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European Union

*Jasper Korving**

"BEFIT and HOT: FASTER and SAFE!" EU Law or Slogan for Slimming Pills?

In this article, the author summarizes and comments on the latest published and announced proposals for directives in the field of direct taxation. In addition, he addresses potential substantive issues inherent in these proposed directives and comments on the drafting process and EU law trends in general.

1. Introduction

"BEFIT and HOT: FASTER and SAFE". This actually sounds like a slogan for slimming pills or the newest gym in town. But appearances can be deceiving. In its last year before the European Parliament elections and, following the example of the United States,[1] the European Commission is increasingly coming up with acronyms for its legislation.

In this contribution, the author summarizes the published and announced proposals for directives in the field of direct taxation. In the author's view, this concerns the package for Business in Europe: Framework for Income Taxation (BEFIT, section 2.) and the directive proposals on Head Office Taxation (HOT, section 3.); the misuse of shell entities (or Unshell) and Securing Activity Framework for Enablers (SAFE, both discussed in section 4.); and Faster and Safer Relief of Excess Withholding Taxes (FASTER,[2] section 5.). In addition, the author addresses potential substantive issues inherent in these proposed directives and comments on the drafting process. He also identifies some trends from the list of pending directive proposals (section 6.). The contribution ends with conclusions in section 7.

Before elaborating on the directive proposals, it should be stressed that they are only proposals. The European Parliament's opinion is yet to be received and the Council may still substantially amend the published proposals. The focus of this contribution is on the published proposals and therefore, obviously, the question of whether or not all proposals will eventually be adopted and implemented remains unanswered.

2. BEFIT Package

2.1. Package or two directives?

On 12 September 2023, the European Commission presented its BEFIT package. The package presents two directive proposals: one for a BEFIT Directive[3] to create a common framework for corporate tax systems and one on transfer pricing.[4]

Before delving into the content of the two proposed directives, the question that needs to be answered is whether BEFIT is proposed as an actual package or as two separate directives that have coincidentally been presented at the same time. This question is relevant because, if there is an actual package, the fate of one directive partly depends on agreement reached on the other. The consequence would be that both directives could enter into force only if they were both adopted, as a package. The fact that the proposals have different effective dates does not alter this. A similar precedent in the tax field is the EU Interest and Royalties Directive (2003/49),[5] the Savings Directive (2003/48)[6] and the Code of Conduct for Business Taxation, i.e. the 2003 package.[7] Tying the fate of the three components together needed agreement on all of them and thus required Member States to accept not only the advantageous elements but also the less advantageous.

The question is whether this also plays a role with regard to the BEFIT package. Both proposed directives explicitly note that they are "separate directives". This does not rule out the possibility that they will be dealt with in tandem, as the 2003 package also involved two separate directives. However, the difference, in comparison to 2003, is that the directive proposals in the BEFIT package appear to be initiated solely by the European Commis-

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1. Such as the relatively recently introduced phenomena of "base erosion and anti-abuse tax" (BEAT) and "global intangible low-taxed income" (GILTI).
2. Though FASTER is not an acronym but rather an abbreviation of the full name of the directive proposal.
3. 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 (accessed 11 Oct. 2023) [hereinafter BEFIT Directive].
4. European Commission, Proposal for a Council Directive on Transfer Pricing, COM(2023) 529 (12 Sept. 2023), available at https://taxation-customs.ec.europa.eu/system/files/2023-09/COM_2023_529_1_EN_ACT_part1_v7.pdf (accessed 11 Oct. 2023) [hereinafter TP Directive].
5. Council Directive 2003/49/EC of 3 June 2003 on a Common System of Taxation Applicable to Interest and Royalty Payments Made Between Companies of Different Member States, OJ L157 (2003), Primary Sources IBFD.
6. Council Directive 2003/48/EC of 3 June 2003 on taxation of savings income in the form of interest payments, OJ L157 (2003), Primary Sources IBFD.
7. Conclusions of the Council (ECOFIN) of 1 December 1997 on tax policy – Resolution of the Council and the Representatives of the Governments of the Member States, meeting within the Council of 1 December 1997 on a code of conduct for business taxation – taxation of savings, Pb [1998] C2/1.

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sion without an explicit desire for harmonization by the Member States. Thus, in this case, there is no immediate demonstrable "sour" that needs to be compensated for by something "sweet", as was the case in 2003 when the benefits for companies and Member States (the "sweet") was directly related to the potentially less desired Savings Tax Directive (the "sour"). Given that such a need to balance interests is lacking in respect of the BEFIT package, the author suspects that the European Commission would be more than pleased if either directive were adopted and the designation "package" refers mainly to their joint presentation rather than to an actual linkage.

2.2. BEFIT Directive

2.2.1. Introduction

The European Commission launched the BEFIT Directive with much fanfare. The publication of the proposed directive also implies the withdrawal of the previous proposals on harmonization of the corporate tax base, the CCTB[8] and CCCTB.[9] Under these proposals, qualifying group entities were to first determine their individual tax base (CCTB), following which the consolidated tax bases were allocated to the group entities according to an allocation formula (CCCTB). This set-up is similar under BEFIT. The tax base under CCTB, however, was to be determined differently compared to the current BEFIT proposal. The political bottleneck, in the end, always appeared to be the allocation formula. Therefore, an alternative formula is included in the BEFIT proposal.

