below). The numerical illustration of this first solution can be found in Table 2 below.

Table 2

	MNE Unit 1	**MNE Unit 2**	**MNE Unit 3**
Y -2 taxable result	-20	-10	-5
Y -2 BEFIT Base	-35 [loss-carry forward]		

Y -1 taxable result	-5	-10	-5
Y -1 BEFIT Base	-55 [loss-carry forward]		
Y 0 (1st scenario) taxable result	+20	+15	+5
Y 0 (1st scenario) BEFIT Base	+40-55 = -5 [loss-carry forward]		
Y 0 (2nd scenario) taxable result	+20	+15	+25
Y 0 (2nd scenario) taxable result	+60-55 = 5 (profit to be distributed)		
Y 0 (2nd scenario) Baseline allocation percentage	*zero*	*zero*	100%

However, when domestic CIT computation impacts the BEFIT baseline allocation (in the first three years), the above solution does not appear to work as it might be that the previous one/two (domestic CIT) years bring a loss that is greater than the BEFIT profit. Nonetheless, since there can be no loss offsetting between the domestic loss and the BEFIT tax result, there is still profit that needs to be allocated. However, it cannot be allocated since the average result on a group member level over three years is still zero. For a numerical example that illustrates this issue, see Table 3 below.

Table 3

	MNE Unit 1	**MNE Unit 2**	**MNE Unit 3**
Y -2 taxable result (domestic CIT rules)	-20 [no carry-forward into BEFIT]	-10 [no carry-forward into BEFIT]	-5 [no carry-forward into BEFIT]
Y -1 taxable result (domestic CIT rules)	-5 [no carry-forward into BEFIT]	-10 [no carry-forward into BEFIT]	-5 [no carry-forward into BEFIT]
Y 0 taxable result (BEFIT rules)	+20	+15	+5
Average tax result (ATR) and baseline	ATR: negative BAP: zero	ATR: negative BAP: zero	ATR: negative BAP: zero

allocation percentage (BAP)			
Y 0 BEFIT Base	+40 [cannot be allocated under the baseline allocation formula as all MNE units have a baseline allocation percentage of zero]		

Hence, the only solution (and possibly the most practical) is simply to never take into account domestic CIT for the baseline allocation. This has the effect that in the first year of BEFIT, the allocation would simply be the current year determined individual tax base. Future years would benefit from the smoothing effect of the averaging and, by year three, the full BEFIT effect will be in play. In this case, the domestic CIT results are excluded from the very beginning, which not only solves the above initial allocation problem but might also ease some other frictions between the systems noted in section 5.4.2.1. below, such as issues with pre-existing domestic group consolidation regimes. Alternatively, the proposed Directive should include some form of profit-carry forward regime.

The last issue, unrelated to those previously discussed, pertains to the baseline allocation formula and average losses by a group member. The current wording of the provision renders the formula ineffective when a group member's average tax result is negative.

Let us imagine that there is a BEFIT MNE that consists of three units: Unit 1, Unit 2, and Unit 3. For the sake of simplicity regarding the averaging, let us assume that Unit 1 always generates an individual BEFIT base of +15, Unit 2 always generates an individual BEFIT base of -10, and Unit 3 always generates an individual BEFIT base of +100. According to the provision of Article 45(2)(a), the taxable result of these units for the purposes of the numerator of the baseline allocation formula will be +15, -10, and +100, respectively. According to the provision of Article 45(2)(b), the denominator of the formula should consist of 'the addition of the average of the taxable results, as referred to in point (a), of all BEFIT group members in the three previous fiscal years.' In our example, this would be 105 since 100-10+15 = 105 (the addition of the average taxable results). The above is represented in a simple table as follows:

Table 4

MNE Unit 1 (numerator)	**MNE Unit 2** (numerator)	**MNE Unit 3** (numerator)	**Total** (denominator)
+15	-10	+100	+105

Since the units in our example always produce the same individual BEFIT tax base, each year, the BEFIT base to be distributed would be 105. However, if we try to allocate these 105 under the current rules, we face a significant problem. MNE Unit 2 is excluded from the beginning since, based on Article 45(2), last paragraph, it is allocated a zero percentage. MNE Unit 1's baseline allocation will be calculated by dividing 15 by 105 and then multiplying by 100: 15/105*100 = 14,28%. MNE Unit 3's baseline allocation will be calculated in the same way: 100/105*100 = 95,24%. The effect is that the loss in MNE Unit 2 is fully ignored and

MNE Unit 1 is allocated 15 profit, and MNE Unit 3 is allocated 100 profit for a total of 115 profit, being 109,52% (which is in excess of the BEFIT common base). This allocation cannot be correct.

For the formula to function correctly, it is necessary to exclude any negative average results from a BEFIT group member when calculating the total taxable result for baseline allocation. In our example above, while the BEFIT tax base that must be allocated should remain 105 (so that losses are utilized cross-border), the denominator in the baseline allocation should be the sum of only the positive results – of Units 1 and 3. In this case, the denominator would be 115, and the baseline allocation will look as follows: for Unit 1 - 15/115*100 = 13,04%; and for Unit 3 – 100/115*100 = 86,96% (in total 100%). The 105 BEFIT tax base will be then allocated (with 13.7 profit to MNE 1 and 91.3 profit to MNE 3, equalling the 105 profit in the BEFIT common base and utilising the loss across the group) in accordance with these percentages of baseline allocation.

While we recognize that this outcome was certainly the intent of the Commission, the current wording of the provision of Article 45(2) does not generate the intended result. Therefore, the authors suggest considering the following amendment to Article 45(2)(b): "the total taxable result of the BEFIT group shall be the addition of the average of the taxable results, as referred to in point (a), of all BEFIT group members in the three previous fiscal years", *excluding the taxable results of BEFIT group members whose average taxable result for the three previous fiscal years is negative*.

5.2.3. Treatment of pre-BEFIT domestic losses

The proposed BEFIT directive clearly distinguishes between domestic pre-BEFIT losses and the post-BEFIT losses. The pre-BEFIT losses remain domestic and are thus to be deducted only from the attributed share of the specific BEFIT group member that generated them before becoming a member of the BEFIT group. This is the outcome of Article 38, read in conjunction with Article 48(1)(a). However, the authors identify at least two problems with these provisions.

The first problem is that both Article 38 and Article 48 use the word *shall*: "[…] shall be deducted from its share of the BEFIT tax base […]" (Article 38) and "[a] BEFIT group member shall […] decrease its allocated part by […] unrelieved losses incurred before becoming subject to the rules of this Directive […]" (Article 48(1)(a)). These provisions appear to create a(n EU) right for the BEFIT group members to deduct these domestically incurred losses without any meaningful reference to a potential national loss-carry forward limitation such as a time frame or a maximum percentage that exists in the vast majority of the Member States.[331] Given the provision of Article 1(3), which allows reference to domestic CIT only as far as the BEFIT directive envisages such, it would be reasonable to conclude that while domestic pre-BEFIT losses remain to be deducted only from the allocated domestic base, they are relieved from the limitations that the domestic CIT system entails with respect to domestic loss-carry forward. This, alongside the opt-in regime for groups that prepare consolidated statements, creates tax planning opportunities with respect to avoiding domestic legal barriers to loss-utilization. A potential solution to this problem is to include a final phrase to Article 38

[331] See section 3.2.1. above.

as follows in italics: "shall be deducted from its share of the BEFIT tax base as determined in accordance with Chapter III*, to the extent that they are deductible under the corporate tax law of the Member State in which the BEFIT group member is resident for tax purposes or situated in the form of a permanent establishment*". Such an approach will align the treatment of losses to that of "other deductions" under Article 48(h)-(j).

The second problem relates to domestic pre-BEFIT losses that remain "attached" to a BEFIT group member that is subsequently liquidated or closed in a way that makes the sustained domestic loss 'final' under the *Marks & Spencer*[332] line of case law.[333] According to this line of case law, if there is a final foreign loss, it will need to be taken into account by the country of the parent entity/HQ state. However, the problem with BEFIT is that now the parent entity is subject to the BEFIT regime and, therefore, cannot take into account such foreign losses since it is no longer subject to its own CIT system (Article 1(3)). Further, pre-entry losses shall be taken into account domestically only if they were 'incurred before the entry date [of the BEFIT regime]'. Left at that, the proposed Directive will be potentially incompatible with the final losses case law of the CJEU since final losses cannot be utilized anywhere. Such an outcome leads to manifest incompatibility between the proposed Directive and primary law as the former will introduce unjustified discrimination in a clear violation of well-established (even if criticised) case law of the Court.

One solution to this problem is to apply a broad meaning to Article 38's expression – "any unrelieved losses incurred before the entry date, in accordance with the corporate tax law of the Member State of its tax residence or location respectively" – and to consider that it also encompasses foreign final losses that are eventually attributable to the BEFIT group member under the final losses' doctrine. The rationale behind this solution is that the corporate tax law of a Member State implicitly encompasses the EU law dimension, including the rulings of the CJEU on the Member State's obligations under EU law. Thus, pre-BEFIT losses of a subsidiary or a PE might be deemed to be incurred 'before the entry date' for the parent even if they become final post-BEFIT. This solution keeps a strict separation between the pre-BEFIT and the post-BEFIT losses, by only changing the Member State that needs to consider final pre-BEFIT losses. In any case, it would be better if the text of the proposed Directive was clarified, to avoid any uncertainty as regards its interpretation.

An alternative solution would be to include a new provision in the proposed Directive that explicitly treats instances of finality of pre-BEFIT losses by, for example, allowing them

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[332] UK, CJEU: 13 December 2005, Case C-446/03, *Marks & Spencer*, EU:C:2005:201.

[333] We will not delve into the question as to when a loss is 'final' and whether this is at all possible since this has been subject to countless contributions and an ever-increasing confusion stemming from the case law. For the purposes of this analysis, we will only assume that there should be circumstances in one of the 27 Member States where this is possible (otherwise the whole discussion in literature and the case law would be moot). We will also recognize that some decisions may cast doubt as to whether subsidiary losses that are carried forward may ever be final – see UK: CJEU, 3 February 2015, Case C-172/13, Commission v. United Kingdom, EU:C:2015:50, Case Law IBFD. Some more recent decisions on the definition of 'final losses', especially with respect to finality of losses of permanent establishments include DE: ECJ, 22 Sept. 2022, Case C-538/20, Finanzamt B v. W AG, ECLI:EU:C:2022:717, Case Law IBFD; DK: ECJ, 12 June 2018, Case C-650/16, Bevola, EU:C:2018:424, Case Law IBFD.. For recent analyses on the topic of final losses see Georg Kofler, 'Editorial: Should We Cut 'Final' Losses?', (2022), 31, EC Tax Review, Issue 3, pp. 108-114; Rita Szudoczky, 'Case Law Trend: Foreign Permanent Establishment Losses Under the Fundamental Freedoms: Does W AG Bring an End to a Rollercoaster Ride?', (2023), 51, Intertax, Issue 5, pp. 432-443; T. Kollruss, The Concept of Final Losses under EU Law and Its Scope of Application, 63 Eur. Taxn. 2/3 (2023), Journal Articles & Opinion Pieces IBFD.

to be taken into account and offset against the aggregate BEFIT tax base. This solution essentially makes communal the pre-BEFIT losses that become final post-BEFIT in a derogation from the logic underpinning Article 38. The conditions for applying such a rule (when a loss can be considered "final") should be carefully crafted to prevent instances of abuse and to ensure alignment with CJEU's case law.[334] For example, there might be an exception to the rule such that any final loss incurred by a liquidated or closed unit must be primarily absorbed or carried-forward by any other group unit in the same Member State under the regime of Article 38, if such group units exist. This solution allows the loss to be utilised by the group, but contained within the Member State in which it was incurred and to rely on cross-border absorption only as an exception.

5.3. Interaction between the domestic computation and the BEFIT computation

The domestic CIT taxable result computation and the one under BEFIT will often yield very different results. Due to the lack of domestic CIT harmonization and the mismatches in the rules regarding the determination of the tax base, during the domestic CIT computation (in the first three years of application of the proposed Directive), one should expect that the overall sum of all domestic results (the denominator of the formula) would be lower or higher than 100% as compared to a hypothetical BEFIT calculation, which will also be reflected in the relative weight of the separate BEFIT group members (the nominator of the formula). This would create an initial distortion in the allocation of the base between the Member States, favouring countries with a broader (domestic CIT) tax base rules (than the ones under BEFIT) and putting at a disadvantage those countries that have narrower rules.

The effects will likely be longer lasting and creep in beyond the initial three-year period through the specificities of pricing intra-BEFIT transactions. Group members established in Member States the tax authorities of which were more likely to not challenge excessive intra-group transactions, would eventually be favoured by the 10% presumptive TP rule of Article 45(3)(a), which will allow them higher relative TP shifts in the years to come.

The potential solution to this issue coincides with the one suggested already in the previous sub-sections: exclude the use of the domestic CIT result and rather start cleanly with the BEFIT computations. This solution loses the advantage of averaging (at the beginning) but solves the problems of the creeping influence of the domestic CIT computation. Under such a system, any preliminary TP dispute would need to be adequately addressed as the initial level of accepted intra-group transactions will set the tone for the years to come, given the below 10% presumptive TP rule. This also will entail that the presumptive 10% TP rule will not apply in the initial year of assessment, a matter that the authors will discuss in greater length in the following sub-section.

5.4. Intra-group BEFIT transactions

One of the most important elements in the functioning of the proposed Directive relates to the pricing of intra-BEFIT transactions during the transitional period (i.e. until 2035 or up

[334] A recent example would be excluding an exempt PE under a double tax treaty: see DE: ECJ, 22 Sept. 2022, Case C-538/20, Finanzamt B v. W AG, ECLI:EU:C:2022:717, Case Law IBFD.

to the adoption of a formulary apportionment). This pricing directly impacts the allocation of tax base between the different group members and, from there, the taxing powers of Member States (at least when the rules apply to a cross-border group). Under the proposal, the pricing of such transactions is based – for the lack of a better phrase – on presumptive transfer pricing, which raises a number of essential issues.

The key factor for the functioning of the TP presumption under the proposed Directive is whether a BEFIT group member has, in a given tax year, an increase of more or less than 10% in its income or expenses generated from intra-BEFIT transactions as compared to the average of the previous three fiscal years. If the increase is less than 10% of the previous three-year average, then the BEFIT group member is in the low-risk zone, and there is a presumption that the intra-BEFIT transactions are at arm's length. If the increase is 10% or more, then there is a presumption that the difference above 10% is not at arm's length and is thus not recognized for calculating the baseline allocation. Furthermore, it seems that the presumption for entities in the low-risk zone is irrebuttable, a contrario of the fact that there is a mechanism for rebutting the presumption when an entity is in the high-risk zone.[335]

5.4.1. Low-risk zone

The irrebuttable nature of the presumption in the low-risk zone essentially means that BEFIT groups can freely shift profits to low-tax EU jurisdictions, disregarding any elements of value creation and traditional transfer pricing analysis, to the extent that they remain below the 10% mark each year. Moreover, the 10% per year shift, of course, *compounds*. Therefore, it may potentially result in an increase of the values of intra-BEFIT scrutiny-free transactions of 150% in 10 years and more than 670% in 20 years (with the actual numbers being lower due to the effect of the three-year averaging, but the point remains).[336]

Additionally, the low-risk zone can be further manipulated by careful structuring of the group for the application of the BEFIT regime. This may be to facilitate increasing the volume of (even accurately priced) intra-group transactions to specific group members or by creating new group members for the sole purpose of creating intra-group transactions that can later be exploited once the BEFIT regime commences. This risk is particularly prevalent for groups that opt-in voluntarily, but may equally apply to groups that are mandatorily in-scope due to the long transitional period. All the above possibilities demonstrate that the low-risk zone of intra-BEFIT transactions might be used as a tool for implementing a fool-proof strategy to shift relative weights to low-tax jurisdictions within the EU.

Moreover, the low-risk zone contains no reference to any correction resulting from inflation, which could be needed. If inflation, in any given year, is higher than 10%, then any amendment in the pricing merely to reflect inflation would place the entity immediately in the high-risk zone.

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[335] See the relevant provision of Art. 45(4) of the proposed Directive.

[336] One cannot count on the fact that this regime will apply only for a limited number of years before the adoption of a formula since this is fully dependent on reaching consensus regarding the factors of the formulary apportionment. Thus, as mentioned earlier in the adoption of the transitional regime, the Union legislator should act under the assumption that this regime might be also permanent.

There is also no indication of the consequences for an infringement of transfer pricing methods, raising the question of whether companies are, as a result of this proposed Directive, free to determine pricing and are released from an obligation to strict adherence to the arm's length standard. The wording of the proposed Directive appears to point in such a direction. This is an odd outcome since, logically, the 10% threshold should be calculated with reference to *accurately* priced transactions. Otherwise, under the proposed regime, an MNE might misprice transactions at will for the sole purpose of remaining below the 10% mark.

A further question that arises regarding the 10% threshold is whether it applies on a per-entity or per-item basis. If it applies per item, the rule will make slightly more sense since some of the above problematic effects will be minimized, albeit not entirely. Just to give an example, if an item is priced 100 EUR in y1, at a 10% increase per year, it may be priced 672 EUR in y20,[337] which is way above the average of the historical inflation over a 20-year period.[338] However, if the 10% threshold was per-item, the rule gives no answer as to what to do with items that the group member has not priced or transacted with in the past – for example, a newly developed IP right. Should they be presumed to fall in the high-risk zone automatically? On top of this issue, in the authors' view, the provision's wording clearly refers to application per entity and not per transaction since it refers to "intra-BEFIT group transactions", with "transactions" being in the plural tense. This suggests an aggregation of the transactions rather than a transaction-by-transaction approach. This interpretation is further supported by the explanatory memorandum, which reads the following, in its relevant part: "BEFIT group members will benefit from increased tax certainty (a comfort zone) if, as a result of their intra-BEFIT group transactions, *their expenses or income* remain within a limit of less than 10% increase compared to the average of the previous three fiscal years". [emphasis added]. The explanatory memorandum evidently refers to the expenses or income of the BEFIT group member and not to the pricing of any specific item.

5.4.2. High-risk zone

5.4.2.1. Existence of discrimination

When one turns to the high-risk zone, the issues do not become less substantial. The first issue focuses on the rebuttable presumption related to a BEFIT group member's expenses or income. Specifically, we question whether this presumption, activated when expenses or income exceed the 10% threshold, is in line with the CJEU case law. The CJEU has made it clear that taking measures regarding pricing of transactions might be scrutinized under the Treaty freedoms when it applies in a discriminatory manner to cross-border transactions. It further concluded that such discrimination could be potentially justified by the balanced allocation of taxing powers and the need to prevent tax avoidance as long as the measure is proportionate.[339]

One might argue that the correction for high-risk zone BEFIT-group members is not discriminatory since the proposed Directive also applies to domestic groups (Article 2(1)(a)) and, thus, their transactions are also scrutinized in exactly the same way. However, it must be

[337] Again, with the note that the actual number is smaller due to the effect of averaging.
[338] For information on the inflation rates per year see for example:
https://www.macrotrends.net/countries/EUU/european-union/inflation-rate-cpi
[339] DE: ECJ, 31 May 2018, Case C-382/16, Hornbach-Baumarkt-AG v. Finanzamt Landau, Case Law IBFD.

noted that the proposed Directive allows for fiscal consolidation regimes to be applied where all group members from a given jurisdiction file as a single taxpayer (see Article 7(4) and Article 62(3)). In such circumstances, and since in fiscal consolidation regimes, purely domestic transactions remain irrelevant for TP purposes, the rules of Article 45(3) and (4) will never be applied in a domestic context – not only in practice but also theoretically. This will create relevant discrimination.

