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Considerations on Pillar Two and Befit

1. General considerations

The Pillar Two directive on the global minimum tax, adopted in December 2022, is now in force and is being implemented by all EU member states. Pillar Two also been adopted by some other important countries, like the UK, Japan, Canada, Brazil, South Africa, Korea, Australia, Turkey, Switzerland, Norway, New Zealand, Kenya, Malaysia, the United Arab Emirates, Singapore, Vietnam to name a few. Overall, 45 countries (including EU member states) have joined the project or announced the intention to join. But the major players, i.e. the US, China, and India, have not joined and it is very unlikely that they will do so. Several other countries will not join either.

On 20 January 2025 the US Presidency published a Memorandum on “The Organization for Economic Co-operation and Development (OECD) Global Tax Deal”. The intention of the new US administration is very clear. Not only the commitments of the Biden administration to the Globe rules have been rescinded; in addition, if foreign countries adopt “extraterritorial” tax rules that would force US groups to pay taxes abroad that do not comply with the existing US tax treaties, this will be considered a sort of an ‘act of aggression' against the US economy and would trigger retaliations. While the cancellation of the commitments of the previous administration was expected, it was less so for the vigorous menace of retaliations.

The main target of the retaliations against foreign “extraterritorial” taxes is the UTPR (Under Taxed Profit Rule)[1]. The UTPR is a fundamental feature of Pillar Two and forbidding its implementation by other countries might create problems for the functioning of the whole project. A disruptive clash will not start right now: a year ago the Inclusive Forum of the OECD has agreed that the application of the UTPR to US multinationals is suspended, as a temporary “safe harbor”, until 2026. But a serious confrontation will take place during 2025. Hopefully, there is time to find an agreement. But for now President Trump’s executive order has mandated the US Treasury to investigate all cases of foreign “extraterritorial” taxes which “disproportionately” affect US companies and do not comply with US tax treaties, and make proposals for retaliatory measures[2]. The European Commission has reiterated the commitment to the decisions already taken, while remaining “open to a meaningful dialogue”.

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[1] The Income Inclusion Rule (IIR), under which foreign countries can tax the profits of US-resident subsidiaries of foreign multinationals, and the Qualified Domestic Minimum Top-up Tax (QDMTT), under which foreign countries can tax the profits of US subsidiaries resident in their jurisdiction, should not be considered as ”extraterritorial” or “discriminatory” taxes (although the QDMTT could have a material impact on US tax revenues through the foreign tax credit). See Mindy Herzfeld, *Trump Executive Orders Bring U.S. Course Change on International Tax*, International Tax Notes, Jan. 27, 2025.

[2] It can be expected that the report of the US Treasury will not limit its investigations to the UTPR but will also address the existing (or planned) web taxes (Domestic Service Taxes). This would lead to a major confrontation, not only with European countries.

The EU has been at the forefront of the adoption of the global minimum tax, extending the rules to purely domestic groups to ensure compatibility with EU law. The objectives of contrasting tax arbitrage and tax competition and of raising additional revenues (aimed partly to new own resources of the Union) were at the core of this adoption. But it is not granted that the results will meet the expectations.

It has been pointed out that tax competition among states (and the possibility of tax arbitrage) will not disappear but take new forms[3]. It may well move to other obligatory contributions different from the corporate income tax (CIT), such as energy taxes, property taxes, other indirect taxes, payroll contributions and other non-tax factors. Furthermore, jurisdictions that adopt the Pillar Two rules can still compete on the CIT for entities that are not in scope of Pillar Two. In other words, some jurisdictions may collect the top-up tax on large multinational companies that fall under Pillar Two rules (using a QDMTT) while keeping a lower (even zero) general level of domestic corporate taxation and attracting companies that do not qualify for the application of Pillar Two. This might be the case for tax-haven jurisdictions. Governments are also exploiting some possibilities offered by the rules of Pillar Two: some tax incentives that now reduce the corporate tax due and therefore reduce the numerator of the effective tax rate (ETR) might be transformed into 'qualified refundable tax credits' or 'marketable transferable tax credits'. These tax credits are considered as government grants and according to Pillar Two rules are excluded from the covered taxes (the numerator of the ETR): therefore, they do not affect (do not reduce) the ETR[4]. In other words, by transforming existing tax benefits that reduce the tax base (and the amount of covered taxes) into these types of credits a jurisdiction will offer a higher ETR and hence a lower top-up tax due for Pillar Two, while leaving the financial benefits of the incentives substantially unchanged for the companies involved[5].