The European Commission stated that the BEFIT proposal would reduce the administrative burden for large companies operating in more than one EU Member State and would make it easier for national tax authorities to determine taxes due. Other objectives of BEFIT are the simplification of the corporate income tax system, a reduction in disparities between the national legal systems and the avoidance of double taxation. If the proposed directive is adopted in its current form, the provisions should be implemented effective 1 January 2028 and apply from 1 July 2028.[10] This article discusses the content of the proposed directive in sections 2.2.2. to 2.2.7, albeit briefly given the nature of this contribution.

2.2.2 Scope of application

BEFIT's scope of application is hybrid, with both mandatory and optional application. Groups falling within the scope of the EU Minimum Taxation Directive (2022/2523)[11] (groups with annual combined revenue of at least EUR 750 million) must apply BEFIT, but only in respect of their (i) EU-based group entities in which at least a 75% shareholding is held and (ii) EU-based qualifying permanent establishments (PEs) (BEFIT group). The shares must be held continuously throughout the tax year. If the group's ultimate parent is located outside the European Union, BEFIT would only apply if the BEFIT group's intra-EU income exceeds 5% of total group income and accounts for at least EUR 50 million of combined income in two or more of the last four years. Specific rules for calculating income apply in respect of intra-group restructurings.

On top of the mandatory application of BEFIT, the proposed directive allows multinational corporate groups or domestic groups to opt for BEFIT if they prepare consolidated accounts but remain below the EUR 750 million threshold.

2.2.3. Substantive rules for determining the tax base

In line with the EU Minimum Taxation Directive (2022/2523), the starting point for determining the tax base is net income according to the financial reporting of each member of the BEFIT group, prepared in accordance with a generally accepted accounting standard of an EU Member State (i.e. a national GAAP) or IFRS. Each member of the BEFIT group must determine its tax base on an individual basis. Subsequently, upward or downward adjustments are made to the tax base. According to the European Commission, the number of adjustments is less than under the EU Minimum Taxation Directive (2022/2523).[12]

Even though the intention was to stay close to the Pillar Two tax base, but only with fewer adjustments, a comparison of the two indicates that there are some differences, in all respects. Some adjustments are being made in both the EU Minimum Taxation Directive (2022/2523) and the BEFIT Directive, but the wording is different, and some adjustments are only made in either the EU Minimum Taxation Directive (2022/2523) or the BEFIT Directive. One example of an adjustment that is included in both instruments, but is different in the proposed article in the BEFIT Directive in comparison to the similar provision in the EU Minimum Taxation Directive (2022/2523)is the downward adjustment in respect of dividends and capital gains.[13] The adjustment is "only" 95% in the BEFIT Directive. In more popular terms: BEFIT mandates a 95% participation exemption in intra-BEFIT relationships. This is in line with the EU Parent-Subsidiary Directive (2011/96),[14]

8. European Commission, Proposal for a Council Directive on a Common Corporate Tax Base, COM(2016) 685 final (25 Oct. 2016), Primary Sources IBFD [hereinafter CCTB Directive Proposal].
9. Common Consolidated Corporate Tax Base. *See* European Commission, Proposal for a Council Directive on a Common Consolidated Corporate Tax Base, COM(2016) 683 final, p. 2 (25 Oct. 2016), Primary Sources IBFD [hereinafter CCCTB Directive Proposal].The 2016 CCCTB Directive Proposal should not be confused with the 2011 proposal of the same name (Proposal for a Council Directive on a Common Consolidated Corporate Tax Base (CCCTB), COM(2011) 121 (16 Mar. 2011).
10. BEFIT Directive, *supra* n. 3, at art. 78.
11. 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 Dec. 2022), Primary Sources IBFD [hereinafter Minimum Taxation Directive (2022/2523)].
12. The upward and downward adjustments are contained in the BEFIT Directive, *supra* n. 3, at arts. 8-20.
13. Id., arts. 8 and 9.
14. Council Directive 2011/96/EU on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States, OJ L 345/8 (2011), Primary Sources IBFD.

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which allows Member States to designate an amount not exceeding 5% of a dividend received as non-deductible notional expenses.[15] However, some Member States, including the Netherlands, provide for a full participation exemption. Moreover, the 95% exemption that BEFIT provides seems to be at odds with the EU Minimum Taxation Directive (2022/2523), which, in contrast, seems to contain a full participation exemption if certain conditions are met.[16] A full exemption seems more appropriate, as the premise of BEFIT is to avoid distortions and double taxation.[17] Cumulating notional cost deduction limitations does not seemingly contribute directly to this goal. It is hoped the Council's Working Party (WP) will take a closer look at this. Given that "simplicity" appears key for the European Commission, referring to Ursula von der Leyen's State of the European Union address, it would be a lot easier to introduce an adjustment for BEFIT that corresponds to the adjustment under the EU Minimum Taxation Directive (2022/2523).

