taxnotes® international

Volume 84, Number 12 ■ December 19, 2016

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by Sandy Bhogal and Kitty Swanson

Reprinted from *Tax Notes Int'l*, December 19, 2016, p. 1093

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BEPS CORNER

A Review of the EU's Proposals for a Common (Consolidated) Corporate Tax Base

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In this article, the authors discuss the challenges facing the European Commission's renewed effort to introduce a common consolidated corporate tax base in the EU.

On October 25 the European Commission relaunched its proposal to introduce a common consolidated corporate tax base (CCCTB), with the aim of creating a level playing field for multinationals in Europe and creating a simple and pro-business tax environment. The launch coincided with two further proposals, one aimed at updating previously announced hybrid antiavoidance measures and the other relating to an extension of double taxation dispute resolution mechanisms in the EU. The volume of tax proposals coming from the EU is unprecedented, and the political climate continues to create the opportunity for further proposals.

What Is the CCCTB?

In brief, the proposed CCCTB is a set of corporate tax rules that is intended to apply on a consistent basis throughout the 28 member states of the EU, with profits being consolidated at the group level and then apportioned between the relevant member states on the basis of a prescribed formula (and then taxed at domestic rates). If the CCCTB is implemented, it would represent a dramatic shift in international tax coordination and cooperation and constitute an unprecedented harmonization of tax measures across a large number of sovereign states.

Background

Although the EU has traditionally had limited power regarding tax matters, the idea of establishing a common tax base throughout the EU was first mooted in the 1990s as a logical extension of the single market. Although various harmonizing measures were put forward in the 1990s (not all of which were implemented — for example, a proposal on cross-border loss relief), it was not until the European Commission evaluated corporate taxation within the EU in 2001, and concluded that most of the perceived obstacles to completing the internal market arose as a result of the coexistence of multiple tax systems, that serious consideration was given to attempting to harmonize national tax systems under a CCCTB.

The commission considered an alternative to a CCCTB, described as a ''home state taxation'' system, which would have allowed small and medium-size enterprises to apply the corporate tax rules of their home state to calculate taxable profits, after which those

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profits would be apportioned between member states and taxed at the applicable domestic rates; however, following public consultation, the CCCTB emerged as the leading contender to resolve the perceived problems and a working group was established in 2004 to help the commission develop the proposal. After much discussion and debate, a draft directive was finally published by the commission in March 2011, which proposed an optional CCCTB regime (that is, companies could choose whether or not to apply the regime).

This proposal met with significant opposition from a number of member states, including the U.K., and it was ultimately unofficially abandoned (the 2011 draft directive is still pending before the European Council but is expected to be withdrawn if the new proposals are approved). Some member states (including the U.K.) were concerned about losing the ability to determine corporate tax policy, and some believed (and still do) that any form of unitary taxation is a disguised attempt to reallocate tax revenues to larger jurisdictions.

However, in light of the OECD's base erosion and profit-shifting project and increasing global trends toward increasing tax transparency and eliminating mismatches between national tax regimes, the commission has decided the time is ripe for another attempt. Because previous attempts to introduce a CCCTB have failed, the commission's latest proposals involve two phases, to be governed by two directives: The first would introduce a common corporate tax base (CCTB) from 2019, and the second would bring consolidation rules into effect from 2021.

Unlike the previous attempt, the new proposals are intended to be mandatory for groups with an EU presence and global revenues exceeding €750 million per annum ($795 million), although companies that do not meet this threshold but are subject to an EU member state's corporate tax will be entitled to opt in to the regime.

Will It Succeed?

From a pure timing perspective, even allowing for the deferral of the consolidation proposal, the commission's proposals appear ambitious — the CCTB is proposed to apply from January 1, 2019, which allows only a period of two years for 28 member states to reach agreement on the terms of the proposal and implement it into national law. Considering the prior failures to reach agreement on a CCCTB and the continuing inability of a relatively small subset of member states to agree to the terms of a financial transaction tax (which is inherently much more straightforward than a CCTB), it seems that this is an unrealistic objective.

To complicate matters, this two-year window is expected to overlap with the two-year period for the U.K., which has previously been a principal opponent of a CCCTB, to negotiate its withdrawal from the EU once notification has been given under article 50 of the Treaty on European Union. It is not clear whether the U.K. would continue to oppose this contemplated (partial) harmonization of EU tax regimes in light of its intended departure from the EU, nor whether it would implement a CCTB if this portion of the commission's plan is agreed to for implementation with effect from a date earlier than the date the U.K. leaves the EU.

It is also important to note that, although the CCTB is capable of operating as a stand-alone proposal, the commission intends it to be followed by the introduction of consolidation rules to form the CCCTB. This is likely to influence the negotiation process for the CCTB, since member states will be cognizant that even if introducing a CCTB does not automatically lead to consolidation being introduced, support for a CCTB may give credence to the subsequent consolidation proposal, which the commission considers an essential element of the initiative.