A potential way out of this discrimination would be to do away with fiscal consolidation under the proposed Directive. However, this will create problems in its own right. In such a scenario, the issue would be on how to allocate the BEFIT tax base to a BEFIT group member that is currently part of a domestic consolidation regime such as the Dutch *fiscal eenheid* regime or the German *Organschaft*, and then needs to be subjected to Directive rules that do not allow for consolidation (to avoid TP discrimination). Specifically, the baseline allocation calculation for the period when the domestic CIT result is relevant (the first three years) will become impossible. In this scenario, the pre-BEFIT domestic corporate income tax (CIT) result would conflict with the post-BEFIT result. The former is calculated at the fiscal unity level, while the latter is determined per entity or permanent establishment. This discrepancy makes averaging across the two systems unfeasible.

While the removal of BEFIT fiscal consolidation is unworkable under the current allocation mechanics, the potential solution is if the whole idea of pre-BEFIT domestic CIT result and post-BEFIT averaging is eliminated, as suggested earlier. Removing the reference to the domestic CIT for the baseline allocation results in only BEFIT rules being of application on a per-entity basis, starting with the first year when those rules are applicable and moving forward up to a three-year average. Such exclusive calculation under the BEFIT rules will allow the application of the principles under Article 45(4)(b) for high-risk situations to all domestic intra-BEFIT transactions, and removes possible discrimination. However, as mentioned, this requires removal of the possibility to file on a fiscal unity basis post-BEFIT.

5.4.2.2. Compatibility with the CJEU's case law

Absent such reworking of the proposed Directive, the application of Article 45(4)(b) will lead to discrimination in fiscal unity situations. According to the CJEU case law, while potentially justifiable, the rule creating the discrimination must also be proportionate. Specifically, the CJEU demands that "on each occasion on which there is a suspicion that a transaction goes beyond what the companies concerned would have agreed under market conditions, the taxpayer is given an opportunity, without being subject to undue administrative constraints, to provide evidence of any commercial justification that there may have been for that transaction".[340]

It might seem at first glance that the rule of Article 45(4) complies with these requirements as, indeed, in its last paragraph, the provision allows the taxpayer to rebut the presumption by providing evidence (which will include commercial justifications). However, the authors would like to draw the reader's attention to the first (often overlooked) part of the proportionality test in this context, which refers to "on each occasion on which there is a

[340] Idem.

suspicion that a transaction goes beyond what the companies concerned would have agreed under market conditions" [emphasis added]. The need to already have a suspicion for the purposes of reversing the burden of proof can be traced to the case law of the Court on anti-avoidance cases, where the CJEU always requires that for the burden of proof to be switched to the taxpayer, the tax authorities must at the very least establish a *prima facie* situation of abuse.[341] This excludes provisions such as the one of Article 45(4)(b) that creates a presumption based on an objective fact – namely, the sheer value of intra-BEFIT transactions – without reference to value deviations of specific transactions or any other indicator that may suggest deviation from the arm's length principle. Thus, this provision does not establish prima facie deviations from the arm's length principle, and it goes contrary to the principle of proportionality.

5.4.2.3. Rebutting the presumption

The last paragraph of Article 45(4), which allows the taxpayer to rebut the presumption of arm's length incompatibility, presents further significant hurdles.

The first issue relates to the definition of the arm's length standard that needs to be applied. It seems at first glance that in this respect, the proposed BEFIT Directive relies implicitly on its "sister" proposed Directive on transfer pricing,[342] with which it shares an impact assessment report. However, one must not forget that these are separate proposals that, from now, go their own separate way, and it might very well be that one is adopted and the other is not, or that they are adopted at different moments. Hence, the proposed BEFIT Directive must be adjusted to stand on its own. The current application of Article 45(4), last paragraph, does not facilitate such a standalone approach. The Article does not appear to allow reference to domestic law as regards the content of the arm's length standard (Article 1(3)). This leaves the taxpayer, the tax authorities, the domestic courts, and eventually the CJEU with very little to work with (no context) in order to provide an accurate definition and content of the term. What seems likely in such a scenario is that the domestic authorities will eventually revert to national definitions and practices, with the Court potentially intervening on the content of the autonomous concept 'arm's length principle' used in the proposed Directive only when those national practices produce manifestly erroneous results. This would mean fragmentation of the internal market, inconsistent national practices, and little value added for MNEs in terms of simplification.

The above brings us to the question of ascertaining who decides on whether the rebuttal was successful. A careful reading of the provision gives a hint as to the possible answer. According to the rule of Article 45(4), last paragraph: "a BEFIT group member shall be entitled to provide evidence to *the competent authority of the Member State in which it is resident* for tax purposes or situated in the form of a permanent establishment that the pricing of the relevant intra-BEFIT group transactions is set in accordance with the arm's length principle. In such case, the full amount of *expense* from the intra-BEFIT group transactions in question, as

[341] I. Lazarov, Anti-Tax Avoidance in Corporate Taxation under EU Law: The Internal Market Narrative (IBFD 2022), pp. 150-152.
[342] Transfer Pricing Directive Proposal, supra n. 9.

evidenced, shall be recognized for the purpose of computing the baseline allocation percentage of that BEFIT group member." [emphasis added]

First of all, it is clear from this rule that the rebuttal takes place in a single Member State and, therefore, accepting or not the claimed arm's length price is unilateral. Secondly, the second sentence of the provision speaks of "expense" and does not mention income, thereby inferring that only the Member State where a deduction is sought is competent to hear a rebuttal. This approach might be somewhat understandable since the income will already be included at the recipient's level, and it makes sense that the rebuttal should be in the jurisdiction where a deduction and a consequent reduction of the tax base is sought.

This solution in the proposed Directive, however, leaves a few outstanding issues. First, if the rebuttal is unsuccessful, there will be unresolved double taxation since the income will be included in the recipient's country and not deducted in the country of the payor. The second issue is that the provision gives no answer where a group member has *too much* income, and for this reason alone passes the 10% threshold. Even if all rebuttals in the jurisdictions where expenses were incurred were successful (and such rebuttals might not even take place since the 10% threshold might not be passed in these jurisdictions), there is no mechanism for accepting the corresponding increases as compatible with the arm's length principle. As the provision stands now, any increase above 10% in the income from intra-BEFIT transactions must be disregarded for the baseline allocation without any possibility of rebuttal. Such an outcome is unacceptable as the prices leading to such an increase might be very well at arm's length.

Accepting that a rebuttal also in the country of the income increase is possible by interpreting the provision of Article 45(4), last paragraph broadly (or by amending it in the final text of the adopted directive) creates problems in its own right since the tax authorities of such a Member State would, of course, be inclined to accept that the higher income of their resident is at arm's length as this will increase their domestic tax base under the baseline allocation. Even if no other jurisdiction would have agreed with such an evaluation, the result will be reflected in the functioning of the baseline allocation formula, as the unilateral increase in one Member State will lead to corresponding proportional decreases in all other group members. If all these other group members are kept in the low-risk zone, there would be no means for the Member States concerned to react.

All of the above examples demonstrate the fundamental flaw of *unilateral* transfer pricing adjustments within the context of a proposal that essentially relies on transfer pricing for base allocation amongst jurisdictions. Further, with respect to unilateral TP adjustments, the proposed Directive remains silent as regards any possibility for an advanced pricing agreement (APA) that may give certainty to MNEs regarding the treatment of transactions that will lead to a shift beyond the 10% threshold. This is significant in light of one of the proposal's main objectives, which is to improve tax certainty. In-scope MNEs will hardly see this development as an improvement on that front since, currently, their significant transactions are covered (or could be covered) by APAs in many Member States. Moreover, in the context of the rebuttal, which speaks of recognizing "expenses", it remains unclear how one-sided transfer pricing methods can be used consistently in the jurisdictions involved, especially in light of the unilateral character of the rebuttal. Further significant issues might be created in consistently applying one-sided methods: for example, where different methods are applied to the same transaction by the two entities within the BEFIT group, potentially leading to mismatches in the outcomes.

5.4.3. A possible way forward on intra-BEFIT transfer pricing

When talking about the possible way-forward on transitional rules regarding allocation, it is important to start off by saying that the authors are fully supportive of the idea of the Commission relying on transfer pricing with certain forms of simplification. This is probably a much more realistic approach as compared to going directly for formulary apportionment (as was the idea under the former proposals), and it has the benefits of relying on rules and principles that MNEs and tax authorities are already familiar with in practice. That said, when adopting these rules, one must not view them as a mere transitional phase over a short period, as a new formula for apportionment might never be agreed upon. Hence, the rules must be robust enough to survive being a permanent solution. From this perspective, the authors have put forward the criticism above and made the suggestions outlined below.

The first and most significant suggestion is that any simplification of future transfer pricing must be based upon initial mutually agreed transfer prices between the group that align as closely as possible with the arm's length principle and that resolve any pending instances of double taxation and double non-taxation arising from transfer pricing mismatches. The only meaningful way to achieve this is through a multilateral APA on the BEFIT group transfer pricing strategy that involves all tax authorities represented within the (future) BEFIT team. Such a multilateral APA could cover more than one transaction and, whenever possible, the most relevant transactions of the group.

This APA should be concluded before the first year of application of BEFIT to the MNE in question and should be a precondition for applying the proposed Directive. The agreement might be between the BEFIT team and the MNE, with any potential disputes between BEFIT team members regarding the allocation of income from certain transactions being subject to meaningful dispute resolution mechanisms.[343] In the absence of such an initial approach that fundamentally resolves the TP position of an MNE, any allocation mechanism will only exacerbate existing issues and imbalances.

The agreement should mandate periodic renegotiation, with simplified transfer pricing rules applied in the interim. Only new and complex transactions would warrant bilateral or multilateral APA, or a post-factum rebuttal involving all relevant tax authorities. Embedded dispute-resolution mechanisms should also be in place.

BEFIT and its 'transitional' approach to base allocation creates an excellent occasion for creating a truly multilateral approach to transfer pricing (at least in the EU), which would be welcomed both by the MNEs (that will receive unprecedented legal certainty) and by the tax authorities (which will have the occasion to tackle any instances of transfer pricing mismatches and non-taxation). It will also allow the EU to be at the forefront of a topical issue at the international level.[344] Moreover, if executed well and correctly, such a multilateral approach might make the transition to formulary apportionment obsolete as instead of fitting

[343] More generally on dispute resolution mechanisms see section 6. of this study.
[344] OECD (2023), Manual on the Handling of Multilateral Mutual Agreement Procedures and Advance Pricing Arrangements: Enhancing Tax Certainty, OECD Publishing, Paris, https://doi.org/10.1787/f0cad7f3-en.

any business model into a standard formula, it would allow for accurate ad hoc assessment that reflects the specificities of a given group.[345]

5.5. Rules as of 2035: the formulary apportionment

Of course, all issues related to intra-BEFIT transfer pricing will become moot if the European legislator amends the future directive, dispensing the initial allocation regime and substituting it with a formulary apportionment. To do that, the Commission plans to study the possible composition and relative weight of factors by 2030 and potentially, if it 'deems it appropriate', make a legislative proposal on that basis.[346] While the authors will not delve into another discussion on the benefits/downsides of formulary apportionment, as this is beyond the scope of this study, the authors will just outline some of the issues that one might wish to take into account when undertaking a transition from TP to formulary apportionment as a mean of allocating the BEFIT base.

First, such an approach will lead to a dual legal regime whereby some transactions within a group will be outside the scope of transfer pricing rules (intra-BEFIT transactions), while others – i.e., with third-country units of the MNE and with intra-EU units which fall outside the scope of the BEFIT group but are nevertheless associated enterprises – will be subject to traditional transfer pricing. This dual regime seemed to be a significant concern for business during the public consultation on BEFIT.[347] In our view, there is nothing particularly troublesome in such a dual approach since many MNEs are already subject to something similar in the context of domestic fiscal consolidation regimes. Moreover, experience in federal jurisdictions that apply formulary apportionment has demonstrated that the approach is indeed realistic.[348]

The second issue regarding formulary apportionment concerns which factors should be taken into account for the allocation. What is currently on the table is labour, assets, and sales, with a question mark as to whether assets should include also intangible assets.[349] In the authors' view, there is no good reason for excluding intangible assets beyond simplification and preventing tax planning. However, intangible assets are such an important factor in generating value in the modern economy that excluding them for these reasons could be seen as artificial and could lead to a significant distortion between value creation and tax base allocation for some business models. Thus, the authors endorse their inclusion alongside rules for economic ownership attribution similar to the OECD modified nexus approach.[350] While such rules will not entirely exclude certain forms of tax planning – e.g. by means of shifting substantial functions to low tax jurisdictions, the authors maintain that forms of tax planning

[345] This conclusion is in line with the scepticism of abandoning the arm's length principle expressed by some: see CFE Tax Advisers Europe, Opinion Statement FC 1/2023 on the European Commission Public Consultation on the Introduction of a New Corporate Taxation System in Europe (BEFIT), 63 Eur. Taxn. 7 (2023), Journal Articles & Opinion Pieces IBFD. p. 299.
[346] See Art. 45(9) of the proposed Directive.
[347] Impact Assessment, supra n. 3, p. 75.
[348] European Commission, Directorate-General for Taxation and Customs Union, Weiner, J., *Formulary apportionment and group taxation in the European Union – Insights from the United States and Canada*, Publications Office, 2005.
[349] See the different policy options: Impact assessment pp. 29-30.
[350] OECD (2015), Action 5: Agreement on Modified Nexus Approach for IP Regimes, available at https://www.oecd.org/ctp/beps-action-5-agreement-on-modified-nexus-approach-for-ip-regimes.pdf

that rely on the shifting of substantive activities are in line with the object and purpose of the internal market and the remaining leeway for tax competition between the Member States.

Third, of course, is the practical way in which the tax base will be shifted among the Member States as a result of the formula. Even though, at this stage, the outcome is difficult to predict, a preliminary study has demonstrated a significant impact both in absolute and relative terms, with big markets significantly gaining (such as France, Germany, Italy, Poland, and Spain) and smaller markets significantly losing (such as Denmark, Sweden, Ireland, Luxembourg, and the Netherlands).[351] Since this study does not include intangibles, one might expect that the result will be less pronounced for some of the smaller economies if intangibles are included. In any event, it seems that under such conditions, achieving an agreement on a formula is unlikely. This conclusion further stresses the importance of developing a robust baseline allocation system rooted in transfer pricing.

5.6. Transfer pricing with non-BEFIT units

5.6.1. The need for a comprehensive transfer pricing rule

The rules on transfer pricing between BEFIT group members and non-BEFIT members that are nevertheless associated units also have significant (but indirect) importance for the baseline allocation of profits within the BEFIT group during the transitional regime. They influence the income of BEFIT group members and, therefore, their relative weight during the baseline allocation. Therefore, accurate transfer pricing between a BEFIT group member and an associated unit outside the BEFIT group is fundamental for the accurate allocation under the formula.

However, as a preliminary point, it remains unclear[352] why Chapter IV of the proposed Directive only directly addresses instances of low-risk distributors and contract manufacturers but does not introduce an overreaching default rule which stipulates that transactions between BEFIT group members and associated units must be priced for tax purposes in accordance with the arm's length principle (and including a definition of that principle).

While the proposal might have relied on its 'sister' proposal on transfer pricing,[353] as noted earlier in section 5.4.2.3., these are separate pending legislative proposals which, therefore, must be able to function autonomously from one another. The conclusion regarding the necessity of including an explicit arm's length principle-based transfer pricing rule in the

[351] Gilles Franssens and Hannes Polfliet, *How the BEFIT Proposal May Disadvantage Smaller Countries*, Tax Notes International, vol. 109, (2023), pp. 211-212.

[352] For instance, it does not necessarily seem to converge towards simplifications recently or currently discussed at the global level, including within the framework of the so-called "Amount B" initiative under Pillar One. Namely, with reference to "Amount B", simplifications would be prospectively introduced in connection with baseline distribution activities. Likewise, focus on "contract manufacturers" does not necessarily seem to find a match with other global initiatives nor with other simplification proposals that had already been developed within the EU Joint Transfer Pricing Forum, such as the introduction of a simplification regime for low-value-adding intra-group services, which later were also incorporated in the OECD Transfer Pricing Guidelines. Compare European Joint Transfer Pricing Forum, *Guidelines on Low Value Adding Intra-Group Services* (2009) and section 7.4.3 et seq. of the 2017 OECD Transfer Pricing Guidelines. For a reconstructive overview, see G. Maisto, *Transfer Pricing Aspects of Low Value Adding Services*, in *Transfer Pricing in a Post-BEPS World* p. 145 (M. Lang, A. Storck & R. Petruzzi eds., Kluwer Law International 2016).

[353] Transfer Pricing Directive Proposal342.

proposed BEFIT directive is further reinforced by the recent interpretation of the CJEU concerning the use of a restrictive frame of reference regarding the arm's length principle (based solely on domestic law) when it comes to compliance with state aid provisions.[354] Application of arm's length through reference to domestic law gives the Member States a wide margin of discretion in this regard, including possibly a derogation from internationally recognized standards.

Furthermore, the absence of a general transfer pricing rule might create incentives for profit shifting between domestic associated enterprises where one is a member of a BEFIT group, and the other is not. Such shifting will allow the relative weight in the baseline allocation of different BEFIT group members to be manipulated. This is especially likely and easily achievable in jurisdictions that do not apply transfer pricing rules to domestic transactions.[355] It must be noted that adopting the proposed TP directive will not remedy this problem as the scope of application of the TP rule thereunder is solely with reference to cross-border transactions.[356]

The numerical example in Table 5 below demonstrates the point.

Table 5

	ACo (10% tax rate)	**BCo (20% tax rate)**	**CCo (20% tax rate)**	
Assessment Year	-10	+90	+120	
Assessment Year BEFIT Base	200			
Y -3 taxable result	-5	+50	+45	Total result: 90
Y -2 taxable result	-5	+40	+65	Total result: 100
Y -1 taxable result	+15	+45	+50	Total result: 110
Average tax result	1,67	45	53,33	100
Baseline allocation percentage	*1,67%*	*45%*	*53,33%*	

354 LU: CJEU, 8 November 2022, Case C-885/19 P, *Fiat Chrysler Finance Europe v Commission*, EU:C:2022:859, para. 93.

355 For a comparative analysis as to which EU Member States do not apply TP to domestic transactions see S. Buriak & R. Petruzzi, Transfer Pricing Rules under the ECJ's Scrutiny: Green Light for Non-Arm's Length Transactions?, 25 Intl. Transfer Pricing J. 5 (2018), Journal Articles & Opinion Pieces IBFD, Table 1.

356 See Art. 4 of the Transfer Pricing Directive Proposal342.

Taxation	200*0,0167 = 3,34 tax base 3,34*0,1 = **0,33 tax**	200*0,45 = 90 tax base 90*0,2 = **18 tax**	200*0,533 = 106,6 tax base 106,6*0,2 = **21,32 tax**	Total tax in assessment year: **39,65 tax**

Under the above example, where the CIT rate in Member State A is 10%, and the CIT rate in Member States B and C is 20%, the total amount of taxes paid over the 200 BEFIT income that is assessed is 39,65.