Other relevant rules affecting the tax base relate to depreciation and timing.[18] Fixed tangible assets with a value of less than EUR 5,000 are fully depreciated in the year of acquisition. Other fixed assets are depreciated by the beneficial owner on a straight-line basis over their useful life. In this regard, immovable property is deemed to have a useful life of 28 years. For fixed intangible assets, including acquired goodwill, the useful life is the period in respect of which the asset has legal protection or for which the right has been granted, or, if that period cannot be determined, a period of five years. The BEFIT Directive also contains specific depreciation rules and requires maintaining a register of fixed assets,[19] rules on valuation of stocks and work in progress,[20] provisions,[21] bad debts,[22] long-term contracts[23] and hedging.[24]

Since BEFIT's premise is that it only applies to BEFIT group members who are part of the group throughout the financial year, the proposed directive also contains provisions to determine the treatment of group members entering or leaving the BEFIT group during the financial year.[25] These relate to both the timing and tax treatment of pre-existing long-term contracts and losses before entering the BEFIT group.

2.2.4. Aggregation and allocation

The individually determined tax bases of BEFIT group members (preliminary tax results) should be added together at the level of the filing entity, being either the ultimate parent company in the European Union or a designated BEFIT group member in the European Union (if the ultimate parent company is not located in the European Union).[26] The effect of this mathematical exercise is to effectively allow cross-border loss relief. Intra-group transactions involving beneficial owners in the BEFIT group may not be subject to withholding taxes.[27]

The aggregated tax base (BEFIT tax base) can then be positive or negative. A BEFIT loss is carried forward against positive BEFIT tax bases in later years. In the absence of specific rules, it is assumed that the loss carry-forward is indefinite.

A positive BEFIT tax base should be allocated to each of the BEFIT group members. Previous CCCTB proposals used an allocation formula that referred to labour, turnover and assets to determine what portion of the tax base could be taxed by each Member State. Under the BEFIT proposal, there should be a transitional period for the first seven years during which the BEFIT tax base would be allocated to BEFIT group members according to a "baseline allocation percentage". This percentage would be determined using the following formula:

$$\frac{\textit{taxable income of a BEFIT group member}}{\textit{total taxable income of the BEFIT group}} \times 100$$

In determining the taxable income, the average of the taxable income (determined in accordance with national corporate income tax rules) in the three previous tax years would be taken into account, with no recalculation to BEFIT standards required.[28] For allocation purposes, a negative preliminary tax result would be considered zero. Specific allocation rules would apply to EU Member States applying a distribution-based tax system, such as Estonia and Latvia.[29]

By introducing the seven-year transition period, the European Commission is buying time to eventually arrive at a "real" allocation formula. A report to this effect must be submitted to the Council before 1 July 2031. This may lead to an adjustment to the allocation formula. As indicated in section 2.2.1., the formula apportionment included in previous proposals to harmonize the corporate income tax base across the European Union, in particular, has been subject to discussion. By directly referring to national rules for the determination of the tax base as the starting point for allocating the BEFIT tax base, Member States might consider this approach more successful. The importance of these national tax bases, however, is diminishing. In addition, it cannot be guaranteed that the Member States will come up with a new acceptable allocation formula within three years following the adoption of

15. Id., art. 4(3).
16. Minimum Taxation Directive (2022/2523), art. 16(2), in conjunction with para. 1(b).
17. BEFIT Directive, *supra* n. 3, at preamble no. 5.
18. Id., art. 22.
19. Id., arts. 23-28.
20. Id., art. 29.
21. Id., art. 30.
22. Id., art. 31.
23. Id., art. 32.
24. Id., art. 33.
25. Id., arts. 34-41.
26. Some items are excluded from the BEFIT base, such as certain income in the field of oil or gas exploration or production and in respect of (especially international) air and water transport. *See* BEFIT Directive, *supra* n. 3, at arts. 46 and 47.
27. Id., art. 43.
28. Regarding later years, reference is still made to taking into account the previous three years in the formula. However, in the second BEFIT year, the three previous years are calculated based on two years of tax bases calculated under domestic rules (y2-3 and y2-2) and one BEFIT year (y2-1). As such, the application of national corporate tax bases becomes increasingly less important to the allocation of the BEFIT tax base.
29. BEFIT Directive, *supra* n. 3, at art. 49.

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the BEFIT Directive. If no agreement is reached and there is no proposal to adopt the allocation formula, the "transitional rule" will continue to apply. As such, the Member States should take into account that this "transitional rule" might as well become the main rule. Still, the pressure to quickly come up with a solution for an even better and newer formula might impact the decision as to whether to adopt the BEFIT Directive.

Once the allocated share has been determined, the BEFIT group member must deduct certain items from the share allocated to it, including expenses and losses from the period before entering the BEFIT group or deductible items under national law, such as gifts and donations to charities or pension contributions.[30] This is an exhaustive list of items that should also reasonably be covered in the country where the group entity is established; for instance because the pension premiums relate to employees working in that Member State. In addition, the BEFIT Directive provides that national tax folklore may lead to additional upward and downward adjustments of the allocated portion.[31] According to the Explanatory Memorandum, the only requirements that Member States will need to respect in this regard are the rules of the EU Global Minimum Tax Directive. In other words, the company should at least pay an effective tax of 15% over its allocated BEFIT profits. This statement is not reflected in the BEFIT Directive itself.

2.2.5. *Relationship with non-BEFIT entities*

Since members of a BEFIT group may also engage in activities and transactions with affiliates outside the BEFIT group, the BEFIT proposal contains transfer pricing rules.[32] These transfer pricing rules foresee, in particular, simplification of the transfer pricing administration and documentation. Contrary to the proposed rules in the Transfer Pricing Directive (TP Directive), the BEFIT transfer pricing rules do not provide for substantive transfer pricing rules (*see* section 2.3.).

