Towards a common consolidated corporate tax base in the EU?

On 16 March 2011, the European Commission adopted the long-awaited proposal for a directive on a common consolidated corporate tax base (CCCTB) in the EU.

The CCCTB, which is designed to eliminate tax obstacles to intra-EU cross-border activities, would provide a single set of rules that companies operating within the EU could use to calculate their taxable profits. Under the CCCTB, a company or group of companies would only have to comply with a single EU system for computing taxable income, rather than a different set of rules in each Member State in which they operate, and only one tax return would have to be filed for the company’s or group’s entire activities in the EU.

The main benefits of the CCCTB would be as follows:

- It would provide a common tax base that would considerably reduce compliance costs because it would be possible to calculate the tax base in the same way in all the participating Member States;
- It would eliminate the need to determine arm’s length transfer prices for intragroup transactions;
- It would provide a consolidation mechanism to offset profits and losses of the same company in various Member States; and
- A “one stop shop” system would be used to administer the CCCTB.

The CCCTB has been under discussion since 2001, with a proposal being put forward in 2008 (which never moved forward due to Ireland’s rejection of the Lisbon Treaty), and was most recently reinstated in the EU agenda in October 2010 as a key component of the European Commission’s Work Program for 2011, “Towards a Single Market Act – For a highly competitive social market economy: 50 proposals for improving our work, business and exchanges with one another.”

The proposed directive will now be submitted to the vote of the Member States meeting in the Council of Ministers and to the opinion of the European Parliament (and Economic and Social Committee).

Overview of CCCTB

The CCCTB aims to remove serious tax obstacles to the Internal Market and to reduce significant compliance costs and administrative burdens for businesses operating in two or more EU countries. According to the explanatory memorandum to the Directive:

The CCCTB aims to tackle some major fiscal impediments to growth. A key obstacle involves the high cost of complying with transfer pricing formalities. Further, the ways that closely-integrated groups tend to organise themselves strongly indicate that transaction-by-transaction pricing based on the ‘arm’s length’ principle may no longer be the most appropriate method for profit allocation.

The adoption of a single tax base, which would be optional, would allow companies to elect to consolidate all of their European operations for at least a five-year period (with automatic three-year renewals unless the companies gave notice otherwise). This would allow a company or qualifying group of companies to comply with only one EU system – rather than up to 27 different systems – for computing taxable income. The single consolidated tax return would be used to establish the tax base of the company. Profits would automatically be set off against losses, without any border barriers, to generate a single base, which would then be split among the group companies in the countries in which they operate.

The regime would be available to single EU resident companies, groups of EU resident companies and EU parent companies with qualifying EU subsidiaries, as well as to EU branches of third-country companies. Eligibility for consolidation (group membership) would be determined under a two-part test based on (1) control (i.e. the holding of more than 50% of the voting rights) and (2) ownership (i.e. the holding of more than 75% of the equity) or the rights to profits (i.e. the holding of more than 75% of the rights giving entitlement to profits).

Broadly, the common tax base would consist of taxable income, such as trading income, passive income and capital gains, less deductible expenses and other deductible items. With respect to dealings between the group and entities outside the group, dividends received from, and gains derived from the disposal of shares in, a company outside the group and the profits of foreign permanent establishments would be exempt. However, income in the form of interest and royalty
payments received from outside the group would be taxable, with credit granted for withholding tax paid on such payments. Moreover, transactions between a taxpayer and an associated enterprise that is not a member of the same group would be subject to pricing adjustments in line with the arm’s length principle.

The consolidated taxable profits of the group would be shared among the individual companies based on a simple formula so that each Member State could tax the profits of the companies located in its territory. The formula for apportioning the consolidated tax base would be comprised of three equally weighted factors:

- **Labor** – The labor factor would be computed on the basis of payroll and the number of employees (each item counting for half);
- **Assets** – The assets factor would include all fixed tangible assets (intangibles and financial assets would be excluded from the formula due to their mobile nature and the risks of circumventing the system); and
- **Sales** – The sales factor would consist of the total sales of a group member at destination (i.e. sales would be included in the sales factor of the group member located in the Member State where the dispatch or transport of the goods to the person acquiring them ends).

The CCCTB rules would include a general anti-abuse rule, supplemented by measures designed to curb specific types of abusive practices. These measures would include limitations on the deductibility of interest paid to associated enterprises resident for tax purposes in non-EU low-tax countries that lack a standard information exchange with the Member State of the payer.

In addition, groups using the CCCTB would be able to use a “one-stop-shop” system for administering the tax and consequently file a single consolidated tax return for all of their activities in the EU.

The CCCTB does not deal with corporate tax rates – Member States would remain free to determine their own rates.

According to the Commission, companies that choose the new system would save two-thirds of the administrative costs they currently incur to operate a business in another Member State, particularly as groups already having cross-border activities would no longer have to justify their transfer pricing methods.

Member States budgets should not be impacted because the new base would be broader than the average of existing tax bases, which should compensate for the loss of tax revenue caused by the consolidation of losses and profits.

**Comments**

The proposal for the CCCB directive is a very welcome development, after so much work and so many contributions from interested parties. The greatest challenge, however, remains: adoption by the Council. Even if the European Parliament supports the proposal (which is likely given that the Parliament has previously supported it), unanimity of the Council is unlikely to be achieved in the next few months.

Is it possible that the CCCTB could become the first instance where the “enhanced cooperation” mechanism within the EU, which only requires the agreement of at least nine Member States, would operate in a tax context? It will be important to see the extent to which Germany and France are prepared to cooperate (as they were invited to do by the recent report from the French Court of Auditors on the comparison of the tax systems of the two countries) and how many other Member States will be prepared to acquiesce. Based on past discussions, Italy, Spain and the Benelux countries would seem to be natural candidates, which adds up to about 90% of the Euro zone (perhaps also joined by Denmark) – a very respectable percentage.

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