Let us assume Member State A does not have a domestic transfer pricing rule, and ACo has a profitable associated enterprise in Member State A that is not part of the BEFIT group. Let us also assume that in y -1, the associated enterprise has shifted an additional 85 of profit to ACo for a total of +100 instead of the initial +15. The calculation is represented in Table 6 below.

Table 6

	ACo **(10% tax rate)**	**BCo** **(20% tax rate)**	**CCo** **(20% tax rate)**	
Assessment Year	-10	+90	+120	
Assessment Year BEFIT Base	200			
Y -3 taxable result	-5	+50	+45	Total result: 90
Y -2 taxable result	-5	+40	+65	Total result: 100
Y -1 taxable result	+100	+45	+50	Total result: 195
Average tax result	30	45	53,33	128,33
Baseline allocation percentage	*23,38%*	*35,06%*	*41,56%*	
Taxation	200*0,2338 = 46,76 tax base 46,76*0,1 = **4,68 tax**	200*0,3506 = 70,12 tax base 70,12*0,2 = **14,02 tax**	200*0,4156 = 83,12 tax base 83,12*0,2 = **16,62 tax**	Total tax in assessment year: **35,32 tax**

As demonstrated, by relying on domestic profit shifting in a low tax jurisdiction – but the same effect can very well be achieved also in a high tax jurisdiction if instead of the income, the expenses of a BEFIT group member are increased – the overall tax due in the year of assessment can be decreased from 39,65 units to 35,32 units.

The same effect can also be achieved by means of cross-border profit shifting if the countries involved have a more relaxed stance towards applying the arm's length principle. The principle under the calculations also stands if the year of assessment is taken into account in the baseline allocation, as the authors have suggested in section 5.2.2.

The above considerations demonstrate that the proposed Directive is missing a key set of provisions, namely those that should regulate the pricing between BEFIT group members and associated units that are not part of the BEFIT group. The high threshold of becoming a BEFIT group member of 75% exacerbates the problem, as such transactions could be fairly common. Moreover, while the potential adoption of the TP directive proposal would provide something of a remedy in cross-border situations, the problem would remain in case of domestic profit shifting between members of the BEFIT group and non-members. Finally, it is important to note that the 10% presumptive rule regarding the compatibility with the arm's length principle under Article 45(3) will not provide a safeguard since it applies only to intra-BEFIT transactions but not with respect to transactions between BEFIT group members and other associated units.

5.6.2. Simplified approach for low-risk distributors and contract manufacturers

Even where the proposed Directive adds specific rules on transfer pricing for transactions between associated units and BEFIT group members, this is done in a way that scarcely adds value.

First of all, the proposed Directive derives the principles of applying one-sided transfer pricing methods to what it calls 'low-risk distributors' and 'contract manufacturers' from the OECD TP Guidelines. Thus, it will be useful to rely on the same terms as the OECD TP Guidelines do. In that respect, it must be noted that the OECD TP Guidelines do not use the term 'low-risk distributor' but 'limited-risk distributor'.[357] Although this may be a small point, the authors would like to stress the need to use consistent terminology when referring to the same phenomenon, especially in light of the explicit reference that the TP directive proposal makes to the OECD TP Guidelines.[358]

Secondly, the authors highly doubt that the transfer pricing problems arising around limited-risk distributors and contract manufacturers are the most pressing for transactions between associated enterprises. Contract manufacturing and the treatment of distributors have already been covered since the 1995 OECD TP Guidelines.[359] By now, Member States have gained significant practice in determining the transfer prices of such relatively simple activities. Therefore, and in light of the more significant transfer pricing problems that may arise – as

[357] There is one exception where also the OECD TP Guidelines show a lack of consistency – see OECD (2022), OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2022, OECD Publishing, Paris, https://doi.org/10.1787/0e655865-en, p. 365.
[358] See Art. 14 of the Transfer Pricing Directive Proposal342.
[359] OECD, Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (Draft Text of Part II) The Committee on Fiscal Affairs, 1995.

demonstrated in the previous sub-section with potential important repercussions for the baseline allocation formula balance – the choice of Chapter IV of the proposed Directive is puzzling.

Finally, the authors doubt that the proposed Directive adds any specific value, even for the activities of a limited-risk distributor and contract manufacturer. According to Article 51(5)(a), the Member States retain the right to perform transfer pricing adjustments even for units that fall in the low-risk zone, so there is no safe harbour for the taxpayer. Moreover, for all the low-risk, medium-risk, and high-risk zones, the Directive uses the verb 'may' as regards the actions to be taken by the Member States' tax authorities, such as dedicating resources, monitoring, or initiating an audit. So, the provision refers to mere possibilities but contains no hard rule in the sense of an obligation.

Thus, when it comes to the simplified approach to transfer pricing with non-BEFIT group members that are associated enterprises, the proposed Directive picks two not especially complicated transfer pricing scenarios and introduces rules that recommend certain behaviours to the tax authorities, which already have ample experience on how to deal with these specific scenarios. At the same time, the proposed Directive is silent on all other instances of transactions between BEFIT group members and associated enterprises outside of the group.

5.7. Power of the Member States with their allocated tax base

No matter whether the BEFIT base will be allocated under the transitional regime centred on transfer pricing or on the potential formulary apportionment, the Member States will remain obliged to make certain domestic adjustments[360] and have the option of making further adjustments based on their domestic CIT.[361]

The mandatory adjustments are all related to timing issues between the previously applicable CIT and the BEFIT regime, whereby there is a mismatch between the revenues and costs (accruing/being incurred before the BEFIT Directive is applicable) and their potential inclusion in the tax base (after the BEFIT Directive is applicable). The goal here is to have these items taken into account in the domestic allocated base but not in the consolidated one. The same treatment is awarded to pre-BEFIT losses, the issues surrounding which were already discussed in section 5.2.3 above. Then, Article 48(1)(h)-(j) provides that Member States must grant further deductions as long as they are deductible under their domestic corporate tax law. As noted under section 5.2.3 above, the authors consider that the same treatment should be extended to domestic pre-BEFIT losses.

The most significant power that the proposed Directive grants the Member States is provided under Article 48(2). This provision will be the main focus of this sub-section. It is instructive to start by examining the provision and then commenting upon its proper interpretation. Article 48(2) reads as follows:

"In addition to the adjustments listed in paragraph 1, a Member State may allow for increasing or decreasing, through additional items, the allocated part of BEFIT group members

[360] See Art. 48(1), (a)-(g) of the proposed Directive.
[361] See Art. 48(1), (h)-(j) and Art. 48(2) of the proposed Directive.

that are resident for tax purposes or situated in the form of a permanent establishment in that Member State."

At first glance, nothing in this provision suggests that there are any limits as to the additional items from its corporate tax system that a Member State may rely on to decrease or increase the allocated share of the respective BEFIT group member that is resident in its territory. This is a significant and unexpected twist as compared to the founding principle of Article 1(3), according to which the domestic CIT does not apply to BEFIT group members unless expressly stated otherwise by the Directive. Article 48(2) may deprive this principle of any meaning as the exception it introduces is so broad that any domestic CIT rule can be relied upon whenever the Member State so provides.

Since such initial textual interpretation is, to say the least, problematic, the authors referred to the recitals and the explanatory memorandum to confirm the meaning. Recital 14 provides as follows: 'Member States would also be free to further adjust their allocated share *without a ceiling* in order to ensure that Member States can make their national policy choices in this area.' [emphasis added] The explanatory memorandum further confirms the interpretation by reading: 'Member States will be free to further apply any deductions, tax incentives, or base increases to their allocated parts, *without restrictions* (Article 48, paragraph 2).' [emphasis added].

It seems clear that the proposed Directive intends to award the national tax policymakers with the greatest possible room for manoeuvre to further adjust their allocated share of the tax base. So much so that, without a limit, it may deprive the whole BEFIT Directive of any value. To see whether this would be indeed the case, it is useful to refer back to the main objectives of the BEFIT Directive. In considering the impact assessment of the proposal, the explanatory memorandum, and the recitals, several expressions stick out: 'tax simplification', 'single set of corporate tax rules', and 'cross-border loss utilization'. Article 48(2) may nullify all of these aims.

Since Article 48(2) allows for tax base increases and decreases to be applied at will, one might need to recompute the national tax base. If a Member State wishes, its whole CIT system may actually "survive" the BEFIT regime. Moreover, the authors argue that a Member State may potentially even rely on Article 48(2) to undermine or eliminate the effects of cross-border loss-utilization. The amount of cross-border losses' that impact any group member is easy to compute by simply comparing the preliminary tax result of a BEFIT group member (not taking into account foreign losses) with the allocated tax base share of that BEFIT group member (after foreign losses have been taken into account at the level of the computation of the BEFIT tax base). A rule that will entirely nullify the effect of foreign losses would be a domestic rule on the basis of Article 48(2) in the sense that the domestic allocated part of a BEFIT group member is increased by the difference between the preliminary tax result of a BEFIT group member and the share that would have been allocated to it under Article 45 if the taxable result of the group member and the group were computed with respect to the year in question and not based on the average of the previous three fiscal years.[362]

[362] The additional relevance of the modified baseline allocation in such a case would be in order to avoid the effects of averaging when trying to recapture any benefit of a foreign loss utilization.

The above demonstrates that the potential functioning of Article 48(2) might make the whole objective of the proposed Directive moot, as both cross-border loss utilization and the harmonization elements may be circumvented. In such a case, the added value of the act is negative as it only creates further compliance burdens – leaving MNEs having to compute three separate tax bases: the national base, the base under the proposed BEFIT Directive, and the base under the GMT Directive – without delivering on the BEFIT's promised objectives. The authors understand that the provision of Article 48(2) might have been included in the hope of reaching unanimity for easier adoption of the proposed Directive. It should be noted that no such rule was included in the the unsuccessful 2011 CCCTB proposal,[363] as well as in the 2016 CCCTB proposal.[364] However, if including such a provision is the price to be paid for reaching an agreement, there is little point in adopting this piece of secondary legislation. Adoption may do more harm than good in light of the failure of its stated objectives if no limitations are introduced as regards the remaining normative power of Member States.[365]

When discussing the way forward with respect to domestic adjustments, the first and foremost point the authors want to make is that Article 48(2) should be simply deleted. Still, if one wants to keep a margin of discretion for the Member States, this should be done by including further *explicit* options in the list of what is now Article 48(1). These might encompass common incentives/base increases that the Member States might choose from, but this must be for the Directive itself to harmonize and not left for the Member States' national tax policies "without a ceiling". As a compromise solution, as an alternative policy option, the scope of Article 48(2) might be restricted only to instances of tax incentives[366] but exclude discretionary increases of the tax base.

[363] See Art. 102 of the CCCTB (2011) proposal, supra n. 25.
[364] See Art. 44 of the CCCTB (2016) proposal, supra n. 32.
[365] A similar position was already expressed also by the Netherlands, see Beoordeling Richtlijn Business in Europe: Framework for income taxation, p. 9, available at https://open.overheid.nl/documenten/dc837b31-4319-4913-b8cb-4e74e158c024/file
[366] That are anyway subject to the Pillar Two restrictions at least when it comes to the mandatory in-scope MNEs.

6. Administration and procedures

6.1. General issues

6.1.1. The new BEFIT tax procedure in a nutshell

The proposed BEFIT Directive introduces common procedural rules for CIT across the EU, which limit the sovereignty of EU Member States in this area. It introduces some important supranational rules on filing, assessment, audits, administrative reviews and judicial appeals for in-scope groups.

This is an ambitious innovation. It strengthens the body of EU supranational procedural tax law and prevents some of the disparities that might otherwise arise in the application of the BEFIT system on the mere basis of national procedural autonomy. It is, in fact, to allow that the interpretation and application of the rules of the proposed Directive could be homogeneous across the entire European Union and should be welcomed. An indirect effect of this harmonisation is also to facilitate collaborative work between tax authorities from different countries, which might primarily take place by electronic means.[367]

Time will tell whether this system can correctly function in the absence of a centralised monitoring authority, with technical oversight to secure homogeneous interpretation and application by the various teams of tax authorities (the so-called BEFIT teams). The possibility of establishing a BEFIT oversight body remains a suitable option for the future. Such a body could secure the stability of administrative practice and could be consulted by the BEFIT teams and entities, nudging correct and homogeneous interpretation of the common normative framework (such as tax authorities do at the domestic level), creating legitimate expectations on the side of the taxpayers and preventing possible discrepancies in the practice of the BEFIT teams. Other areas of EU law of joined cross-border supervision have certainly benefited from the existence of such bodies. A good example in this regard is the European Banking Authority (EBA), which has ensured over the years consistent prudential supervision by the national authorities in the European banking sector.

The proposed Directive is presented as a one-stop shop for tax compliance in the European Union for large corporate entities.[368] Still, the authors are not entirely persuaded that the procedural requirements contained in the proposed Directive are entirely consistent with such pursued rationale. This section will review Chapter V and (some parts of Chapter VI) of the proposed Directive to verify this hypothesis. It will also assess the procedural steps and how they align with the traditional categories of procedural domestic law, putting forward some concrete proposals for amendment, which can streamline the procedures and set aside some unnecessary steps. This kind of assessment is particularly important if one considers that the procedural requirements contained in the proposed Directive do not prevent the application of domestic procedural rules of EU Member States and, in some cases, rely on their correct functioning.

Preliminarily, Article 1(3) of the proposed Directive refers to "corporate tax law" without including any more precise reference to whether it also comprises procedural matters. This might create legal uncertainty for some interpreters as to the potential implication of this

[367] This is confirmed by the wording of Article 60(3), which indicates a preference for communication by electronic means within the BEFIT team.

[368] See Explanatory Memorandum of the proposed Directive, pp. 16-17.

clause for the procedural rules of corporate tax. This means that procedural matters, as long as they are not regulated explicitly by the Directive, remain within the realm of the national procedural autonomy of the Member States subject to the principles of equivalence and effectiveness. The EU Commission has no power to adopt delegated acts that amend procedural rules. Moreover, as noted in section 3., it remains for national procedural law to govern the way in which the mandatory scope groups can exercise the opt-in right provided under the proposed Directive.

The cornerstones of the procedure are contained in Articles 54-72 of the proposed Directive. The analysis in this section reviews such rules to the extent required for addressing the specific issues related to the main hypothesis. However, for that purpose, the analysis will also cover the data protection clause and all other issues concerning the protection of fundamental rights of taxpayers raised by the BEFIT proposed Directive.[369]

The filing of tax returns has a central relevance within the architecture of the proposed Directive. The existence of a two-tier set of filing obligations is, by its own nature, in contradiction with the one-stop shop approach envisaged as an aim of the proposed Directive. Contrary to that aim, the proposed Directive imposes filing obligations both at the level of the filing entity and at the level of the individual group members, whereas the latter is not, from a technical perspective, unavoidable. The two filing obligations are bundled in a way that the so-called preliminary tax result from the BEFIT information returns is presupposed for the filing of the BEFIT information return. For this reason, the proposed Directive might have limited the filing obligation of the individual tax returns to supply only those facts that the filing entity might not be able to identify independently based on the BEFIT information return. Alternatively, it could have required the filing entity to report, on behalf of all BEFIT group members, the factual information needed for the assessment at the Member States' level (and that is currently required for individual tax returns). By contrast, the choice of the proposed Directive is to establish a full-fledged obligation to file tax returns at both the central level and that of the group members. This is an unnecessary duplication, which creates a structural exposure to parallel flows of information within the group, an extra burden for the group entities and a source of complexity for tax authorities to handle within the BEFIT team. Eventually, it deprives the expression one-stop shop of its meaning, as the current architecture of the proposal turns it into a one-*more*-stop shop.

The BEFIT team constitutes perhaps the most important procedural innovation introduced by the proposed Directive. It is the starting point of EU-wide tax administration and an evolution of the concept of joint audits, which also operate in the framework of the proposed Directive. The BEFIT team is, in substance, a dedicated international team of tax authorities in charge of implementing the procedure for each BEFIT group, which operates in line with commonly established rules. That a non-national BEFIT team has the power to make final decisions on tax-relevant facts in direct taxation within the European Union is an important innovation.[370]

[369] This delimitation of the boundaries of this section will indirectly allow to consider, together with Article 72, also other clauses of the proposed Directive concerning penalties, such as the ones contained in Articles 16 and 59.
[370] This can be inferred from the wording of Article 61(2) 2nd sentence, subject of course to the right of tax authorities to conduct tax audits.

The operation of the BEFIT team engages all relevant tax authorities from the Member States involved and is headed and coordinated by the Member State of the BEFIT filing authority. The work conducted by the tax authorities of such EU Member States proceeds in parallel with that of the BEFIT team, even though the proposed Directive introduces some limits to the operation of domestic law. A good example of such limits is the final nature of the content of some parts of the BEFIT information return.[371]

The procedures concerning each group member culminate in the filing of the individual tax return, but are supplemented by the so-called individual tax assessments, conducted by tax authorities in each country of the group members and presupposed for the continuation of the procedure until the final levying of taxes. While the BEFIT team ensures the consistency of the procedure with the rules of the Directive across the different countries,[372] the actual audits[373] and enforcement[374] will still be governed by the applicable rules of the Member State of the individual tax assessments.

The separation between the obligation to file tax returns and the tax assessment in the Member States of the BEFIT group entities constitutes another innovative point of the BEFIT procedure. Such activities are normally bundled together and imposed on taxpayers, who are usually required to proceed with the so-called tax self-assessment and voluntary compliance. Reintroducing the direct engagement of tax authorities as a necessary step in the assessment of taxes seems like a step back in the history of tax procedures. A possible justification for such an option might have been the need to align tax assessment with the operational framework of the BEFIT team in a way that reduces the scope for possible inconsistencies. However, it creates a disconnection with how the same procedure operates in the Member State of the filing entity and, more in general, with the architecture of domestic procedural tax law throughout the European Union. This might lead to practical issues, such as, for instance, in the dynamics of tax assessment and auditing, whereby the latter is currently designed and operates as a reassessment by tax authorities of how taxpayers have determined the applicable taxes. Such issues will be analysed in more detail in this section.

Another surprising element of Chapter V of the proposed Directive is that the wording of the rules preserves the relevance of the information tax returns throughout the procedure and when tax authorities adjust them. From a conceptual perspective, this is rather odd, as the adjustment is conducted through administrative acts issued by tax authorities, which are more directly relevant to the procedure than the initial fact-finding produced by the taxpayers in the tax return. From a procedural perspective, the administrative acts of adjusting the tax returns remain the sources of potentially adverse effects arising to the legal sphere of the taxpayers and are, therefore, the ones that steer the procedure. Consequently, even when the proposed Directive refers to the amended or adjusted tax returns, it in fact, means to refer to the outcome of the administrative acts issued by tax authorities amending such returns, which are the ones that will constitute the object of administrative reviews and judicial appeals.[375] Accordingly, from the latter perspective, there seems to be, in fact, less of a difference with the conceptual

[371] See Art. 61(2) 2nd sentence of the proposed Directive.
[372] See Art. 61 of the proposed Directive.
[373] See Art. 65(3) of the proposed Directive.
[374] See Art. 64(1) 2nd sentence of the proposed Directive.
[375] In conformity with the rules contained in Arts. 66-69 of the proposed Directive.

framework of tax procedures that would otherwise apply under domestic law of EU Member States.