2.2.6. *Tax authorities and procedural rules*

The BEFIT rules apply for a minimum of five years. In principle, the filing entity may not change, but exceptions are possible under specific circumstances. The "BEFIT information return" must be filed no later than four months after the end of each fiscal year with the tax authorities of the EU Member State where the filing entity is resident. The BEFIT information return must include all information on the group entities and calculations on how the allocation of profits to each BEFIT group entity was arrived at.[33]

A BEFIT team should then be established, consisting of representatives of the tax authorities of all EU Member States where the BEFIT group has group members. The BEFIT team is chaired by a representative of the tax authorities of the filing entity and is responsible for examining the completeness and accuracy of the data in the BEFIT information return. The BEFIT team must agree on the contents of the BEFIT information return within four months. If no consensus is reached within that period, consensus will be deemed to have been achieved if a simple majority agrees. In the event of a tie, the chairperson's vote will be decisive. Specific rules apply to the BEFIT team.

Within three months of receiving notification from BEFIT team members that the information return has been approved, each member of the BEFIT group must file its own tax return with the national tax authorities. Members of the same BEFIT group, who are tax resident in the same Member State, may choose to file one combined tax return in that Member State.

2.2.7. *DEBRA*

Beyond the proposal for a BEFIT Directive, it should be noted that the European Commission published another proposal in 2022 for a directive on the introduction of a Debt Equity Bias Ratio Allowance (DEBRA).[34] This directive proposal was heavily criticized[35] and ultimately temporarily postponed until it was clear how the scheme would relate to BEFIT.[36] Some kind of deduction on equity was also included in an earlier directive proposal to achieve corporate tax base harmonization[37] and, therefore, it was expected that DEBRA would be reintroduced in some form in the BEFIT Directive. However, DEBRA is not currently reflected in the proposed BEFIT directive. This does not rule out its return in some form later on, but the European institutions will likely have enough on their plate with other tax proposals and will ignore DEBRA for now.

2.3. Transfer Pricing Directive

The second directive proposal in the BEFIT package is the TP Directive. Most countries are, in essence, familiar with a domestic principle requiring business-like pricing of intra-group transactions or pricing based on the "arm's length principle" (ALP) as shaped by the OECD Transfer Pricing Guidelines (OECD Guidelines).[38] Also, in most EU Member States, there is political will to follow the ALP stemming from article 9 of the OECD Model (2017),[39] its

30. Id., art. 48(1).
31. Id., art. 48(2).
32. Id., arts. 50-53.
33. Id., art. 57.

34. European Commission, Proposal for a Council Directive laying down rules on a debt-equity bias reduction allowance and on limiting the deductibility of interest for corporate income tax purposes, COM(2022) 216 final (11 May 2022), available at https://ec.europa.eu/taxation_customs/system/files/2022-05/COM_2022_216_1_EN_ACT_part1_v6.pdf (accessed 11 Oct. 2023).
35. *See*, among others, L. Hulten, J. Korving & A. Nolten, *DEBRA: A Good Idea?*, 23 Fin. & Cap. Mkts 3 (2022); and H. van den Hurk, *DEBRA, you are so beautiful*, Kluwer International Tax Blog (20 June 2022), available at https://kluwertaxblog.com/2022/06/20/debra-you-are-so-beautiful/ (accessed 23 Sept. 2023).
36. *See also* E. Lamers, *European Commission Draws Lessons From Past Failures With BEFIT*, Tax Notes International 2023-26134 (2023).
37. CCTB Directive Proposal, *supra* n. 8, at art. 11.
38. The *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* (20 Jan. 2022), Primary Sources IBFD [hereinafter OECD Guidelines].
39. *OECD Model Tax Convention on Income and on Capital* (21 Nov. 2017), Treaties & Models IBFD.

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Commentary[40] and the OECD Guidelines. Nevertheless, the rules are often applied differently across the Member States and the European Commission is therefore seeking to pursue harmonization through the TP Directive.

The TP Directive will apply to all companies established in an EU Member State and to PEs within the European Union. Under the proposals, in the event of a cross-border transaction with an associated enterprise, the EU entity would have to determine the amount of its taxable profits in a manner consistent with the ALP. The Directive subsequently defines the concept of "associated enterprise".[41] It extends the definition of "associated enterprise" as contained in the EU Anti-Tax Avoidance Directive (2016/1164)[42] to include where "an enterprise [participates] in the management of another person by being in a position to exercise a significant influence over the other person".

