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EU Re-launches Common Consolidated Corporate Tax Base

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On 25 October 2016, the European Commission released the revamped draft proposal for the Common Consolidated Corporate Tax Base (CCCTB). The proposal includes two draft directives that are cross-referenced and designed to operate as parts of a single package, with the CCCTB being mandatory for the largest groups in the EU.

The CCCTB is a single set of rules to calculate the taxable profits of companies in the EU. It would allow companies to file one tax return for all of their EU activities, and offset losses made in one member state against profits earned in another. The consolidated taxable profits would be shared among the member states in which the group is active, using an apportionment formula. Each member state then would tax its share of the profits at its national tax rate.

As explained below, previous attempts by the European Commission to introduce the CCCTB have encountered unsurmountable obstacles. Nevertheless, the Commission continues to favor the adoption of the CCCTB as a further step toward harmonization in the context of the fight against base erosion and profit shifting (BEPS). Despite the previous rejection by many member states, the Commission hopes that the new proposed two-step approach and deferral of some of the most difficult areas of the project will allow negotiations to move forward.

The two-step approach consists of the following:

Step One (Common Corporate Tax Base (CCTB)): Large multinational groups with global sales of at least EUR 750 million would be subject to a single set of rules to calculate their taxable profits in the EU (rather than calculating profits based on the rules under their national tax systems). Companies falling below the threshold would be permitted to voluntarily adopt the rules.

Step Two (CCCTB): Following the adoption of the CCTB, the CCCTB would introduce rules for consolidation, formulary apportionment and a "one-stop shop" for tax administration. Losses in one EU member state would be available for offset against profits in another member state.

Background and process

The policy to work towards a CCCTB was established in 2001, with a draft directive proposed in 2011. It was opposed by many member states, with tax consolidation being one of the more intractable debates. The European Commission issued a public consultation in October 2015. The key changes from the 2011 proposal are mandatory adoption for consolidated groups above a certain threshold, the move to a two-step approach, additional incentives for research and development (R&D), and an allowance for equity financing.

Direct taxation is the preserve of EU member states, and individual member states retain sovereign legislative power, subject to the EU treaties. Harmonization throughout the EU, therefore, is possible only if there is unanimous agreement amongst the member states. Thus, the enactment of EU directives relating to taxation requires full agreement (or if that is not possible, in some cases a subset of member states may choose to implement a measure under “enhanced cooperation” rules).

Once a draft proposal has been presented by the European Commission, a number of levels of discussions will take place at the Council of Finance Ministers (ECOFIN), including delegation to officials for technical analysis. The president of the council then will facilitate a discussion where member states will raise concerns and possibly make recommendations for changes to the draft directive. In some cases, it may not be possible to find sufficient support at ECOFIN for the directive to be approved (e.g. as in the case of the 2011 draft directive for a common consolidated corporate tax base).

Overview of the new proposal

The new rules would be mandatory for parent companies or qualifying subsidiaries incorporated in a member state that belong to consolidated groups with total consolidated group revenues in excess of EUR 750 million during the previous financial year. Entities would need to be in one of the prescribed legal forms and subject to one of the prescribed corporate taxes. Permanent establishments (PEs) situated within the EU also would subject to the rules. Entities incorporated outside the EU in an equivalent legal form (to be established by the European Commission on an annual basis) would be subject to the rules in respect of their EU PEs, subject to the threshold.

A company belonging to a consolidated group with revenues below the threshold would be permitted to opt into the CCTB (and CCCTB) regimes for a minimum five-year period.

Companies subject to the CCTB would automatically transition to the CCCTB on adoption.

CCTB Directive: The proposed EU-wide tax code would include the following rules:

- All revenues would be taxable unless exempted. Exemptions would include dividend income and proceeds from the disposal of shares for participations of at least 10%. Profits of PEs would be exempt from tax in the state of the head office.
- Financial costs would be deductible up to the extent of financial revenues, with the excess restricted to the higher of EUR 3 million or 30% of EBITDA, which is similar to (but not quite the same) as the provision in the EU Anti-Tax Avoidance Directive (ATAD).
- An allowance for growth and investment would provide a tax deduction for 10 years based on a percentage of the increase in taxpayer's equity; equity decreases would be taxable on the same basis. A percentage of 2.7% would apply based on current conditions.
- A super deduction would be available for R&D costs. The full cost would be deductible, along with an additional deduction of 50% (or 100% for start-up companies without any associates) up to EUR 20 million, and 25% above this limit.
- Fixed assets would be depreciable for tax purposes, subject to certain exemptions.
- Losses would be able to be carried forward indefinitely subject to rules to prevent the purchase of loss-making companies.
- Anti-avoidance measures would include the general anti-abuse rule (GAAR), hybrid mismatch rules and (broadly similar) controlled foreign company rules from the ATAD. A "switch-over clause," which provides that dividends and capital gains from zero or low-taxed companies would not benefit from the participation exemption, has been added (this was proposed as part of the ATAD, but withdrawn as part of the negotiations amongst member states).
- In the absence of cross-border consolidation during the "first step," temporary relief would be available for losses incurred by immediate subsidiaries and PEs, subject to certain conditions and subsequent recapture.