For the sake of precision, it is useful to mention that the proposed Directive includes a *de minimis* threshold in various clauses to limit the relevance of variations that do not exceed the lower of 10 000 EUR or 1% of the BEFIT tax base.[376] All such clauses essentially share the same content and might have justified the inclusion of a single provision on *de minimis*. Nevertheless, there is no *de minimis* rule in Article 58 on the errors in the BEFIT information return, and this might have been the reason not such a single clause.[377]

After the filing and the assessment, the BEFIT procedure might continue with the audits, to be initiated upon initiative of tax authorities of the country of residence of the BEFIT group member (or of the location of the permanent establishment) and allows joint audits in line with Article 12 of the Directive 2011/16 on Administrative Cooperation on Direct Taxes. Surprisingly, the proposed Directive neither contains an express reference to Article 12a of the Directive on Administrative Cooperation (which is the applicable rule to joint audits, as amended by the so-called DAC 7)[378] nor establishes a clear mechanism for cases of parallel initiation of tax audits by the tax authorities of different EU Member States. Considering the complexity of those matters and the simultaneous applicability of national procedural rules, which might include different methodologies for conducting tax audits, the risk of parallel audits is not merely a theoretical one. There are also no rules to prevent conflict between different audits or that prevent multiple audits within the BEFIT group team. In this respect, it should be noted that the territorial limitation of the power to initiate an audit in the country of residence does not, per se, exclude such risk, considering that there might be issues in the relations between head office and permanent establishments or between entities that are resident for tax purposes in more than one country. Such circumstances might generate a potential conflict with the foundations of the prohibition of double jeopardy, which are acceptable in the context of non-harmonised systems but might raise critical issues in the context regulated by secondary EU law that introduces a common procedural system. Nevertheless, the BEFIT proposed Directive at least does include a clear obligation for tax authorities that decide to initiate a tax audit to inform the BEFIT team of the results of such an audit.[379]

Regardless of whether an audit takes place, taxpayers have the right to request the review of any administrative act issued in the framework of the proposed BEFIT Directive by

[376] Such de minimis clauses are included in Article 63(4) in respect of errors in the individual tax return, Article 64(4) in respect of individual tax assessments, Article 65(6) on tax audits, Articles 66(4) and 67(4) on administrative reviews, and in Articles 68(4) and 69(4) on judicial appeals.

[377] From a policy perspective, the authors of this study wonder whether the choice of not including a *de minimis* clause also in Article 58 is reasonable and consistent with the overall architecture of the proposed Directive, also considering the following two reasons. First, the outcome of the preliminary tax result of the BEFIT information return is done by assembling the individual results of each group member. This argument might nevertheless also justify the intention of avoiding a double counting of the *de minimis* rule. Second, it might be strange to have a *de minimis* clause on the reviews and appeals of the BEFIT information return, but not on the return itself.

[378] Council Directive (EU) 2021/514 of 22 March 2001 in OJ L 104/1 of 25 March 2021.

[379] See Art. 65(4) of the proposed Directive. The second sentence of this clause also allows the other members of the BEFIT team to express their views within three months.

activating the rules on administrative reviews[380] and judicial appeals. The rules contained in the proposed Directive

However, in the phases of administrative reviews and judicial appeals, the two-tier procedural system may lead to overlaps and unnecessary complexity, narrowing down the content of possible objections that the filing entity and other group members may have. This choice is the consequence of the intention to keep consistency with the parallel running of the two parts of the procedure from the moment of filing the tax returns. However, for the reasons outlined later, it might run the risk of leaving a group member without an effective legal remedy.

Furthermore, the different paces of administrative and judicial procedures in the various countries may create a bias between reviews and appeals in favour of the countries that do not include an obligation of prior exhaustion of the administrative review as a condition to access justice. The proposed Directive allows for direct filing of the judicial appeal in countries whose procedural rules do not foresee an obligation of prior exhaustion of administrative reviews.[381] The wording of the proposed Directive is unclear as to whether the competence of the administrative review body of first instance excludes further review by other administrative instances (in case it was applicable under the relevant domestic law).[382] However, even if the administrative review were capped at one single instance, there would be a structural bias for countries that secure a swifter time to justice and, in the presence of a final judicial decision by a Member State, delicate procedural issues might arise as to whether the rules of the proposed Directive may overcome it in the interest of the correct interpretation and application of EU law to the facts of the case.

Even though the object and purpose of the proposed BEFIT Directive is to harmonise procedural rules, the existence of a Directive will unavoidably raise additional issues. This is certainly the case of the protection of taxpayers' rights, which will be addressed in the final part of this section.[383] In *Berlioz*,[384] the Court considered fundamental rights applicable in connection with DAC, based on the general principles of EU law, as enshrined in the EU Charter of Fundamental Rights, despite the absence of specific rules in the Directive. Our study will apply this line of reasoning in a comprehensive way, i.e., to the situations expressly regulated by Articles 70-72 and 76, as well as to the ones that do not find an express regulation but should still be considered.

6.1.2. The strive for harmonising procedures applicable to CIT: bringing together law, policy and compliance

[380] The expression administrative reviews shall be used throughout this paper, as it reflects the power of tax administrative to review an act issued by tax authorities and correct it. Moreover, this terminology will also mark the distinction with the right of the taxpayers to prompt such authorities to conduct such review and the one to appeal before an impartial body which administers justice. Due to such features, the latter body constitutes a judicial instance under EU law, i.e. a tribunal, which might refer a case in the framework of a preliminary ruling procedure to the European Court of Justice.

[381] See Art. 66(1) 4th sentence and Art. 67(1) 4th sentence.

[382] See Art. 66(1) 2nd sentence and Art. 67(1) 2nd sentence.

[383] See sec. 6.4. of this study.

[384] LU, CJEU, 16 May 2017, Case C-682/15, Berlioz, EU:C:2017:373, para. 49.

From a policy perspective, the approach taken by the EU Commission in the proposed Directive is generally consistent with the goals that it pursues also when it comes to overcoming procedural tax disparities. Such disparities exist even within more harmonised areas, such as VAT. Disparities should not be underestimated when pursuing the goal of enhancing the functioning of the internal market and simplifying the tax rules that govern the levying and implementation of taxes.

The proposed Directive overcomes the traditional reluctance to enter the mazes of such disparities, introducing – at least to some extent – common rules. However, three policy choices require some closer consideration.

First, the proposed Directive keeps the application of domestic procedural rules but makes them subject to some specific limitations. This policy choice creates a fragmentation in the applicable procedural rules, which might be difficult to manage in practice. Fragmentation is, in principle, unavoidable when new rules apply to some taxpayers only. However, the way in which the proposed Directive shapes this fragmentation is potentially problematic. Moving away from self-tax assessment in the countries of the group members can create different dynamics in the relations with tax audits, which will focus on the facts filed by such entities and reassess taxes that have already been the object of an assessment by tax authorities. One may wonder how issues regarding the burden of proof, timing of allegations, and duplications are going to be solved.

Second, the proposed Directive qualifies as tax assessment the one conducted by tax authorities at the level of each group entity, but not the outcome of the conduct by the BEFIT team. Article 61 of the proposed Directive indicates that the objective of the activity conducted by the BEFIT team is the agreed determination of the content of the BEFIT information return among all participating tax authorities.[385] The issue might arise as to what is the correct characterisation of the activity of the BEFIT team. Certainly, it does not start as an audit, and its substance seems closer to that of an overall scrutiny of the filed group return. This has consequences for the local-level tax return as some of the facts, as green-lighted by the BEFIT team, must mandatorily be inserted in such individual tax returns. The issue arises as to whether taxpayers could have a remedy against the BEFIT team outcome, insofar as it sets tax-relevant facts that must incorporate the ones contained in the individual tax return. Article 61 of the proposed Directive remains silent, but Articles 66 and 68 indicate that there is a right to administrative review and judicial appeal in respect of the information return. This means that access to the latter procedures arises in respect to the verdict of the BEFIT team, too. This is interesting from a procedural perspective, especially if one considers that the filing (tax) authority will notify an administrative act even in cases where the absence of a consensus has prompted a majority voting under Article 61(4) of the proposed Directive that might have also concluded with a negative position by that very tax authority.

Third, the proposed Directive creates a two-tier procedural system, which introduces fact-finding and/or gathering both at the level of the filing entity and at the level of each group member. The wording used by Article 57(3)(d) of the proposed Directive seems to indicate that some facts contained in the BEFIT information return must then be reflected in each BEFIT group member's individual tax return. Accordingly, some data may have to be filed twice. The proposed Directive contains clear-cut information obligations among the tax authorities

[385] Exception being made for Art. 57(3)(d)(i) of the proposed Directive.

involved in the procedure. However, the two-tier data filing generates unnecessary complexity in an already complex system. From a policy perspective, the presence of a BEFIT team with technical competence on the data filed by the BEFIT group of entities might have justified a more ambitious attempt to have this body taking control of all aspects of the corporate income tax filing procedure, which could have secured a one-stop shop filing. This means that the proposed Directive might have chosen instead to oblige the BEFIT group members to supplement the filing provided by the filing entity with additional information that could best be known at the level of such entities.

Fourth, continuing the point of the one-stop shop, the authors of this study acknowledge that the preamble depicts it as such. Indeed, in-scope groups can now comply with part of the filling obligations through one single entity. However, the combination of national procedural rules with the two-tier set of procedures related to the filing entity and the group members creates a significant potential for unnecessary duplications. In particular, this means that the group entities are still exposed to several tax assessments in the countries in which they operate, several tax audits, to conflicts between assessments and audits, as well as to administrative reviews and judicial appeals that may arise in such context.

Fifth, the proposed Directive does not include a proper set of dispute resolution rules. Certainly, some of them may already be addressed with the existing instruments. This is, for instance, the case of those that fit within either the EU Dispute Settlement Directive, or the Arbitration Convention. However, most of such disputes fall under neither of them. Based on such grounds, it would be highly desirable to supplement the existing rules with dedicated supranational dispute settlement mechanisms. Such instruments might also operate along the procedural schemes of the EU Cross-Border Dispute Settlement Directive and set the pace for a potential unification of all existing procedures applicable under supranational law of the European Union in direct taxation. Alternatively, the scope of the dispute resolution directive could be enlarged.

The scope of the proposed Directive mainly addresses the collection of taxes by large multinational enterprises operating in the EU. The steps enshrined in the proposed Directive presuppose that the procedure follows the scheme filing-assessment-audit-administrative review-appeals. However, tax compliance of multinational enterprises relies to a growing extent on an ex-ante approach, which prevents possible contentious assessments of relevant facts between taxpayers and tax authorities. Besides the analysis of advance pricing agreements, it is important to verify here how the proposed BEFIT procedural rules can operate in the presence of mechanisms of cooperative tax compliance and advance rulings, as well as with other pieces of secondary EU legislation in the field of tax procedures.

Cooperative tax compliance presupposes a trust relationship between the parties of a tax relation, namely the taxpayer and the tax authority. Its growing popularity in various tax systems where it was introduced shows its importance, and it should not have been ignored in the context of BEFIT. One of the essential features of cooperative tax compliance is that tax authorities establish an ex-ante constructive dialogue with taxpayers on tax-related facts. In such context, tax authorities are normally bound by what they agreed, except in limited cases (such as, for instance, in case of subsequently discovered fraudulent cases). Exception being made for the latter cases, the legitimate expectations of taxpayers acting in good faith are to be protected. Therefore, tax authorities cannot legitimately change their position in such circumstances.

It remains dubious whether the proposed Directive leaves enough room to rely on domestic procedural law in the country of each group member for the purposes of applying national cooperative compliance regimes. In any event, when one looks at the potential implications arising from the decisions of the BEFIT team concerning the allocation of the BEFIT information return, the authors of this study wonder if the lack of an explicit possibility to rely on some form of cooperative compliance may not raise some critical issues that might be worth addressing with an ad hoc intervention. If reliance on domestic procedural rules is possible for the purposes of cooperative compliance programs, one such issue is whether BEFIT groups will not be positioned to choose the Member State of the ultimate parent entity or filing entity for the purposes of gaining access to an existing domestic cooperative compliance program. It remains unclear how this would affect the functioning of the BEFIT team and the other Member States that would be impacted by the BEFIT information return and that have not agreed to the exact scope and framework of such cooperative compliance. If reliance on domestic procedural rules for the purposes of cooperative compliance programs is not possible, the question remains whether this would not amount to discriminatory treatment of BEFIT groups as compared to other groups that have access to cooperative compliance. Thus, and in order not to leave the outcomes of this important issue to uncertain reconciliatory interpretation, the authors suggest introducing some ad hoc adjustments in the text that make the reference to and the impact of cooperative compliance programs clearer. In this respect, another possible approach may be to rely on the work developed within the framework of the European Trust and Cooperation Approach (ETACA), which, in its pilot phase, has seen the participation of the Tax Administrations of some Member States as well as the involvement of several multinational groups that may likely to fall also within the scope of application of the BEFIT initiative.[386] While it is true that the programme has focused primarily on a high-level risk assessment for transfer pricing purposes, it comes across as a remarkable innovation on the procedural plane as it envisages to develop an EU cooperative compliance framework and may thus bridge the earlier delineated gaps in this area.

Similar problems may arise from the perspective of advance rulings, given the binding commitment of tax authorities to its content. For this reason, no further analysis of such issues is addressed, and the criteria outlined in respect of cooperative tax compliance may operate *mutatis mutandis* also to reconcile the content of the procedural rules of the proposed Directive with advance rulings. Regarding the presumptive transfer pricing rules as regards intra-BEFIT transactions, one can question whether a domestic APA might be relied upon for rebutting the presumptions with ex-ante effects.[387]

An additional procedural issue arises as to the coordination of the proposed Directive with the system of administrative cooperation in tax matters, which might require attention to prevent possible undesirable consequences from a policy perspective or doubts as to the interpretation and application of the relevant rules.

A good starting point for addressing such issues is the reference to joint audits contained in Article 65 of the proposed Directive. Besides the issues concerning their legal basis in DAC,

[386] Compare the Guidelines on the European Trust and Cooperation Approach (ETACA) released in 2021.
[387] See sec. 5.4.2. of this study.

it is important to understand whether the information circulated in the framework of the BEFIT procedures falls within the boundaries of the DAC system.

Even though the proposed Directive does not address those issues expressly, the circumstance that all this information is handled by tax authorities within the European Union should be sufficient to make it eligible for mutual assistance in such a context. This interpretation secures a wide degree of access to tax-relevant information by tax authorities throughout the Union. Adding a dedicated clause in the proposed Directive or in one of the next amendments to the DAC system might be a meaningful option. For the sake of completeness, the authors acknowledge hereby that the proposed Directive does include clauses on disclosure in Article 71 and on data protection in Article 76. The issues raised by both clauses will be addressed in more detail later in this Section.[388]

The overall analysis of policy and compliance matters shows that some amendments to the proposed Directive might be meaningful. The amendments suggested in this section will not only achieve a more harmonious degree of consistency between tax policy and compliance, but also enhance the consistency of the rules with the principles of EU law and remove possible doubts of interpretation and application.

6.1.3. Applicable procedural law, terminology, and definitions

Terminology issues are often hard to address at the level of interpretation and application of EU Directives, especially due to the autonomous characterisation for EU law purposes and the fact that EU Member States might introduce additional conceptual and wording nuances when implementing secondary EU law into their national legislation.

The choice of including definitions within the text of the proposed Directive and of finding other ways to clarify the meaning of the expressions used by it is welcome. This choice reflects a consolidated approach of the European Commission to such issues and the criteria of clear and reasonable legal drafting.

From the perspective of the procedural content of the proposed Directive, three main techniques are used to achieve conceptual and terminological clarity.

The first technique is to rely on domestic law. Considering the traditional relevance of domestic procedural law, the proposed Directive uses this technique to a large extent by determining which domestic law concretely applies. This type of intervention should be very positively evaluated, as it prevents possible disputes on the determination of the applicable domestic law.

Merely as an example, this occurs in four sets of rules. The first rule is the one of Article 61(2) 3rd sentence and relies on domestic law of the Member State of residence of the group member (or of the location of the permanent establishment) for determining the content of the BEFIT information return concerning the tax base, its allocation and the respectively applicable percentage. The second rule is contained in Article 64(1) 2nd sentence and establishes the relevance of domestic law of the State of tax enforcement. Such implicit reference to the law of the State where the individual tax assessment takes place may be deemed to exist in Article 64(1), too. The third set of rules includes Articles 66(1) 2nd and 4th sentences and,

[388] See sec. 6.4.2. of this study.

symmetrically, 67(1) 2nd and 4th sentences and refers to the determination, respectively, of the administrative body competent to hear the request for a review and the applicable procedural rules on the BEFIT information return and the individual tax assessment. The fourth set of rules includes Articles 68(1) 2nd sentence and, symmetrically, Article 69(1) 2nd sentence for applying the procedural rules of the Member State in which the judicial appeals take place. It should be noted that a reference to the laws of the Member State is also included in Article 71 for allowing such State to use the information collected by means of this proposed Directive for its own tax administration and enforcement purposes.

Interestingly, the proposed Directive remains silent as to the rules that will govern the BEFIT information return and the BEFIT team. However, the point can be made that the procedural tax law of the State of the filing entity and authority (which include rules that have implemented the mutual assistance directives) will be applicable with a subsidiary function to all aspects of the BEFIT information return that are not expressly regulated in Articles 57, 58 and 59 of the proposed Directive. Accordingly, one might, for instance, hold that the failure to file a BEFIT information return might not immediately trigger the consequences of Article 59 if the law of the Member State of the filing authority includes some tolerance for late filing.

The second technique consists of the inclusion of some definitions in the text of the Directive or a reference to other Directives. Some appear in Article 3. As far as the procedural aspects are concerned, the list includes those of "filing entity" in n. 10, and of "filing authority", in n. 17 of Article 3.

The definition of filing entity primarily refers to the ultimate parent entity and is formulated in a way that prevents possible problems in cases where such an entity is not established in the European Union, allowing for a choice by the non-EU ultimate parent entity to appoint another entity, established in the EU, for such purpose. Issues may arise for dual-resident ultimate parent entities. It is consistent with the object and purpose of this proposed Directive to consider that the Member State with a stronger personal tax nexus, as determined in light of the applicable double taxation convention, should prevail. However, this outcome is not clear from the text of the proposal since the latter does not refer to the residence but to the 'location' of an entity without giving clear guidance as to when an entity would be 'located' in a Member State. Moreover, even if this was to be understood as a reference to tax residence, the tax residence under domestic law is not affected as such by double taxation conventions, for the latter allocates residence via the tie-breaker only for the bilateral treaty pair but not erga omnes. Hence, an explicit reference to double residency situations must be made, and a potential solution, at least for instances where double tax treaties apply, should be explicitly introduced. This is especially relevant in the case of an ultimate parent company that is a dual resident of an EU and a non-EU Member State since the wording of n. 10 leaves ample room for ambiguity. In any case, the proposed Directive could be amended to include these scenarios.