The TP Directive also contains a definition of the ALP. Interestingly, the definition does not refer directly to any OECD document. However, the TP Directive does contain further rules on the application of the ALP.[43] This provision does explicitly refer to OECD documents and requires Member States to record, in their national legislation, that they will ensure that the ALP is applied in a manner consistent with the OECD Guidelines.[44] In principle, this legal safeguard would have allowed adjustments to the OECD Guidelines to have direct effect in national law. Unfortunately, this is not the case, as the term "OECD Transfer Pricing Guidelines" by definition only includes the 2022 guidelines. This means that subsequent adjustments to the OECD Guidelines would either have to result in adaptation to the Directive (which again requires unanimity) or application of article 218(9) of the Treaty on the Functioning of the European Union (2007).[45,46] To the author's knowledge, the application of the latter provision – the part of the chapter regulating the conclusion of international agreements *by* the European Union – has no precedent with regard to direct taxation. Though this is obviously not necessarily an obstacle in itself, a thorough study of the possibilities in this regard would be needed to avoid potential negative consequences. Moreover, a simpler solution is available: remove the limitation to the 2022 guidelines from the definition of "OECD Transfer Pricing Guidelines". However, not all EU Member States are also members of the OECD. Non-members cannot influence discussions on the creation of updates to the OECD Guidelines. If the limitation to the 2022 guidelines were to be removed, those Member States would have to accept amendments to rules that they had no input on. This could constitute an obstacle for those Member States. On the other hand, it is questionable whether or not the approach under new guidelines would be substantially different in comparison to the 2022 guidelines that those countries have accepted.

The TP Directive also identifies the five applicable and defined TP methods: (i) comparable uncontrolled price method; (ii) resale price method; (iii) cost-plus method; (iv) transactional net margin method; and (v) profit split method.[47] Other TP methods would only be applicable in exceptional cases. The proposed Directive does not prescribe a specific order of application, but states that the most appropriate TP method should be used taking into account the circumstances of the case.[48] However, considering the definitions and explanations relating to the five transfer pricing methods, one may discern a certain preferred method for certain situations. Application of an "interquartile range" is also allowed.[49]

In addition to these more general rules, the Directive includes provisions on comparability analysis[50] and transfer pricing documentation.[51] With regard to the latter, a delegation power is included to specify the documentation requirement.[52] Before adopting a delegated decision, experts will also be consulted, which – in the author's opinion – strongly implies a reintroduction of the EU Joint Transfer Pricing Forum.[53]

A relevant last point, which may warrant a dedicated contribution, is the side effects of adopting the TP Directive. In several State aid cases, the European Commission has sought to challenge tax rulings, arguing that an incorrect TP method was applied or an incorrect TP amount was determined. With the adoption of the TP Directive, the concept of the ALP is given an EU meaning and one might call it an EU ALP. On top of that, the methods are also regulated to a certain extent, so the European Commission may consider a certain method (which is factually not applied to a specific case) more appropriate than another method (which is applied to that case). A counterargument would then be that the European Commission presumably has little leeway to interpret that EU ALP independently, as the TP Directive repeatedly refers to the

40. *OECD Model Tax Convention on Income and on Capital: Commentary* (21 Nov. 2017), Treaties & Models IBFD.
41. TP Directive, *supra* n. 4, at art. 5.
42. Council Directive 2016/1164 of 12 July 2016 Laying down Rules against Tax Avoidance Practices that Directly Affect the Functioning of the Internal Market, OJ L 193/1, art. 2(4) (2016), Primary Sources IBFD [hereinafter ATAD].
43. TP Directive, *supra* n. 4, at art. 14.
44. In the Explanatory Memorandum, the European Commission formulated it stronger by indicating that the OECD Guidelines would have binding effect in the Member States' domestic tax laws. The text of the proposal for a directive is a bit less strict, only requiring Member States to "ensure" to be "consistent" with the OECD Guidelines. From an interpretational perspective, the relevance of the phrasing in the Explanatory Memorandum compared to the actual wording of the Directive is an interesting question. *See also* DE: ECJ, 13 July 2023, Case C-180/22, *Finanzamt Hamm v. Harry Mensing*, ECLI:EU:C:2023:565.
45. Treaty on the Functioning of the European Union of 13 December 2007, OJ C115 (2008), Primary Sources IBFD.
46. TP Directive, *supra* n. 4, at art. 3(18).
47. Id., art. 9.
48. Id., art. 10.
49. Id., art. 12.
50. Id., art. 11.
51. Id., art. 13.
52. Id., art. 18.
53. A group of experts, with representatives from each Member State's tax authority and 18 non-governmental organizations, such as academia, multinational enterprises and tax advisory firms. The EU Joint Transfer Pricing Forum advises the European Commission and adopts proposals for pragmatic, non-legislative solutions for practical problems relating to transfer pricing practices within the European Union. *See also* https://taxation-customs.ec.europa.eu/joint-transfer-pricing-forum_en (accessed 23 Sept. 2023).

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desire to align it with the OECD Guidelines. The exact implications of the TP Directive for these State aid discussions remain unclear and warrant separate research. However, the author believes it would be wise to include a final answer in the preamble to the TP Directive and to take the answer into consideration before adopting the Directive. If the TP Directive is adopted in its current form, the provisions must be implemented by 31 December 2025 and will be applied from 1 January 2026.

3. HOT

On the same day as the BEFIT package, the European Commission published the proposed directive establishing a Head Office Tax,[54] as part of a package to address the needs of European small and medium-sized enterprises. The European Commission has made simplification the key feature of the HOT Directive. The Directive is limited to standalone companies that qualify as micro, small or medium-sized enterprises,[55] operating in other EU Member States exclusively through one or more PEs. Companies applying a tonnage tax regime are excluded from the Directive.[56] A qualifying company may opt to compute the taxable results of its PE(s) solely based on the taxation rules of the head office's Member State.[57] Once opted in, the option applies to all of that entity's PEs.[58]

To prevent circumvention of the rules, strict eligibility criteria apply. Under these criteria, the combined turnover of the PEs must not have exceeded twice the turnover of the head office in the last two tax years and the head office must have maintained its tax residence in the head office state for the same period. If opted in, the option, in principle, applies for five years[59] (but is renewable indefinitely),[60] unless the head office changes its state of residence in the intervening period or the combined turnover of the PEs becomes at least three times the turnover of the head office,[61] in which case the HOT rules no longer apply.