Most relevant, in various countries the anecdotical evidence from the business sector shows that the initial tax revenues will likely be much lower than expected[6], and in certain instances lower than the compliance costs incurred by business to comply with the rules.

Initially the one-off administrative costs for the setting-up of the new procedures will be quite high. However, continuous adjustments will be needed in the future, to take on board the modifications and clarifications of the administrative guidance issued by the OECD Inclusive Framework (such as in the case of abandonment of the provisional safe harbors and the

[3] For some references on tax competition effects, see: Devereux M., Vella J. and Wardell-Burrus H. (2022), *Pillar 2: rule order, incentive, and tax competition,* Oxford University Centre for Business Taxation Policy Brief, 14 January; CEPS-ECMI (2023), *EU corporate taxation in the digital era: the road to a new international order*, Centre for European Policy Studies; Devereux MP. and Vella J. (2023), *The Impact of the Global Minimum Tax on Tax Competition*, World Tax Journal, Amsterdam, Vol. 15 (2023), n. 3, pp. 323-378; Haufler A. and Kato H. (2024), *A Global Minimum Tax for Large Firms Only: Implications for Tax Competition*, CESIFO Working Papers n. 11087, April 2024.

[4] This effect is partially mitigated by the fact that 'refundable' and 'marketable' tax credits are included in the Globe income, i.e. in the denominator of the ETR.

[5] In fact, the benefits of the 'refundable' or 'marketable' tax credits might be higher than the benefits of the tax allowances that reduce the tax base, in so far as the exploitation of the latter find limits in exhausted tax losses. Simmetrically, governments might incur higher revenue losses.

[6] The global additional revenues from the application of Pillar Two have been estimated in USD 155-192 billion per year (Hugger F. (et al.) (2024), *The Global Minimum Tax and the taxation of MNE profit*, OECD Taxation Working Papers, n. 68).

adoption of the definitive ones). Business will also have to factor in their own changes (M&A, dismissals, changes of the business model, etc.) which occur on a regular basis in any large group. Finally, the administrative costs for tax administrations should also be considered, given the complexity of the rules and the issues that will likely arise.

Some commentators hold that the overall administrative costs, even after the initial adoption, will remain close to (or even higher than) the additional tax revenue generated[7]. The initial low level of revenues, much lower than expected, could become apparent in the next future, triggering discussions among politicians and the public opinion at large. The recent memo from President Trump anticipates the need for reflections, from both a political and a technical point of view and makes more urgent the search for answers to a very complex environment, that requires a change in gear at the EU level.

Recently, in the framework of the Competitive Compass, the Commission has announced a proposal for a 28th legal regime that will simplify applicable rules, including relevant aspects of corporate law, insolvency, labour, and tax law, in order to allow innovative companies to benefit from one single set of rules in the Single Market.

In a more restricted perspective and limiting the scope to corporate taxation, an appropriate reaction could be to push forward to the adoption of a (revised) BEFIT. Setting a common consolidated tax base and an improved co-ordination with Pillar Two (particularly as regards jurisdictional blending and the treatment of losses and deferred assets and liabilities) might overcome the comparative disadvantage raised by Pillar Two. A simplified and streamlined Befit, well coordinated with Pillar Two, would drastically cut administrative costs, create a level playing field contrasting tax arbitrage and raising additional revenues, foster intra-EU integration, and improve the functioning of the internal market. Hence, would improve the competitiveness of the European economy.

However, the tax base in the current Befit proposal is too complex, would add new largely unnecessary compliance costs for taxpayers and tax administrations, in contrast with the strategy of "decluttering". The renewed Befit tax base should be drastically simplified: the denominator of the ETR calculated for Pillar Two should be considered as the starting point for the new tax base and further adjustments should be drastically minimized (see para. 2). For groups subject to Pillar Two the benefits of a streamlined Befit could largely compensate the compliance costs of Pillar Two

Furthermore, the application of Pillar Two and Befit would greatly benefit from a European Tax Agency in charge of setting common administrative rules and guidelines and solve controversies (see para. 3). This would be a great step forward for tax certainty and homogeneity of application within the EU.

Starting a discussion on this type of proposals would be useful *per se* but becomes more urgent and necessary after Trump's memorandum.

