Q&A

The relaunched common consolidated corporate tax base

Speed read

On 25 October 2016, the European Commission relaunched its proposal for a common consolidated corporate tax base (CCCTB). Under the new proposal, the CCCTB would be implemented in two stages: first, the creation of a common corporate tax base (CCTB) to harmonise the calculation of taxable profits across member states; and second, the consolidation of this tax base into the CCCTB to allocate the tax base between EU member states. The radical nature of the CCCTB means that it will struggle to obtain the required unanimous agreement. The CCTB is less radical, but has considerable disadvantages for taxpayers and tax authorities, with few obvious benefits. Businesses should keep a watching brief but take no steps for now.

Dan Neidle

Clifford Chance

Dan Neidle is a partner at Clifford Chance, specialising in the UK and international tax treatment of corporate and financial transactions. He has particular experience advising on restructurings, corporate and portfolio disposals, acquisition and structured finance transactions. Email: dan.neidle@cliffordchance.com; tel: 020 7006 8811

What is the CCCTB?

The CCCTB is a single set of rules that companies operating in the EU would use to calculate their taxable profits, rather than national tax rules. The profits would then be allocated between member states on a formulary apportionment basis by reference to employees, assets and sales in each member state. Each member state then applies its own tax rate to the profits allocated to it. Member states would therefore retain sovereignty over corporate tax rates, but most other aspects of corporate profits taxation would become an EU competency.

The idea for a harmonised EU corporate profits tax dates back almost a quarter of a century, to the *Ruding Report*, produced for the Commission in 1992 by the Institute for Fiscal Studies. The policy has since been the subject of various Commission communications, including *Towards an internal market without tax obstacles* (2001). A Commission Working Group was set up in 2004, and a Commission CCCTB legislative proposal was finally published in March 2011.

This was, however, highly controversial. Some member states (and, in particular, the UK) were opposed in principle, on the basis that member states would cease to be able to determine most questions of corporate tax policy. Other member states were concerned that unitary taxation would have the overall effect of shifting tax revenues and employment from smaller countries to larger countries (see *Study on the economic and budgetary impact of the introduction of a common consolidated corporate tax base in the European Union*, commissioned by the Irish Department of Finance from EY in 2011).

Hence, the 2011 proposal did not proceed. The Commission has now published a revised CCCTB proposal in an attempt to revitalise the process.

What is the Commission proposing?

Under the Commission's new proposal, the CCCTB would be implemented using a two stage approach:

- **Step 1 (CCTB Directive):** the creation of a common corporate tax base by establishing standardised rules which each member state would apply in order to calculate a taxpayer's taxable profits. Allocation between member states would remain on the traditional basis of residence, permanent establishment and transfer pricing.
- **Step 2 (CCCTB Directive):** the consolidation of EU groups' profits and losses and the allocation of profits to individual member states using an apportionment formula. Note that the CCCTB does not apportion the tax-adjusted profits in a group's consolidated accounts; rather, it requires that the tax-adjusted profits from the individual accounts in each operating jurisdiction are aggregated. Tax-adjusted profits are determined in broadly the same manner as under the CCTB rules.

The intention is that step 1 would be implemented; and only then would work begin to seek political agreement for step 2. Presumably, the Commission is hoping that the CCTB will be sufficiently successful that political opposition to the CCCTB will diminish.

How does the new proposal differ from the 2011 proposal?

The key changes, reflected in both CCTB and CCCTB, are:

- The CCTB and the CCCTB rules would be mandatory for large multinational groups with consolidated annual revenues exceeding €750m.
- An R&D incentive has been included, which would allow taxpayers to deduct (in addition to a regular deduction) an additional 50% of R&D costs up to €20m, and 25% of any amount exceeding this. Start-ups would be eligible for an 'enhanced super-deduction', which would allow them to deduct up to 200% of their R&D costs (up to a maximum of €20m).
- The proposal seeks to reduce the 'incentive for debt accumulation' by proving a limited deemed deduction for equity (an 'allowance for growth and investment') and imposing heavy restrictions on interest deductibility. Net borrowing costs would only be deductible up to the maximum of 30% of a taxpayer's EBITDA or €3m. There is an exemption for debt funding for long term public infrastructure profits but there is no general safe harbour for external debt, similar to the proposed BEPS Action 4 group ratio rule. However existing debt is grandfathered, which will create a substantial incentive for businesses to retain old loan facilities/bonds.
- The proposal includes a BEPS Action 2 style hybrid mismatch rule, similar to that in the Anti-Tax Avoidance Directive (ATAD) but extended to apply to payments to/from outside the EU.
- Taxpayers are exempt from tax on dividends received, subject to a 'switch-over rule' of the kind considered but rejected for the ATAD. The effect of the rule is to fully tax dividends received from a company in a third country, where the tax rate is less than half that of the taxpayer state (subject to a credit for foreign tax paid).

How would the common tax base be calculated?

