C(C)CTB
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Agenda

- Introduction
- Determination of the tax base
- Anti tax avoidance legislation
- Consolidation and allocation
- One-stop-shop
- Political and practical perspectives

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Introduction

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Challenges – The Current System

- 28 domestic tax systems within the EU.
- Increasing number of international tax disputes.
- Risk of and actual double taxation.
- Vulnerable to aggressive tax planning.
- Administrative burdens.
- Language and cultural barriers.

CCCTB in a Nutshell

- Single set of rules to determine companies’ taxable income within the EU.
- Consolidation of all activities within the EU.
- Allocation of taxable income using an apportionment formula.
- The allocated taxable income will be taxed at the national tax rate.

History and Background

- Longstanding efforts to harmonize:
  - Neumark Report (1963).
  - Tempel Report (1970).
  - Ruding Committee Report (1992).
- Working papers published in 2007/2008.
- CCCTB-directive proposed in 2011.
- New directive proposals in October 2016.

History and Background

- Purpose: Improve the internal market:
  - Reduce the administrative costs to companies:
    - Single set of rules for all MS.
    - One-stop-shop principle.
  - Companies may offset losses in one MS against profits in another.
  - Reduce risk of double taxation.

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Why a New Proposal Now?

- Increased focus on fair and effective taxation:
  - The European Commission’s action plan, June 2015.
- Re-branding of the idea in a new context:
  - The fight against tax avoidance and aggressive tax planning.
  - The post financial crisis growth agenda.
- The CCCTB directive shall also:
  - Eliminate mismatches and mitigate tax avoidance etc.
  - Create transparency and reduce harmful tax competition.
  - Promote investment and growth.

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Overview

- Two proposals:
  1. CCTB, COM(2016) 685 final:
     - Single set of rules to determine the tax base.
  2. CCCTB, COM(2016) 683 final:
     - Consolidation and allocation.
- Divided in order to facilitate progress in the negotiations.
- Agreement on consolidation and allocation expected to be difficult.
- Expected timeline:
  - CCTB: Entry into force, 1 January 2019.
  - CCCTB: Entry into force 1 January 2021.

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Determination of the Tax Base

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Scope and Definitions

- A company shall cease to be subject to national corporate tax law in respect of all matters regulated by the directive, unless otherwise stated.
- Mandatory for corporations and PEs in MSs, if:
  a) Listed in annex 1,
  b) Subject to tax mentioned in Annex 2,
  c) For accounting purposes belong to a group with a consolidated turnover > EUR 750,000,000, *and*
  d) Constitute a parent company or a qualified subsidiary.
    - Voting rights > 50%, *and*
    - Capital/profit share > 75%.
- PE concept in line with updated OECD version.
- Other companies can opt to apply the rules for 5 years at a time, if covered by a) and b).
- Exempt if covered by a tonnage tax regime.

Elements of the Tax Base

- Realization principle.
- Elements of the tax base:
  - Revenues ÷ exempt revenues, deductible expenses and other deductible amounts.
- Exempt revenues – "Principle of territoriality":
  - Gains/losses relating to the disposal of subsidiary shares.
  - Dividends from subsidiary shares.
  - Income from PE.

Elements of the Tax Base

- Deductible expenses:
  - Expenses shall be deductible only to the extent that they are incurred in the direct business interest of the taxpayer:
    - Includes all costs/expenses that the taxpayer incurred with a view to obtaining and securing income, including R&D and costs of funding.
    - 50% additional deduction for R&D ≤ EUR 20 million (if > EUR 20 million → 25% additional deduction).
    - Super deduction for start-ups: Extra 100% deduction for R&D ≤ EUR 20 million.

- Other deductible amounts:
  - Depreciation of fixed assets (see below).

Elements of the Tax Base

- Allowance for growth and investment (AGI).
  - EU wide Allowance for Corporate Equity (ACE):
    - Tackle debt bias.
    - Widely endorsed by the EU Commission but only used in a few countries.
  - **Yield** on the **AGI equity base increases** shall be deductible from the tax base of the tax payer.
  - **Decrease** in AGI equity base shall be taxable.
  - Defined yield:
    - Equal to the euro area 10-year government benchmark bond in December of the year preceding the relevant tax year + a risk premium of 2%-points.
    - Floor of 2%.

Elements of the Tax Base

- Allowance for growth and investment (AGI) - continued.
  - AGI equity base:
    - Difference between the equity of a tax payer and the tax value of its participation on the capital of associated enterprises.
    - Calculated as the difference between AGI base at the end of the year and on the first day of the year (for the first 10 years).
  - Equity:
    - Capital and reserves defined in accounting directives.
    - Equity as defined in IFRS used within the EU.

