Technology Industries of Finland

24 January 2024

Technology Industries of Finland's submission to the public consultation:
Business in Europe: Framework for Income Taxation (BEFIT)

The European Commission (EC) has requested comments regarding the Business in Europe: Framework for Income Taxation (BEFIT) proposal. According to the European Commission the purpose of the proposal is to boost the competitiveness of the single market, reduce compliance costs (also SMEs'), making it easier for companies to do business and to support investment in the EU. BEFIT would be a single corporate tax rulebook for the EU, consisting of rules for common tax base and later the allocation of profits between Member States using an allocation formula (formulary apportionment) would be added to the model. During the transition period (before 2028) a temporary statistical own resource would be used to gather revenues to the EU budget. Technology Industries of Finland (TIF) welcomes the opportunity to comment the BEFIT initiative.

1 Summary of TIF's recommendations

TIF is of the opinion that although the said goals of BEFIT are highly supportable, BEFIT is not the correct tool, nor is it introduced at the right time.

- Proposal is untimely. Companies and tax administrations alike have their hands full with trying to properly implement the minimum tax directive. **The BEFIT proposal should be postponed to 2030** and discussed only after the OECD pillars and the EU minimum taxation directive are in place, fully and successfully implemented and have been in use for several years. **A legislative break is acutely needed.** After the minimum taxation tax base calculation rules are in use, the alleged necessity of BEFIT tax base calculation rules is even more questionable.

If, however, the BEFIT directive proposal is advanced, there are key conditions that need to be met in order for the BEFIT to be attractive to businesses:

- **BEFIT should always be optional for business**. The model has to be made so attractive that companies will prefer joining it rather than staying outside the system. Also companies below the threshold of 750 million euros.
- An introduction of **a cross-border tax relief** is considered a welcome improvement and would boost competitiveness of the EU single market.
- Also the proposal to **abandon withholding taxation** is supportable.
- The **tax base calculation rules must be built on the OECD pillar 2 model rules** and accompanying documents and the minimum tax directive. **No deviating tax base calculation rules should be introduced.**
- The goal must be to **make taxation simpler**. It should use a "**one stop shop**" -model allowing for filing just one consolidated tax return. In the EC's BEFIT directive proposal the OSS model would be used only for filing the BEFIT information return. Each group company would still have to file a separate tax return to their country of residence. This is not supportable.
- The Commission urges to allocate saved administrative costs to green investments. TIF suggests that in order to effectively support green investments, the **BEFIT model should include considerable R&D tax incentives for digital green investments**, boosting double transition to green and digital business.

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- **Intangibles must be included in the possible allocation formula.** Value creation in the digitalising economy relies on intangible assets. A decades old allocation formula is not sustainable and up to date.
- As the idea is to have an overall reform of corporate income taxation, the EC should also **propose which EU tax regulation will be abandoned (in addition to withholding taxation)**.
- No permanent allocation formula has been published in the BEFIT directive proposal, but it is mentioned multiple times that one will be provided later. During the previous public consultation round (in January 2023), the Commission referred to CCCTB's distribution formula and the elements of the substance-based exemption of the OECD Pillars. The decades-old distribution formula is neither sustainable nor up-to-date. No Member State can commit to such a significant element without knowing what the allocation formula will be. The Commission should **publish the outlines of the allocation formula before proceeding with the preparation of BEFIT.**

The BEFIT model has also been proposed as a **EU's new own resource**, in which case part of the BEFIT income would be credited to the EU budget.

- Finland’s government program includes a position that development of the EU's own funds system must not cause disproportionate additional cost to Finland. Changes in EU taxation must be fair also on a Member State level.
- If Finland's (or other small Member States’) tax and payment revenues decrease drastically, it might result in increasing level of national taxation, possibly weakening incentives for growth, investments, entrepreneurship, entrepreneurship, and work.
- The new own resources proposal must not be a detour to push through old, previously rejected tax reforms.
- TIF is critical about the Commission's proposal for a 0.5% temporary statistical own resource on gross operating surplus statistics, which would be in force before the BEFIT model comes into effect. The statistical own resource would complicate the Union's financial system. According to the Finnish Ministry of Finance’s calculations, the Commission's proposal seems to be economically significantly disadvantageous for Finland.
- Qualified majority voting should not be used in EU tax matters.

2 BEFIT must be optional to all

Regardless of how competitive a new system is said to be, any shift from a domestic tax system to a common system within the EU, will entail significant costs. These costs may, at least temporarily, outweigh the benefits of a new system. For groups with a turnover exceeding the threshold of 750 million euros, a vast amount of tax reporting and tax legislation becomes obligatory: country-by-country reporting, minimum taxation, etc. Tax reporting is starting to become a substantial and undue obstacle to growth.