[7] As an example, preliminary and unofficial estimates for Germany indicate additional revenues from Pillar Two around 20 million euros, compared to an official forecast of 200 million. Business would incur 600 million euro for one-off administrative costs related to the initial set up of the system, which would then stabilize at around 130 million per year after the initial investment (Christoph Spengel C., Schulz I. and Winter S. (2023), *Steuerplanung unter der globalen Mindeststeuer*, Der Betrieb, 2023.

2. The EU common corporate tax base: a simplified Befit

The definition of the common tax base has always been one of the most critical issues in the EC proposals on corporate income taxation. Initially, the CCCTB tax base was defined independently from financial accounts: all the elements that formed the base, i.e. all taxed and exempt revenues and deductible and non-deductible expenses were defined. The main reason was the impossibility of identifying uniform accounting principles for the financial statements of individual companies.

The OECD Pillar Two project adopts a different approach. In order to calculate the denominator of the effective tax rate, it was decided to derive the Globe Income (i.e., the tax base) from the financial statements. The Globe Income (or loss) is calculated, in accordance with Chapter 3 of the Globe Model rules and Chapter III of the Directive, starting from the Financial Accounting Net Income or Loss (FANIL) as determined under the applicable financial accounting standard. The FANIL is then adjusted taking into account required adjustments (to eliminate income that should not be taxed or expenses that should not be deducted) and elective adjustments. It is worth noting, with a view to the European context, that most companies adopt the IFRS.

The idea to consider the Globe income as the starting point for a European common corporate tax base is in line with Recital 6 of the Befit Directive proposal: "*considering the efforts that both tax administrations and businesses have made in order to implement the framework of a global minimum level of taxation, it would be important to capitalise on this achievement and design rules that remain as close as possible to the OECD/G20 Model Rules and Directive (EU) 2022/2523. On this basis, the common framework of rules should be mandatory for groups with a taxable presence in the Union provided that they have annual combined revenues of more than EUR 750 000 000 based on their consolidated financial statements. In this way, the scope would thus be targeted at businesses that are most likely to have cross-border activities and, thereby, can benefit from the simplification which a common legal framework would offer. The threshold would also provide alignment with Directive (EU) 2022/2523 for a consistent approach in the Union.*"

Indeed, under many respects the tax base of Befit (artt. 8-41 of the Directive proposal) is similar to the one provided by Globe model rules: e.g. there is a participation exemption for dividends and capital gains on shares; illegal payments are not deductible; corporate taxes are included in the tax base, etc.

Nevertheless, it has been underlined that "*the BEFIT corporate tax base ultimately presents itself as a half-baked mix of Pillar Two and CCTB ingredients*."[8] In fact, on many other important aspects the proposed Befit tax base remains very different from the Globe model rules. The main differences regard the depreciation of fixed assets (that under Befit should follow specific straight-line criteria) and provisions (that should not be deducted unless some conditions are met, e.g. because of a legal obligation). Notably, these rules produce only temporary differences between the Globe income and the Befit tax base, i.e. they only lead to a different time allocation of income. They seem good candidates for simplification. And streamlining Befit tax base would also be in tune with the current strategy of decluttering.

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[8] Daniela Hohenwarter and Gunter Mayr, *Pillar Two and BEFIT: Shocks and Opportunities for the EU Internal Market*, European Taxation, October 2024.

3. The need for a European tax agency

After a pause following Directive 77/799/EC, on mutual assistance in the field of direct taxation[9], and Directive 76/308/EEC, concerning mutual assistance in the field of recovery[10], the evolution of the legislative framework for European tax cooperation has been rapid and far-reaching: in the 2000s a system of administrative cooperation with its specificities has begun to develop, with Directive 2003/48 known as the "Savings Directive" and the sectoral regulations on VAT and Excise Duties.

This movement has accelerated with the adoption of Directive 2011/16 on administrative cooperation, known as DAC 1, by which the Member States of the European Union agreed to automatically exchange information relating to, in addition to savings interest (already covered by Directive 2003/48), other categories of capital income. In few years, DAC 1 has been amended seven times, sometimes very substantially, by means of the following new DAC Directives, until Directive No. 2021/514 (DAC7) which regulated also joint audits between tax administrations, and Directive No. 2023/2226 (DAC 8) which imposes exchange of information on crypto-assets and electronic money. On 28 October 2024 the Commission has adopted a new proposal, DAC (9), which will facilitate the administrative obligations of Pillar Two, providing a common format for filing, and will set up a system of exchange of information among national tax authorities.