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Elements of the Tax Base

- Allowance for growth and investment (AGI) - continued.
  - Commission delegated to adopt acts against tax avoidance, e.g.:
    - Intra group loans,
    - Cash contributions and in kind contributions,
    - Transfers of participations,
    - Re-categorization of old capital as new capital,
    - Creation of subsidiaries,
    - Acquisitions of businesses held by associated enterprises,
    - Double dip structures, and
    - Increase of amount of loan financing receivables.

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Elements of the Tax Base

- Non-deductible items:
  - Profit distributions and repayment of equity/debt.
  - 50% of entertainment costs.
  - Transfer of retained earnings to a reserve (equity).
  - Corporate tax and similar taxes on profits.
  - Bribes and other illegal payments.
  - Fines and penalties.
  - Expenses incurred for the purpose of deriving exempt income.
  - Gifts and donations:
    - MS may provide for the deduction of gifts and donations to charitable bodies.
  - Acquisition and construction costs (except for R&D).
  - Losses incurred by a PE in a 3rd country.

Elements of the Tax Base

- Income from transparent entities:
  - If an entity in a MS is transparent according to the rules of that MS → Taxpayer shall include its share of the entity's income.
    - The income should be calculated according to the rules of the directive.
  - Entities located in 3rd countries → Determination of transparency or not to be made in accordance with the law of the MS of the taxpayer.

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Timing and Quantification

- Main rule:
  - Revenues, expenses and other deductible items, shall be recognized in the tax year in which they accrue or are incurred:
    - Accrual at the moment that the right to receive the revenues has arisen and the revenues can be measured reliably.
    - Deductible expenses are incurred at the moment the obligation to make the payment has arisen and the amount can be quantified with reasonable accuracy.
- Several specifications and special provisions.

Depreciation of Fixed Assets

- Depreciation shall be deducted by the economic owner:
  - If the economic owner cannot be identified → the legal owner.
  - Commission empowered to adopt delegated acts.
- No depreciation: Financial assets and assets not subject to wear, tear and obsolescence.
- A full year's depreciation in the year of acquisition or entry into use, whichever comes later.
- No depreciation in the year of disposal.
- Rollover relief possible for replacement assets.

Depreciation of Fixed Assets

- Forced, linear and individual depreciation of:
  - Commercial, office and other buildings → 40 years.
  - Industrial buildings and structures → 25 years.
  - Other long-life fixed tangible assets → 15 years.
  - Medium-life fixed tangible assets → 8 years.
  - Fixed intangible assets → remaining period of legal protection or 15 years.
  - Second-hand assets → Possibility of shorter depreciation period.
- Other fixed assets → Pooled together, 25% annually of depreciation base.
- Commission empowered to adopt delegated acts to define more clearly the categories of fixed assets.

Losses

- Losses:
  - Infinite loss carryforwards for resident taxpayer and PE of a non-resident taxpayer.
    - Oldest loses shall be deducted first.
  - No carry-back (no negative amount).
  - Restricted loss carryforwards, if:
    - Change of control.
    - Major change of activity (more than 60% of turnover).

Losses

- Losses – Continued.
  - Temporary access to deduct losses in qualified subsidiaries and PEs:
    - If taxpayer is still profitable after having deducted own losses.
    - Incurred in the same year.
    - In proportion to the holding.
    - Not result in negative amount.
    - Rules on ordinary and extraordinary recapture:
      - Max. 5 years of "credit" hereafter full inclusion.
      - Full inclusion upon sale, winding up or transforming into a PE.
      - Sale of PE, winding up or transforming into subsidiary.
      - No longer parent company.
  - Losses and the Marks & Spencer Doctrine?

Entering and Leaving the CCTB

- All assets and liabilities shall be recognized at their value, as calculated in accordance with national tax rules immediately prior to applying the directive.
- Specific rules dealing with the transition (entry/exit) of:
  - Fixed depreciable assets, long-term contracts and provisions.
- Pre-entry losses may be deducted from the tax base if and to the extent that national legislation allows this.
- Unrelieved losses incurred under the application of the directive shall be carried forward in accordance with national corporate tax law.

Relief for Double Taxation

- Double taxation relief.
- Credit relief shall be allowed where the taxpayer derives income that has been taxed in another MS or in a 3rd country:
  - Decreased by related deductible expenses.
  - 3rd countries: Credit may not exceed the final corporate tax liability, unless an agreement between the countries states otherwise.