Part of the simplification, at least for the taxpayer, is the introduction of a "one-stop shop". Companies using the HOT scheme will only have contact with the tax authorities of the head office's Member State for the optional scheme, tax return obligations and tax payments. The head office acts as the "taxable entity" for all PEs and a single tax return is filed with the tax authorities of the head office's Member State, separately reporting the taxable income of the head office itself and of all PEs.[62] To the profits attributed to the PEs, that Member State subsequently applies the rates applicable in the Member State or states where the head office has PEs.[63] After the total amount of taxes due has been collected from the head office, the tax authorities transfer the calculated tax revenue to each Member State where the head office has PEs.

Apart from the simplified calculation of the tax base of foreign PEs, the HOT Directive provides for the automatic exchange of information on the HOT return.[64] In respect of tax audits and dispute resolution, each Member State retains the power to audit PEs within its jurisdiction.[65]

HOT reminds the author most of an old proposal, with only one letter being different: HST or Home State Taxation.[66] In the distant past, the European Commission proposed introducing a CCCTB for large enterprises, and HST for SMEs. Back then, too, a calculation of the foreign tax base by applying the Member State of the head office's – or the parent company's – taxation rules was the starting point for HST purposes. HST was not limited to the relationship between a head office and its PEs, but could also apply to the relationships between a parent company and its subsidiary. HOT and HST have other differences as well, as HST was based on determining profits that were subsequently allocated to the respective countries based on an allocation key (share of total wage bill and/or turnover). The HOT Directive has no such allocation key. The European Commission itself also refers to HST, without providing any further interpretation.[67] All in all, HOT appears to be a case of "old wine in new bottles". The question is, however, whether the wine has matured enough to finally reach an agreement.

Besides that, it could be argued whether the HOT Directive can be considered proportionate. As the tax base of a foreign PE is calculated based on the rules of the head office's Member State, this could result in a higher tax burden for the PE's profits than under the current situation. That would not be a preferred solution. Of course, the use of HOT is optional, so this higher tax burden could be avoided by just not opting in. On the other hand, if a single entity has PEs in several EU Member States and for some of the PEs this would result in a benefit and for others in a higher tax burden, the entity has to opt in under an "all or nothing" approach. In the author's opinion, it would be more proportionate to introduce a "per country" approach in this matter. Apart from that, the effectivity of the HOT Directive in its current form is also open for debate due to the restricted personal scope. It is only open to stand-

54. European Commission, Proposal for a Council Directive establishing a Head Office Tax system for micro, small and medium sized enterprises, and amending Directive 2011/16/EU, COM(2023) 528 final (12 Sept. 2023), available at https://taxation-customs.ec.europa.eu/system/files/2023-09/COM_2023_528_1_EN_ACT_part1_v4.pdf (accessed 11 Oct. 2023) [hereinafter HOT Directive].
55. As defined in 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, OJ L 182/19, art. 3(1)-(3) (2013).
56. HOT Directive, *supra* n. 54, at art. 5.
57. Id., art. 4(1).
58. Id., art. 4(2).
59. Id., art. 7.
60. Id., art. 9.
61. Id., art. 8.
62. Id., art. 11.
63. Id., art. 12.
64. Id., art. 14.
65. Id., art. 13.
66. *See*, for example, European Commission, Communication from the Commission to the Council, the European Parliament and the Economic and Social Committee tackling the corporation tax obstacles of small and medium-sized enterprises in the Internal Market – outline of a possible Home State Taxation pilot scheme, COM(2005) 702 final (23 Dec. 2005), available at https://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=COM:2005:0702:FIN:EN:PDF (accessed 11 Oct. 2023).
67. HOT Directive, *supra* n. 54, at p. 1.

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alone companies with foreign PEs. In many countries, it is quite common for SMEs to be incorporated via two companies: a holding company and an active subsidiary where the actual enterprise is being performed. This two-tier structure commonly finds a basis in the separation of the activities and liabilities, but not necessarily in tax-driven motives. Still, such rather traditional structures cannot benefit from the HOT Directive, even though they materially would be in scope for the remaining part. This flaw should be acknowledged and amended as well.

If the HOT Directive is adopted in its current form, the provisions must be implemented by 31 December 2025 and applied from 1 January 2026.