CCCTB directive: Consolidated taxable profits would be apportioned among group members through formulary apportionment, based on three equally weighted factors:

- *Labor:* Based in equal measure on the number of employees (including persons who perform tasks similar to those performed by employees) and payroll costs (including all types of employee compensation);
- *Assets:* Tangible fixed assets (whether owned, rented or leased).
- *Sales:* Sales (other than intragroup sales) of goods and services net of discounts, returns, VAT and other taxes and duties. Exempt dividends, interest, royalties and disposal proceeds would be excluded unless they are revenues of the ordinary trade or business. Sales would be included by destination.

The following rules would apply:

- Allocated profits would be taxed at the national corporate tax rate as set by individual member states. The proceeds of withholding taxes on interest and royalties also would be allocated on this basis.
- Cross-border loss relief would be automatic, intragroup transactions would be ignored and transfer pricing rules would not apply within a qualifying group.
- A negative consolidated tax base would not be apportioned but would be offset against the next positive consolidated tax base.
- An alternative method could be used, subject to agreement of all the competent authorities, in exceptional circumstances.
- Sectoral rules would apply to adjust the formulae in respect of financial institutions and insurance undertakings, the oil and gas industry, as well as for the shipping and air transport sector.
- A group for these purposes would be defined through a two-part test: control of more than 50% of voting rights, and more than 75% of equity or more than 75% of the rights to profits.
- Transitional rules would apply in respect of companies joining and leaving the group. Individual tax years would have to be brought in line with the group's tax year.
- Special rules would apply for asset transfers and the treatment of unrelieved losses within a business reorganization. Companies with losses joining a group would be required to stream them and companies leaving a group would not take losses with them, unless as part of a wider business reorganization. A tax exemption on the disposal of shares would be is denied if it is used for a disposal of underlying assets, unless there is a valid commercial reason.
- Qualifying companies would be accountable to a single tax administration ("one stop shop"). The principal taxpayer (parent of the group) would be responsible for preparing and submitting a consolidated tax return for the group to the tax authorities in the member state of its residence (principal tax authority).

Proposed timetable: Each of the two separate, but interconnected, draft directives must have the unanimous approval by the member states for adoption. The proposal for a CCCTB will remain pending until the elements of the CCTB are politically agreed.

If approval is obtained, member states would be required to adopt and publish legislation to comply with the CCTB directive by 31 December 2018. The CCTB then would apply as from 1 January 2019. The CCCTB directive would require legislation by 31 December 2020, with application from 1 January 2021.

Comments

Despite the hopes of the European Commission, it remains unclear whether unanimous agreement among the EU member states is achievable, and negotiations are likely to be a highly politicized matter.

Many member states do not favor a common tax base, including smaller economies reliant on offering competitive tax regimes to attract inward investment.

France and Germany did work together on limited harmonization of their corporate tax base, but discontinued the project. The UK historically has opposed the CCCTB project, but the impact of the UK's referendum on EU membership will need to be considered.

Designing an effective common base is a major project and the current draft CCTB raises numerous tax, as well as accounting, questions. There is no common accounting standard for tax reporting across the EU and transitional adjustments on the adoption of the CCTB could be highly complicated, particularly in areas such as financial instruments, provisions and long-term contracts.

The requirement for mandatory adoption historically has been a major sticking point for business, which has argued that adoption of the regime should be optional. Mandatory adoption only above the EUR 750 million threshold also poses a challenge for governments: should they maintain two parallel tax systems, with major boundary/resource implications or should they seek to apply the common base to all but the very smallest businesses?

CCCTB is an even more difficult area. Formulary apportionment was rejected at the outset of the G20/OECD BEPS project (which includes 21 EU member states), and adoption would leave the EU out of step with the international consensus. The exclusion of intangible assets ignores one of the major drivers of modern business—and numbers of people and tangible assets are not necessarily good proxies. Small economies with fewer customers seem likely to lose out to larger economies on the destination sales factor. The interaction of the proposed rules with those of non-EU countries also is unclear.

The proposals do not provide answers to many important technical questions, which would need considerable work before any common tax base could be adopted across the EU. The timescale put forward in the draft directive for adoption of the CCTB as from 2019 and the CCCTB as from 2021 appears very ambitious on technical grounds alone.