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Anti Tax Avoidance Rules

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Switch-over Clause

- Switch over from exemption-relief to credit-relief:
  - Participation exemption of distributions from 3rd country entities.
  - Participation exemption proceeds from disposal of shares in a 3rd country entity.
  - Income from 3rd country PEs (principle of territoriality).
- Low taxation requirement:
  - Statutory corporate tax rate lower than 50% of the statutory tax rate in the MS of the taxpayer.
  - Legal consequence: Taxpayer shall be subject to tax on the foreign income.
  - Credit-relief for tax paid in 3rd country (ordinary credit).
  - Not apply if tax treaty prevents a switch-over clause.
- Not applicable to:
  - Losses from the disposal of shares.

Switch-over Clause

- Comment:
  - Aiming at too generously applied tax-exemption regimes.
  - Impact?
    - Tax incentives on rate (but not on tax base).
    - E.g. permanent establishment in Dubai.
    - Potential double taxation: Low tax subsidiary owns high tax lower tier subsidiary.

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Transfer Pricing

- Associated enterprises:
  - Taxpayer participating in the management (significant influence), control (20% of voting rights) or directly or indirectly in the capital (20% of capital), of:
    - A non-taxpayer, *or*
    - A taxpayer that is not in the same group.
  - The two enterprises shall be regarded as associated enterprises.

Transfer Pricing

- Transfer pricing adjustments.
  - Arm’s length principle:
    - Different wording than OECD MC article 9:
      - Primary adjustment.
      - Secondary or corresponding adjustment?
    - PEs:
      - Separate entity approach.
      - Same or similar conditions, taking into account the functions performed, assets used and risks assumed.

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Exit Taxation

- Exit tax on an amount equal to the market value of the transferred assets less their value for tax purposes:
  - At the time of exit.
  - Transfer of assets from PE in a MS to head office in another MS or 3rd country.
  - Transfer of assets from PE to head office or another PE in another MS or 3rd country - if exit state does not have the right to tax.
  - Transfer of tax residence – except assets connected to PE.
  - Transfer of business carried out by PE between MS or to 3rd country – if PE state cannot tax the transferred assets.
- No mentioning of deferral, interest or guarantee.
- Entry value equals market value in the recipient state (step-up).
- Certain exemptions for *temporary* transfers of assets.

Interest Limitation Rule

- Borrowing costs up to the amount of interest etc. received is fully deductible.
- Exceeding/net borrowing costs.
  - Broadly defined.
- Limitation: 30% of EBITDA (tax) *or* for a maximum of EUR 3 million whichever is higher.
  - Option to fully deduct exceeding borrowing costs for a stand alone entity.
- Application at group level if entity member of group, which may opt for tax consolidation.

Interest Limitation Rule

- Carry forward.
  - Infinite carry forward of restricted borrowing costs.
- Financial undertakings are exempt.
- Exempt loans:
  - Concluded before political agreement.
  - Long term public infrastructure projects within the EU.

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CFC-Legislation

- Very similar to model A of the ATAD CFC rule:
  - Wide control test: > 50% of voting rights, capital or profits.
  - 50% effective tax rate threshold.
- Applicable to subsidiaries and PEs – but not applicable:
  - Intra-EU/EEA if set up for valid economic reasons.
  - If ”tainted income” ≤ 1/3 of total income.
  - To financial undertakings if ”tainted” income from group companies ≤ 1/3 of “tainted income”.
- Tainted income: Broadly defined.
- Legal effect:
  - Parent company shall include the specifically mentioned non-distributed income (“tainted income”).
  - Calculation in accordance with the rules of the directive.
  - Inclusion, in accordance with the parent’s entitlement to profit.
  - Relief provisions.

Hybrid Mismatches

- Definition:
  - A situation between a taxpayer in one MS and an associated enterprise in another MS/3rd country, *OR*
  - A structured arrangement between parties in MS.
  - Where double deduction or deduction non-inclusion is caused by differences in the legal characterization of a financial instrument or entity, or in the treatment of a commercial presence as a PE.
- Double deductions:
  - A deduction of the same payment, expenses or losses occurs in both MSs or MS and 3rd country.
  - The deduction shall be given only in the MS where such payment has its source, the expenses are incurred or the losses are suffered in another MS.
  - 3rd countries: MS shall deny deduction.

Hybrid Mismatches

- Deduction non-inclusion:
  - There is a deduction of a payment in the MS in which the payments has its source without a corresponding inclusion for tax purposes of the same payment in the other MS.
  - The MS of the payer shall deny the deduction of such payment.
  - 3rd country:
    - Deny deduction.
    - Include income.
- PEs.