More than 85 % of TIF’s member companies are SMEs, but most have cross-border activities. BEFIT should be so attractive that all companies would prefer joining it rather than staying outside the system. Thus, we support the proposal that also companies below the threshold of 750 million euros can opt in. For governments a fully optional system entails the benefit of a gradual adoption by businesses.

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3 The purpose of the BEFIT proposal must remain clear

CCCTB was originally launched to address cross-border tax obstacles and boost growth. In our opinion, this should remain the focus of the CCCTB's successor BEFIT.

The EC says the two-pillar approach of the Organisation for Economic Co-operation and Development (OECD) and the G20 will be a source of inspiration for the design of the BEFIT policy framework, namely the formula for allocating profits of Pillar 1 and the tax base calculation rules developed for Pillar 2. **However, the tax base calculation of Pillar 2 should not be a "source of inspiration", it should be a solid building block as is.** The EC is continuously building tax models said to be in line with the global (OECD) model but are still different. On top of that each Member State will make unilateral changes to their national legislation. **The result of BEFIT is three layers of overlapping tax legislation, double taxation, disputes and unreasonable administrative costs.**

EU, OECD and the Member States have invested great effort in combating harmful practices in the recent years. Most recently, all EU Member States are implementing the minimum tax directive. There is not enough experience on how successful the new measures will be in reaching the desired outcomes, but it can be reasonably expected that they remove tax evasion and avoidance. That has at least been the promise from policy makers. Therefore, it would be **beneficial for EU to give a legislative break for the Member States and companies to fully implement all of the new tax measures and do a thorough analysis on the effects before launching new tax proposals.**

TIF also requires that in connection with the overall reform of corporate taxation, the Commission will propose which EU tax regulation to abandon. Changes to the protection of legitimate expectations and distribution of the burden of proof (for example, when analyzing negligence in the determination of tax penalties) must be reanalyzed, when the company supplies more and more information to the tax administrations.

4 The elements in the allocation formula are outdated

As mentioned in the EC's consultation paper the idea of developing a common (consolidated) corporate tax system for the EU has been around for decades, as early as the 1960s. Previously the proposal was named CCCTB, now the name is BEFIT but it seems little has changed. The root problem is that the EC is trying to modernize taxation system by using a tax model and allocation formula reflecting the business and world of the 1960s.

According to the BEFIT directive proposal, the long-term permanent goal is to add a permanent allocation formula model.

> "The Commission shall carry out a comprehensive review of the transition rule as part of which it shall prepare a study on the possible composition and weight of selected formula factors and submit a report to the Council <u>by the end of the third fiscal year</u> during the transition period referred to in paragraph 1. <u>If the Commission deems it appropriate, taking into account the conclusions of this report, it may adopt a legislative proposal during the transition period, to amend this Directive by introducing a method for the allocation of the BEFIT tax base using formulary apportionment and based on factors."</u>

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Taxable result calculated based on the BEFIT rules would be allocated to the Member States using an allocation formula. However, this formula has not been published in the BEFIT directive proposal, but one would be published later, amending the BEFIT directive. Thus, the allocation formula has not been deleted, only postponed. **It is crucial to discuss this formula already now, and not to accept BEFIT model without knowing what the formula will be.**

Finland is a small, net-exporting country that relies on high value creation through R&D&I (research, development and innovation) and intangible assets. Finland has just introduced two R&D tax incentives, because the **crucial importance of R&D&I-investments in boosting green growth was seen evident.** Thus, Finland supports R&D&I with its tax revenues, from the national budget. The BEFIT allocation formula would result in the small export driven countries to carry the losses and costs of supporting innovation and growth, but the large Member States having more sales by destination would be allocated more tax revenues. This would disincentivise R&D&I investments. There are several researches supporting the analysis that larges countries would benefit at the expense of small Member States such as Finland. **TIF does not consider this to be fair taxation on a Member State level.**

4.1 Intangible assets must be added to the formula

The EC emphasizes, that an essential principle for a fair taxation is to ensure that a business pays taxes where its profits and value are created and generated. TIF agrees that this established principle, also supported by the OECD, is the only reasonable way to allocate taxable profits and value. However, TIF is of the opinion that **the location of the consumer is not a key value driver.**

The EC has suggested that the formulary apportionment approach introduced in the CCCTB proposal would better reflect where the value is created, and therefore, might be used also in the BEFIT proposal. The old CCCTB attribution formula being a percentage calculated based on amounts of tangible assets, employees, salaries and sales by destination does seem to fail to allocate taxable profit where the value is created. This is especially true concerning digitalised economy companies, where tangible assets are not as relevant, but the businesses derive much of their value from intangible assets. Such an allocation formula would not encourage Member States to invest in digitalization, sustainable growth and new technologies, R&D etc.