Issues may also arise when the ultimate parent entity transfers its residence to another Member State. This may occur when the tax rules on domestic law of tax residence determine that such a transfer has occurred.[389] The proposed BEFIT Directive remains silent on this issue.

[389] A specific problem might also occur in case of transferring the corporate seat in circumstances where this leads to the company losing legal personality – e.g. in case of a transfer from a real seat to a statutory seat country. However, the outcome of such a transfer would need to be treated in accordance with the factual pattern and any PEs that might arise from it since whether or not a legal entity exists is solely determined by national law.

The authors of this study find it hard to address such issues at the level of interpretation and consider an amendment needed. Such amendment might include the opportunity for an agreed assessment of the change of tax jurisdiction, which also determines the moment in which the filing authority hands over its function, including within the BEFIT team. This is also prompted by the fact that the definition of "filing authority" in the proposed Directive includes a reference to the competent authority of the Member State of residence of the filing entity and, therefore, presupposes a prior identification of the residence of such entity. This definition also includes a reference to permanent establishments with a view to overcoming possible situations in which there is no State of residence. The latter criterion should have a subsidiary function only as to the reference to the State of residence of the entity.

Chapter V itself does not contain any definition, but some terminological implications arise in connection with the wording used by the English version of Article 55 of the proposed Directive, which refers to the "fiscal year" as a synonym of "tax year".[390] The choice not to include definitions within Chapter V might be due to the goal of securing consistency with the substantial content of the proposed Directive to which the procedural parts are, in essence, instrumental. Definitions are instead contained in other Chapters of the Directive, such as, for instance, in the case of the concept of "preliminary tax result", which is contained in Art. 4 (1) of the proposed Directive.

Chapter V uses the expression "competent authority" without defining it. In the absence of possible criteria that identify the precise meaning of these expressions, interpretative issues may arise. Such issues may be addressed by applying domestic law and the definition contained in the Mutual Assistance Directive. Domestic procedural law will also make it possible to understand the exact meaning of tax assessment in Article 64 and of audits in Article 65 of the proposed Directive.

When looking at situations in which the proposed Directive expressly refers to definitions of procedural matters contained in another Directive, the best example arises as to the determination of joint audits. Article 65 of the proposed Directive defines them by reference to Article 12 of the Directive 2011/16/EU, by indicating that they "shall be conducted in accordance" with such provision. The circumstance that DAC 7 has introduced a new Article 12a to the Directive 2011/16/EU might raise critical issues as to the relevance of this clause, which might be easily overcome in case the reference to the latter Directive remains, but the indication of the relevant clause is deleted.

The third technique used by the proposed Directive is to provide elements that define the content of what it regulates. There are various examples of this technique throughout Chapter V of the proposed Directive. This occurs in Article 54 as to the meaning of BEFIT group; in Article 57 as to the content of the BEFIT information return, which contributes to delimitate the conceptual boundaries of this return as compared to the individual tax returns regulated by Article 62; in Articles 60 and 61 as to the BEFIT team.

6.2. Filing, assessment and audits

[390] The influence of the expression "*fiscale*", often used in the French versions of official EU documents, influences the official terminology used in official acts of the European Union, which differs from the expression "tax" that is more common in the English technical idiom to mark a clearer distance from budgetary implications.

6.2.1. The relationship between filing, assessment and audits

Filing, assessment and audits implement the philosophy of the one-stop shop approach, which streamlines the levying of taxes and prevents cross-border procedural disparities by steering the bulk of such procedure towards one single entity and country.

Filing of tax returns consists of communicating all relevant facts for levying corporate income taxes in conformity with the requirements of the BEFIT procedure. It is the core part of such procedure, which contains innovative rules, making it possible for groups of companies to streamline the filing of tax returns across the different countries of the European Union in which they operate. In the BEFIT procedure, the filing starts at the level of the ultimate group parent and is passed down to the individual entities of the BEFIT group. The authors of this study wonder whether this duplication of the compliance burden is necessary. It might have instead been preferable to limit the obligation of the individual group members to the sole facts that are known to them only, i.e., to supplement the BEFIT information return with such content. Alternatively, all group members could be requested to provide such information to the filling entity, which would provide all group and local information merely once, at the central level.

The assessment of taxes constitutes a separate activity and requires competent authorities of the Member States in which the group members are resident (or, in the case of the permanent establishment, located) to assess on the basis of the tax returns. In such a context, it represents a necessary component of the BEFIT procedure at the local level (i.e., that of group members), which duplicates the functions that can be performed with the combination of self-assessment of taxes by such taxpayers and audits by tax authorities.

The audit of tax returns is part of the procedure to the extent that tax authorities ascertain possible violations of the applicable rules. The BEFIT procedure allows for conducting audits not only on a standalone basis by one country, but also jointly with the involvement of two or more countries.

The proposed Directive establishes several rules that oblige tax authorities of each BEFIT group member to timely communicate and adjust all relevant data as filed and assessed. While such mechanisms may create a complex procedure, they prevent possible inconsistencies.

This section shall now review all steps of filing, assessment and audits on a separate basis. The authors have chosen to follow a logical order that reflects the steps of the procedure, rather than the numbering of the Articles contained in Chapter V of the proposed Directive.

Accordingly, the analysis of filing will focus on the subjective scope, the objective scope, the time framework and the obligations of tax authorities, which will set the groundwork for addressing one of the major procedural innovations of the proposed Directive, namely the introduction of the so-called BEFIT team. The review of issues connected with tax assessment will then continue and compare how this part of the tax procedure can impact the functioning of coordination between tax authorities. The same concept will also guide the analysis of tax audits.

A comprehensive overview of the issues related to the protection of taxpayers' rights in this part of the tax procedure will complete the analysis. The need for including this analysis arises from the circumstance that settled case law of the Court of Justice requires compliance with the fundamental rights and general principles of EU law in all areas that relate to secondary law, including where the latter includes no specific rules in this respect.[391]

6.2.2. Subjective scope of filing obligations

6.2.2.1. Introduction

The one-stop shop approach envisaged in the proposed Directive should attract filing at the level of one single group entity and tax authority, allowing for a centralised handling of all tax-related matters. However, the one-stop shop approach does not operate as such, as mentioned before. Since the individual tax return follows the BEFIT information return, the subjective scope of the latter will be analysed first. From a systematic perspective, the authors of the study find it appropriate to address the issues related to the objective scope of the filing obligations and the timeline of such obligations in separate subpoints.

As a general point, it should be noted that, as a rule, the determination of the entity responsible for the procedural filing obligations arises as an automatic consequence. Considering the wording of Article 54 of the proposed Directive, this is subject to automatic renewal on a five-year basis, except in the presence of a notice of termination. Differently, for the non-EU parented groups, the option constitutes an additional procedural requirement necessary for the establishment of the said obligations.

6.2.2.2. BEFIT information return

The subjective scope of the BEFIT information return filing obligation is regulated by Article 57, which refers to the so-called “filing entity”. By doing so, it establishes such obligation on the ultimate parent entity[392] in its country of residence or, in the absence of such entity on the territory of the European Union, on an entity officially appointed by the group.

Except for the cases of voluntary scope of the proposed Directive, enshrined in Article 2(7), and when the BEFIT group is a domestic group, this obligation arises automatically in connection with the existence of a BEFIT group.

The filing entity may not be changed unless such entity ceases to meet the conditions referred to in Article 3(10).[393] In the latter circumstances, the proposed Directive contains a clear and precise time threshold of two months for designating a new filing entity and includes a subsidiary power of designation for the BEFIT team.

The authors of this study consider that the designation of the new filing entity may not be the outcome of free choice,[394] but rather be governed by the entity that meets the conditions indicated in Article 3(10). This means, inter alia, that the filing entity must always submit its BEFIT information return in its country of residence. By contrast, the wording of Article 57 leaves more leeway to select the EU Member State in which the BEFIT group may submit the

[391] The authors of the study consider this as a clear implication of the line of interpretation developed in CJEU, *Berlioz*, cit., para. 49.
[392] See Art. 3(10) of the proposed Directive.
[393] See Art. 56 of the proposed Directive.
[394] Exception being made of course for the cases of voluntary scope.

filing of the BEFIT information return when the ultimate parent company is established outside of the European Union. However, in the authors' view, such leeway should be kept within the boundaries of an effective link with the jurisdiction of this country, such as in connection with the existence of a permanent establishment. The policy choice of providing more freedom in cases of ultimate parent companies established outside of the European Union might seem logical, but in fact, might have indirect repercussions, which might even go as far as prompting the relocation of ultimate parent companies outside of the European Union in case of particularly adversarial relations with the tax authorities of a given EU Member State or, more frequently, to a change of tax residence of the latter entity or group structure reorganization. In the latter circumstances, the authors of the study consider that the prohibition of changing the filing entity contained in Article 56 does not prevent such entity from transferring its tax residence, as long as this is concretely possible for company and/or tax law, and accordingly changing the filing authority for the purposes of Article 57 ff. of the proposed Directive.[395] Hence, one should expect that the potential adoption of the proposed Directive would lead to jurisdiction shopping as regards the location of the filing entity.

The examples made above indicate that the subjective scope of the BEFIT information return in the proposed Directive has precise limits, which preserve legal certainty and prevent possible arbitrary exercise of powers by tax authorities, as well as abusive practices by taxpayers.

The obligations of the ultimate parent company arising in connection with this status are not mutually exclusive with the ones arising in respect of the filing of the individual information return. Accordingly, the ultimate parent company will be obliged to file, on the one hand, its own individual information return (under Article 62) and, on the other hand, the BEFIT information return for the entire BEFIT group (under Article 57). The time-limit for submitting the latter information return is four months after the end of the tax year.[396]

For various reasons, the latter obligations are significantly more important for procedural purposes than the former ones. In line with the logic of the one-stop shop approach, the filing entity is solely responsible for the correct and timely compliance with the filing obligations and should be regarded as the sole taxpayer for BEFIT purposes. This does not imply, however, that the group entities obliged to file the information returns will not have such capacity in their respective countries in line with the requirements of the applicable procedural tax law.

The responsibility for the failure to file a BEFIT information return lies exclusively with the filing entity. Therefore, it must implement a comprehensive and correctly functioning system for gathering such information within the BEFIT group, showing its due diligence to comply with the said obligation. This is particularly important for the facts that cannot be extracted from the consolidated financial accounts. The failure to establish an appropriate set of tools will not constitute a valid reason to avoid responsibility but should certainly constitute a relevant element when determining the applicable penalties. Moreover, this exclusive

[395] From a policy perspective, an alternative reasonable option might have been to keep flexibility also as to the identification of the filing entity, thus allowing also BEFIT groups with an EU ultimate parent entity to designate a filing entity of choice, and/or to change it every period of five years in line with the time framework enshrined in Article 54 for the renewal of the BEFIT group.
[396] See Art. 57(2) of the proposed Directive.

responsibility for the BEFIT information return will produce some potential repercussions on the filing obligations by the group members, which might be subject to a preliminary tax result determined by estimate, based on Article 59, for reasons that are not dependent on their own failure to fulfil the respective obligations.

Nevertheless, the authors of this study hold that the responsibility for the failure to file the tax returns will remain a matter governed by the applicable domestic law, except for the aspects, such as the ones enshrined in Article 59, which receive an express regulation within the proposed Directive.

6.2.2.3. Individual information return

The analysis of the subjective scope of the individual information returns by each group entity and/or permanent establishment consists of two main parts, namely the identification of such entities and of their obligation of transmission to the relevant tax authorities, which also applies in respect of errors. In the overall architecture of BEFIT, the filing of the individual tax returns follows the one of the BEFIT information return and depends on its data.

According to Article 62(1) of the proposed Directive, the submission of the individual tax returns should take place within the three months following the notification from the filing authority. They must report their relevant income (and losses) to the tax authorities of the states of residence, based on the content produced in the BEFIT information return.

Such obligation arises because of the creation of a BEFIT group. In such circumstances, the filing obligations will follow the rules contained in the proposed Directive rather than the ones that would otherwise operate for such an entity based on the domestic procedural tax law.

Another important element of streamlining the filing obligations at the level of group entities is the option, contained in Article 62(3) to allow such entities, including permanent establishments, to bundle them all together on a per-country basis. This means that also, in such circumstances, BEFIT makes it possible to have one filing obligation per EU Member State. The authors consider that this option should not be interpreted in a way that deprives the Member States of requiring a clear and precise identification of the attribution of assets among the different entities that may choose to file their local tax returns together. This will remain a matter to address at the level of implementation of the proposed Directive.

The filing obligations also implicitly include that the individual tax return will be made available to tax authorities of the country of residence of such entities (and/or in which a permanent establishment is located). This interpretation is required by the need to set the ground for tax authorities of such countries to carry out tax assessments.[397]

Even though the proposed Directive does not explicitly mention this in Articles 62 and 63, the obligation of e-filing seems implicitly required by the circumstance that Article 60(3) of the proposed Directive establishes this standard for the communication between the members of the BEFIT team "to the extent possible". Nevertheless, also considering the possibility of extending the proposed Directive to what is referred to in the preamble as "the voluntary scope", enshrined in Article 2(7), the authors of this study do not exclude exceptions

[397] As required by Art. 64 of the proposed Directive.

to this implicit obligation at the time of implementation of the proposed Directive into national legislation may be compatible with the object and purpose of the proposed Directive. This might be particularly the case when Member States introduce mechanisms to make sure that also, in such circumstances, the information filed will comply with the standards of communication within the BEFIT team.

An express obligation of notification of errors in the individual tax return is included in Article 63 of the proposed Directive. However, since this obligation is limited to the two months that have followed the timely submission of the individual tax return, the issue might arise as to what may happen for errors that are discovered at a later moment, including whether the group entities are still obliged to notify the relevant tax authorities. The proposed Directive remains silent on those matters, thus allowing for a strict interpretation, which might frame such errors within the overall situations of incompliance and, as such, liable to the applicable penalties' regimes. This will contrast with existing domestic regimes of voluntary disclosure. It remains unclear whether such regimes would apply to the proposed Directive and, more specifically, to restricting the requirement of Article 72 for effective, proportionate and dissuasive penalties.

Whether this strict interpretation is the only way to address these issues or not, the authors of this study find it important to say that the object and purpose of Article 63(1) expresses the more general obligation of the group entities to promptly inform tax authorities about errors in the individual tax return. This reading of the underlying spirit of this clause is also in line with the overall obligation of taxpayers to cooperate in good faith in the levying of taxes. Accordingly, the obligation of notification of such errors has a general nature and should, therefore, also exist beyond the two months indicated in Article 63(1). The view might thus be held that even a notification of such errors beyond two months of the timely submission of the individual tax return, but with little delay from the moment in which the entity has realised the occurrence of the error, should be considered as a relevant indicator of the diligent behaviour of the taxpayer at the time of determining the applicable penalty.

6.2.3. Objective scope of filing obligations

6.2.3.1. Introduction

The content of the individual tax and group information returns partly depends, namely on the outcome of the preliminary tax base of each BEFIT group member, on the content produced by the filing entity and included for the purpose of computing the overall BEFIT tax base, and on the remaining computations required by Article 57(3) of the proposed Directive.

The analysis of the content of the two filing obligations will follow the same order already applied to their subjective scope and address the implications that this two-tier system creates within the framework of the one-stop shop approach to tax compliance of large MNE groups regulated by the proposed Directive.

The overall impression of those issues is that the degree of flexibility applicable to the determination of the results of each group member and of the whole group is significantly more limited when it comes to procedural matters as compared to what might have been observed with respect to prior Chapters of the proposed Directives.

6.2.3.2. BEFIT information return

The content of the BEFIT information return is clearly regulated by Article 57(3) of the proposed Directive. Also, in this case, all the elements listed therein are mandatory for the filing entity to submit a correct BEFIT information return to the filing authorities. Unlike the individual information returns, the BEFIT information return will be examined, as to its completeness and accuracy by the BEFIT team. The list of mandatory elements does not raise major conceptual and practical issues. All such content is subject to the scrutiny of the BEFIT team, which has no final decision power on the first three numbers listed in letter (d). The matter will be more specifically addressed in a separate section of this study.[398]

6.2.3.3. Individual information return

Article 62 of the proposed Directive requires each EU-based group member, including the permanent establishment, to file an individual information return and submit it to the tax authorities of the Member State of residence in which the permanent establishment is located.

The content of the individual tax return is clearly outlined in Article 62(2) of the proposed Directive. All elements are mandatory for the filing of the individual information return by each group member (whether it is a company or a permanent establishment).

Letter (a) requires the return to include the computation of the preliminary tax result.[399] The latter expression is used by several other clauses of the proposed Directive as the main reference point for determining the tax liability. This might indicate that even if the proposed Directive does not rely on self-assessment of taxes (and includes tax assessment by tax authorities as a separate moment in the procedure), the outcome of filing by the taxpayer has a preeminent role in the actual determination of taxes due. Critical issues may arise in connection with discrepancies between the data supplied by the filing entity and the ones that are recorded by the group entities. Such issues must be addressed timely at the level of scrutiny of the individual tax returns. However, the existence of a later tax assessment of the individual tax return by the tax authorities of the country of residence of each group member also gives a possibility to address those issues. Apart from that, the main function of the tax assessment is to give formal confirmation of an informal self-assessment determined by the local group member through the filing.

Letters (b) and (c) respectively refer to the part allocated to the specific BEFIT group member in conformity with Article 45, and to the items that shall be adjusted in accordance with Article 45. The actual boundaries of both components are determined in line with the requirements established in section 2 of Chapter III of the proposed Directive and require no major analysis for procedural purposes, except for one point.

Their actual correct determination depends on data that the group member receives from the ultimate parent entity. Therefore, leaving aside the objective responsibility for the

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[398] See further on this under sec. 6.2.4. of this study.

[399] The expression is used in Art. 62(2)(a) of the proposed Directive, which regulates the objective scope of the individual tax return.

failure to include the correct information in the individual tax return, the issue arises as to why the proposed Directive does not establish this obligation only at the level of the filing entity and then transmits the content via BEFIT team to all tax authorities involved. This mechanism would avoid unnecessary duplication of the compliance obligation on the group members and adhere more closely to the establishment of a one-stop shop as a pronounced aim of the proposed Directive.

Finally, letter (d) requires the indication of the applicable foreign tax credits of the BEFIT group member. This factual information is the one that should come from each individual group member. From a procedural perspective, it is important to consider that the relief from foreign tax essentially relates to juridical international double taxation. This should be done with caution in the case of the relations between a group entity and its foreign permanent establishments to prevent forms of incorrect reporting. The same might hold true with respect to relief from economic international double taxation when it comes to relations with other non-BEFIT group entities, with a view to preventing possible forms of double dip that would alter the overall correct determination of the group's income. More critical issues arise as to additional forms of credits for other types of foreign taxes, including in connection with CFC legislation and the implementation of the so-called Pillar 2 into the GMT Directive.

6.2.4. The BEFIT team and its role

The BEFIT team is possibly one of the most relevant procedural innovations that the proposed Directive introduces. In essence, it is a specialised pool of members of the competent authorities that scrutinise the BEFIT information return and yields a single reply to the facts submitted by the filing entity. Due to its features, the BEFIT team can be considered as a supranational administrative ad hoc body, which intervenes in the procedure with different powers in respect of different parts of the BEFIT information return.

The BEFIT team is chaired by the delegate of the filing authority.[400] This means that such delegate will also conduct the function of coordinating the activity of the BEFIT team, making sure that the team timely fulfils all obligations.