4. Unshell and SAFE

On 22 December 2021, the European Commission presented the proposed directive establishing rules to prevent misuse of shell entities for tax purposes, i.e. the Unshell Directive or "ATAD 3".[68] This contribution provides a limited outline of the Unshell Directive.[69]

The Unshell Directive aims to counter the use of EU-based companies with insufficient substance, using a funnel approach to determining whether or not a company can be qualified as a "reporting undertaking". In principle, the scope of the Directive encompasses all companies that are tax resident in a Member State.[70] The funnel approach is the next step: if companies fail to meet the gateway criteria and thus have, in popular terms, either sufficient operations or insufficient cross-border operations, they are the first to be eliminated.[71] The next type of company to be eliminated is those that are otherwise regulated under EU law, like certain credit institutions or investment entities.[72] The remaining companies must report whether or not they have sufficient substance, which requires them to have their own premises in the relevant Member State, their own and active bank account in the European Union and a specific number of qualifying employees or directors.[73]

The outcome of whether the substance is sufficient is recorded in the tax return. If the company meets the three substance requirements, sufficient substance is presumed to exist and no further action is taken besides mentioning this in the tax return.[74] If the substance is insufficient, it is still possible to provide rebuttal evidence based on which sufficient business motives can be established and the presumption of insufficient substance rebutted.[75] If this fails as well and – thus – the enterprise has insufficient substance, this will have tax consequences both in the Member State of the shell entity[76] and in the other countries – i.e. potentially including non-EU Member States – concerned.[77]

After the proposal for the Directive was published, it was sent to the European Parliament and the Council in concert, with the European Parliament proposing amendments.[78] Behind the scenes, the Council also seems to be heavily involved in the proposed Directive. The substance criteria[79] and the tax consequences[80] have triggered many discussions among the Member States in the Working Party, which – apparently – would seem to be leading to a new, as of yet unpublished, compromise proposal.[81] The Spanish Council Presidency has, however, since said that the Unshell Directive will be limited to obvious situations of abuse[82] and will not undermine existing anti-abuse measures in the Member States.[83] So any presumption established under the Unshell Directive of there not being a shell entity can be overruled by national anti-abuse provisions, raising the question as to how effective the Unshell Directive will be. As that still could not convince all EU Member States, the Spanish Presidency of the Council proposed a two-step approach: First, the information on the existence of a shell entity should be exchanged automatically and, later, tax consequences for using a shell entity could be added.[84] EU officials were not enthusiastic about the splitting of the Unshell Directive,[85] but most Member States appear receptive to the two-step approach.[86] However, even under an exchange of information directive, the Council should seek unanimity on the definition of sufficient substance. Otherwise, Member States still do not know what information they actually need to exchange. As the criteria defining substance appear to be causing the current deadlock, the introduction of Unshell, or DAC9 as a new amendment to the existing Directive on Administrative Cooperation, is still uncertain.[87] The implementation date of the Directive has now also been pushed back to 1 January 2026.

It should be borne in mind that the Unshell Directive only addresses the use of EU-based shell entities. The European

68. Proposal for a Council Directive laying down rules to prevent the misuse of shell entities for tax purposes and amending Directive 2011/16/EU, COM(2021) 565 final (22 Dec. 2021) [hereinafter Unshell Directive]. The proposed Directive does not adapt ATAD in any way. Therefore, in the author's opinion, the name ATAD 3 is being incorrectly used. That name should be reserved for the next directive that actually amends the ATAD.
69. For a detailed description, *see* P. Pistone et al., *Abuse, Shell Entities and Right of Establishment: A Plea for Refocusing Current Proposals and Achieving Deeper Coordination within the Internal Market*, 14 World Tax J. 2, p. 187 (2022), Journal Articles & Opinion Pieces IBFD.
70. Unshell Directive, *supra* n. 68, at art. 2.
71. Id., art. 6(1).
72. Id., art. 6(2).
73. Id., art. 7.
74. Id., art. 8.
75. Id., art. 9.
76. Id., art. 12.
77. Id., art. 11.
78. European Parliament legislative resolution of 17 January 2023 on the Unshell Directive proposal, document 52023AP0004.
79. E. Lamer, *EU to Discuss Restoring Some Unshell Substance Criteria*, Tax Notes International 2023-1944 (2023).
80. E. Lamer, *EU Countries to Discuss Limiting Tax Fallout for Shell Companies*, Tax Notes International 2023-4720 (2023).
81. E. Lamer, *EU Seeks Compromise on 'Substance' for Unshell Proposal*, Tax Notes International 2023-8089 (2023).
82. E. Lamer & S. Paez, *Unshell to Focus on 'Manifest Cases,' EU Council Chair Suggests*, Tax Notes International 2023-19627 (2023).
83. E. Lamer, *EU Seeks Balance Between Unshell and National Antiabuse Rules*, Tax Notes International 2023-25943 (2023).
84. E. Lamer, *EU Council Presidency Suggests a Two-Step Approach on Unshell*, Tax Notes International 2023-28561 (2023).
85. E. Lamer, *EU Official Cautions Against Unravelling of Unshell Proposal*, Tax Notes International 2023-28661 (2023).
86. E. Lamer, *Member States Appear Receptive to Two-Step Approach to Unshell*, Tax Notes International 2023-28830 (2023).
87. Id.

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Commission, however, also wants to tackle the use of such entities outside the European Union, so another initiative has been launched. Directives obviously do not affect non-EU entities without any substance themselves, but the European Union can tackle intermediaries that facilitate tax avoidance and potentially aggressive tax planning, for example through the use of non-EU shell entities. This was why the European Commission announced the proposed directive for Securing the Activity Framework of Enablers (SAFE),[88] which will potentially lead to a register of intermediaries and tax consultants.[89] For now, the proposed Directive appears to have been postponed indefinitely,[90] although the European Commission maintains it is still working on it.[91] SAFE has one major problem: the struggle to agree on the definition of "aggressive tax planning".[92] For non-EU situations, it seems that SAFE will not progress until there is more clarity on the Unshell Directive.