This rapid evolution of administrative cooperation in the field of taxation is the result of a strong political consensus on combating tax fraud and avoidance, and was made possible by the partial removal of the unanimity rule, using as legal bases Articles 6 and 197(1) of TFEU, instead of Articles 113 and 115. This legal basis was also used to establish the "Fiscalis" program[11] (Regulation 2021/847) and the "Customs" program (Regulation 2021/444), essential tools for cooperation between Member States' tax administrations, in particular in terms of training and IT capacity building, funded by the Union.

More recently, on 5 November 2024, the Council has approved the proposal of the VIDA Directive (VAT in the Digital Age). VIDA, which will be adopted after a re-consultation with the new Parliament, will mark an important step forward in simplification, reduction of administrative burdens for business (particularly SMEs), and fight to tax fraud, through new provisions for electronic invoicing, digital reporting requirements, single VAT registration, automatic transmission of data.

Over time, administrative cooperation has acquired an additional and distinct dimension from tax harmonisation in the proper sense, in a relationship of complementarity with it, contributing to achieving the Union's own objectives, in particular the proper functioning of the internal market.

The rapid and very important progress in administrative cooperation and exchange of information presents significant challenges. These are underlined by the European institutions themselves, starting with the EU Commission which, in a report to the European Parliament

[9] Council Directive 77/799/EEC of 19 December 1977 originally concerned mutual assistance by the competent authorities of the Member States in the field of direct taxation.

[10] Council Directive 76/308/EEC of 15 March 1976 on mutual assistance for the recovery of claims relating to certain levies, duties, taxes and other measures.

[11] Regulation of 20 May 2021, OJ, 28 May 2021, L 188, p. 1.

and the Council of 18 December 2017[12] underlined that the implementation of the automatic exchange of information has had the effect of considerably increasing the amount of data that tax administrations manage, while on average, their ability to treat them has not increased in the same proportions. More recently, the European Court of Auditors has also expressed concerns[13], lamenting that the information exchanged lacks quality, completeness and accuracy, that it is not widely used and that Member States do not exercise a high degree of vigilance with regard to the information exchanged. In addition, Member States do not sufficiently monitor the effectiveness of the system, resulting in a significant loss of tax revenue for both national and EU budgets.

In the same vein, the European Parliament in a 2021 resolution[14] recognised the added value of sharing best practices and the Commission's continued support for strengthening the powers of national tax administrations, while taking note of the findings of the European Court of Auditors that more can be done in terms of monitoring, ensure the quality of the data and use the information received to make the exchange of tax information more efficient and effective. The image that seems to emerge is that of a lack of technical and political coordination of these new mechanisms in terms of administrative cooperation. Moreover, despite long-standing bilateral and multilateral cooperation between different national tax authorities, the coordination of cross-border tax audits still appears to be limited in the absence of a fully operational framework at the EU level.

However, it does not appear possible to resolve all these problems without considering institutional developments such as the creation of a body specifically responsible at the European level for coordinating the action of the tax administrations of the Member States in a cross-border context.

In 2023, the Commission submitted a proposal for an EU regulation fully rewriting the Union Customs Code[15]. Of the 265 articles of the future code, 33 (articles 205 to 237) aim to create a "Customs Authority of the European Union". It would be the EU's 38th "executive agency" and the first ever in the field of taxation, the latest being the European Anti-Money Laundering and Countering the Financing of Terrorism Authority (AMLA) approved by Parliament on 24 April 2024 and by the Council on 19 June 2024.

The agencies are an institutional mechanism to achieve the objective of joint administrative action without changing the balance of powers between the European Union and its Member States. In addition, they allow for the creation of networks of national and supranational entities.

The proposal for a new EU Customs Code is based on the recognition that the current cooperation between Member States' customs administrations has proved insufficient. National practices for the implementation of the EU Customs Code still differ between the 27 Member States, there is no centralised analysis of customs fraud risks or uniform classification of these

[12] COM (2017) 781 final.

[13] Court of Auditors, *Exchanging tax information in the EU: solid foundation, cracks in the implementation, Special Report*, 03/2021, available at https://op.europa.eu/webpub/eca/special-reports/tax-03-2021/en/

[14] European Parliament resolution of 16 September 2021 on the *Application of EU requirements for exchange of tax information: progress, lessons learned and obstacles to overcome* (2022/C 117/13).

