Business in Europe: Framework for Income Taxation (BEFIT)

An Initiative by the Corporate Taxation Working Group of The Malta Chamber

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1. INTRODUCTORY REMARKS

Malta's status as a micro-island state on the periphery of the European Union poses several challenges to its economic development and diversification, particularly in the current global and European economic environment. Malta's small market size limits the scalability of many of its start-ups, it suffers restricted access to the EU labour market due to its geographical limitations and its manufacturing and retail sector are affected by freight costs which were acerbated during the supply chain crisis.

In light of the above reasons, it has been the policy of successive governments to attract foreign direct investment to ensure the sustained growth of Malta's economy, not least by offering a competitive corporate tax environment which can serve as the necessary incentive to overcome the otherwise increased cost of operation that companies would experience by investing in Malta due to aforementioned barriers. While the introduction of tax harmonisation could cause challenges to a country like Malta, it is hard to determine the exact effect and extent of the impact that the introduction of a system of tax harmonization within the European Union would have on the Maltese economy.

2. OBJECTIVE

The Malta Chamber takes the view that the BEFIT initiative will have a detrimental economic impact on the Maltese islands, particularly given that the implementation of the system described is not aligned with the best interests of Maltese businesses and the Maltese economy. In order to address these concerns, the four objectives listed in the call for an impact assessment will be addressed sequentially.

2.1 Reducing Compliance Costs

> *"To increase businesses' resilience by reducing the complexity of tax rules and the compliance costs faced by EU businesses operating across borders;"*[1]

The call for evidence document of the BEFIT initiative acknowledges that the scope of the system would be limited to companies with consolidated global revenues exceeding EUR 750 million, with the "broader scope" option allowing for an opt in for companies with a smaller revenue. By its nature, this initiative will be increasing the complexity of tax rules, with the existing network of tax rules still applying to some companies, while others are governed by a new, thus far untested, system. The scale of the proposed initiative, as well as the complexities of tax issues it would need to address, particularly given the existing taxation regimes that are autochthonous to each member state and geared towards their individual economies, would lead to a lengthy and fraught implementation period which would put substantial and sustained stress on businesses. This strain would come at a time when businesses are still recovering from the impact of the COVID-19 pandemic and dealing with issues related to labour shortages, increased transport costs from the 2022 supply chain crisis, record inflation and the war in Ukraine, amongst others. Furthermore, the initiative would complicate matters further for those businesses that will now need to conform with this new framework while still operating in non-EU jurisdictions. The status quo model is one which companies, corporate service providers, and tax professionals are well accustomed to and have adapted their processes to. Altering the existing system will inherently bring with it further complexity for these entities and is likely to increase their compliance burden at a time of economic hardship.

2.2 Attracting International Investment

> *"To remove obstacles to cross-border investment and make the single market a more attractive location for international investment;"*[2]

It is unclear to what extent, if any, the proposed initiative would make the single market more attractive to international investment. The addition of a new system overlapping the current system is likely to increase the complexity of tax related matters for companies and therefore act as an

[1] Business in Europe: Framework for Income Taxation (BEFIT), Call for an Impact Assessment, Ref. Ares(2022)7086603 - 13/10/2022, Page 3
[2] Business in Europe: Framework for Income Taxation (BEFIT), Call for an Impact Assessment, Ref. Ares(2022)7086603 - 13/10/2022, Page 4

impediment to investment. The attractiveness of the single market under the BEFIT framework would largely depend on the ease of its application as well as the scope of the companies to which the framework applies. It is unclear to The Malta Chamber whether or not the status quo has served as a deterrent to any international investment.

2.3 Fair and Sustainable Growth

> *"To create an environment conducive to fair and sustainable growth by paving the way for administrative simplification;"* [3]

The concept of fair and sustainable growth cannot be limited to tax base calculation and the allocation of profits but should be taken in a holistic manner. The equitable nature of the initiative is based on the presupposition that all member states comprising the single market are otherwise beneficiaries of a fair apportionment of factors leading to economic growth, a supposition which does not consider the impediments of insularity, peripherality and micro island status that Malta faces within the single market. Malta's island status limits its access to the European labour market, while its high population density and small land mass limit its appeal to certain industries. Furthermore, The Malta Chamber believes that the criteria indicated for the allocation of taxable profits would operate in such a manner as to skew the results towards favouring larger states. This point will be expanded upon in the section related to the formula for allocating taxable profits.

2.4 Sustainable Tax Revenue

> *"To provide sustainable tax revenue, which is particularly important in the current challenging economic climate."* [4]

It is unclear to The Malta Chamber how the implementation of this initiative would provide a more sustainable framework for taxation than the status quo. Furthermore, the challenges in the economic climate referred to in the call for evidence for an impact assessment are amongst the reasons why overhauling the corporate income tax system at this juncture would cause an undue stress on companies due to a transitory, and potentially long lasting, increase in compliance costs as the framework comes into effect.