5. FASTER

This section now turns to a brief discussion of the final proposed FASTER Directive. In practice, procedures to obtain reimbursement of withholding tax are often time consuming and expensive. In addition, significant differences exist among the Member States, for instance in relation to the use of different and non-standardized forms. In order to streamline the withholding tax reimbursement process, the FASTER Directive provides for a harmonized digital certificate of residence and aims to speed up the procedures for relief of excess withholding taxes.[93] The latter can be achieved by having a certified financial intermediary request application of the correct withholding tax rate at source or an application for an accelerated refund procedure. The provisions of the Directive are proposed to apply from 1 January 2027.

6. Trends

Leaving aside the question of how these proposed directives will ultimately be implemented and interpreted if adopted, two more existential questions can be raised: Why do we need these directives and why do they contain so many choices and options for implementation? There is no immediate answer, but with most pending directive proposals, one of the two existential questions mentioned above leads to a problem.

As the European Commission argues, "simplification" and "fighting abuse" are needed most. Both are noble aspirations. However, in relation to the BEFIT package, in particular, the question can be raised whether we actually need those directives. The European business community has not been a vociferous champion of base harmonization since 2011 and the Member States did not put tax base harmonization high on the political agenda either. It is legitimate to ask whether the desire for a growing number of directive proposals is not driven more by the European Commission's political desire to have a tighter grip on direct taxation. After all, once a directive has been adopted, the subject becomes an EU competence and then the European Commission can further expand its influence. If that is the real reason, it would be better to renew discussions on article 115 of the TFEU as a legal basis for direct tax harmonization and see whether an alternative legal basis can be created.[94]

Fundamentally, the speed at which harmonization of direct taxes is being introduced, adopted and implemented is just too high. Provided the rationale is well considered, the author would be in favour of harmonization, but it needs to be done correctly. One example of where speed has caused a lot of issues and real "harmonization" is hard to find, is the fight against tax avoidance. The author agrees with the objective pursued but thinks that a Europe-wide approach would be more effective. But the eagerness to harmonize has led to a myriad of options being built in – presumably to meet the wishes of individual Member States. In the end, a byzantine patchwork of implementation regulations is being created.[95] The author does not consider this to be harmonization. Under real harmonization, the common objective is clear and that objective is to be implemented by making domestic policy choices. This is something totally different than including so many options in a directive that it actually lacks a real harmonized approach. We are now facing the same problem in respect of the Proposed Unshell Directive: with the Member States failing to find common ground and not wanting to lose political face, we might end up with a compromise directive that can be overruled by national law. What good, then, would such politics-laden directives be? Further, there is the question of whether the information systems of Member States' tax authorities are even equipped to handle all this change.

7. Conclusion

Europe is in full swing. Right before the European Parliament elections, after which a new European Commission will be inaugurated, the current European Commission is making quite a lot of noise. And the year is not over yet.

88. Internet consultation on the proposal for a Council Directive on the role of enablers in facilitating tax evasion and curbing aggressive tax planning, Call for evidence for an impact assessment, Ares(2022)4939801, available at https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/13488-Tax-evasion-aggressive-tax-planning-in-the-EU-tackling-the-role-of-enablers_en (accessed 11 Oct. 2023).
89. S. Paez, *EU Wants SAFE Proposal to Focus on 'Bad Apples,' MEP Says*, Tax Notes International 2023-18904 (2023).
90. Id.
91. E. Lamer, *Angel Assures That EU's SAFE Proposal Is Still in the Works*, Tax Notes International 2023-15591 (2023).
92. E. Lamer, *SAFE Proposal Will Pin Down Meaning of Aggressive Tax Planning*, Tax Notes International 2023-19477 (2023).
93. European Commission, Proposal for a Council Directive on faster and safer relief of excess withholding taxes, COM(2023) 324 final (19 June 2023), available at https://taxation-customs.ec.europa.eu/system/files/2023-06/COM_2023_324_1_EN_ACT_part1_v3.pdf (accessed 11 Oct. 2023).
94. *See also* J. Korving, *Fiscal sovereignty versus tax harmonization: a matter of coordination and interpretation* (not yet published). The chapter will be published in the congress book following the 17th GREIT Congress titled "National (Tax) Autonomy and the European Union: Revival or Demise?".
95. As was the case upon implementation of the ATAD provisions. *See*, for example, in respect of ATAD, Deloitte, *Implementation of the EU Anti-Tax Avoidance Directive* (2 May 2023), available at https://www.deloitte.com/global/en/services/tax/perspectives/atad-survey.html (accessed 16 Sept. 2023). *See also* Korving, *supra* n. 94.

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Several proposals for harmonizing directives in the field of direct taxation have been published or announced, which have been summarized herein. From the author's perspective, it would be preferable if the Member States were to take more time to discuss and negotiate the proposals. This would, in the end, lead to actual policy choices being made instead of adopting directives in a hurry that grant Member States too many implementation options.

Which directive proposals will eventually reach the finish line is still unknown. The author cannot hypothesize on this. Despite his aversion to the gym, he is definitely ACTIVE: Always Cooperative on Tax Initiatives Valuing Europe.

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