[15] European Commission, Proposal for a Regulation of 17 May 2023 laying down the *Union Customs Code and the Customs Authority of the European Union*, and repealing Regulation (EU) No 952/2013, COM/2023/258 final.

risks, nor is there any coordination of controls. These shortcomings have led many economic operators to engage in "border shopping", i.e. to choose the least controlled part of the EU's external border to illegally introduce products into the EU's internal market, and then move them freely within the EU borders.

The future EU Customs Authority would be endowed with 15 competences (Article 208), three of which are the most important and the most "operational". First of all, precisely in order to combat border shopping, the Authority will be responsible for developing customs fraud risk management at European level in order to identify the products and economic operators on which to focus controls. It will have the power to notify national customs "control recommendations" which they will be required to implement. The Authority will also be responsible for coordinating and monitoring the management by the customs administrations of the Member States of crises at the Union's external borders that have an impact on customs procedures, through the activation of a "(European) crisis cell". Finally, the Authority will have the function of organising and coordinating “joint inspections”.

The proposal of a European Customs Authority raises the issue of the establishment of a strictly fiscal counterpart. It is in this spirit that 131 professors of tax law from 17 EU Member States sent an open letter to the Commissioner for Taxation in January 2024 calling for the creation of a European Tax Cooperation Agency[16]. The open letter was accompanied by a draft European regulation, inspired, in addition to the proposal for a European customs authority, by the regulations governing other previous European authorities, namely the European Labour Authority (ELA) and the three European Authorities operating in the field of financial markets and institutions (ESMA, EBA and EIOPA).

According to the draft, the tasks of the future European Agency for Tax Cooperation would initially consist of supporting the action of national tax administrations and facilitating cooperation between them. The Agency would therefore be primarily responsible for facilitating the exchange of information between national tax administrations and supporting their effective compliance with the cooperation obligations imposed on them by the EU directives and regulations currently in force, such as Regulation 904/2010 and the EUROFISC network for VAT, Directive 2011/16/EU (CRS, cross-border rulings, CBC Reporting) for direct taxes and Directive 2010/24/EU on mutual assistance for the recovery of debts. The Agency should thus strengthen cooperation and streamline the exchange of information between Member States, helping them to comply with obligations under Union law, as well as facilitate the follow-up of requests and exchanges of information, by providing logistical and technical support.

A second task of the future Agency would be to coordinate and support simultaneous audits and joint investigations, as already provided for in EU regulations and directives in the areas under the Agency's competence, or even propose concerted or joint inspections to the tax administrations of the Member States.

The Agency could also be entrusted with tasks related to the operational management of certain European IT platforms or common communication systems containing data on taxpayers or taxable transactions that have been put in place by EU legislation in the field of harmonised taxes, in particular in the area of VAT and excise duties and in the areas covered by DAC

[16] Available at https://www.politico.eu/wp-content/uploads/2024/01/25/EATC.UE-OpenLetter-5.12.23.docx

directives. It would coordinate, develop and apply frameworks to ensure a seamless exchange of information between Member States and with the Agency, based on the European Interoperability Framework and the European Interoperability Reference Architecture.

Furthermore, the European tax cooperation agency could effectively complement the action of EU bodies whose mission is to protect the EU's financial interests by combating tax fraud and corruption. It would aim to ensure cooperation, avoid overlaps and promote synergies with other EU agencies and specialised bodies, such as the European Anti-Fraud Office (OLAF) and the European Public Prosecutor's Office (EPPO). It could also conclude cooperation agreements with agencies such as Europol and Eurojust.

In the longer term, the European Agency for Tax Cooperation might assume the powers of investigation and control, and even taxation, of large cross-border groups, currently involved in the European approach for trust and cooperation (ETACA)[17], a pilot project to establish a framework to foster preventive dialogue between administrations and taxpayers in the assessment of transfer pricing risks.

Last but not least, the Agency could contribute to the European implementation of the Pillar Two on global minimum taxation, addressing consistency of administrative guidelines, ex-ante clarifications, and disputes resolution.

[17] European Commission, Guidelines European Trust and Cooperation Approach (ETACA), 11 October 2021, available at https://taxation-customs.ec.europa.eu/eu-cooperative-compliance-programme/european-trust-and-cooperation-approach-etaca-pilot-project-mnes_en