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EU tax alert

European Commission publishes final Common Consolidated Corporate Tax Base (CCCTB) proposals

Final proposed Directive provides companies a detailed basis upon which to assess and calculate impact

On 16 March 2011, shortly following the conclusion of an important European Union (EU) summit to stabilize the Euro, the European Commission has adopted formal proposals regarding a CCCTB for Europe, making use of political momentum to further align the Member States' fiscal policies. The formal proposals contain elements not previously seen, such as the ability to request an alternative apportionment method. In addition, detailed guidance around a proposed consolidation regime is also provided, as are apportionment formulae specific to a range of different industries.

Background

The Directive, containing some 134 Articles, is the result of nearly ten years of work to produce a uniform standard for calculating the tax base of multinational groups operating in the EU. The Directive is fundamentally based on the assumption that companies will treat the European Union as a single market for corporate tax purposes, instead of dealing with 27 different tax systems. If adopted by the Council of Ministers, the CCCTB will provide an optional tax system that consolidates the taxable profits of a group of companies under common control, and has a mechanism for allocation of the harmonized tax base amongst the participating Member States according to a specific apportionment formula. The Member States themselves will then use their respective corporate tax rate to calculate the final tax burden of each company.

The objective of the proposed solution is to create the possibility for companies to pool profits and losses amongst their group members, minimize tax compliance costs by introducing a "one-stop-shop" concept and significantly reduce transfer pricing issues, whilst safeguarding the fiscal sovereignty of each Member State. The Commission estimates that the CCCTB will save business across the EU €700 million in reduced tax compliance costs each year, and €1.3 billion through consolidation.

The Directive in detail

The Directive consists of three main elements:

- The substantive rules on determining the tax base (Chapter I-XV)
- The apportionment section, containing specific provisions for different industries such as financial institutions, insurance, oil and gas, shipping and air transport (Chapter XVI)
- Administration and procedures (Chapter XVII-XVIII)

In its substantive rules, the proposed Directive follows commonly accepted OECD principles and definitions and adheres to well-known accounting and tax principles with the implicit objective that technical discussions will be limited to detailed amendments as opposed to a complete overhaul.

While earlier proposals for a CCCTB focused on the needs of large multinational groups of companies, the final proposed Directive encompassing all companies, regardless of size. In this regard, the Directive not only applies to EU-resident companies and their Permanent Establishments, but also to companies established under the laws of a third country that have a similar legal forms and are subject to corporate taxation in at least one Member State. It should also be noted that the CCCTB is an optional regime for companies.

Consolidation

A consolidation regime will be available to companies who fulfill a two part test. Immediate and lower-tier subsidiaries will be qualified for consolidation when the parent company holds both a right to exercise more than 50 % of the voting rights and an ownership right of more than 75% of the company's capital or more than 75% of the rights with respect to profit. For calculation purposes of the 75% voting rights threshold in relation to non-immediate subsidiaries, the parent company is deemed to hold 100% of the rights once the 75% threshold is reached. The interests held in intermediate subsidiaries are to be multiplied for the purpose of calculating the parent company's entitlement to profit and capital ownership. Direct or indirect ownership rights (including rights in non-EU resident companies) of 75% or less are to be considered in the calculation. The Directive also provides for anti-abuse rules which ignore artificial transactions deemed to have been carried out for tax avoidance purposes and which disallow under specific circumstances the deduction of interest paid to associated companies resident in a third country. Moreover, the non-distributed income of controlled foreign companies is required to be added to the tax base under certain circumstances.

The Commission papers also consider a CCTB, where there is a common base but no consolidation. This may prove attractive as an interim compromise measure.

An alternative apportionment method may be requested

While the Directive is designed in part to reduce overall compliance costs, it will no doubt create immediate complexities in terms of how countries will administer the single taxpayer and tax return concept in alignment with tax audit protocols, administrative and judicial appeal systems. In addition, significant complexity can also be foreseen regarding the contentious choice of the allocation ratio used to apportion the profit to involved Member States. In terms of this apportionment of the consolidated tax base, the principal taxpayer can request the use of an alternative method in cases where they believe the outcome of the apportionment formula does not fairly express the extent of the their business activity. However, in the case where the principal taxpayer requests the use of an alternative formula, it must be agreed to by all Competent Authorities of the Member States involved.

In addition, due to the strict "in-or-out" principle once a group of companies opt to use the CCCTB, the member companies are no longer able to utilize individual Member States´ incentives for areas such as Research and Development or beneficial accelerated depreciation. Therefore, it is of utmost importance that companies not only assess the appropriate apportionment formulae when making a European tax rate comparison, but also issues such as the loss of specific incentives.