The composition of the BEFIT team and the procedure for its establishment[401] allows such body to play an important role in the creation of a multilateral dialogue among all tax authorities involved, securing a consistent outcome and enhancing the joint technical management in line with the object and purpose of the one-stop-shop approach envisaged by the proposed Directive.

Since the proposed Directive does not contain more specific rules as to how the procedure within the BEFIT team will concretely operate, it is assumed that a dedicated protocol/agreement might be agreed from time to time before the team becomes operational. Such protocol/agreement will likely also address the linguistic issues, which, in the authors' view, should give authentic value to the official language(s) of the procedural rules of the States involved when such language(s) is/are not the working languages agreed for the functioning of the BEFIT team. Considering the relevance of domestic law for various aspects of the BEFIT

[400] See Art. 60(3) of the proposed Directive.
[401] See Art. 60(1) and (2) of the proposed Directive.

procedure, the failure to take the official languages of the States into account might otherwise generate more complex issues connected with the underlying protection of taxpayers' rights.

The scope of the completeness and accuracy review conducted by the BEFIT team excludes the outcome of the preliminary tax result of each BEFIT group member, which will be subject to an individual tax assessment in line with the requirements established in Article 64 of the proposed Directive.

Once the BEFIT team has achieved consensus, its review of the content of the BEFIT information return becomes final as to the identification of the filing entity, the information of the structure and ownership of the BEFIT group, the tax (fiscal) year and the baseline allocation percentage, except for the power of competent authorities to conduct tax audits.[402]

The rules on decision-making in the BEFIT team[403] articulate consensus in a way that unanimity is no longer required after four months from the date of reporting and that simple majority voting can apply in the following month.[404] The latter modality of adopting decisions introduces an important innovation not just for tax procedures, but also for EU tax law in general, as it may end up binding a State to a resolution also against its own will. The authors of this study find that this ground-breaking innovation goes in the right direction and consider that the spirit of reaching unquestionably motivated technical decisions will certainly mitigate the potential critical effects of this innovation on the perceived boundaries of tax sovereignty within the European Union.

However, from a more practical perspective, the authors wonder how the allocation of voting rights will concretely operate in cases of transfer pricing disputes between two countries, which might be precisely on how much the BEFIT group members have earned on each territory.

Moreover, in the absence of a dispute settlement mechanism, the issue may arise as to why issues dealt with in the framework of the BEFIT team have to be decided by a coalition of interests, rather than by instruments that take into account the underlying rights of the affected taxpayers. After all, the BEFIT team conducts its activity in the framework of an administrative tax procedure, which may not be entirely carved out from a mechanism that secures the effective protection of taxpayers' rights. From the latter perspective, the wording used in Article 61(2) 2nd sentence as to the circumstance that on points (a), (b), (c) and (d) (iv) of Article 57(3) "the consensus of the BEFIT team shall mean that these points cannot be subject to any future challenge" might give rise to some critical issues if it were to be interpreted as excluding the application of any further administrative and judicial remedy.

The authors of this study consider that an extension of the EU Dispute Resolution Directive with more direct involvement of the filing entity and/or of other group members might be a meaningful amendment to make. After all, this development might also approximate the BEFIT one-stop shop to the conditions that the filing entity would face if it had a dispute in one single state. In the latter circumstances, just as much as in this one, the protection of

[402] In conformity with Article 65 of the proposed Directive.
[403] See Art. 61(4) of the proposed Directive.
[404] See Art. 61(5) of the proposed Directive, which contains very precise rules on how the simple majority vote is to be computed, requiring inter alia a quorum of at least two thirds of the BEFIT team members for deliberations and admitting, in case of an equally split vote, the casting vote of the filing authority.

fundamental rights of taxpayers requires that the action of administrative bodies is subject to the requirements of the rule of law and, thus, to judicial scrutiny.

Such issues raise a more limited concern in the cases where the BEFIT team makes non-final decisions, i.e. in respect of the information referred to in Article 57(3), letters (d) (i), (d) (ii) and (d) (iii), which remain within the exclusive competence of the Member State of residence of the group member (or of the establishment of a permanent establishment). In such circumstances, the role of the BEFIT team remains merely advisory, allowing the entities to seek for adequate protection of their fundamental rights before the local judicial instances.

6.2.5. Tax assessment of the individual tax returns

Most modern procedural tax systems bundle together filing with self-assessment of taxes by the taxpayer.[405] The BEFIT proposed Directive only partly follows this model, namely in connection with the filing of the BEFIT information return. However, Article 64 of the proposed Directive requires tax assessment as a separate activity by the competent authorities of the Member State in which each individual tax return is filed.[406]

The authors of this study find it hard to understand the reasons for the latter requirement, which introduces an asymmetry in the BEFIT tax procedure, deviates from the operational framework in which tax authorities normally conduct their procedural activity and creates an unnecessary duplication with the function of filing, on the one hand, and of audits, on the other hand.

Like any tax assessment, the one enshrined in Article 64 of the proposed Directive is the outcome of an act issued by tax authorities suitable to produce immediate adverse effects in the legal sphere of its addressees. In line with the goal to provide the latter persons with an effective legal remedy, the proposed Directive rightly makes it subject to administrative review and judicial appeals, respectively, under Articles 67 and 69. The interaction of these procedural mechanisms aligns such procedural mechanisms with the minimum standards of protection required by the EU Charter of Fundamental Rights for the enforcement of the tax liability, which will then be governed by that State's domestic law.[407]

However, the asymmetry between the tax assessment of the BEFIT information return, and the facts as appearing in the BEFIT individual tax returns might raise critical issues, which are briefly outlined hereby.

Whilst the BEFIT information return assesses facts and is autonomously relevant insofar as it is not challenged, the one filed at the level of each group entity begets its procedural validity to an act of tax authorities (i.e., the act of tax assessment), which in substance validates them. The internal validity of the latter information return can be understandable in light of the logic of the one-stop-shop approach to BEFIT tax compliance, which attributes a preeminent role to the BEFIT information return. However, this still may not justify that the individual

[405] It should be noted that various decades ago tax assessment used to be primarily an exclusive competence of tax authorities.

[406] See Art. 64 of the proposed Directive.

[407] See Art. 64(1) 2nd sentence of the proposed Directive, which indicates expressly that the enforcement of the tax liability shall be governed by the law of the State of the group member that has filed the individual tax return and received the individual tax assessment.

information returns lack their own validity in self-assessing taxes without an administrative act of tax authorities.

Individual information tax returns lack their own validity until the competent authorities issue a tax assessment.[408] The obligation of the competent tax authorities to issue the tax assessment[409] and to transmit it to the filing authority does not substantially change the conclusion that the tax assessment might constitute an unnecessary step in the procedure.

Tax authorities could still question the self-assessment at the level of audits under Article 65. The latter circumstance also shows the further potential critical issues that may arise. When conducting their tax audits, tax authorities have the power to do under Article 65 something that they might have already done under Article 64. Certainly, the framework of tax audits gives them the possibility to question the validity of the facts put forward in the individual tax returns. However, they might still bundle that type of intervention with the one that they are otherwise obliged to do per each single individual tax return at the level of tax assessment.

Even acknowledging that, unlike tax assessment, tax audits are selective, i.e. do not involve all taxpayers, the two activities could be unified with the addition of some forms of automated control that can be instrumental to determining what returns are to be subjected to a more thorough audit.

Some further consideration is needed for addressing potential critical issues at the intersection between the BEFIT tax procedure and the domestic tax procedural rules. The application of the latter rules is not precluded by the proposed Directive, but is given a subsidiary function, which should eventually make it possible to enforce the tax liability under domestic law, as required by Article 64(1) 2nd sentence, in the framework of the tax collection directive[410] or of any other instrument of public international law.[411]

The absence of BEFIT procedural rules on tax assessment applicable to the BEFIT information tax return might be justified by the circumstance that the content of the preliminary tax result of each BEFIT group member remains a final decision of the competent authorities of the Member States in which such group members are situated. In fact, there is no assessment at the group level.

6.2.6. Tax audits

The function of tax audits has already been described earlier in this section, with the indication that they constitute a non-essential part of tax procedures.

The dedicated section to tax audits within the BEFIT procedure has a fundamental role in preventing potential overlaps and conflicts between the applicable rules that are otherwise

[408] In conformity with Art. 64(2) of the proposed Directive. By contrast, errors in the BEFIT information return have their own validity upfront and are only the object of an obligation of transmission under Article 58 of the proposed Directive.
[409] Except in the case of Art. 64(4) of the proposed Directive.
[410] See Council Directive 2010/24/EU of 16 March 2010 concerning mutual assistance for the recovery of claims relating to taxes, duties and other measures in OJ L 84/1 of 31 March 2010.
[411] See bilateral tax treaty clauses following the wording of Art. 27 of the OECD Model Convention, see supra n. 122.

essentially regulated by domestic tax law. Also, it allows a more precise understanding of how this part of the BEFIT procedure allows for the interaction with the domestic rules, which are the only ones to govern the enforcement of the tax liability.[412]

The need for tax audits is crucial within tax procedures that allow for self-assessment of taxes, allowing tax authorities to question such assessment in the light of fact-finding that indicates a different picture from the one presented by the taxpayer. However, tax audits are not by their own nature incompatible with a system that relies on assessment conducted by tax authorities, such as is the case for the individual tax returns within the BEFIT procedure.

Before delving into the technicalities of tax audits and their regulation within the BEFIT tax procedure,[413] the authors of this study find it important to stress that no tax system can rely on a thorough scrutiny of all returns of all taxpayers. For this reason, besides the mechanisms that shift the dynamics of taxes towards a trust relationship between taxpayers and tax authorities, it is important to combine tax auditing with an appropriate methodology to single out potential critical situations which might require closer scrutiny in the framework of an in-depth tax audit.

Article 65(3) of the proposed Directive allows for the use of inquiries, inspections, and examinations within an audit. The fact that no more precise indication is given on how to conduct such activities, which also operate at the level of the preliminary phases of tax audits, implies that domestic rules are applicable, even if with a residual function. This means, for instance, that the methodologies applicable for conducting such activities are, in principle, applicable to the BEFIT procedure. However, the general need to make this procedure compliant with the requirements of primary law and general principles of law of the European Union will have an immediate impact on verifying whether such methodologies, in fact, are admissible. Accordingly, for instance, the use of refutable presumptions lacking a valid background might clash with how the protection of fundamental rights admits the burden of proof in the framework of tax procedures.[414] Moreover, the particularly intrusive nature of on-site inspections should allow for their use as instruments of last resort within the framework of a proportionate approach to tax audits. This might mean that the failure to comply with such requirements might induce taxpayers to raise issues of compatibility with primary law that could require scrutiny by the Court of Justice of the European Union.

More complex issues may arise in the context of using the findings of audits across borders and of determining the extent to which they produce binding effects throughout the entire BEFIT procedure.

The BEFIT procedure on audits does not contain a specific regulation on the cross-border use of information gathered in the framework of an audit. However, some clear results can be achieved at the level of interpretation of its rules.

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[412] See Art. 64(1) 2nd sentence of the proposed Directive. The fact that domestic rules regulate tax enforcement does not of course prevent the application of rules of mutual administrative assistance in tax matters within the European Union.

[413] As contained in Art. 65 of the proposed Directive.

[414] On this matter see, for instance, J.F.P. Nogueira, Abuse, Proportionality and the Burden of Proof in CJEU's Case Law on Direct Taxation, in: J. Korving, N. Kerinç and F. Souza de Man (eds.), Taxes Crossing Borders (and Tax Professors Too): Liber Amicorum Prof. Dr R.G. (Rainer) Prokisch, Maastricht University Press, 2022, pp. 225-2448

The starting point of the analysis of this point should be Article 65(2) of the proposed Directive, which expressly allows for joint audits to be conducted in conformity with Article 12 of Council Directive 2011/16/EU.[415]

Joint audits are an important instrument to gather one single set of facts, which competent authorities can then use for all purposes of the BEFIT procedure.

The right of initiating a joint audit is regulated directly in Article 65(2) of the proposed Directive, which admits it for any competent authority of a Member State in which a BEFIT group member is resident for tax purposes (or situated in the form of a permanent establishment). The combined reading of this clause with the wording of Article 65(1) might indicate that the competent authority that requests to initiate an audit will also coordinate it. However, the authors of this study consider that the expression "and", which coordinates the words "initiate" and "coordinate", might also be read as not requiring this conclusion, thus allowing the coordinating functions to be conducted on an agreed basis between the competent authorities. If that is not the legislative intention, then it should be clarified.

The obligation for the requested authority to engage in a joint audit is slightly more complex and requires further interpretation. The last sentence of Article 65(2) of the proposed Directive indicates that the requested competent authority "shall" accept such request and inform the BEFIT team. This might indicate that, in the context of the BEFIT procedure, there is an obligation to accept the request to engage in a joint audit. However, such obligation only exists insofar as the request is conducted in conformity with the applicable rules. Determining the exact boundaries of such rules is, in fact, more complex for various reasons. Leaving aside the already mentioned misleading reference to Article 12 of the DAC, the wording of Article 65(2) last sentence starts by "Notwithstanding this rule" [i.e., Article 12 of Council Directive 2011/16/EU]. This might mean that the obligation exists under Article 65(2) of the proposed Directive also in cases in which it might not arise under the DAC system. The authors of this study consider this interpretative nuance as preferable and better complying with the spirit of the proposed Directive to pave the way to more frequent use of joint audits in this context, which is very sound from a policy perspective. After all, conducting a joint audit will also be a way to establish synergies in fact-finding and audits, as well as prevent possible critical issues as to the right to use the collected information between different tax authorities.

Once the decision to initiate the procedure has been cleared, the next step is determining the laws that will regulate the joint audit. Article 65(3) expressly indicates the application of the law in which the audit is to be conducted, but also requires the necessary adjustments to the rules contained in the BEFIT proposed Directive. Since the procedural rules contained in Article 12a(2) of the DAC are more specific, the issue is whether such rules may apply on a residual basis because of the reference contained in Article 65(2) of the proposed Directive. The affirmative answer seems plausible, but only to the extent that a given matter is not regulated by the BEFIT Directive and is compatible with it.

The BEFIT procedure might often require conducting the fact-finding in more than one Member State. If this is the case, it is important for the initial memorandum between the

[415] As indicated earlier in the text, the reference should have instead been to Article 12a, which regulates joint audits in the DAC system. The authors assume that this reference will be corrected in the final version of the Directive.

authorities involved to determine which rules will govern the procedure.[416] In principle, this might be determined by the plan outlined in the request for initiating the joint audit; in practice, an agreement may be reached by the authorities involved, as long as this is decided before initiating the procedure and remains stable throughout the procedure itself. The same criteria will also govern all other matters concerning the procedure.

The wording of Article 65(2) of the proposed Directive does not seem to require the joint audit to necessarily involve all competent authorities of the Member States in which the group entities are established. However, it indicates in the last sentence of Article 65(3) that, upon acceptance, the requested authority shall inform the BEFIT team. Moreover, Article 65(4) also adds that the competent authority of the Member State in which an audit is conducted has an obligation to inform the BEFIT team about the results of the audit. The wording used by the latter expression seems to limit this obligation to the sole cases in which the findings of the audit affect the outcome of the allocation of the BEFIT tax base in a given year. In such circumstances, the wording of the last sentence of Article 65(4) clearly expresses an obligation for the competent authorities involved in the BEFIT team to express their views within three months.

The following step in the procedure is the obligation for the filing authority to proceed with reissuing the BEFIT information return. This step is of particular importance for determining whether the findings of a tax audit may have binding effects throughout the entire BEFIT procedure, thus including with respect to the other countries involved.

The wording of Article 65(5) of the proposed Directive ("shall") seems to indicate the existence of an obligation to issue a revised BEFIT information return within a one-month deadline. This obligation is bundled with the one to transmit such return immediately, via the BEFIT team, to all other competent authorities involved. In turn, this transmission may prompt all tax authorities to issue amended tax assessments. Also, in this case, the wording of Article 65(5) of the proposed Directive establishes an obligation to do so where appropriate.[417] Interestingly, Article 65(5) of the proposed Directive extends this obligation also to the filing authority. This is clearly necessary in consideration of the fact that the findings of the audit may arise from different countries and, therefore, be by their own nature not suitable to produce automatic binding effects in a different country.

The obligation to issue a revised BEFIT information return does not necessarily have to imply that the filing authority is bound by the tax audit issued by one or more other tax authorities. However, the obligation to express views in the framework of the BEFIT team is of extreme importance to reach some technically correct conclusions. At the end of the day, whether the findings of the audit will produce binding effects on the filing authority is something that depends on the criteria established in Article 61(2) of the proposed Directive.

The overall assessment of the rules on tax audits contained in the proposed Directive leads the authors to wonder whether a stronger reliance on the coordinating function of the filing authority might not have been desirable with a view to achieving a more homogeneous functioning of the procedure. Certainly, there is awareness that if that had been the case, there

[416] This agreement is required under Article 12a (2) of the DAC, as amended by DAC7.
[417] See Art. 65(6) of the proposed Directive, which includes a de minimis exception, which relieves the tax authorities from issuing such revised assessment.

would have been a stronger pressure on tax authorities of certain EU Member States. This might have also produced indirect repercussions on making the procedural tax rules of those countries have a stronger influence within the European Union, albeit within the residual function that the proposed Directive attributes to them. However, if that were the case, such issues could be addressed respectively by establishing a system of sharing the costs of BEFIT procedures, and by issuing more detailed procedural rules applicable for BEFIT purposes.

6.2.7. The timeline of the BEFIT procedure

The procedural requirements of the two-tier system of filing and assessment follow a precisely regulated timeline. Besides mentioning the different steps of the timeline in other parts of this study, the complexity of the timeline throughout the phases of filing, assessment and audits makes it useful to recapitulate them briefly in the synoptic charts below.

Tax (Fiscal) year

Duration	***12 months, calculated alike for all BEFIT group members***
Starting year of a new group member	Shorter until it aligns with the BEFIT tax year

Article 55 requires the alignment of the tax (fiscal) year of all BEFIT group members. This implies a shorter year for the new group members and the corresponding pro-rating of the allocated part.[418]

Filing returns timeline

Activity	***At the level of filing entity (BEFIT return)***	***At the level of group members*** ***(Individual returns)***
Submission of return	Four months after the end of the tax year (Article 57(2))	Three months after notification of BEFIT information return from the filing authority (Article 62(1)), or eight months in case of domestic group
Transmission by authority	Immediate (Article 57(4))	*See the BEFIT team timeline*
Notification of errors	Two months from submission of return (Article 58(1))	Two months from submission of return (Article 63(1))
Transmission by authority	Immediate (Article 58(2))	Immediate (Article 63(3))

[418] See Art. 55(2) and (3) of the proposed Directive, which regulates pro-rating respectively for the years of joining and leaving the BEFIT group.

The filing timeline shows that the filing process starts at the central level and then continues at that of the individual group members. The existence of immediate transmission obligations on tax authorities should secure a smooth functioning of the filing mechanisms.

