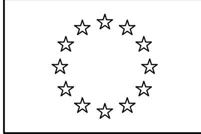

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COMMON CONSOLIDATED CORPORATE TAX BASE WORKING GROUP (CCCTB WG)

An overview of the main issues that emerged at the third meeting of the subgroup on group taxation (SG5 – 05 & 06 February 2007)

Meeting to be held on Tuesday 13 March 2007

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WORKING DOCUMENT

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I. Background information and purpose of the document

1. The purpose of this note is to give an overview of the main issues that emerged at the third meeting of the subgroup on group taxation (hereafter SG5), and to steer the discussion on those on which the SG5 seeks more guidance from the plenary.

2. At the meeting, the discussion followed the order of the power point slides prepared by the Commission Services together with the Chair.

3. The Chair of the SG5 prepared the Report on the results of the meeting, which gives an overview of the discussion and views expressed by the members of the subgroup. The SG5 being a technical group, the conclusions contained in the report represent a contribution by the sub-group to be discussed at the main working group[1].

4. The Commission Services would particularly welcome comments on the following issues discussed at the subgroup meeting:

    1. Definition of the group and connected issues (see paragraphs 5 to 20);

    2. Treatment of losses (see paragraphs 21 to 25);

    3. Methodology (see paragraphs 26 to 39);

    4. Entering and leaving entities of the group with underlying capital gains (see paragraphs 40 to 46).

II. Key discussion points

Definition of the group and connected issues

Optionality

5. For the first time, the issues related to the practical and administrative aspects of optionality were discussed. Even though consolidation itself in the CCCTB is not envisaged as an optional system, the Commission Services intend to table a proposal for an optional common tax base (with compulsory consolidation for the entities which would opt for this common base).

6. As a preliminary comment, several experts made clear that they did not envisage implementing CCCTB as an optional system and would prefer to use it as a mandatory set of rules for all their companies or for a category of their companies. In this respect, the Commission Services would like to stress that its current policy is propose an optional system to provide companies with a consistent set of rules to allow them to benefit from the single market. MS would be free to extend the implementation of CCCTB by deciding not to have domestic rules any longer. Making the CCCTB compulsory for all companies, or a category of companies,

[1] In common with all CCCTB Working Group documents references to 'Member States' refer to the comments by experts from the various Member States administrations and do not represent a formal position of a Member State.

would go beyond the Commission's current policy and making it compulsory for a selected category of companies, it could potentially raise problems in terms of state aid rules.

7. As regards the practicalities of the optionality of the common tax base, having in mind the views expressed by the experts, the main points to underline could be as follows.

8. The controlling entity would be the entity entitled to exercise the option for the group. However, to be valid the option should be accompanied by a list of the relevant entities together with a written agreement signed by the management of these entities (could constitute a clarification and thus mitigate risks of litigation in terms of auditing and minority interests). Of course if consolidation were to apply in cases when the controlling entity is not located in the EU, it could be necessary to designate an administrative entity located in the EU to deal with this administrative task (obviously this entity would also have to deal with the other administrative tasks).

9. As regards the timing, the favoured approach would be to require a notification of the option before the opening of the considered tax period. However newly created or acquired entities would be able to be included as soon as they meet the criteria (tax period cut into two parts for the newly acquired). As regards the renewal of the option (if we assume that it would last a number of years), there seems to be a general view that it should be automatic (this would mean in practise that unless the controlling entity notifies that it does not intend to apply the regime for a new period, it would be deemed to agree to continue to apply the CCCTB for a new period).

10. A four or five year duration of the option was regarded as a sensible rule (that would imply that the entity opting for CCCTB would not be allowed to opt out during this period). However the option would be automatically cancelled when the group terminates.

11. It is the view of the Commission Services that the option should be notified to one single tax administration and then it would be up to this tax administration to exchange the information with the other administrations involved. A few experts favoured however a system where the controlling entity still needs to inform all the different involved tax administrations which tends to increase the compliance costs of a cross border group implementing CCCTB rather than lowering them.