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- Legal effect:
  - Arrangements etc. shall be disregarded for the purposes of calculating the corporate tax.
    - Calculated by reference to economic substance.
- Requirements:
  - "Arrangement or series thereof".
    - An arrangement may comprise more than one step or part.
  - Having been put in place for the essential purpose of obtaining a tax advantage.
  - That defeats the purpose or object of the otherwise applicable tax provision.
  - "Non-genuine".
    - Not put into place for valid commercial reasons, which reflect economic reality.
- Tax authorities should carry the burden of proof.

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Consolidation and Allocation

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Consolidation and Allocation

- Stage 2.
- The tax bases of all members of a group within the EU shall be added together into a consolidated tax base.
  - Intra-group transactions are eliminated.
  - No withholding taxes or other source taxes should be imposed on intercompany transactions.
  - As a main rule business reorganizations within the group shall not give rise to profits or losses.
  - If negative tax base → Carried forward and offset against any subsequent and positive consolidated tax base.
- If positive tax base: Allocation by formula.

Formula Apportionment

$$\text{Share A} = \left(\frac{1}{3}\frac{\text{Sales}^{A}}{\text{Sales}^{Group}} + \frac{1}{3}\left(\frac{1}{2}\frac{\text{Payroll}^{A}}{\text{Payroll}^{Group}} + \frac{1}{2}\frac{\text{No of employees}^{A}}{\text{No of employees}^{Group}} \right) + \frac{1}{3}\frac{\text{Assets}^{A}}{\text{Assets}^{Group}} \right) * \text{Con'd Tax Base}$$

- Formula based on company-specific factors:
  - Sales (destination-based).
  - Labor (payroll and number of employees).
  - Assets (fixed tangible assets).
- Safeguard clause:
  - If the formula does not fairly represent the business activity of a group member, one may request use of alternative formula – agreement required.
- Special industry-specific rules:
  - Financial institutions, insurance, oil & gas, shipping and air transport.
- Commission may lay down detailed rules.

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One-stop-shop Principle

- One-stop-shop principle.
  - Groups should be able to deal with one single tax administration.
- Principal tax authority:
  - The competent authority of the MS in which the principal taxpayer is resident for tax purposes.
  - Initiates and coordinates audits.

One-stop-shop Principle

- Principal taxpayer:
  - Main definition: A resident taxpayer that forms a group with its qualifying subsidiaries, with one or more PEs located in MS, or with one or more PEs of a qualifying subsidiary located in a 3rd state.
  - Shall give notice to the principal tax authority upon creation of a group.
  - Shall file the consolidated tax return with the principal tax authority.
- Administrative and judicial appeals.
  - Should be made to the administrative body or court of the MS of the principal taxpayer.

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Political and Practical Perspectives

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Political Perspectives

- The proposals have to be unanimously adopted.
- Some national parliaments have raised formal objections → Not in line with principle of subsidiarity:
  - Ireland, Malta, The Netherlands, Luxembourg, Sweden and Denmark.
  - Not enough for the evocation of the ”yellow card procedure”.
  - True concerns or ”bad excuses”?
- Will be difficult to reach agreement unanimously (soon):
  - But: The Commission has some momentum.
  - ”Enhanced corporation procedure” a possible alternative.
- The current Maltese presidency intends to start examination of the CCTB proposal with a view to stabilise the text by the end of June 2017.

Political Concerns

- Loss of tax sovereignty:
  - Loss of flexibility and of tax system as MS policy tool.
  - Loss of possibility to ”undercut” each other.
- Possible decline in tax revenues for some MS.
  - More narrow tax base?
- The allocation formula not fair:
  - May favor larger MS with manufacturing industries and huge consumer markets?
  - ”Old school formula” not taking intangibles into account.
- Risk of facilitating a race to the bottom on tax rates.
  - Some MS asks for a minimum tax rate.

Practical Concerns

- Transfer pricing issues still present with respect to 3rd countries:
  - Unclear how much be the administrative burden will be reduced.
  - ”Transitional costs” for businesses and authorities.
- The rules of the proposals are not as detailed/comprehensive as the national tax codes:
  - Initially, no case law will be available.
  - Will MS, tax authorities and courts be able to interpret the rules consistently?
  - How will the Commission use its competence to adopt delegated acts?
- What if stage 1 is adopted but not stage 2?

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Benefits

- Only one set of rules!!!
- Only one tax authority to deal with.
- Risk of double taxation significantly reduced.
- Cross-border loss utilization.
- Fully coordinated anti-avoidance rules.
- Higher transparency of tax systems.
- Enhanced stability, as changes require unanimity.

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