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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 including for 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 the allocation of profits between Member States using an allocation formula (formulary apportionment). 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.

- **The BEFIT proposal should be postponed and discussed only after the OECD pillars and the EU minimum taxation directive are in place, fully and successfully implemented and operated for several years.**

If, however, the BEFIT directive proposal is drafted and published Q3/2023, 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. If optional, also companies below a possible threshold of e.g. 750 million euros should be accepted to use the model, in case they choose to opt in.
- **Intangibles must be included in the allocation formula.** Value creation in the digitalising economy relies on intangible assets. A decades old allocation formula is not sustainable and up to date.
- An introduction of **a cross-border tax relief** would be considered a welcome improvement and boost competitiveness of the EU single market.
- The **tax base calculation rules must be built on the OECD pillar 2 model rules** and accompanying documents (such as the minimum tax return form being drafted) and minimum taxation directive. **No deviating tax base calculation rules.**
- The goal must be to **make taxation simpler.** It should use a "one stop shop" -model allowing for the filing of one consolidated tax return.
- The BEFIT model **must include considerable R&D tax incentives, boosting double transition to green and digital business.**
- **Tax rates should be decided by national governments.**
- **Current transfer pricing rules and arm's length principle need to be kept in force.**

2 BEFIT must be optional

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. Making BEFIT obligatory as soon as a group establishes

itself in another Member State would introduce obstacles to growth and cross-border expansion. As more than 85 % of our member companies are SMEs but most have cross-border activities, we worry that making the BEFIT obligatory would cause significant costs to these companies affecting their business and growth. BEFIT should be so attractive that companies will prefer joining it rather than staying outside the system. If optional, also companies below a possible threshold of e.g. 750 million euros should be accepted to use the model, if they wish to opt in.

For governments an optional system entails the benefit of a gradual adoption by businesses, thereby ensuring a limited short-term impact on corporate tax revenues. Governments would in any case have to administer two corporate tax systems, unless they do not make all businesses forced to apply the new corporate tax rules irrespective of any presence of cross-border activity, size and business model.

3 The purpose of the BEFIT proposal must remain clear

As mentioned in the EC's consultation request 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.

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. If the BEFIT would entail neutralisation of intra-group transactions, it would provide important stability and certainty for the taxpayer. 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.**

The abandoned CCCTB proposal was widely discussed and scrutinized since it was introduced in 2011. It was launched to address cross-border obstacles in the corporate tax field. However, when the CCCTB was relaunched, in 2016 the Commission changed the main intention of CCCTB and declared that the main objective is to use CCCTB as a tool to combat aggressive tax planning. The main focus for the BEFIT should be addressing cross-border tax obstacles in order to promote investments, jobs and growth.

EU, OECD and the Member States have invested great effort in combating harmful practices in the recent years. Most recently, the EU reached an unanimous agreement on the minimum tax directive in December 2022. We do not have experience on how successful the new measures will be in reaching the desired outcomes, but it can be reasonably expected that they remove all material planning alternatives. That has at least been the promise from policy makers. Therefore, it would be **beneficial for EU to give the new measures a fair chance before launching new and potentially harmful measures.**

4 The elements in the allocation formula are outdated

Intangible assets are a progressively increasing value driver to today's economy. In the consultation request the EC recognises this and describes that one of the problems that the initiative aims to tackle is:

"the current corporate tax systems do not fully reflect the realities of today's economy and global developments as they are still mainly based on the principles of local brick-and-mortar production. These principles are believed to be outdated since globalisation, digitalisation and the intensified use of intangibles have substantially changed how companies do business. These changes should also be reflected in how they are taxed."

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 even though they have not contributed to the R&D&I investments. 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 it to be used also in the BEFIT proposal. The old CCCTB attribution formula being a percentage calculated based on amounts of tangible assets, employees and sales by destination does seem to fail to allocate taxable profit where the value is created. The formula would allocate taxable income to the country of sales. This is especially true concerning digitalised economy companies, where tangible assets are mostly irrelevant, and the businesses derive much of their value from intangible assets. The current allocation formula does not encourage Member States to invest in digitalization and new technologies, R&D etc.

