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European Commission proposes CCCTB

On March 16, 2011, the European Commission released a proposal for a council directive on a Common Consolidated Corporate Tax Base ("CCCTB"), accompanied by an impact assessment. The CCCTB purports to reduce existing inefficiencies and distortions resulting from the co-existence of twenty-seven different regimes by offering a single set of rules which taxpayers operating within the EU can use to calculate their taxable profits. Under the proposal, the application of the CCCTB is optional for taxpayers. Taxpayers that opt for the CCCTB regime will only have to file a single tax return with the tax authorities of one EU Member State for their activities in the entire EU (one-stop-shop system). A single consolidated tax return will be used to establish the corporate tax base, after which all EU Member States in which the company or CCCTB group is active would be entitled to tax a certain portion of that base, according to a specific formula based on three equally-weighted factors (assets, labor and sales).

The European Commission aims for the current proposal to be unanimously approved by the Council of the European Union in 2013, after consultation of the European Parliament. Two or three years after adoption, EU Member States should have transposed the proposal into national law.

The main elements of the proposal are summarized below.

Common corporate tax base

The proposal defines a common corporate tax base, including detailed rules on when taxable profits are deemed to be realized for tax purposes, the tax depreciation of assets, principles of group affiliation and the treatment of income from third countries. The prospect of having one such multilateral common corporate tax base across the EU is appealing. However, it is necessary for taxpayers to determine the differences between the currently applied domestic tax systems and the CCCTB system before one can make a fair assessment of whether it is desirable to opt for CCCTB. The CCCTB system uses the "all in or all out" principle. If a taxpayer opts in for CCCTB, each and every EU affiliated company that meets the conditions must be included. Once a taxpayer has opted in, the CCCTB is to be applied for a minimum of five years

Consolidation

The proposal includes a European cross-border corporate tax consolidation. Such results in the absence of a requirement to comply with transfer pricing rules with respect to transactions within a CCCTB group, the ability to restructure internally without immediate adverse tax consequences, and the ability to utilize and setoff tax losses in a cross-border manner (within the year among and between the various consolidated companies located in various jurisdictions, as well as the carry-forward of consolidated losses to future years for utilization against consolidated profits). CCCTB provides for an indefinite carry forward of tax losses but does not allow any carry back of losses.

Eligibility for consolidation (group membership) is determined in accordance with a two-part test based on (i) control (more than 50% of voting rights), and (ii) ownership (more than 75% of equity) or rights to profits (more than 75% of rights giving entitlement to profit). The two thresholds should be met throughout the tax year; otherwise, the company should leave the group immediately. There is also a nine-month minimum requirement for group membership.

If, for example, an EU parent company that applies the CCCTB system holds more than 75% of the aggregate votes in a non-EU subsidiary company, which in turn holds more than 75% of the aggregate votes in a lowertier EU subsidiary company, this lower-tier EU subsidiary must be included in the EU parent's CCCTB filing. Consolidation is also possible where a non-EU parent company owns permanent establishments in various EU Member States.

In calculating the consolidated tax base, profits and losses arising from transactions directly carried out between members of a group are ignored. This means that profits and losses on intra-group transactions between consolidated companies and income/expenses realized/incurred on intra-group services are excluded from the consolidated tax base. An adjustment may be made where gains are realized on the disposal of shares in a subsidiary company. Such gains would not benefit from a tax exemption to the extent that assets with taxable built-in gains have been transferred to the sold company during the current or previous tax year, unless it is demonstrated that these intra-group transactions were carried out for valid commercial reasons.

The proposal contains several provisions dealing with consolidation and deconsolidation. Tax loss Carry forwards available to a taxpayer at the time of its accession to a tax consolidation can only be utilized against consolidated taxable profits to the extent such profits are attributable to the respective taxpayer. When a company deconsolidates, no CCCTB group tax loss carry forward will be attributed to such deconsolidating company, but rather such CCCTB losses will remain with the CCCTB group. If the CCCTB group terminates in its entirety (or the election has been made after the initial five-year period to discontinue the CCCTB), the remaining CCCTB group tax loss carry forwards will be attributed to the various companies of the CCCTB group at such time.

Sharing mechanism

CCCTB does not intend to harmonize the corporate tax rates of the various EU Member States. The CCCTB is attributed to the various EU Member States, which would subsequently levy corporate tax on the tax base so attributed in accordance with their domestic provisions, including domestic corporate tax rates. The CCCTB is attributed to the various taxpayers by means of a sharing mechanism, which takes the form of the following formula:

$$\text{Tax Base} \left[\frac{1}{3} \frac{\text{Sales}^{A}}{\text{Sales}^{Group}} + \frac{1}{3} \left(\frac{1}{2} \frac{\text{Payroll}^{A}}{\text{Payroll}^{Group}} + \frac{1}{2} \frac{\text{Number of employees}^{A}}{\text{Number of employees}^{Group}} \right) + \frac{1}{3} \frac{\text{Assets}^{A}}{\text{Assets}^{Group}} \right] {}^{*}\text{CCCTB}$$

Under the proposal, the three factors are equally-weighted. Of course, the relative weight of each of these factors is not a question of technique, but one of a political nature to be resolved between the EU Member States in the next stages of the legislative process. This is because a change in the relative weight of the factors may result in a shift of taxable profits from one EU Member State to another compared to the current situation. Clearly, the EU Member States will only be able to decide on this matter after they have analyzed the impact on their own state budget.

Special rules will apply to financial institutions, insurance undertakings, oil and gas companies and transportation services (shipping/airlines/railways). The proposal also includes a "safeguard clause", pursuant to which, upon request of the taxpayer or a relevant EU Member State, and subject to approval by all relevant EU Member States, a formula which deviates from the statutory formula can be applied.

Anti-abuse provisions

In addition to a more general anti-abuse provision stating that artificial transactions will be ignored, the proposal also includes more detailed anti-abuse provisions such as limitation of interest deductions, ‘switchover’ provisions applying a credit method instead of exemption method for the avoidance of double taxation, CFC rules, rules to avoid the manipulation of the tax base attribution, and rules to avoid the sale of assets disguised as a sale of shares.

Administrative framework

Groups will be able to deal with a single tax administration ('principal tax authority'), namely of the EU Member State in which the parent company of the group ('principal taxpayer') is resident for tax purposes. The proposal also includes an advance ruling mechanism.

Audits should be initiated and coordinated by the principal tax authority, but the authorities of any EU Member State in which a group member is subject to tax may request the initiation of an audit. Furthermore, the competent authority of the EU Member State in which a group member is resident or established may challenge certain decisions of the principal tax authority before the courts of the EU Member State of the principal tax authority.

Final observations

Taxpayers engaged in businesses across the EU could achieve – at least in theory – significant efficiencies by applying for CCCTB. It remains to be seen whether this proposal will receive the required unanimous political support. In the long process leading to the proposal, a number of EU Member States have made reservations. If no unanimous approval is obtained, a smaller group of EU Member States may voluntarily continue with the CCCTB project by means of enhanced cooperation.