Briefing

International review for November

Speed read

The European Commission has published a call for evidence on the proposal to implement a new EU wide corporate tax system. Whether it will succeed where similar initiatives have stalled remains to be seen. In a decision worth €30m in tax, the CJEU has ruled in favour of Fiat Chrysler that a Luxembourg transfer pricing ruling did not breach EU state aid rules. The Australian government has announced its Federal Budget for 2022-23 with a number of noteworthy measures for multinationals. Hungary and Germany have published draft domestic legislation to implement EU public country-by-country reporting. The ECOFIN Council has agreed on a revision of the code of conduct for business taxation. Finally, Australia, the Netherlands and Germany have taken further steps to implement Pillar Two locally.

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European Commission consultation on a new common corporate tax system in the EU (BEFIT)

On 13 October 2022, the European Commission (EC) published a call for evidence on policy options for a new corporate tax system referred to as 'business in Europe: framework for income taxation' (BEFIT).

BEFIT has emerged in response to the EC's longstanding concerns that the lack of a common corporate tax system in the European Union (EU) creates a competitive disadvantage compared to third country markets. The initiative proposes common rules for determining the corporate tax base and for the allocation of profits between member states, based on a pre-defined formula. Once allocated, those profits would be subject to the corporate income tax rate of the respective member state.

BEFIT aims to boost the competitiveness of the single market by reducing tax complexity and compliance costs. This will encourage investment in the EU and provide sustainable tax revenue in light of current economic challenges. To achieve these aims, the EC recommends an EU directive on BEFIT, composed of key building blocks. These are summarised at a high level below.

Scope: The call for evidence sets forth two options. The first is to include groups with consolidated global revenues above €750m (i.e. aligned with the Pillar Two model rules). The alternative is a lower revenue threshold to make the framework more inclusive and to reduce disparities. This could include an 'opt-in' option for SMEs with cross-border activities.

Tax base: To determine the tax base, the EC draws inspiration from Pillar Two and proposes a list of tax adjustments that would be applied to the consolidated financial account net income or loss of a group entity. Once calculated, the individual tax bases of all EU group members would need to be consolidated. The EC recognises that this approach would mean the abolition of transfer pricing adjustments for EU intra-group transactions. As a result, the option to offset cross-border losses would be introduced.

Alternatively, the EC proposes establishing a framework that would provide for detailed rules for the determination of the tax base under BEFIT. However, this option would increase complexity as member states would have to operate two comprehensive sets of corporate tax rules in parallel.

Allocation of taxable profits: The EC proposes a pre-defined formula to allocate taxable profits to member states. This allocation would be based on three factors: tangible assets (excluding financial assets), labour (possibly a combination of employee numbers and payroll), and sales by destination. While these factors should be the most resistant to abusive practices, the EC is also considering a fourth factor – intangible assets – to better reflect economic reality.

Administration: Administration of BEFIT will play an integral part in reducing the cost and compliance burden for taxpayers and member states. The call for evidence explores simplifications including a single EU corporate tax return combined with a 'one-stop shop' for submitting the group's tax return and settling the annual tax liability. Coordinated tax authority audits, including joint audits and alternative dispute prevention and resolution methods are also discussed.

Interested parties have until the 5 January 2023 to provide feedback on the proposals, with the EC expecting to adopt a legislative proposal in the third quarter of 2023. Whether BEFIT can succeed where previous attempts to introduce a common EU tax system have failed remains to be seen.

Luxembourg: finding of illegal state aid involving application of arm's length principle set aside

On 8 November 2022, the CJEU gave its decision in the joined cases *Fiat Chrysler Finance Europe v Commission* (C-885/19) and *Ireland v Commission* (C-898/19). Both cases concern the validity of a decision issued by the EC, which found a transfer pricing ruling granted by Luxembourg to be incompatible with EU state aid rules.

The case was first disputed in front of the General Court of the EU, which ruled in favour of the EC. On appeal the CJEU concluded that the General Court was wrong to confirm the Commission's approach. In its judgment, the CJEU stated that in order to classify a national tax measure as illegal state aid, four conditions must be fulfilled:

- there must be an intervention by the state or through state resources;
- the intervention must be liable to affect trade between member states;
- it must confer a selective advantage on the beneficiary; and
- it must distort or threaten to distort competition.

The CJEU asserted that in examining the third condition relating to selective advantage, the 'reference system' (i.e., the normal tax system applicable in the member state concerned) must first be identified.

The CJEU found that the General Court committed an error in endorsing the approach taken by the EC. This approach was confined to the abstract expression of the arm's length principle that failed to take account of the principle as defined by Luxembourg law. Accordingly, the CJEU set aside both the original decision of the EC and the appeal judgment of the General Court.

The judgment – which is final and cannot be appealed – means that Fiat Chrysler will not have to pay €30m in tax to Luxembourg. This is the latest in a series of high profile cases in recent years where EC state aid rulings have been overturned on appeal by the taxpayer. The parties in the state aid cases currently pending before the CJEU will be watching this decision with close interest.

Australian Federal Budget 2022/23 announcement

Following its success in the May 2022 election, the new Australian government outlined its priorities for the coming term in its first Federal Budget on 25 October 2022.