The general principle is that all revenues are taxable unless expressly exempted. The CCTB/CCCTB rules calculate the tax base by taking 'revenues less exempt revenues, deductible expenses and other deductible items':

- Exempt revenues: These include income consisting of dividends and sale proceeds from the disposal of shares held in a company outside the group, where the taxpayer has a minimum participation of 10%.
- Deductible expenses: These include the new deductions for R&D costs (as described above).
- Other deductible items: These include deductions for depreciation of fixed assets. Long-life and medium-life assets are depreciated individually, whilst others will be placed in an asset pool (annual rate of 25% of the depreciation base).

As with the 2011 proposal, taxpayers would be able to carry forward losses indefinitely, but losses cannot be carried back. The CCTB Directive includes transitional cross-border loss relief provisions, pending the implementation of the CCCTB Directive.

Which entities would be included in the mandatory grouping criteria?

A resident taxpayer that meets the mandatory enrolment criteria (i.e. consolidated revenues of over €750m) would be required to form a group with:

- all of its own and its qualifying subsidiaries' permanent establishments situated in a member state;
- all qualifying subsidiaries that are tax resident in a member state; and
- other resident taxpayers and permanent establishments that are qualifying subsidiaries of non-resident taxpayers.

'Qualifying subsidiaries' would be determined in accordance with the following two part test:

- a minimum control test (i.e. more than 50% of the voting rights); and
- a minimum ownership test (i.e. more than 75% of the company's capital *or* more than 75% of the rights giving entitlement to profit).

How would the consolidated tax base be apportioned?

Under the CCCTB Directive, the tax bases of all group members would be added together to form a consolidated tax base. Where this amount is negative, this loss would be carried forward. Where the amount is positive, the consolidated tax base would be apportioned between the different members of the group (and therefore the relevant member states) using an apportionment formula. Member states would then apply their own tax rate to the relevant apportioned amounts.

The formula (shown above right) comprises three equally weighted factors:

- assets (all fixed tangible assets, but not intangible assets or financial assets);
- labour (half allocated to payroll and half to number of employees); and
- sales.

Intangible and financial assets are said to be excluded from the formula due to their mobility, to avoid the risk of circumventing the system. This, of course, creates obvious anomalies for the financial sector and businesses, dependent on intellectual property. (This is discussed further below.)

Is there a one-stop shop?

Under the CCCTB proposal, each group would be represented by a single group member (the principal taxpayer). The principal taxpayer would then only deal with one tax administration (the 'principal tax authority'), which would be the tax authority in which it is tax resident.

Audits would be initiated by the principal tax authority. However, other member states in which group members are resident may also request the initiation of an audit.

Any disputes between taxpayers and tax authorities would be heard by an administrative body which is competent to hear appeals at first instance under the laws of the member state of the principal tax authority.

Formula for apportionment of consolidated tax base

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

What are the benefits?

The Commission sees two key benefits for the CCCTB.

The first is countering tax avoidance by eliminating 'mismatches and loopholes between national systems, which companies currently can exploit to avoid taxation'. The Commission suggests that the CCCTB would eliminate 70% of profit shifting for tax purposes.

The second is reducing the administrative burden of compliance costs that companies face when dealing with 28 national tax systems, in particular transfer pricing rules. The Commission has estimated that time spent on annual compliance could be cut by 8%, whilst the time taken to set up a subsidiary would decrease by up to 67%.

The Commission believes the same benefits apply to the CCTB (to a lesser degree).

What are the problems with the CCCTB?

The difficulties with unitary tax systems such as the CCCTB have been discussed in the literature for many years.

Perhaps the most significant challenge is the practical one of agreeing a formula that is acceptable to all parties, particularly given the expectation that smaller member states will lose tax revenues and employment. It would therefore be most surprising if the CCCTB achieves the required unanimity. (It should also be noted that even the US states have been unable to agree consistent apportionment rules.)

Leaving aside the minor detail that the CCCTB will likely not be adopted, it suffers from two fundamental conceptual problems.

First, it will, of course, only apply within the EU. Therefore, traditional transfer pricing and permanent establishment concepts would have to be applied at the 'water's edge', where EU entities transact with affiliates outside the EU. Profit shifting could still occur between the EU and the US, Asia and (critically) tax havens. Hence, the Commission's claim that 70% of profit shifting would be eliminated is correct only if one limits the frame of reference to intra-EU profit shifting (and this has been accepted by the Commission). It is, therefore, questionable quite how effective the CCCTB would be at reducing tax avoidance, compared to the *status quo* plus BEPS.

Second, the current international tax system, flawed as it is, attempts to attribute corporate profits to jurisdictions by reference to where the profit arises. The CCCTB instead attributes corporate profits to jurisdictions on a basis that is entirely unconnected with the extent to which profit actually arises in those jurisdictions. This would have a number of anomalous and distortive effects.