Intangible assets, data and knowledge are important value drivers within multinational groups, but are difficult to identify and value. TIF is strongly of the opinion, that the solution to this difficulty cannot be that intangible assets would not be given a value at all. **Intangible assets must be included in the final BEFIT allocation formula proposal. The old CCCTB apportionment formula should not be promoted.**

4.2 The allocation formula does not value or support environmental values

If the later to be revealed permanent BEFIT allocation formula would be based on tangible assets, the number of employees and salaries and sales by destination, it would **not give any value to environmental issues, efficiency, productivity, value add. It does not give weight to benefits of circular economy, digitalisation, automatisation, robotics** etc. This could hinder the Member States' and companies' incentives to find environmentally friendly, effective solutions. One major element of green transition is digitalisation. EU cannot have a more digital economy if the value of digitalisation is not understood or recognized in a new EU wide corporate tax system.

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On page 11 of the preamble of the BEFIT directive proposal, the Commission describes that by reducing the administrative burden of taxation, companies could use the freed-up funds for green investments. The basic idea is supportable, but the BEFIT model itself must not lead to opposite actions.

- BEFIT could also lead to inefficient group structures: equity and assets trapped to companies (and not to green investments), personnel and fixed assets (or leasing/renovation costs) located in countries with the lowest tax rates.
- The increasing amount of /remote work adds an element to this discussion. Will the BEFIT allocation formula value only the physical presence of personnel or how will mobile workers be valued? Or will remote work be banned and all need to start travelling again? Not very environmentally friendly.
- Allocating taxable profits based on sales by destination gives an incentive to a Member State to maximize the purchase power and consumption of its companies and consumers. **Expecting constant growth of consumption is not sustainable from the environmental perspective.**

4.3 Sales by destination – a major risk to data privacy

It is good that the BEFIT directive proposal has analyzed data protection risks taking into account the GDPR regulation. If sales by destination -element is added to the permanent BEFIT allocation formula, risks with data privacy will emerge related to tracking the true location of the customer.

The Commission should also analyze the information security risk from the point of view of business secrets. How to ensure that the confidential information of companies is not revealed when the data used in the calculation of the tax base is processed by the BEFIT team formed by several tax administrations?

The GDPR limits e.g. the type of data that can be gathered, the purposes and who can collect and supply the data and how long data can be stored. The data privacy aspect needs to be considered also in the relationship between the group companies and companies in a tax paying position and third parties.

- If personal data needs to be processed to allocate taxes, it should be carefully considered what would be the minimum dataset subject to processing and how to minimise risks incurred by the processing. All the data processed needs to be limited to strictly necessary to facilitate taxation.
- Usually giving access to data is limited to certain use. Data privacy rules and nondisclosure rules limit the use of data. Thus, if the 3rd party companies are required to collect and report consumer data, contracts would have to be renegotiated to allow using data for taxation purposes. This seems to be an unreasonable demand.
- Even a small company might be obliged to collect and report the user data to an in-scope bigger company. A tiny SME does not have personnel nor tools to do this. Thus, sales by destination rules might result in extensive costs to 3rd parties and notable risk of data privacy sanctions.
- What is the legal situation concerning 3rd party companies or group companies not in a tax paying position? Would BEFIT rules require changes to GDPR regulation and changes to all companies bound to GDPR rules?

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- Due to GDPR regulation, user data cannot be collected for tax purposes before the tax liability is triggered, i.e. once the legislation is in force and the company is in scope.

5 BEFIT might lead to less taxable income to the EU

One of the key objects of the BEFIT initiative is "to provide sustainable tax revenue". TIF is concerned that the BEFIT allocation formula could result in less taxable income to be allocated to the EU Member States. As for now, the parent companies can prove that arm's length principle has been used correctly and equally, so that profit is taxed where the value was created based on the OECD's transfer pricing model rules. However, EU based companies have experienced that group companies in e.g. China and India, are questioning the principles of income allocation. If within the EU the amount of personnel is e.g. 100 and in China 700, there have been requests to allocate more income to China, no matter what the value add created is. **If the EU agrees that the only elements that create value add are sales by destination, amount of personnel, paid salaries and tangible assets, more taxable income will be without a doubt be allocated outside of the EU. Current transfer pricing rules and arm's length principle need to be kept in force.**

6 Pre-BEFIT costs and losses, but no tax revenue to pay for them

The proposed BEFIT allocation formula would erode especially small Member States' tax base. Today, the taxes are principally paid to the country where the value is created. For example, relevant R&D-functions require skilled employees. All education costs and contributions to digitalisation would be a cost to Member States and companies, but there would not be taxable income to pay the costs.