BEFIT Team timeline

Activity	***Timeline***
Creation	One month after filing of BEFIT return (Article 60(1))
Consultation	Response expected within a reasonable time (Article 60(1))
Scrutiny of the BEFIT information return	Four months from submission to achieve consensus (Article 61(2)), then decision by simple majority voting by the end of the following month
Transmission to the filing entity	No deadline

The BEFIT team timeline shows a variable duration according to whether the outcome of the scrutiny of the BEFIT information return reaches consensus.

Assessment of individual tax returns

Activity	***Timeline***
Individual tax assessment	Determined by domestic law
Transmission of an amended tax assessment to the BEFIT team	Immediate (Article 64(2))
Issuing of revised BEFIT information return	One month (Article 64(2))
Transmission of revised BEFIT information return	Immediate (Article 64(2))

The assessment of the individual tax returns combines the application of domestic procedural law of the relevant EU Member States with additional obligations, such as that of issuing the revised BEFIT information return and its transmission to the other competent authorities via the BEFIT team, which are governed by the special procedural rules contained in the proposed Directive.

Audits

Activity	***Timeline***
Conducting the audit	Determined by domestic law (Article 65(3))
Information to the BEFIT team about the request to initiate a joint audit	No indication of time (Article 65(4))

Information to the BEFIT team about the outcome of an audit (or joint audit)	No indication of time (Article 65(4))
Expression of views by other members of the BEFIT team	Within three months from information (Article 65(4))
Deadline for issuing a revised BEFIT information return	One month from the end of the audit (Article 65(5))
Deadline for issuing amended individual tax assessments	Follows Article 64 timeline (Article 65(5))

The interaction with the applicable rules of domestic law affects the concrete shaping of the timeline, which otherwise precisely indicates the timing of coordination within the BEFIT team and the implications for issuing the revised BEFIT information return. However, no timeline is indicated for the information to be provided to the BEFIT team.

6.2.8. Filing, assessment and audits

The BEFIT tax procedure introduces a clear and comprehensive system of obligations for the tax authorities involved. Throughout filing, assessment and audits, the main common obligation for tax authorities is to liaise with each other, securing a swift transfer of information and also with the taxpayers involved. This obligation is instrumental to the implementation of the one-stop shop approach, reflects its spirit and simplifies the red tape for the BEFIT taxpayers. However, other obligations with a different content are imposed on tax authorities primarily of the filing authority, but also of the BEFIT team and of the competent tax authorities of the other countries in which the BEFIT group members are established.

The obligation to transfer information is imposed on the filing authority in three groups of situations. First, Article 57(4) of the proposed Directive imposes an obligation to transfer the BEFIT information return to the other competent authorities involved. This operates back-to-back with the one of the filing entity to file such a return. Second, this also applies under Article 58(2) when the filing entity notifies amendments of the BEFIT information return to correct prior errors. Third, Article 61(4) requires the filing authority to notify the BEFIT information return to the filing entity after the BEFIT team has completed its scrutiny.

Considering that the BEFIT team should secure a swift communication and flow of information, Article 60(1) expressly imposes various obligations of consultation among its members, which, according to Article 60(3), should preferably take place by electronic means.

The competent authorities of the Member States of the BEFIT group members have notification obligations, too. Such obligations arise in connection with errors in the individual tax return notified by a BEFIT group member,[419] with individual tax assessments,[420] and the findings of an audit or joint audit, enshrined in Article 65(4) of the proposed Directive. The

[419] See Art. 63(2) of the proposed Directive.
[420] See Art. 64(2) of the proposed Directive.

latter obligation prompts a corresponding obligation of the BEFIT team members to express their views within three months from notification and the one for the filing authority to transmit the revised BEFIT information return after having issued it in conformity with Article 65(5) of the proposed Directive.

The emphasis is now shifted to other obligations, starting with the ones imposed on the filing authority, which must issue the BEFIT information return in two groups of situations.

This first group of situations refers to the notification of errors in the individual tax return[421] and of an amended tax assessment.[422] In both such cases, the involvement of the filing authority is mainly to adjust – within a month from the notice – the levying of taxes to make it consistent with fact-finding arising from the correction of errors and/or the tax assessment conducted in one or more countries of the BEFIT group members.

The second situation has a rather exceptional nature and arises when the filing entity fails to fulfil its obligation to file the BEFIT information return. In such circumstances, Article 59 obliges the filing authority to issue the BEFIT information return, based on estimated findings and processing the best information available, and apply the corresponding penalties in conformity with Article 72 of the proposed Directive.

Article 59 should be interpreted strictly to reflect its exceptional nature as an instrument of last resort, which secures the correct functioning of the information system within the BEFIT tax procedure.

In principle, a timely submission of the BEFIT information return prevents the activation of the obligation under Article 59. This might also mean that the filing of an incomplete return is sufficient to block the application of Article 59, or at least to limit the estimate *pro rata parte*, except when the return contains major structural deficiencies that prevent its actual use for the purposes of the procedure. This suggestion might secure a proportionate reaction to such a severe consequence, such as the one of completely ignoring the data provided by the filing entity in the submitted, but incomplete, BEFIT information return.

A more complex issue is to determine whether the same may apply when the deficiencies of the BEFIT information return amount to fraudulent practices. Even though there is no specific hint in the wording of Article 59, the possible affirmative answer to such a question may be plausible considering the general principles of EU law.

The wording of Articles 57(2) and 58 of the proposed Directive provides some useful elements to determine the moment from which the obligation enshrined in Article 59 may operate. Considering that the latter clause presupposes the failure to file the BEFIT information return, this obligation may neither start before the period of four months after the end of the tax year for submitting the BEFIT information return (indicated in Article 57 (2)), nor, in the case of correction of errors, before the two months from the submission of the same return.

[421] See Art. 63(3) of the proposed Directive, subject to the exception of Art. 63(4) when the de minimis rule, enshrined in Art. 63(4) of the proposed Directive applies. This rule releases the filing authority from such obligation when the difference does not exceed the lower of Eur 10,000 or 1% of the BEFIT tax base.
[422] See Art. 64(3) of the proposed Directive.

Further issues may arise in connection with a strict interpretation of Article 59 as to the application of penalties in accordance with Article 72 of the proposed Directive. The authors find that the power to levy such penalties in connection with the failure to file a BEFIT information return does not exclude the application of sanctions in connection with the possible violations of the obligation of group members to file the individual information returns. The link between the two sets of returns might make the situation problematic. However, insofar as they constitute two separate formal obligations required from two different taxpayers, they should be treated separately also for applying two separate sanctions: the latter result is just one of the many issues caused by the unnecessary duplication of the filing obligation. This issue might have presented different features if there had been a single integrated filing of tax returns.

Shifting now the focus to the BEFIT team, the main obligation besides liaising with the other authorities is regulated by Article 61(2). It requires the BEFIT team to scrutinising the content of the BEFIT information return with a view to achieving consensus, or at least a qualified majority agreement, on it, taking into account the limitations established in the third sentence of this clause as to the information concerning the preliminary tax result, the tax base and the allocated part of each BEFIT group member.

As for the competent authorities of the Member States of the BEFIT group members, Article 64(1) of the proposed Directive requires them to issue an individual tax assessment per each return, and Article 64(2) of the proposed Directive extends this obligation to cases of amended tax assessment, except when the *de minimis* rule of Article 64(4) applies.

The basic obligations connected with audits are, in principle, no different from the ones that apply in each Member State under its own domestic law. However, the flip side of the power of one authority to initiate and coordinate a joint tax audit is that the other competent authorities have an obligation to cooperate, including in the framework of inquiries, inspections, or examinations. Such obligation is to be intended as existing only insofar as the requirements of the proposed Directive are satisfied.

The completion of audits or joint audits also generates the obligations for the filing authority to issue a revised BEFIT information return within one month from the completion of the audit,[423] and that of the competent authorities of the Member States of residence of the group entities to issue amended assessments in conformity with Article 64.[424] Both the latter obligations do not apply when the *de minimis* rule applies.[425]

6.3. Administrative reviews and judicial appeals

6.3.1. Administrative reviews

The proposed Directive acknowledges the right to an administrative review and a judicial appeal. By doing so, it complies, in principle, with the basic requirement of the right to access to justice and to a fair trial, which constitutes a fundamental right of all addressees of measures that can adversely affect their legal sphere to activate an effective legal remedy.[426]

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[423] See Art. 65(5) 1st sentence of the proposed Directive.
[424] See Art. 65(5) 2nd sentence of the proposed Directive.
[425] See Art. 65(6) of the proposed Directive.
[426] J. Kokott, P. Pistone, *Taxpayers in International Law: International Minimum Standards for the Protection of Taxpayers' Rights*, 263-281 and 307, Bloomsbury, (2022).

Before addressing the issues arising in connection with the protection of fundamental rights, it is important to provide a granular analysis of the procedural issues that arise in connection with the application of Articles 66-70 of the proposed Directive.

The architecture of the appeals essentially consists of two sets of remedies which are to be exercised in a way that the administrative review, where available under domestic law of the relevant Member State, must precede the judicial appeal.

As indicated earlier in this section, the authors of this study find it necessary to use the expression "appeals" only in connection with the right of access to justice, namely with the measures enshrined in Articles 68 and 69. Despite acknowledging the official terminology used in the English language by the proposed Directive, the authors find it more appropriate to regard the so-called administrative appeal as a mere review that a (generally) separate body of tax authorities from those that have issued the acts of filing, assessment and audits of the BEFIT procedure.

The right of filing an administrative appeal under Article 66 is formulated in a way that the object of such appeal is the BEFIT information return. Even though the initial filing of the BEFIT information return is a prerogative of the filing entity, it is obvious that such an entity might feel the need to file an administrative appeal only in cases where such an entity disagrees with how the filing authority has amended it. The administrative act through which the filing authority has amended the initial BEFIT information return fits within the usual boundaries that characterise the procedures of administrative review in tax matters.

However, Article 66 of the proposed Directive does not expressly mention audits, thus raising the issue of how an effective remedy can operate in this context. When looking at the wording of Article 65(5) of the proposed Directive, an audit that affects the outcome of the allocation of the BEFIT tax base will also produce repercussions on the BEFIT information return, creating an obligation for the filing authority to amend it. This means concretely that, in case an audit results in an administrative act duly notified to the taxpayer, that produces such adverse consequences for the filing entity, the latter will first have to wait for the filing authority to issue the revised BEFIT return and then proceed with the request for an administrative review. The latter act (additional assessment) should admit review, under domestic law.

It is important to verify whether the silence of the proposed Directive on the right to request a direct administrative review of an audit is in line with the requirements of a fair trial. Possible doubts arise, on the one hand, because the audit may determine an impact on the addressees' legal sphere and, on the other hand, because domestic law generally admits the right of such persons to question the validity of the audit by requesting its review. Clarifying those issues with an amendment to the proposed Directive might be a meaningful way to proceed, also with a view to preventing possible clashes with the right to an effective legal remedy in respect of each measure that can adversely affect the legal sphere of a taxpayer.

The wording of Articles 66 and 67 characterises administrative review as a prior obligation for accessing justice under Articles 68 and 69 of the proposed Directive. From a policy perspective, there has been a lot of discussion within the European Union as to whether this prior (mandatory) administrative step is desirable. On the one hand, especially when the administrative praxis is that such review ends up being decided mostly in favour of tax authorities, it, in practice, merely delays access to justice; on the other hand, when the private party has more reasonable chances to obtain the annulment of the administrative act, the review can properly operate as a balanced filter to limit the number of cases requiring judicial litigation. The solution contained in Article 66(1) 3rd sentence and 67(1) 3rd sentence of the proposed Directive is pragmatic and easier to comply with the notable differences that arise in this context in procedural tax law systems across the European Union.[427]

Since this obligation of prior exhaustion only applies to the extent that domestic law of the relevant Member State requires it, the Member States, which admit direct access to tax justice and a parallel exercise of administrative review, will not be bound by it.

The existence of a flexible mechanism with respect to the appeals mechanism should be interpreted in a way that if the filing entity is established in a country that requires prior exhaustion of the administrative review as a condition for accessing tax justice, that obligation will produce immediate repercussions throughout the BEFIT group. Even though this effect might be clear in theory, its practical application might generate some critical issues in connection with the right of appeal of any BEFIT group member with respect to the individual tax assessment.

A structural issue might arise from the parallel running of administrative reviews of the BEFIT information return under Article 66 and of the individual tax assessments under Article 67 of the proposed Directive. Leaving aside the fact that each administrative review procedure might be accessed only in respect of the flaws of the administrative act whose validity it questions, the problem is that the assessment of relevant tax facts at the local level would benefit from dialogue with the (earlier-in-time operating) BEFIT team. Current mechanisms do not include any possibility of establishing a dialogue between the administrative bodies in charge of the reviews. The authors find it important to consider a possible amendment of the proposed Directive in a way that establishes some form of coordination between such procedures, which would reflect what occurs at prior stages of the procedure with the involvement of the BEFIT team. A possible option might be to include amendments to the proposed Directive with clauses that allow for consultations between administrative bodies in charge of the reviews and create binding effects for all tax authorities involved. The framework of the mutual agreement procedure might be a good point of reference for avoiding possible conflicts of administrative review towards a single outcome. This might also be very meaningful from the perspective of securing in practice full compliance with the right to a single and effective administrative remedy.

Critical issues might also arise when the right of accessing justice is exercised in a State that does not require prior exhaustion of administrative reviews or when the filing entity moves its tax residence to this type of State from one that instead requires the prior exhaustion of administrative reviews. These issues might be handled at the interpretative level by considering that the appeal will remain regulated by the rules of the country in which it started. However, an explicit rule stipulating this would be desirable from the perspective of securing legal certainty. The potential exposure to the critical issues described so far might also arise from the circumstance that Articles 66 and 67 of the proposed Directive might operate in parallel,

[427] The European academic community has conducted a comprehensive research project on the occasion of the 2019 congress of the European Association of Tax Law Professors (EATLP) held in Madrid on "Tax Procedures", Pistone, P., General Report, in Pistone, P. (ed.) Tax Procedures, IBFD Publications, 2020, pp. 1 ff.

but without an actual norm of coordination between them. The need for a coordinating clause seems important, especially if one considers that the decisions made in such procedures will unavoidably create repercussions on the filing and scrutiny at either the central level or at that of the individual group members.[428]

Moreover, when looking at the wording of Article 66 of the proposed Directive, it is unclear whether the reference to the competence of the administrative body of first instance to hear the appeal, contained in Article 66(2) of the proposed Directive, should be regarded as precluding any further instance of administrative review. The doubt arises from the circumstance that the following sentence expressly admits the application of domestic law for governing the procedure. From a policy perspective, limiting this obligation of prior administrative review might be a meaningful compromise between the need to activate a fair administrative filter and the one to secure a swift access to justice.

Another limit to the application of domestic tax procedures applicable to the administrative review arises in connection with the obligation for the filing authority to consult, via the BEFIT team, and the other competent authorities involved.[429] However, unlike in the provisions with the corresponding obligations enshrined in Section 5 of Chapter V of the proposed Directive, this obligation of consultation is not bundled with the one to express views.

Logically, the BEFIT team should also have at least a right to express its views, especially if one considers that the outcome of the administrative review might produce immediate repercussions on the BEFIT procedure, as it appears to be the case if one considers the content of Article 65(3) of the proposed Directive. According to the latter clause, the administrative review that amends the (agreed) BEFIT information return will replace it. Perhaps even a right to intervene in the procedure of administrative review might have been a meaningful option to consider, especially to address the cases in which the simple majority consent has been reached within the BEFIT team against the view expressed by the filing authority in the cases enshrined in Article 61(4) of the proposed Directive.

It is rather surprising that neither of such articles contains an obligation to notify the decision of the administrative body, almost presupposing that this will be automatically brought to the attention of the private party that has requested the administrative review. Even though this might be disposed of automatically by domestic law of the Member State involved, establishing a common mechanism with an obligation of notification might be important to allow a smooth transition to the judicial appeals, especially if one considers that the (short) deadline for filing such appeals Articles 68(1) and 69(1) starts counting from the time of receipt of the decision of the administrative appeals body.

Finally, Articles 66 and 67 contain an express regulation of the timeline. The wording used prevents uncertainties or situations in which the procedure might end up on a dead-end road or confined in a perpetual limbo. In particular, the para. 1 of both clauses gives the respective taxpayers two months to file the request from administrative review, which starts from the time in which the act was duly notified to them. Even though no specific deadline is

[428] It should be noted that Article 67(4) includes a *de minimis* clause that exempts competent authorities of the State of residence of the group members from the obligation to issue an amended tax assessment, but no similar clause is included in Article 66 of the proposed Directive in respect of the outcome of the administrative review of the BEFIT information return.

[429] See Art. 66(2) of the proposed Directive.

included in either Article for conducting the consultation with the BEFIT team, a deadline of two months for the decision by the administrative body is included in Article 66(3) of the proposed Directive. The very tight timeline leads the authors of this study to question how the consultation with the BEFIT team can be conducted in a useful way when the tax authorities make their submissions. The proposed Directive does not include any express indication of a minimum period for the tax authority to make its submission and present the arguments in its defence. This might, in fact, be an issue both with the right to a fair trial for tax authorities, which the domestic procedural tax law might not have the opportunity to fix, also considering the said tight timeline.

This type of issue can arise in a different way in the context of Article 67 of the proposed Directive, which includes no corresponding provision to the one contained in Article 66(3) as to the timeline for the issuing of the administrative review decision.

6.3.2. Judicial appeals

The right to a judicial appeal[430] allows for parallel access to justice by the filing entity and the BEFIT group member in respect of disputes originating from the BEFIT information return and from the individual tax assessments, respectively.

Just like for the two clauses on administrative reviews, the two judicial appeals can be respectively initiated by the filing entity (Article 68) and by each group member (Article 69). The parallel running of the two procedures might generate an overlap in what concerns the data that overlaps in the two returns, whose repercussions on the BEFIT procedure raise similar issues to the ones that have already been discussed in respect of the administrative reviews and which need no separate analysis hereby.

The issues concerning overlaps may be magnified by faster final decisions arising in countries that do not require prior exhaustion of an administrative review. Overruling a final judicial decision is often problematic for national judicial procedures in several Member States, even though the need to prevent an incorrect application of European Union law has prompted the CJEU to impose it, by virtue of the primacy of EU law over national law. Nevertheless, there may still be a conflicting assessment of facts with either the outcome of an administrative review or that of a judicial decision resulting from the other line of appeals. The point can be made that the factual assessment by one domestic court might be given validity throughout the whole BEFIT procedure and Member States. One alternative is to solve this by following the principle of mutual recognition of such decisions. Another alternative is prompting mandatory adjustments to the procedure in all Member States involved. In such circumstances, the authors wonder whether it might be meaningful to introduce some specific rules in the Directive, which regulate or overcome the problems connected with the formation of *res judicata*. Such solutions might be found along the path of the EU tax dispute settlement directive, whose mechanism might be extended to cover conflicts between judicial decisions within the BEFIT procedure.

The rules raise other issues as to the timeline for accessing justice. On the one hand, such rules include a two-month deadline in both Articles 68 and 69 of the proposed Directive from the receipt of the decision of the administrative review body; on the other hand, the rules make an express reference to domestic procedural law for determining the deadline for

[430] See Arts. 68 and 69 of the proposed Directive.

accessing justice in cases where no obligation of prior exhaustion of administrative review applies.[431] It is not clear whether the latter reference might be used in a broader context to admit the application of the entire domestic law of a Member State governing judicial procedures on tax matters. This might prove useful to address whether, for instance, more than one judicial instance is admissible in the BEFIT procedure.

