Seminar on *Transfer Pricing: Alternative Methods of Taxation of Multinationals*

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The Common Consolidated Corporate Tax Base (CCCTB) in Europe

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A New Approach to TNC Taxation?

From League of Nations to OECD to UN Committee

Carroll Report 1935: Global Apportionment `politically impossible'
Havens problem: US Subpart F >>> OECD CFC Rules
ALP: US Regs. 1968 >>> OECD TP Guidelines 1979
US 1986 Tax Reform: intangibles `commensurate with income'
Variety of `methods' - transaction pricing or profit split?
System disfunctional: could UN now investigate alternative?

Unitary Taxation

Tax TNCs on **consolidated** basis
Would deal with **both** havens **and** TP problems

CCCTB: EU Policy since 2001

2004 `non-paper '
2005 Working Group (reps of MS experts, + academics & business), 13 meetings to 2008.
2007 Communication & Working Paper (proposed IASB Standards)
2011 February Franco-German Competitiveness Pact urged `creation of common assessment basis for corporate income tax', & asked Commission to bring forward proposals.
2011 March Commission proposed CCCTB Directive
April 2012 Approved by Parliament with amendments

Next Steps for CCTB

ADOPTION FOR EU AS A WHOLE?

Would need **unanimous** approval
Commission: **may** adopt Parliament's amendments
Council technical scrutiny, then onto Agenda
(opposition likely from Bulgaria, Ireland, Malta, Poland, Romania, Slovakia, Sweden, Netherlands , UK)

IF THIS FAILS

Council could decide to proceed by
`**enhanced cooperation procedure**' [urged by Parliament]
Would need new proposal by Commission
Support by minimum of 9 states
Must be open to others
Further opportunity for consultation of Parliament

IF ADOPTED

Directive: implemented by national legislation (transition period)
Review 5 years after entry into force

What is It?

COMMON RULES for

- **calculating** tax results of each company/branch
- **consolidation** of results for members of a group (eliminating intra-group transactions) &
- **apportionment** of consolidated tax base to each eligible MS

Companies & groups opting-in would

- apply a single set of tax rules across the EU
- deal with only one tax administration (one-stop-shop)

Companies not qualifying or not opting-in

- remain subject to the national corporate tax rules including specific tax incentive schemes
- (could create competition between CCCTB & national rules)

Complete set of rules for company taxation:

- who can opt
- how to calculate the taxable base
- perimeter and functioning of the consolidation
- anti-abuse rules
- apportionment of consolidated base to Member States MSs
  - (3-factor Formula: Sales/Labour/Assets)
- administration by MSs under 'one-stop-shop' approach

Scope of Application

ELIGIBILITY

companies tax resident in the EU
EU-located branches (PEs) of 3rd-country companies
if company of type listed in Annex I (similar if 3rd-country)
& if subject to tax listed in Annex II (similar if 3rd-country)
No size requirement

OPTIONALITY

Commission: should not force companies not planning to expand beyond national territory to bear the cost of new tax system
Impact Assessment:
`optional & compulsory both result in slightly higher welfare'
(BUT: Bettendorf et al.: country variations : Belgium -4.5% GDP, Spain +1%; overall gain only if rates harmonised)
Parliament 452 - 172 (36 abstentions):
apply to European Companies & Cooperatives within 2 years;
compulsory for qualifying companies within 5 years,
SMEs to choose (subject to Commission review)

OPTING-IN

Notice 3> months before tax year
effective for 5 years + 3 year terms
subject to notice of termination in last 3 months of term

Aims

REMOVE IMPEDIMENTS ON SINGLE MARKET

‘disincentives for investment in the EU’

`growth-enhancing initiative’

Interaction of national tax systems leads to over/double taxation, heavy administrative burdens & high business compliance costs

RESOLVE TRANSFER PRICING PROBLEMS

High cost of compliance using AL approach

For closely-integrated groups transaction pricing based on AL `may no longer be the most appropriate method’

ANTI-AVOIDANCE & HAVENS?

HARMONISATION OF TAX BASE

Only for computation of the tax base

National rules on financial accounting remain

NO HARMONISATION OF TAX RATES?