Start-ups and heavily investing companies typically generate losses when building up their business. The loss can arise when BEFIT is not applicable due to revenue thresholds. However, if the company becomes profitable while BEFIT is applicable, the losses can only be utilized in the country where they have originated. The outcome does not encourage risk-taking or entrepreneurship, as governments in customer countries are getting compensation before owners and creditors, who have financed building of the starts-up and growth companies. Neither it is fair for the country, where the business has been ramped-up. That country is stuck with pre-BEFIT tax losses, while other countries receive the revenues.

In the minimum, **BEFIT should allow pre-BEFIT losses and other tax attributes to be carried over to the BEFIT group**. Otherwise, the model will lead to unreasonable outcomes. As a result, a company can be cumulatively loss making, while it still has to pay taxes.

7 BEFIT model seems to significantly add complexity and administrative burden

Key objectives of the BEFIT initiative are "to increase businesses' resilience by reducing the complexity of tax rules and the compliance costs faced by EU businesses operating across borders" and "to create an environment conducive to fair and sustainable growth by paving the way for administrative simplification." **TIF agrees that the current administrative costs of complying with up to 27 different tax regimes constitute major obstacles to cross-border business activity in Europe. Thus, these objectives of BEFIT are fully supportable.**

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Companies must be able to be tax compliant: tax laws must be clear, comprehensive and efficient, predictable and as simple as possible. TIF is pleased that one of the main objectives of the Commission's Communication on Business Taxation for the 21st Century is to reduce the administrative burden of taxation. The Commission has also launched projects (including an Action Plan to Fight Tax Evasion and Making Taxation Simple and Easy) to increase the use of digital taxation tools and to simplify tax reporting. TIF's opinion is that **digitalization of taxation is the correct path to make the single market competitive and appealing for companies.**

However, TIF does not see that the BEFIT would meet its key objectives.

- All changes in taxation mean costly changes to companies' systems and are unpredictable. Introducing totally new and different taxation systems (especially such a huge reform as the BEFIT), will cause significant uncertainty. Therefore, an international approach (OECD) is the only reasonable option. The cumulative effect of OECD, EU and national corporate tax regulation would be unreasonably heavy.
- Transfer pricing and taxation with countries outside of EU will continue to exist even if an EU BEFIT was agreed. For companies doing business outside EU, the BEFIT is considered mainly as an extra layer of work, costs and disputes.
- Companies worry that there is no predictability on where the taxable income will be allocated, as the sales by destination -factor is unpredictable. Thus, taxable income could be allocated to a country, where there are no actual funds to pay the tax. This unpredictability in the allocation formula seems to trigger a barrier to expand business operations to other EU countries.
- The BEFIT directive proposal emphasizes the lightening of the administrative burden through easy tax reporting. Article 57 defines that the reporting company ("filing entity", usually the parent company) reports the BEFIT information return to one tax authority on behalf of the entire group, using a one-stop shop. However, Article 62 clarifies that each group company must submit its own separate tax return to the tax authorities of its country of location. Two more separate tax returns, in addition to each country's national corporate tax return, GloBE information return (GIR), each country's national minimum tax return, country-specific authority and public reporting (CBCR) and 27 different reporting processes for most other types of tax. Possible BEFIT reporting should be a completely centralized one-stop-shop model and national tax declarations should not be required.

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Technology Industries of Finland (TIF) represents Finnish technology industries and has over 1,800 member companies, sizes varying from small SMEs and start-ups to world leading MNEs. The technology industry is comprised of five sub-sectors: electronics and the electrotechnical industry, mechanical engineering, metals industry, consulting engineering and information technology. Technology industry is the most important export industry in Finland, with operations constituting over 50 % of all Finnish exports and responsible for 65 % of all private investments in R&D carried out in Finland. Over 350,000 Finns work in technology companies, while a total of around 700,000 people work in the technology sector directly or indirectly (of a total population of 5,500,000).[1]

[1] For further information of TIF's member companies, please see https://teknologiateollisuus.fi/en