On personal taxes, no new tax measures were announced. The government maintained previously legislated measures to remove the 37% income tax bracket from 1 July 2024 and reduce the 32.5% bracket to 30%. In addition, the threshold above which the top marginal rate of 45% applies will increase from $180,000 to $200,000.

On business tax, there was a strong focus on multinational integrity and cross-border financing, building on the government's 'multinational tax integrity and tax transparency' consultation in August 2022. The key measures are summarised at a high level below:

Changes to the thin capitalisation rules: Consistent with its election commitments, the government will amend the thin capitalisation rules from periods commencing on or after 1 July 2023. The changes include:

- replacement of the existing safe harbour method with a 30% of earnings before interest, taxes, depreciation and amortisation (EBITDA) test: following strong feedback, deductions denied under this test may be carried forward up to 15 years;
- replacement of the worldwide gearing ratio with a new earnings-based group ratio to allow debt-related deductions up to the level of the worldwide group's net interest expense as a share of earnings (which may exceed the 30% EBITDA ratio); and
- limiting the arm's length debt test (ALDT) to an entity's third party debt.

Although expected, the thin capitalisation announcement is light on detail. The proposals align broadly with UK rules, but differences exist including that there are no industry-based carve-outs (which exist for certain infrastructure in the UK).

Off-market share buy-backs: The tax treatment of off-market share buybacks undertaken by listed public companies will be changed so they align with the treatment of on-market share buy-backs (in which no part of the buy-back proceeds is treated as a dividend).

Measures aimed at multinationals: The government has proposed a number of measures specifically targeted at multinationals, including denying deductions for payments relating to intangibles held in jurisdictions with a tax rate of less than 15% or a tax preferential patent box regime with insufficient substance. Notably, the proposal moves away from other multinational integrity precedents, with no principal purpose test or broadly applicable substance based carve-outs announced.

The government also proposes to introduce enhanced tax transparency reporting requirements, including public country-by-country (CbC) reporting in line with other similar measures such as the EU public CbC reporting directive. Australia has a reputation for striving for 'best in class' when it comes to tax administration and transparency, so this is unlikely to mark the start of a rush to implement public CbCR beyond Europe – but other countries will be taking note.

Perhaps more interesting is the fact that, although some of the Budget proposals have been refined to deal with the major points of concern raised during the recent public consultation, they still go further than Australia's peers. This could give rise to significant implementation challenges for Groups operating in the region, and they should closely monitor these developments.

EU public CbC reporting

Staying with public CbC reporting, on 30 September, the German government published draft domestic legislation to implement the EU CbC reporting directive. On 18 October 2022, Hungary submitted its own domestic legislation to implement EU CbC reporting to its National Assembly. Whilst both the German and Hungarian domestic proposals are fundamentally in line with the EU Directive, Germany has chosen to make use of the option for in-scope groups to defer the disclosure of commercially sensitive information for up to five years, whereas Hungary has not.

Hungary and Germany are among the first member states to publish draft domestic CbC reporting legislation. With a transposition deadline of 22 June 2023, we can expect to see more European countries following suit in the coming months.

ECOFIN Council agrees revised code of conduct

On 8 November, the Economic and Financial Affairs Council of the EU (ECOFIN Council) agreed on a revision of the code of conduct for business taxation. The revised code expands the definition of harmful tax regimes (originally established in 1997) to: (i) cover features of tax systems that have general application and that may have harmful effects; (ii) provide for additional options to eliminate existing harmful tax regimes; and (iii) strengthen the information exchange between member states in respect of potentially harmful tax measures.

The revised code also clarifies the decision-making process in the Code of Conduct Group, which is responsible for the review of potentially harmful tax practices, the collaboration with the European Commission and the interplay with ongoing state aid proceedings.

BEPS Pillar Two update

Finally, in recent weeks we have seen more jurisdictions announce steps to implement Pillar Two into domestic legislation.

On 13 October, the Australian government released a consultation paper on BEPS 2.0 implementation. The consultation closed on 1 November. Given the Australian government publicly committed to implementing BEPS 2.0 as part of its pre-election plan, the consultation focuses on how and when the rules should be implemented in the region. A 2023 start date has not yet been ruled out, and with a domestic minimum tax being proposed, in-scope groups may have limited time to prepare for implementation.

On 24 October, the Dutch Ministry of Finance launched a six-week online consultation on draft domestic legislation to implement the Pillar Two rules. The explanatory notes state that the goal is full alignment with the proposed EU directive (as per the latest compromise text) and the OECD global anti-base erosion (GloBE) model rules. This follows confirmation by the German government on 17 October 2022 that it is currently preparing draft Pillar Two domestic legislation that will follow the latest compromise text for the EU Pillar Two Directive.

It has been a bumpy year for Pillar Two, with timetables being pushed back, the failure of the US to implement necessary tax reforms and the stalemate on agreement of the EU Pillar Two Directive. However, individual countries have continued to work hard to prepare for domestic implementation of the rules and we can expect to see further developments in early 2023. ■

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- The CJEU's ruling in the *Fiat* state aid case (S Daly, 16.11.22)
- Digital taxation: a bluffer's guide (E Walker, 3.2.20)