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[3] Business in Europe: Framework for Income Taxation (BEFIT), Call for an Impact Assessment, Ref. Ares(2022)7086603 - 13/10/2022, Page 4
[4] Business in Europe: Framework for Income Taxation (BEFIT), Call for an Impact Assessment, Ref. Ares(2022)7086603 - 13/10/2022, Page 4

3. EU ACTION

The feedback given in this section is without prejudice to The Malta Chamber's stated position in favour of maintaining the status quo scenario.

3.1 Scope

The Malta Chamber believes that the introduction of a framework based on the BEFIT initiative would add unnecessary complexity to the existing system of corporate income taxation in the single market. The impact of this change, and its complexity, will be commensurate to the breadth of its applicable scope. Should such a framework be implemented, its scope should be limited to those companies with consolidated global revenues exceeding EUR 750 million. Expanding the scope beyond this bracket, even through an opt in mechanism, would add increased complexity to the system and a corollary compliance burden.

3.2 Tax Base Calculation

The Malta Chamber believes that both of the suggested options for the tax base calculation are unworkable and illustrate the superiority of the status quo scenario. The first option presented is the introduction of standardised limited tax adjustments with the use of financial statements prepared in accordance with an EU authorised accounting standard. This option would effectively result in the harmonisation of tax deductions, removing another element of fiscal policy which disadvantaged Member States can utilise to attract investment. The second option presented in the call for evidence document is self-evidently burdensome with the document stating;

> *"Member States would have to run two comprehensive sets of corporate tax rules in parallel, i.e. BEFIT and their national rules"* [5]

The effect of these proposals is to offer two options for the determination of the tax base calculation; one which in its simplification risks overlooking the specific needs of different industries and member states, while the other introduces a disproportionate complexity and related administrative burden. These options also remove Member States' ability to be statutorily nimble to address and cater for the different needs of different industries.

3.3 Formula for Allocating Taxable Profits

The call for evidence document distinguishes between a formula for allocating taxable profits solely on tangible assets and a formula that also includes intangible assets. Notwithstanding the aforementioned objection to the introduction of the BEFIT Framework, The Malta Chamber believes that intangible assets should be included in formula for allocating taxable profits that may come into

[5] Business in Europe: Framework for Income Taxation (BEFIT), Call for an Impact Assessment, Ref. Ares(2022)7086603 - 13/10/2022, Page 5

effect. The Malta Chamber further notes that the three factors proposed to be used for formulary apportionment, tangible assets, labour, and sales by destination, would skew the apportionment in favour of those countries with a larger consumer base. The use of these factors alone would undervalue intangible elements and may prejudice member states with a service-based economy, particularly those sectors with a strong technological element.

3.4 The allocation of profit to related entities outside the group

The Malta Chamber endorses the second option under this category of the impact assessment, that is the option of keeping current transfer pricing rules. It is unclear in what manner the proposed administration based on macroeconomic industry benchmarks would simplify transfer pricing, particularly given that the arm's length principle would still remain in effect with businesses still carrying out the necessary transfer pricing analysis. The "simplified approach" may provide an unnecessary additional layer of complexity to this process.

4. CONCLUDING REMARKS

With regard to the outline given in the call for evidence for an impact assessment The Malta Chamber is making the following the assertions and recommendations.

1. The proposed framework for income taxation is likely to increase the complexity of tax rules within the single market due to the introduction of parallel systems with an increase in the compliance burden for affected companies.
2. The principles of fairness and sustainable growth referenced in the document should be interpreted holistically with a view to compensating for the barriers that Malta faces as a micro-island state on the periphery of the EU.
3. The contemplated framework for income taxation does not offer compelling benefits that would warrant the costs and risks involved in implementing it. The current tax framework should therefore be retained and improved upon where possible to ensure that European economies remain competitive.
4. Any impact assessment carried out with regard to the proposed framework on income taxation (BEFIT) should include long term behavioural changes and not solely rely on a static model of the economy. Care should be taken to reflect the breadth of the impact of the proposed changes including any far-reaching consequences of the framework's introduction. that may take place due to resulting effect on Member States' economy.
5. Notwithstanding the above, should the framework be adopted:
   i. the scope should be limited to companies with consolidated global revenues exceeding EUR 750 million and should not be lowered in such a manner as to impacts SMEs.
   ii. any formula for the allocation of taxable profits should incorporate intangible assets and be calibrated such that it does not skew towards countries with a larger consumer base.
   iii. the approach of introducing additional guidelines with regard to the manner in which transfer pricing is carried out should be avoided, and the status quo retained.

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