12. Finally, as soon as a controlling entity stops fulfilling the criteria to be a controlling entity, the option should be automatically cancelled (termination of the group). The same would apply to an entity which leaves the group (no matter whether this entity is acquired by a CCCTB or a non CCCTB group). When the controlling entity (or a subsidiary) is acquired by another group which already applies CCCTB or wishes to opt for CCCTB, the CCCTB rules should aim to avoid having a tax period outside consolidation and to allow CCCTB to apply without disruption (some experts stressed that proper ring fencing of losses incurred during the life of the former

group should be envisaged in this case and the Commission Services stressed that if it were to be the case, the symmetrical situation should have to be considered as well i.e. loss making group acquiring a profitable entity or group of entity).

Type of rights to be considered (capital / voting rights)

13. Another round of discussion on this topic revealed a general agreement that for the purpose of definition of the consolidated group, one criterion as regards the control of the parent over the subsidiary should be taken into account and that the percentage of voting rights should be the most appropriate in this respect (considering that full consolidation would apply and that the system aims to cover as many entities as possible).

14. Similarly, in the situation of several tiers of participation, most experts seem to consider that instead of a multiplication of the different tiers of participation, each one could be considered separately in order to include more entities. However some stressed that such a solution would make sense only in the context of a high threshold and remarked that 75 % of voting rights was not sufficient to be regarded as a high threshold.

Duration of ownership / averaging method

15. The objective should be to avoid sales or acquisitions of shares for a few days for example in order to include or exclude a company from the group. A strict requirement of holding of the shares throughout the tax period would allow a company to exclude from the group the entity just by selling a low percentage of its shares for a few days. Consolidation rules should in consequence cover this type of situation. However the discussion revealed that an averaging method would not be an adequate solution in every case. When the ownership of voting rights goes below the threshold at the beginning and/or at the closing of the tax period, most consider that the entity should be regarded as a leaving entity. However, in case of non significant variations of threshold within the tax period, the entity could be maintained in the group provided that the threshold test is fulfilled at the beginning and at the closing of the tax period.

Non EU entities involved

16. A new round of discussion on this topic did not manage to remove the concerns and reluctance of some experts. The Commission Services remains however doubtful that the implementation of consolidation in such cases could trigger major difficulties and remain convinced that the attractiveness of CCCTB would be significantly lower if some group structures which involve non-EU entities were to be effectively excluded from the scheme. In the situation when the EU ownership chain is broken by a non-EU entity, the fragmentation into two or more separate CCCTB groups within a single group of companies would introduce complexity and could trigger tax planning opportunities.

Personal Scope

17. There seems to be a consensus that the personal scope of the CCCTB should be as broad as possible and that MS should not be able to challenge the inclusion in the scope of CCCTB, and thus in a CCCTB group, an entity located in another MS. In practise this means that in the situation of a group with one entity in MS A and one entity in MS B, if the entity located in MS A is included in the scope of CCCTB according to MS A, MS B should not be able to challenge it and deny the inclusion of this entity in the group because this entity would not meet the criteria if it were to be a tax resident of MS B.

18. On the drafting technique itself, some experts still favour a list approach of entities within the scope as is currently the case in existing directives. However, a few remain convinced that a general self standing definition would ensure more uniformity. In this respect the Commission Services currently takes the view that the list approach seems to be preferable. It is currently used in existing direct tax community law and also provides legal certainty together with simplicity and transparency. This list approach would also imply the necessary mutual recognition mentioned in paragraph 17. A self standing definition would in any case be subject to a list of entities not covered.

19. No matter which drafting technique is chosen, a difficulty will remain in any case as regards the non resident entities (entities resident outside the EU carrying out business through a PE in the EU). By definition the foreign entities will not be part of the list of legal forms covered by the CCCTB. Thus, one solution could be to agree on criteria to provide for the inclusion of such PEs in the CCCTB.

20. As regards transparent entities, the general view is that they should not be included in the personal scope. However, for several experts even though these entities should not be included in the personal scope, the income of such entities would be consolidated with the income of their CCCTB shareholder and the relevant percentage of the factors of such transparent entities should be included in the formula (assuming that the transparent entities are located in the EU). This reasoning implies a common definition of a transparent entity and a need to distinguish between entities not in the scope and entities not in the scope but transparent. As regards the involvement of a transparent entity in the chain of participation, the same experts would not see any difficulty (no break of the chain) whereas others would favour a very strict approach in terms of definition of the group (the same experts who see a difficulty with the involvement of non EU entity).