Key Features of the Proposals

Key features of the CCTB proposal include:

- all revenues to be included in the corporate tax base, including dividend income and capital gains unless a participation exemption threshold of 10 percent is reached;
- profits from permanent establishments to be taxed only in the state in which they are situated;
- common rules regarding depreciation, valuation of assets, and transactions between related enterprises;
- an allowance for growth and investment permitting a deduction calculated by reference to increases in equity, which is intended to reduce the debt bias;
- tax incentives for research and development activities, including an enhanced super deduction for start-ups without associated enterprises;
- rules governing cross-border loss relief (available to parent companies on a time-limited basis; that is, the deductions claimed will be added back on the earlier of (i) the subsidiary/PE that surrendered the relief falling back into profit, (ii) entering the consolidation regime under the proposed CCCTB, or (iii) the end of the fifth year after the losses became deductible); and
- antiavoidance rules governing interest deductibility, controlled foreign companies, hybrid mismatches and exit taxes, and a general antiabuse rule (all largely modeled on the provisions of the antiavoidance directive agreed earlier to this year,

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save that the hybrid mismatches rules now extend to third-country mismatches).[1]

Key features of the consolidation proposal include:

- consolidation involving formulary apportionment (using a prescribed formula unless an alternative is agreed to by all relevant tax authorities), meaning that intragroup transactions are to be ignored and there will be no requirement to apply arm's-length transfer pricing;
- rules governing joining and leaving a consolidated group (for example, concerning use of losses, with pre-consolidation trading losses capable of being carried forward to set against profits apportioned under the CCCTB); and
- tax administration via a ''one-stop shop'' in a group's principal tax jurisdiction; that is, tax returns will be filed and tax accounted for in a single jurisdiction, which will allocate tax revenues in accordance with the prescribed/agreed formula, coordinate tax audits, and so forth.

Two-Stage Implementation Process

The explanatory memorandum to the CCTB proposal indicates that work on consolidation will be postponed until agreement is secured on the CCTB; however, the commission is submitting the two proposals for consideration simultaneously and as part of a single initiative, which obfuscates the question of whether agreement to the CCTB requires member states to agree to consolidation later.

From a procedural perspective, the CCTB and CCCTB proposals appear to be independent in that although the CCCTB proposal is inherently dependent on the CCTB proposal first being agreed to, it is technically open to member states to oppose the CCCTB proposal even if they have agreed to the CCTB proposal. However, the commission clearly sees the CCTB and CCCTB as two parts of a single process and appears to assume that both proposals will ultimately be agreed to by the member states, so member states would be advised to bear this in mind in their approach to the CCTB.

It is worth noting that the precedent for phased implementation of an EU-wide tax regime is not particularly favorable. In 1985 the commission put forward a proposal for a common and consolidated VAT regime with VAT revenues being allocated to member states through a central account; however, agreement could not be reached and a ''transitional'' VAT regime was introduced from 1993, which remains in force today because member states have been unable to agree on a ''definitive'' regime. This failed VAT proposal is analogous to the CCCTB proposal for centralized tax filing and payment in a consolidated group's principal state, which does not bode well for the CCCTB given that the transitional VAT regime has now been in place for more than 20 years and there were noticeably fewer member states then.

There are specific challenges associated with the phased implementation of the proposals. In particular, both proposals include the ability for companies or groups that do not meet the threshold for mandatory application of the regimes but are subject to an EU member state corporate tax to opt in. However, an election to opt in to the regime lasts for five years; given that the two directives are expected to enter into force two years apart, that could result in a company or group being eligible to opt out of the common base while still being subject to consolidation.

It also appears to be possible to opt in to the CCTB but not the CCCTB or vice versa — the commission may intend companies or groups to have the ability to opt in to the CCTB without also opting for consolidation (although the fact that loss relief and recapture rules under the CCTB are stated to cease to apply when the CCCTB comes into effect suggests this is unintended), but it is nonsensical for companies or groups to have the ability to opt in to consolidation without also applying the common base.

Interaction With Non-EU Tax Systems

A key aspect of the CCCTB proposals is harmonization, since this is considered important to prevent double taxation or double nontaxation, discourage aggressive tax planning, and prevent tax incentives from distorting the functioning of the internal market. However, there is no proposal to harmonize corporate tax rates within the EU, meaning the introduction of a CCCTB could well lead to a ''rates race,'' with jurisdictions competing to attract business by having the lowest rates. In turn, if this results in corporate tax rates within the EU falling relatively to non-EU corporate tax rates, this could distort business decisions in favor of EU jurisdictions, thus taking business away from non-EU jurisdictions and altering the current tax balance.

Another fundamental aspect of the CCCTB proposal is formulary apportionment of profits between EU jurisdictions using a prescribed formula (unless this is considered unfair and an alternative is agreed to between all relevant tax authorities, which seems unlikely given the competing interests in the outcome of the apportionment). However, for multinational groups that span both EU and non-EU jurisdictions, it is worth noting that there is no provision addressing how transfer pricing should operate between group members within the EU (using formulary apportionment) and group members outside the EU (likely to be applying the arm's-length principle, as preferred by the OECD and recently reaffirmed as part of the BEPS project).

[1] *See* ''The EU Anti-Tax-Avoidance Directive,'' *Tax Notes Int'l*, Sept. 5, 2016, p. 881.

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There are other ways in which the current proposals do not fully address multinationals that span EU and non-EU jurisdictions. In particular, we note that:

- the PE definition in the draft directive (which corresponds to the BEPS action 7 recommendations in substance, if not wording) only applies to intra-EU relationships (that is, it does not apply to non-EU PEs of EU companies or vice versa);
- non-EU resident entities are stated to be subject to corporate tax only on income from activities carried on through a PE in a member state, which cuts across other rules imposing corporate tax on nonresidents (for example, the U.K. rules regarding trading in or developing U.K. land) and may present an obstacle to agreement; and
- the rule stating that profits and losses from intragroup transactions should be ignored assumes that all group members are within the consolidation net, whereas any non-EU group members will not be consolidated (and presumably intragroup transactions with such entities should be included).

Multinationals with group members both inside and outside the EU would therefore be advised to monitor the proposals as they progress.

Conclusion

It is clear that the CCTB and CCCTB proposals present many challenges, not just in achieving international consensus (let alone within the commission's proposed time frame) but also in the interaction of the proposals, how they will be applied in practice, and how they will interact with non-EU tax regimes where multinationals with both EU and non-EU members are concerned. It is not immediately obvious that the latest proposals will have any greater success than their predecessors, but only time will tell. ◆

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