COMMISSION: Fair competition `offers more transparency and allows MS to consider market competitiveness & budgetary needs’

`unfair competition’? e.g. Ireland (Sarkozy Feb. 2011)?

Parliament: Commission should consider minimum rates when Directive is reviewed

Effects & Benefits

FOR FIRMS

cross-border loss compensation :
`calculations on a sample of EU multinationals show approx 50% non-financial & 17% financial multinational groups could benefit from immediate cross-border loss compensation'

Reduction of compliance costs
for recurring tax related tasks in the range of 7%
for opening new subsidiary in MS reduction >60%

tax-free intragroup reorganisation

FOR MEMBER STATES

`not intended to influence tax revenues '

Impact on revenues `hard to estimate', will depend on national policy choices, adaptations of mix of tax instruments / rates

Safeguard clause if apportionment produces unfair result

Review after 5 years

Optional system means managing two distinct tax schemes

Fewer opportunities for tax planning by companies

Fewer disputes involving ECJ or Mutual Agreement procedure

Wider Perspectives

CCCTB & Fiscal Union?

Why Apportion?
Could corporate tax proceeds accrue to EU `own resources'?

Extension Beyond EU

Major shift within OECD if CCCTB adopted.
Link-up with US?
How compatible are CCCTB rules with US Combined Reporting?
New worldwide standard?
Benefits for LDCs

Using CCCTB to Combat Havens & Avoidance

Group defined to include qualifying subsidiaries resident in EU MS
Why not extend at least to dependencies (Cayman, Jersey, IoM)?
Better than CFC rules?
(could be weakened by competitive pressure due to optionality?)

Effects on Profit-Shifting

Relocation to take advantage of Formula factors?
But at least they define real, not paper activities
(depending on robustness of employment & asset ownership definitions)

Calculation of Tax Base

Tax Base = Revenues, **less**

(i) exempt revenues:

- Subsidies directly linked to fixed assets, subject to depreciation (32-42)
- Proceeds from the disposal of pooled assets or shares
- Received profit distributions [including foreign income]
- Income of PE in 3rd-country

(ii) Deductible expenses:

- Costs of sales and expenses net of deductible VAT
- Incurred by taxpayer to obtain/secure income (including R&D & costs of raising capital)
- Gifts to charitable bodies (defined in art.16) established in MS or in 3rd country with comparable EoI to EU Directive 2011/16
- Proportional deduction for depreciation (rules in 32-42)
- [Parl.: environmental protection & carbon emission reduction costs]

Non-deductible expenses:

- Profit distributions, debt/equity repayments
- Transfers to equity reserves
- 50% of entertainment costs
- Bribes, fines & penalties, corporate taxes
- Costs of deriving exempt income (presumed fixed @5%)
- Costs related to fixed assets except under depreciation rules

Timing & Quantification

profits /losses recognised only when realised

Transactions & taxable events measured individually

Revenues & expenses

- recognised when accrue/incurred (= when right to receive arises)

Valuation: price of transaction (goods/services)

- market value for non-monetary consideration/gifts etc
- fair value of financial & trading assets (defined in art. 23)
- Provisions (art. 25), Pensions (26) Bad Debt Deductions (27), hedging (28), stocks & work in progress (29)
- additional rules for Insurance Undertakings (30)
- Transfer of Asset to PE in 3rd country = deemed disposal (31)

Depreciation (ch. VI)

- Fixed assets: straight-line, useful life (buildings 40 yrs, others usu. 15)
- Rollover relief for replacement assets (art. 38)
- Asset pools (39)
- No depreciation for financial or non-obsolescent assets unless taxpayer shows permanent value decrease

Losses

- may be carried forward (unless result in negative tax base)
- oldest first

Entry & Exit from System

On Entry:

- Assets/Liabilities calculated under previous national tax rules
- Qualification of fixed assets for depreciation (45)
- Provisions, pension provisions, bad debt deductions (only for new transactions)
- Prior expenses deductible if not previously deducted
- No double deductions
- Prior losses not set-off may be carried forward as national law allows