Treatment of losses

21. During the SG5 meetings the possible treatment of losses in various situations has been discussed. There seems to be a general agreement by experts on the treatment that must be given in the following aspects.

22. **Previous losses incurred by companies before entering a CCCTB group.** When a new entity enters a CCCTB group the previous losses incurred by this entity that have not yet been compensated with profits could only be compensated, in that tax period and in the future tax periods, with the portion of the CCCTB attributed to the company. This rule has some practical advantages as it implies that the previous losses of one company, which might have been calculated according to national rules, will not be 'exported' to other MS (will not affect the portion of the tax base attributed to other companies of the group that can be located in another MS). The compensation would be done inside the MS.

23. **Losses incurred by a group compensated with profits of the same group (on going losses)**. The losses incurred by the group would remain at group level and would not be shared out to companies in the group according to the formula apportionment. Only the remaining profits (after the compensation of the losses) would be shared. This view is consistent with the idea of treating the group as a single entity.

24. **Company leaving a group**: when a company leaves a CCCTB group it would not be able to receive part of the uncompensated losses of the group. This approach is simple and is consistent with the idea of treating a consolidated group as a single entity. However, two experts were keen to calculate and allocate a share of accumulated losses to a company when it leaves the group.

25. Experts were more divided in the treatment to give to **uncompensated losses when a group terminates**. Some experts considered that the losses should be attributed to the parent while others were of the view that the losses should be shared between the companies that were part of the group when the group terminates. It is the Commission Services view that the losses should be attributed to the companies of the group, this solution will lead to more fair results and does not necessarily have to be complicated. One way of distributing the losses may be according to the last formula apportionment used by the group. It is a simple way of distributing the losses consistent with the rules applying to a CCCTB group. It is not advisable to distribute the losses according to an average of the formula apportionment of various years as it would increase complexity.

Methodology

26. There was an initial discussion of administrative aspects related to group taxation. In general experts did not oppose the idea of the Commission Services of having a 'one stop shop' to allow a CCCTB group to deal only with one tax administration or even to establish an specialised panel of appeal to take care of CCCTB cases. (This possibility is to be the subject of a separate discussion later today).

27. Additionally there was a discussion on the method to determine the consolidated tax base.

28. In practice, it will not be possible to determine the CCCTB starting from the consolidated accounts of the group as the definition of the group will probably be different for tax purposes than for consolidated account purposes. The IFRS must be

applied by listed European groups in their consolidated accounts, but these groups will very likely be different groups than the CCCTB groups (the required threshold to consolidate will probably be more that 50% and the definition of the group for tax purposes will be based more on a legal approach than on an effective control, accounting consolidation applies a worldwide definition of the group…)

29. This being said, the Consolidated Tax Base of the Group should in principle be the addition (+ or -) of:

- The "Tax Base" of every company of the group (parent and subsidiaries).
- +/- Eliminations of intra-group profits or losses
- +/- Recaptures of eliminated intra-group profits or losses
- - Losses brought forward from previous years

30. The objective should be a consolidated tax base without the impact of intra-group transactions. All intra-group profits or losses generated by intra-group transactions must be therefore eliminated as long as they have been initially included in the individual "tax base" (and in the amount that they have been included) and should be recognised/recaptured only when they are 'realised' with third parties.

31. Intra-group transaction must be understood as a transaction between companies belonging to the same consolidated group and at the time when they belong to the same consolidated group (transactions with other companies including entities which do not fulfil the requirement i.e. subsidiaries below the required threshold would not be treated as internal transactions).

32. The CCCTB legislation should determine when an intra-group transaction must be eliminated. Experts as well as the Commission Services favoured having in the CCCTB legislation a general rule to determine when it is necessary to eliminate (in practice only when the internal transactions have been recorded in such a way that an internal profit or loss has been included in the consolidated base); this general rule could be accompanied with a list of the transactions that must be eliminated but just for illustration purposes.