Digitalising businesses and companies rely heavily on intangible assets, data and knowledge, which are becoming more and more the value drivers within multinational groups and which are difficult to identify and value. TIF is strongly of the opinion, that the solution to this difficulty cannot be that intangible assets will not be given a value at all. **Intangible assets must be added to the allocation formula of the BEFIT proposal. The old CCCTB apportionment formula now discussed to be added to the BEFIT directive proposal should not be promoted.**

4.2 The allocation formula does not value or support environmental values

The suggested BEFIT allocation formula does not give any value to environmental issues, efficiency, productivity, value add. It does not give weight to benefits of circular economy, digitalisation, automatisisation, 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. How can the EU have a more digital economy if the value of digitalisation is not understood or recognized in a new EU wide corporate tax system.

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 distance work adds an element to this discussion. Will the BEFIT allocation formula value only the physical presence of personnel or how will distance workers be valued? Or will distance work be banned and all need to start travelling again? Not very environmentally friendly.

Allocating taxable profits based on sales 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

If sales by destination -element is added to the BEFIT allocation formula, risks with data privacy will emerge related to tracking the true location of the customer.

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 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.
- The company liable to collect the user data and in a taxpaying position might not be in such a "negotiating position" that it can force the 3rd party contractors to collect and deliver the required data in given time and without extra costs.
- 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.
- Taxation is likely an acceptable reason for the company in a tax paying position to collect personal geolocation or other relevant personal data required to be collected for BEFIT purposes. However, 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?

- Even the smallest 3rd party companies would have to be competent to evaluate whether the customer data request is such that it can be fulfilled without breaching the GDPR legislation. Data can only be requested to specified use and only to the limit absolutely necessary to that specified use.
- 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.
- Data privacy and business secret issues are at risk when collecting and delivering data from 3rd party companies and through multiple distributors or group companies.

5 BEFIT might lead to less taxable income to the EU

The fourth key object of the BEFIT initiative is "to provide sustainable tax revenue". The EC has suggested the BEFIT would be introduced as a "new own resource". Thus, a part of the taxable income resulting from BEFIT would go directly to EU's budget, not to the Member States. Due to the continuous crisis additional tax revenues are needed all over the EU.

However, TIF is concerned that the BEFIT allocation formula will lead to less tax income for group companies in the EU and the Member States. Companies are reporting that group companies in e.g. China and India, are questioning the principles of income allocation. If in a group company inside the EU the amount of personnel is 100 and in India 700, there have been requests to allocate more income to e.g. India, no matter what the value add is in the work done there. As for now, the parent companies can prove that arm's length principle has been used and the allocation has been done correctly and equally, so that profit is taxed where the value was created. **If, however, all of EU agrees that the value add or intangible assets have no meaning and the only issues to be considered 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 and even longer. 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 VAT is a consumption tax, corporate tax is not

The EU taxation system must be considered in its entirety, also when considering the taxation of digitalising economy. Value-added taxation allocates taxes to the residence country of the consumer. Each country where the consumer is located applies their local VAT percentage to collect taxes. Therefore, implementing destination based sales -factor to corporate income taxation would mean allocating more taxes to big markets.

Also, similar type of problems, as value added taxation has faced over the years, could be triggered concerning the concept of destination based sales -factor, for example related to tracking the true location of the customer.

The OECD's pillar 1 Amount A would already allocate part of the taxation rights to the country of consumption. **Introducing multiple corporate tax models based on consumption is not sustainable nor fair to the smaller Member States.**

8 BEFIT model seems to add complexity and administrative burden

First and third 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.**

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. For example, the VAT directive has been in force for over 40 years and despite the additional specifications to the directive and the vast amount of jurisprudence, there still are disagreements on the interpretation of the directive. Therefore, an international approach (OECD) is the only reasonable option.
- 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.
- 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 Minimum Tax Directive was accepted in December 2022 and the Member States have until 31.12.2023 to implement it. Tax calculation rules in the directive and the OECD model rules and accompanying rules are very complex. Introducing deviating BEFIT tax base calculation rules would add complexity and administrative costs immensely. The cumulative effect of the combination of all the rules is unreasonably heavy.

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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>