Opting-Out

- Assets/liabilities calculated under rules of CCCTB system
- Fixed assets = pool depreciable on declining balance @25%
- No double deduction of expenses
- Losses not yet carried forward may be, to extent allowed under national law

Consolidation

Qualifying Subsidiaries = immediate & lower-tier Subs in which P
holds right to exercise >50% voting rights
(calculation for lower tier assumes 50% = 100%)
OR ownership rights >75% of capital OR entitlement to profit
(interests of intermediate Subs multiplied)
Excluding companies if & when insolvent

Group consists of:
Resident taxpayer & its PEs in MS,
+ its Qualifying Subs & their PEs in MS
Non-Resident taxpayer:
all its PEs & Qualifying Subs resident in MS & their PEs

All tax bases consolidated
if negative, carried forward to next positive year
if positive apportioned under Formula rules

Elimination of Intra-Group transactions
if directly between group members at time of transaction
& when revenues/expenses recognisable
must be consistently documented, to allow identification at lower of cost & value

No Withholding or Source taxation of intra-group transactions

Changes in Group

Entry:
Rules for fixed assets (61) long-term contracts (62), provisions & deductions (63), Losses (64)

Termination of Group:
tax year deemed to end, profit allocated, rules for losses (66)

Leaving Group
rules for fixed assets (67) self-generated intangibles (68), losses not attributable (69)

Business Reorganisations (including transfer of Legal Seat)
Within Group: do not give rise to profits/losses (unless substantially all assets transferred to another MS & asset factor substantially changed)
Between >2 Groups
treatment of losses (71)

Extra-Group Relations

Dealings between Group & Other Entities

Profit distributions, share disposal/PE income otherwise exempt
- (i) may be taken into account in determining applicable tax rate (exemption with progression)
- (ii) **not exempt** if taxed @40% of average rate in MS [Parl.: 70%] **or** under special regime

Assets acquired under intra-group transaction by departing taxpayer not exempt unless transaction for valid commercial reason

Interest, royalties etc taxed at source deductible (proportionately)

Interest etc paid outside Group may be taxed by MS, receipts apportioned

Transactions with (extra-group) Associated Enterprises & PEs (Transfer Pricing)
- If same person participates in management/control/capital in/directly (= >20% of voting rights/capital, or exercise of significant influence in management)
- Standard Arm's Length principle applies

Anti-Abuse Rules

GAAR (80):

`Artificial transactions carried out for the sole purpose of avoiding taxation shall be ignored' [Parliament: `mainly for']
except for `genuine commercial activities where the taxpayer is able to choose between two or more possible transactions'

Interest non-deductible if paid to AE in 3rd country
with no Exchange of Information comparable to EU
& corporate tax rate <40% of EU average
or special tax regime,
unless AE publicly quoted & has active business

Controlled Foreign Corporations (CFCs)

CFCs: **If**

(i) taxpayer in/directly has >50% voting rights/ capital/ rights to profits
(ii) 3rd country tax rate <40% EU average [Parl 70%]
OR special regime
(iii) >30% of CFC income passive
(iv) shares not actively publicly traded
unless CFC is in EEA state with EoI comparable to EU

Passive income = from

financial assets, IP, moveable & immovable property, financial activities
if >50% derived from taxpayer & its AEs in any category

CFC profits

calculated as usual, but losses not set-off (tho carried forward)
included in P's income in proportion to its rights in CFC

Transparent entities (84-5)

Apportionment

Formula: One-Third Sales, Labour, Assets
[Parliament: Sales 10%, Labour 45%, Assets 45%]
Shared only when positive, calculated at end of tax year

Safeguard: if all Competent Authorities agree an alternative method

Commission can lay down rules for calculation & allocation of factors

Special Rules for
- Financial Institutions (98)
- Insurance Undertakings (99)
- Oil & Gas (100)
- Shipping, Inland Waterways & Air Transport (101)

Deductible against apportioned share:
- Unrelieved losses incurred prior to entry into system, or at group level
- Amounts specified in 61, 62, 63
- Optional technical provisions for insurance undertakings (30c)
- Taxes listed in Annex III deductible under national rules
- Royalties etc taxed at source (76)