The authors of this study suggest addressing the problem of the limits to the application of domestic law on judicial tax procedures in an amendment to the final text of the Directive, which clarifies, among others, whether more than one judicial instance is admissible under the BEFIT procedure. In this respect, the authors consider that addressing such issues without reference to the domestic law of judicial tax procedures might be a rather adventurous way to proceed, especially if one considers that in many countries, the right to a judicial review of a prior judicial decision has developed in the framework of a more general protection of the right to defence. Problems might arise in this context also because there is no evidence that a double judicial instance is required at the present state of supranational procedural law of the European Union.

The issues of securing an effective exercise of the right to defence should also be addressed from another perspective, namely in connection with the right of tax authorities to make submissions to courts, enshrined in Article 68(2) and Article 69(2) of the proposed Directive. The Directive could also include an obligation for tax authorities to consult others via the BEFIT team with the other competent authorities.[432] However, the absence of a deadline for the domestic court to issue its verdict does not raise similar issues to the ones that have been already presented in connection with administrative reviews. The right to a fair trial requires the indication of a precise period within which the tax authorities can make their submission.[433] This will prevent them either from having sufficient time to do so or exposure of the private parties of the BEFIT procedure to an excessive duration of the judicial procedure.

The indication of an express obligation of notification of the judicial decision, contained in Articles 68(3) and 69(3), is welcome, as it secures a clear flow of information as a starting point for the obligation of the remaining tax authorities to adjust the tax assessments after the judicial decision.[434] However, adding a time-limit for the other competent authorities to adjust their tax assessments could produce a positive impact in determining a clear time of completion of the procedure after the release of the judicial decision.

[431] See respectively Art. 68(1) 2nd sentence of the proposed Directive for the judicial appeals in relation to the BEFIT information return and Art. 69(1) 2nd sentence of the proposed Directive for the ones in relation to individual tax assessments.
[432] See respectively Art. 68(2) for the judicial appeals in relation to the BEFIT information return and Art. 69(2) of the proposed Directive for the ones in relation to individual tax assessments.
[433] This may also be seen as a corollary of the requirement of the "equality of arms", by which each party shall be afforded a reasonable opportunity to present his case – including his evidence – under conditions that do not place him at a substantial disadvantage vis- à -vis his opponent. See further on this point Kokott, J., Pistone, P., cit., p. 233 ff.
[434] See Arts 68(4) and 69(4) of the proposed Directive include a de minimis rules that exempts tax authorities from amending the BEFIT tax base in connection with the judicial decisions. Even though there is a general degree of tolerance for not complicating the procedures in connection with situations of limited relevance, the authors of this study wonder whether it is legitimate to do so also at the end of a judicial procedure, which should always prevail over the determination by the administrative authorities to preserve the full value of the rule of law.

6.4. Protection of fundamental taxpayers' rights

6.4.1. The impact of EU fundamental rights on the proposed BEFIT directive

All clauses of the proposed Directive – both those which expressly regulate fundamental rights[435] and the remaining clauses[436] - should be interpreted in a way that is consistent with the general principles of EU law and with the effective protection of fundamental rights, which the CJEU always applies to all situations within the scope of EU law.

The EU protection of fundamental rights and the general principles of EU law apply on a general basis to all situations that have an EU law nexus and without any differentiation according to the holder of such rights.[437] Therefore, they apply to the individuals that enjoy a subjective entitlement to such protection, i.e., EU nationals, as well as to all other persons that are in an equivalent situation, except when the nature of the right or a specific set of rules otherwise require.

The limits applicable to the protection of fundamental rights on matters of taxation reflect the need to preserve some leeway for the legislator to determine taxes due. However, from a procedural perspective, there is no leeway that could justify the violation of the requirements of the rule of law,[438] which applies to tax law just as much as to any other domain.

The standards of protection of fundamental rights applicable under EU law should be considered as the main reference framework for determining the impact of such rights on the procedure. Accordingly, the need for complying with any stronger protection, which may apply under domestic law, is per se not suitable to produce repercussions on matters regulated by the proposed EU Directive, provided that the interpretation and application of its rules comply with the standards of effective protection required by EU law.[439]

As far as procedural rights are concerned, this approach to the protection of human rights prevents any possible arbitrary exercise of powers by tax authorities and obliges them to secure effective protection of the right to a fair trial throughout the administrative and judicial phases of tax procedures, requiring the right of taxpayers to obtain a judicial review for all acts issued by tax authorities.[440]

The actual start and end of such phases should be interpreted in line with the criteria put forward by the CJEU and then placed in the context of the proposed BEFIT Directive.

Settled CJEU case law admits the entitlement to protection as implying the right to an effective legal remedy that prevents a taxpayer, just as much as any other person, from having

[435] See Arts 70-72 and 76 of the proposed Directive.
[436] As indicated at the beginning of this section, this is the line of reasoning adopted by CJEU, Berlioz, cit., para. 49, which clarified that even when the object and purpose of a Directive is exclusively to regulate administrative cooperation in tax matters, its implementation must take place in conformity with the rule of law and the general principles of EU law, thus securing an effective protection of fundamental taxpayers' rights.
[437] See further on this Kokott, J., Pistone, P., *Taxpayers in international law*, Bloomsbury, 2022, p. 201.
[438] See further on this Kokott, J., Pistone, P., *Taxpayers in international law*, cit., p. 267 ff. and 458 ff., including the case law quoted in the footnotes.
[439] This is how the authors interpret the potential implications of ES, CJEU: 26 February 2013, Case C-399/11, Melloni EC:C:2013:107, for the procedural requirements of this proposed Directive.
[440] In this sense also see ECtHR, 21.2.2008, Ravon and Others, App. No. 18497/03.

its legal sphere adversely affected by measures adopted or to be adopted by tax authorities. The entitlement to such protection reflects the basic maxim *ubi ius, ibi remedium*.[441]

Accordingly, the entitlement to such protection starts before the moment in which procedures of administrative review and judicial appeals operate and ends when the judicial review has been completed and enforced.

More specifically, settled CJEU case law requires such protection to apply from the moment in which tax authorities conduct the preliminary phases of tax audits, such as inspections,[442] considering that the outcome of the audits is such that it can be imposed on the taxpayers.

In the context of the BEFIT procedure, it is important to stress that the involvement of tax authorities operates already before tax audits. This is clear if one looks at the assessment of individual tax returns under Article 64 of the proposed Directive, but also if one considers that Article 61 allows the filing authority and the BEFIT team to determine in a final way the content of the BEFIT information return. Likewise, the fact that Article 59 requires the issuing of a BEFIT information return by the filing authority (with the application of the corresponding penalties) also clearly shows a situation in which the measure adopted by tax authorities is likely to adversely affect the legal sphere of the BEFIT group.

Within such boundaries, the protection of the fundamental right to a fair trial should operate in the context of the proposed BEFIT Directive. In particular, this should certainly require the application of Articles 47 ff. of the EU Charter of Fundamental Rights, which require the right to an effective remedy and to a fair trial,[443] the respect of the right of the defence,[444] and the proportionality of penalties.[445] The declaratory nature of the EU Charter of Fundamental Rights will not prevent the application of more general principles of EU law than the ones expressly enshrined in the Charter itself, or determine more precise levels of protection than the ones that immediately appear from the wording of the EU Charter.

As mentioned, this study does not comprehensively review all such rights.[446] It suffices instead to mention them and their implications for the BEFIT procedure matters. In particular, insofar as the implications of the right to fair trial are concerned, this implies that procedures secure equality of arms, *habeas data*, i.e. the right of access to relevant information, the right of being heard, the prohibition of double jeopardy and, as long as the penalties are criminal in their nature, a number of additional rights, including the presumption of innocence and the privilege against self-incrimination. However, the latter principle may not be interpreted in a way that allows taxpayers to refrain from cooperating with tax authorities insofar as required for the correct functioning of the BEFIT procedure.

A bundled interpretation of the implications of the equality of arms and the right of access to relevant information requires prompt notification of all relevant information to all members of the BEFIT group. In principle, the proposed Directive scores high on these matters

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[441] See Kokott, J., Pistone, P., cit., p. 307.
[442] See PT, CJEU, 18 December 2008, Case C-349/07, *Sopropé*, EC:C:2008:746, para. 44 ff.
[443] See Article 47 of the EU Charter.
[444] See Article 48 of the EU Charter.
[445] See Article 49(3) of the EU Charter.
[446] For a summary of the analysis of such issues, see Kokott, J., Pistone, P., cit., pp. 304-310, which brings together the conclusions of a granular analysis that started *ibidem*, p. 206.

within each data flow, namely the BEFIT information return and the individual tax returns. However, it does not contain an equally precise set of provisions and obligations that secure the effective protection of those fundamental rights. There are two possible ways to overcome potential issues. The first is to reinforce the direct obligation of information across the lines of reporting by including specific rules that prevent possible conflicts and overlaps; the second is to let the matter be decided by domestic law, but the critical issue might be to determine whether there the domestic law of one single country may have binding effects across the group of BEFIT entities. Should neither way be concretely followed, these issues might still be addressed at the level of legal interpretation, but with a potential for significant repercussions in generating disputes and legal uncertainty.

The right to be heard raises issues in connection with the activities conducted in the framework of the BEFIT team. The latter is a forum for joint action by tax authorities and, therefore, it is essential to preserve a sufficient degree of confidentiality within such group of tax authorities as to the techniques that are used for conducting the scrutiny of completeness and accuracy of the information filed by the BEFIT group. However, the measures adopted by the BEFIT team can produce immediate adverse effects on the legal sphere of the BEFIT group and require respect for the right of the taxpayers to be heard beforehand. For this purpose, the submission of the documents in the filed tax returns may not suffice if other elements are considered, since the taxpayers must be given the right to a brief reaction before the amended BEFIT information return becomes effective.

The right to an effective legal remedy generally scores rather high in the final part of the BEFIT procedure, considering that section 6 of Chapter V contains a sound regulation of the right to request an administrative review and a judicial appeal against the amended BEFIT information returns and individual tax assessment. However, some rules, such as the silent confirmation of the initial assessment under Article 66(3) last sentence, might be problematic, as they deprive the taxpayer of information about the motivation as, instead, Article 41 (expressly) and Article 47 (implicitly) require.

The audi alteram partem principle may not be secured in a timely and prompt manner. Moreover, the absence of dispute settlement mechanisms and the exposure to potential overlaps between administrative reviews and judicial appeals at both levels of the BEFIT information return, and the individual tax assessments might result in more solutions to the same problem, an outcome that is, by its own nature, incompatible with the right to a single effective legal remedy. In other words, having two remedies available in two different states, might not be as good as having one binding all States to a single solution.

The prohibition of double jeopardy (ne bis in idem) raises a more far-reaching and fundamental problem as to the necessity of the two-tier procedural obligations. Besides not being strictly necessary to oblige group members to file returns on matters of overlapping data, the duplication may lead to a conflicting assessment of facts, which forces tax authorities to an even higher flow of data transmission than the one that would otherwise be required. As mentioned, this structural problem is also at odds with the concept of the one-stop shop approach.

The fundamental rights related to penalties will be addressed in more detail when elaborating on the clauses of the proposed BEFIT Directive that apply to penalties. As better illustrated later, according to settled case law, measures that are labelled as penalties by the national legislation might be equivalent to criminal sanctions because of the intensity of their negative repercussions on the sphere of the persons on which they are imposed.

6.4.2. The impact of EU fundamental rights on specific provisions of the proposed BEFIT Directive

6.4.2.1. Legal certainty, enforcement of amendments and statute-on-limitation

When addressing the impact of EU fundamental rights on specific provisions of the proposed BEFIT Directive, the first clause in the numerical order is Article 70, which allows for the implementation of amended tax returns notwithstanding the time limits applicable in the domestic laws of the Member States. The impact of this clause on statutes of limitation only partly addresses the issues that might arise in such a context. It does not address all time-related issues from the perspective of the taxpayers' right to legal certainty and the related specific rights expressly enshrined in the Directive. A good example of the latter type of rights is the one related to the 10-year limitation enshrined in Article 76(2) of the proposed Directive,[447] which will certainly prevail over Article 70 in case of conflict.

Moreover, the domestic statute-on-limitation rules applicable to the parts of the procedure that precede the administrative review and judicial appeal will remain applicable (unless the rules contained in the proposed Directive otherwise indicate), thus determining repercussions also on the possibility of applying Article 70 when the administrative or judicial appeal takes place beyond the admissible time limits.[448]

It might be more problematic to determine the impact of domestic statute-on-limitation rules on legal certainty in cases where such rules considerably extend such time limits to a disproportionate extent, undermining the right of taxpayers to obtain legal certainty as to the applicable rules. These issues might, in fact, have to be addressed at the level of interpretation by the CJEU by applying the criteria developed in its case law to the framework of the BEFIT procedure.

6.4.2.2. Protection of confidentiality (Art. 71)

Article 71(1) of the proposed Directive contains a clear and precise obligation to protect confidentiality of restricted access information and data arising from the proposed Directive, also limiting the use for the sole purposes related to the administration and enforcement of the laws of the Member States concerning the taxes under the proposed Directive.

The wording should prevent possibly unauthorised use or public disclosure of such data, thus creating the ideal legal framework for data protection. The clause of Article 71(2) introduces an exception to the principles contained in Article 71 and presupposes that the administrative review and judicial appeals will, by their own nature, give rise to a public disclosure of such data.

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[447] See further on this below under sec. 6.4.2.

[448] This means concretely that any amendment to the filing of returns, assessment or audit conducted beyond the time-limit will block the validity of all later steps of the BEFIT procedure.

No major issues of protection of fundamental rights should, therefore, arise in this context, except in case of violations of the legal framework established by Article 71 of the proposed Directive.

6.4.2.3. Data protection

Data protection is a good example of EU fundamental rights that are limited by a specific set of rules. The General Data Protection Regulation (GDPR)[449] is limited to data protection for individuals. However, the limited scope of the GDPR does not prevent persons other than individuals from invoking their right to privacy under Article 7 of the EU Charter on Fundamental Rights, or by arguing that the violations of data protection of such other persons produce indirect repercussions on one or more natural persons.[450]

The proposed BEFIT Directive regulates the entitlement to data protection in Article 76. It establishes precise limits to the processing of personal data gathered under the Directive and limits its use to the purposes enshrined therein. The precise identification of the controllers, contained in Article 76(1) 2nd sentence, sets the ground for an effective reaction to potential breaches. The right to retain such personal data only for as long as necessary to implement the BEFIT procedure, in line with each data controller's national law and in any case without exceeding a 10-year limit[451] is welcomed from the perspective of securing a proportionate balance between the right of pursuing an effective tax collection and the one to protect the fundamental right to data protection.

The entitlement of non-physical persons to the protection of other procedural and substantive fundamental rights, such as the right of property and to a fair trial, can be derived from the wording of the subjective entitlement contained in the respective clauses and in line with the interpretation of the European Court on Human Rights, which establishes the minimum standards for the protection of such rights.[452]

6.4.2.4. Penalties

This line of reasoning also applies to the fundamental rights connected with the levying of penalties and sanctions.[453] Two clauses of the proposed Directive[454] which expressly regulate penalties require some more granular analysis.

[449] Regulation (EU) 2016/679 of the European Parliament and of the Council of 27 April 2016 on the protection of natural persons with regard to the processing of personal data and on the free movement of such data, and repealing Directive 93&46&C *General Data Protection Regulation).
[450] See DE, CJEU: 9 November 2010, Joined Cases C-92/09 and C-93/09, Volker and Markus Schecke and Eifert, EC:C:2010:662, paras 52 and ff.
[451] See Art. 76(2) of the proposed Directive.
[452] The reference to the minimum standard steers interpretation in the legal framework of the EU Charter. Consequently, such rights apply under Article 17 and 47 ff. in a broader number of cases than the ones in which the specific limits contained in the corresponding clauses of Article 1, 1st ECHR Protocol and Article 6 ECHR allow for.
[453] See on this Kokott, J., Pistone, P., Taxpayers in international law, cit., p. 331 ff. and the case law quoted therein.
[454] Namely Arts. 59 and 72 of the proposed Directive. For the sake of completeness also Arts. 16 and 71 of the proposed Directive regulate penalties, but their wording does not require further attention from the perspective of the protection of fundamental rights and will therefore not be addressed hereby.

Article 59 contains an express reference to Article 72 of the proposed Directive, according to which Member States are obliged to “lay down” rules on penalties and to take all necessary measures to ensure their implementation and enforcement. The second sentence of this clause adds that penalties “shall be effective, proportionate and dissuasive”.

The combination of these rules sets a legal framework that creates precise obligations for Member States to apply penalties while leaving them leeway to determine the system of their application, subject to the three criteria indicated in Article 72(2) 2nd sentence. The wording of such clauses always refers to penalties without using expressions that could imply the entitlement of EU Member States to apply criminal sanctions.[455] Unless the final version of the Directive amends such wording in a way that includes a reference to sanctions in addition or in alternative to the one related to penalties, this means that EU Member States do not have an obligation to levy criminal sanctions in connection with the requirements of the BEFIT Directive. The issue, therefore, arises as to whether Member States keep the power to apply criminal sanctions in such context or whether the proposed Directive deprives them of such right. Considering that the BEFIT proposed Directive deals with the levying of corporate income tax on large enterprises, even where Member States apply criminal sanctions above a certain minimum quantitative threshold of unpaid tax, it is highly likely that such situations will include the ones regulated by the proposed Directive, For this reason, from a policy perspective it might seem rather odd to consider that the proposed Directive may deprive those Member States of their power to apply criminal sanctions in this context. In fact, the easiest way to overcome potential interpretative problems might be to either replace the current wording with sanctions or to add “and sanctions” to it. Alternatively, it should be clarified that Member States are left with the power to regulate criminal sanctions.

This will also facilitate the consistency with the three adjectives used in Article 72(1) 2nd sentence to set the boundaries of the applicable sanctions. These adjectives are not new in secondary EU law on tax matters,[456] but the precise identification of the boundaries within which national legislators can apply the penalties is a delicate matter. There is a latent intrinsic clash between the proportionate and dissuasive effect of penalties[457] which is difficult to properly achieve. One might achieve such balance by requiring, on the one hand, a structural limitation to the use of deterrent penalties, which would be by their own nature disproportionate and, on the other hand, to that of mild penalties, which would lack a dissuasive effect. It is reasonable to prevent the latter problem by requiring a proportionate determination of the penalties based on the severity of the violation and on the individual situation of each BEFIT group member. The latter benchmark might also be determined in a way that allows Member States to apply stronger penalties to violations of the BEFIT Directive as compared to those that would otherwise normally apply to smaller taxpayers.

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[455] By contrast, Arts. 9(2)(b) and 30(1) of the Directive of 30.5.2018, n. 2018/843 refers to “sanctions” or to “measures or sanctions”.

[456] See Art. 25a of DAC 2011/16/EU; Art. 26(2) of Regulation EU 2023/956 of 10.5.2023 establishing a carbon border adjustment mechanism. Even though the tax component has an ancillary nature to the latter instrument of secondary EU law, its application to tax matters makes it relevant for the analysis to be conducted hereby.

[457] See Kokott, J., Pistone, P., cit., p. 440.