For example, a business owning its headquarters building in London would have more profit allocated to the UK as UK real estate rises in value (and vice versa). A business expanding into a new territory might expect to make losses in the early years, but the labour force and sales in that territory would result in a profit allocation towards that territory and away from its profitable territories (and, if the new territory has a higher tax rate, that might discourage such expansion altogether). Tax competition and tax avoidance will still exist, but the fact it will necessitate the movement of assets and personnel would seem to have a more deleterious effect on high tax member states than existing tax competition.

What are the problems with the CCTB?

If one accepts the proposition that the CCCTB will not proceed, then the CCTB should be judged on its own merits. These seem, to the author, to be limited.

The harmonisation intended by the CCTB is only very partially achieved. The proposed CCTB Directive contains just 43 pages of provisions, compared to the many thousands of pages of most member states' existing tax codes. Therefore, there would need to be either detailed (non-harmonised) implementation rules in each member state, or alternatively for the CCTB to modify (rather than replace) existing legislation. Either way, there would still be 28 different tax systems, and it is therefore difficult to see material compliance savings for business.

The other objective – that of reducing tax-avoidance – has been in large part overtaken by BEPS. Indeed, it is not obvious what tax avoidance is permitted by BEPS but prevented by the CCTB. The one area where the CCTB goes further is in restricting interest deductibility. However, the author would query whether the Commission has really thought through the consequences of what is (in large part) a complete bar on interest deductibility of even third party debt. The merits of a proposal of this kind were extensively debated during the BEPS Action 4 process, and attracted very little support amongst OECD members.

Furthermore, the 'cliff edge' effect of suddenly barring interest deductibility when a taxpayer's revenues reach €750m seems very hard to justify.

What is the likely outcome?

In the absence of Brexit, it would have been expected that the UK would veto both the CCCTB and the CCTB. However, it now seems unlikely that the UK would block a measure which would not take effect until some time after the UK had left the EU. The interesting question is which (if any) of the member states instinctively opposed to further harmonisation will use its veto.

The smaller member states most adversely affected by the CCCTB may feel under considerable political pressure not to veto. Hungary and Poland may not be concerned by such sensitivities. Either way, the author sees the CCCTB's prospects as essentially hopeless, and the CCTB's prospects as very dim in their current form.

In principle, the CCTB or even the CCCTB could be adopted by nine or more member states using the 'enhanced cooperation' procedure (as currently being discussed in the context of the proposed EU financial transaction tax). It is, however, unclear whether such an approach would be compatible with the EU fundamental freedoms.

What steps should businesses be taking now?

Given the reasonably remote prospects of either the CCCTB or the CCTB being adopted, the author would suggest that it is premature for business to take any steps to prepare for either tax. Clearly, that would change the moment when either proposed Directive receives approval from the Council of Ministers. At that point, it would be prudent for businesses with a turnover of (or approaching) €750m to commence a detailed technical and compliance/systems exercise (notwithstanding that many questions as to the scope of the tax would remain to be resolved). Businesses with a smaller turnover can afford to wait until the details become clear, and then start to assess whether they would potentially benefit from opting into the CCTB/CCCTB. ■

The author thanks Becky Wall for her assistance with this article.

For related reading visit www.taxjournal.com

- Next steps in corporate tax policy: an EU perspective (Stephen Quest, 13.10.16)
- Examining the revised EC Anti-Tax Avoidance Directive (Tom Wesel & Zoe Wyatt, 7.7.16)
- The EC's anti-tax avoidance package (Heather Corben, 3.2.16)
- 30 questions on BEPS (Jill Gatehouse & Susanna Brain, 29.10.15)
- Examining the 2011 CCCTB proposals (Peter Cussons, 9.3.11)

Report

Finance Act 2016: a summary of the provisions

Claire Hooper
EY
Claire Hooper is an international tax partner and head of technical policy and knowledge at EY. She is also a member of the CBI Taxation Committee and the CIOT corporate tax and international tax committees. Email: chooper@uk.ey.com; tel: 020 7951 2486.

Finance Act 2016 received royal assent on 15 September 2016. The Act implements tax changes not only announced at Budget 2016 but also some first raised in Autumn Statement 2015 and Summer Budget 2015. As such there is a wide range of effective dates for these provisions, many of which are before the date of royal assent. The increasing volume of consultations, with more announcements expected in the Autumn Statement on 23 November, taken together with this pattern of committing to changes from particular dates with legislation following later, makes it increasingly difficult for taxpayers to keep up to date. Not only does the Finance Act have to be reviewed to check what has now been enacted (and in what final form given the amendments that might have been made), but they also have to monitor the effective date for legislation in case it is earlier than expected (and before the legislation has been formally enacted). Draft clauses for Finance Bill 2017 will be published in just over a month.

The Act received the usual scrutiny before the Public Bill Committee but that scrutiny started later than usual, with the first sitting taking place after the EU referendum. There were a number of changes put forward not only as committee stage amendments but also as report stage amendments and this article looks particularly at some of the areas of legislation that developed through amendments. These include the new rules to tackle hybrid mismatch