33. There is no need to require companies to price intra-group transaction at ALP (or at any other price) as the intra-group profits or losses must be eliminated. Thus groups would be able to price the internal transaction as they wish.

34. The intra-group profits or losses are the difference between the intra-group price and the cost. However it might be difficult to determine which cost should be allocated to intra-group transactions.

35. Recaptures of eliminated profits: the eliminated intra-group results should be added back in the Group Tax Base when they are realised with third parties. The elimination of internal profit or loss is consistent with the idea that the group forms a single entity however, this treatment should be recaptured when the transaction takes place for the group as a whole (with third parties), the recapture mechanism must ensure that the whole profit is taxed (or the whole loss is deductible).

36. It is necessary to determine when the transactions are realised with third parties. There was general consensus among experts on considering that in the following cases the transactions are realised with third parties and therefore the recapture mechanism should operate:

- When the asset (or liability) where the intra-group profits or losses are recognised is sold to third parties.
- When the company that owns the asset (or the liability) (the company that bought the asset or liability) leaves the group. This will imply as in the previous case that the asset (or liability) leaves the group.

37. In general experts agreed that in those cases when the selling company is the one that leaves the group (therefore the asset or liability remains in the group) there is no need to recapture the eliminated profit.

38. There may be situations when it is not clear if a recapture should be made. For example when two group companies who have previously bought and sold such an asset respectively merge and the company which purchased the asset 'disappears'. This company 'leaves' the group, but the asset has not left the group so a 'recapture' does not seem necessary.

39. A general rule that could be applied to all the cases could be that the eliminated intra-group profit or loss is only recaptured when the asset or liability leaves the group. Thus when the selling entity leaves the group or in case of internal business reorganisation, there would not be any recapture of the eliminated profit or loss at that time.

Entities entering or leaving a CCCTB group with underlying capital gains

a) Entities leaving a CCCTB group with underlying capital gains.

40. An entity may be part of a CCCTB group and afterwards may leave the group with some capital gains that have been generated during the period when the entity belonged to the group. There are reasons to consider that the capital gains generated during the time the company belonged to the group must be taxed by the group.

41. Even though the items with underlying capital gains are not transferred to another jurisdiction, just by leaving a CCCTB group the MS that will be able to tax these capital gains are going to be different from those that would have shared the base (and therefore the capital gain) if the asset had been sold during the period it belonged to the group.

42. Generally when the shares of a company are sold by a group, the capital gains that arise from this transaction are exempted if a full participation exemption is to be applied. However, some experts consider that not all the capital gain should be exempted but only that part of the gain which has already been taxed in the hands of the subsidiary. This part is exempted to avoid double taxation. The remaining part of any gain, such as underlying capital gains in the assets of the subsidiary, should not be exempted. However the practical implementation of such a partial exemption could be very complex in practise.

43. There are two main approaches to when an entity leaves a CCCTB group with underlying capital gains. Some experts would prefer to apply a full participation exemption. Other experts would prefer to treat the sale of the entity as if it were a sale of assets, on the basis that this is consistent with the idea of treating a CCCTB group as if it were a single entity and the sale of an entity should be treated in the same way as the sale of an asset. The concern is to avoid a group of companies avoiding the taxation of sales of assets by transferring assets into a subsidiary company and selling the shares of the subsidiary with full participation exemption. An added variation would be to exempt only part of the gain, taxing that part of the gain which has not already been subject to taxation.

b) Entities entering a group with underlying capital gains.

44. On the other hand an entity can enter a CCCTB group with underlying capital gains. It is arguable if the group has the right to tax the whole capital gain that arises when the company sells the asset to a third party or only that part that has been accrued during the time the company (and therefore the asset) belonged to the group.

45. The general opinion of the experts was that the group should receive the underlying capital gain; unless the entering company comes from another CCCTB group (if we assume that CCCTB rules in this case would assimilate sale of shares as sale of assets) as the underlying capital gain with which the company enters the new group will have been taxed in the previous CCCTB group.

46. The rules applicable when an entity enters a group with underlying capital gains must be consistent with those rules to apply when an entity leaves a group with underlying capital gains. If both groups are CCCTB groups each group should in principle have the right to tax the capital gains generated during the period of time the company belonged to each groups.