Tax liability = national tax rate applied to apportioned share
(as so adjusted & reduced)

Calculation of Factors 1

Labour = Payroll (50%) + No. of Employees (50%)

Employee

- Defined under law of MS where employment exercised
- Employee count & payroll cost to same entity
- usually entity which pays them,
- **unless** it has >5% of employees which are under physical control of another for > 3 months
- Includes persons not directly employed if perform tasks similar to employees

Payroll

- Includes all compensation including bonuses, pensions etc.
- Valued @ amount employer treats as deductible in tax year

Calculation of Factors 2

Assets = average value of all fixed tangible assets owned/rented/leased
including for 5 years after entry into group total costs over previous 6 years of its R&D, marketing & advertising
allocated to economic owner but if not identifiable legal owner
except where effectively used by another entity & = >5% of its assets
assets leased/rented intra-group allocated to lessor/lessee [sic?]
Valuation: land & other non-depreciable @ original cost
depreciable: average at beginning & end
rented/leased @ 8x rental
asset sold within 2 years of intra-group transfer allocated to transferor unless transfer for good commercial reason

Sales = proceeds of extra-group sales of goods & supplies of services
net of VAT & other taxes
valued as for transactions (22)
allocated (destination basis) to group member in state where despatch to buyer ends/service physically carried out
exempt revenues etc & proceeds of disposals allocated to beneficiary

Opting-In to System

BY NOTICE,

- at least 3 months prior to applicable tax year
- specifying members, status, start year:
- **from Single taxpayer** to competent authority of residence state (if PE of non-resident, where located)
- **from Group** (covers all members):
- by Principal taxpayer (= resident taxpayer with qualifying subs/PEs)
- **To** Principal Tax Authority PTA (= where PT resident)

PTA sends to other competent authorities for comment

- decides on admissibility

TERM:

- 5 years + succeeding 3-year terms
- notice to terminate: in 3 months before end of term
- not affected if member leaves
- if 2 join/merge, continue for longer term
- if one leaves/group terminates, term continues

Members of group have same tax year, previous year ends on joining

Administration

RETURN

filed with competent authority; for Group = PTA
treated as assessment of each member of group
of single taxpayer:
identifies taxpayer & AEs, tax year , calculates base
of group:
identifies taxpayer, group members, AEs
calculates consolidated base, apportionment, liability of members

[Parliament : uniform Return
to be designed by Commission in cooperation with MS]

Principal Taxpayer & Principal Tax Authority

PRINCIPAL TAXPAYER

= resident taxpayer forming a Group with Qualifying Subsidiaries, its PEs, or PEs of 3rd-country Qualifying Subsidiary (4(6))
Once designated can't be changed, unless ceases to be eligible
Exceptionally, Competent Authorities may designate another (116)
Responsible for: filing Notices, Return & all procedural obligations

PRINCIPAL TAX AUTHORITY

Authority of state of residence of Principal Taxpayer
`One-stop-shop'
Responsible for: receiving Notices & Return, verifying Return, issuing assessment if no Return submitted, issuing amended Return, initiating & coordinating audits
(in consultation with other Competent Authorities).
Appeals: to courts/tribunals of PTA (ultimately ECJ)
Competent Authority may challenge PTA decision in PTA's courts
Advanced Ruling: may be made on request by Competent Authority; binding on it, but may be overturned by decision of PTA's courts.

Procedural regulatory arbitrage?
(towards `lax' authorities)?

Coordination of Implementation

COMMUNICATION

Between Competent Authorities where possible electronically, via common communication network/common system interface (CCN/CSI)

CENTRAL DATA BASE

Accessible by PTA & all Competent Authorities,
for Return & other documents

COMMISSION'S DELEGATED POWERS

Defined: update Annexes, detailed rules on leased assets & definition of categories of fixed assets for depreciation, details of Apportionment factors (97), filing procedures (113).

COMMITTEE

to `assist' Commission (131)
using `examination' procedure (majority vote, Commission may not override)

Thank You
Kiitos
Grazie
Merci
Muchas Gracias
Obrigado
Vielen Dank
Asante Sana