Reaction of Member States

While countries such as Germany and France have supported the CCCTB initiative, it has not enjoyed universal support among the Member States. Many Member States — Ireland, Slovakia and others — have already expressed concerns regarding what they perceive as a de facto infringement of their tax sovereignty should such a Directive be written into law.

The way forward

In his press release of 16 March[1] Commissioner Šemeta stated that the CCCTB "*will make it easier, cheaper and more convenient to do business in the EU*" and that it will "*open doors for SMEs looking to grow beyond their domestic market*." The Commissioner considers the proposal as being "*good for business and good for the EU's global competitiveness*."

Klaus von Brocke, Head of EU Taxation at Ernst & Young, commented that "*The publications today take us a long way forward in the journey that the Commission started over a decade ago. Whilst much still remains to be debated, the draft Directive now provides the basis for such debate and companies can fully consider the mechanics of the regime.*"

Commenting on the policy, Chris Sanger, Ernst & Young's Global Tax Policy Leader, stated that "*Today's publication seeks to address a number of the concerns that have been raised by earlier studies and should stimulate further discussion of the details. The detailed provisions for allocation of profits between the Member States, and the potential override are welcome developments. Attention can now be turned to the practicalities of these procedures and the impact that such a tax system would have on Member States.*"

He went on to say that "*A natural conclusion of a CCCTB is the aligning of corporate tax rates across the Member States as the benefit of providing a lower rate to attract incremental investment is reduced due to the allocation of the returns on that investment to other Member States. A key question for those considering the CCCTB is therefore whether a single system outweighs the benefits of competition between the Member States. With the United Kingdom's objective to have 'the most competitive corporate tax system in the G20', it is clear that there remains some considerable discussion to occur before this policy is adopted.*"

Companies should use this opportunity to assess and calculate the impact of such a change in determining the corporate tax base on its European tax rate compared with potential savings in tax compliance costs. Country tax administrations, for their part, will be assessing the proposals alongside the recently-adopted directive on Mutual Assistance[2] in order to develop the required administrative infrastructure which will allow them to cope with the new challenges of being the recipient of a future CCCTB tax return.

As an additional side effect, the Directive has already demonstrated a very significant impact on the likely future design of corporate tax systems in EU Member States. Even if the full Directive is ultimately unsuccessful in being completely implemented, some smaller Member States have signaled interest and commitment to use the Directive as a blueprint for future corporate tax reforms. Although this would not necessarily lead to full harmonization, the underlying change to national corporate tax systems to more closely mirror the basic principles of the CCCTB would start the process of aligning tax systems in many Member States.

As it is unlikely that the proposal will reach unanimous consent amongst the 27 Member States necessary to achieve adoption, the most likely scenario to unfold is a mechanism of enhanced cooperation where a minimum of 9 Member States agree as a first step to adopt the Directive. This mechanism, which has already been successfully utilized in order to adopt the European single currency, may well be an adequate means for the same Member States countries to bring this ambitious work package to life.

How Ernst & Young can assist

Ernst & Young recently published two reports regarding the CCCTB. The first report[3], prepared for the Irish Department of Finance, assesses the economic effects of the 2005 CCCTB proposals, while a further report, prepared for the Irish Business and Employers Confederation (IBEC)[4] considers the impact of the 2005 proposals on corporate tax compliance processes, studying and comparing the data provided by five groups of companies with significant operations in Europe. The model used to calculate the impact on these five groups will now reflect the newly-released CCCTB proposal. With the proposal arguably representing one of the most fundamental changes in corporate taxation attempted within the Union, it will benefit from rigorous testing and consultation to ensure that it delivers the stated objectives. With the final proposed Directive — including industry-specific apportionment formulae — now available, companies are advised to take advantage of this increased availability of information to assess and calculate the impact on their business.

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[1] http://europa.eu/rapid/pressReleasesAction.do?reference=IP/11/319&format=HTML&aged=0&language=en&guiLanguage=en

[2] See EU tax alert 157: http://www.ey.com/Publication/vwLUAssets/EU-Tax-Alert_157/$FILE/EU_Tax_Alert_157.pdf

[3] http://www.finance.gov.ie/viewdoc.asp?m=&DocID=-1&CatID=62

[4] See EU tax alert 160: http://www.ey.com/Publication/vwLUAssets/EU_Tax_Alert_160(CCCTB)_10feb11/$FILE/EU_Tax%20Alert_160(CCCTB)_10feb11.pdf