

Comments on document CCCTB\WP\047
Common Consolidated Corporate Tax Base Working Group
– Sharing Mechanism –

Introduction

In November 2006 the Commission issued a Working Paper dealing with “the Mechanism for Sharing the CCCTB”. The purpose of the paper is to address the various possibilities for how the CCCTB shall be apportioned among the Member States. The working paper has been preceded by a lengthy taxation paper '*The Delineation and Apportionment of an EU Consolidated Tax Base for Multijurisdictional Corporate Income Taxation: a Review of Issues and Options*' by Ana Agúndez-García.

The possible revenue implications of the CCCTB for Member States make the allocation of tax revenues a key question. The BusinessEurope Task Force on CCCTB is grateful to have the opportunity to express its view on this highly important topic. The positions taken in this paper may be subject to revision as other areas of the CCCTB are explored.

General remarks

As has been stated previously, the Task Force sees three core benefits with the CCCTB:

1. removal of *double taxation* due to conflicting tax claims,
2. reduction of compliance costs by allowing for a *single compliance* of a single set of rules in a single location (one-stop-shop), and
3. assurance of net taxation through *consolidation*.

The Task Force consequently supports the Commission in that the CCCTB must be consolidated from the beginning. An important reason for this is to remove the ever more burdensome obstacles related to transfer pricing. It is widely recognized that transfer pricing is one of the most significant hurdles against cross-border activities, imposing huge compliance costs for businesses and having detrimental effects on economic efficiency. In order to achieve a true Internal Market, one of the most important objectives of the CCCTB is therefore the removal of transfer pricing problems and the associated administrative burden and costs within the Union.

To achieve this, the distribution of the consolidated income must deviate from the current system of levying tax based on the perceived origin of a particular income (or loss). As will be discussed further below, this could for example be done by using a Formula Apportionment approach. Although novel from a European perspective, similar allocation regimes are used in other countries (perhaps most notably in the US).

In this context it shall be underlined that a shift from the income allocation approaches currently used by the Member States to any of the allocation methods discussed below (e.g. Formula Apportionment), is by no means a shift from objective accuracy to rough estimates. In an ever more global economy with increasingly complex business structures and production chains, it is in reality not possible to pin down with precision and without disputes or discords where a profit (or loss) has materialized. The production of a car, for

example, involves an endless chain of sub-manufacturing, commercial activities, warranty agreements etc. In such a process, it is not possible to isolate, with accuracy, a geographical location where a certain part of the total profit arising from the sale of the end product has occurred. Transfer pricing studies yield a range of possible prices with upper and lower limits. This is precisely why transfer pricing conflicts frequently occurs (not only between tax payers and the tax authorities, but also between states) and why it is so difficult to find consensus on e.g. what income, if any, to attribute to permanent establishments. Thus, the current system of income allocation is equally based on a more or less fictitious perception of when an income shall be taxable in a given Member State. This should be borne in mind when the various sharing mechanisms proposed for the CCCTB are discussed and analyzed.

Type of Sharing Mechanism

The Commission paper recognizes three principal approaches for sharing the CCCTB:

1. Macro-based Apportionment (MA)
2. Value Added approach (VA)
3. Formulary Apportionment approach (FA)

As pointed out by the Commission, all approaches shows strengths and weaknesses. According to the *MA approach*, profits would simply be distributed to Member States in relation to their GDP, national VAT base or some other macro economic variable. Even though such an approach would be very simple and prevent any manipulations by companies, the Task Force does not see this as either a realistic or an appropriate allocation method. It would mean that taxes would have to be paid to participating Member States in the CCCTB even in the case when the group has no or very limited economic activity in the country. Apart from most likely being unacceptable from the perspective of the Member States, this could create an adverse incentive structure for governments to increase the tax rate for profits taxable under the CCCTB. In theory even a tax rate of 100% could be imposed since there would not be any significant effect on the revenue base from a higher tax rate. However, as Member States increase their tax rates, economic activity in Europe would decrease (at least for companies that opted for the CCCTB) and revenues would be reduced for all governments.

The *VA approach* equally has downsides which imply that it most likely must be rejected as a viable alternative. Indeed, there is a lot of experience in the VAT area in the European Union and value added is in theory a good and reliable concept. Furthermore, as companies will have to comply with the VAT-regulation also after the introduction of the CCCTB, the required allocation information will largely be at hand “automatically”. However, since value added is dependent on prices, an element of transfer pricing will resurface. Even though it is much more difficult to manipulate the value added measure than the profit number, Member States may not agree on the allocated value added and a new kind of transfer pricing issue may arise. As one of the most important issues to be resolved with the CCCTB is the elimination of transfer pricing, any reintroduction of tax difficulties due to shift of profits or value added across countries would call for careful consideration and agreement.

Instead we see the *FA approach* as the most likely method for sharing the CCCTB among the Member States. Under this approach, the tax base is divided by using a predetermined formula based on factors (such as payroll, assets or sales), that are deemed to have been generated the group income. Indeed, Member States will most certainly have different views on the relative importance of the factors included in the formula. Nevertheless, such an approach would, correctly designed, resolve current transfer pricing problems. It would also, at least potentially, be sufficiently simple and at the same time allow for a reasonable allocation of the tax base between the Member States. It has also proven to work at least satisfactory in countries already using such an approach. Important improvements relative to the system as it is adopted in the US are, however, necessary. This especially refers to the importance of having one uniform formula (below).

The choice of apportionment factors as well as the weighting between them need further and more detailed analysis. However, under no circumstances the FA-approach must include a distribution factor which is based on the perceived origin of a specific income (or loss) as this would re-introduce transfer pricing problems into the CCCTB. Moreover, the allocation factors should allow EU wide commercial activities to be developed without regard to borders; such benefits of having a true Internal Market should not disappear by creating an undue administrative burden by requiring – by way of example – to track transactions and movements solely for the purpose of calculating allocation factors.

Uniform formula

As indicated above, it is imperative that the CCCTB eliminates double taxation and fosters economic efficiency. We therefore strongly support the Commission in its view that the FA-approach must be based on a ***uniform formula*** that is identical for all Member States. Looking at the US experience, it is clear that any regional diversities will lead to distorting tax competition and double taxation (as well as double non-taxation). This would contradict the very purpose of the European CCCTB-regime. Also, any allocation key that shows domestic deviations would fail in being a *common* tax system.

Conclusion

To sum up, with respect to the Sharing Mechanism, we see the following factors as important for the success of the CCCTB:

1. full consolidation from the outset (no two-step approach),
2. the removal of transfer pricing problems,
3. an allocation key based on a Formula Apportionment approach, and
4. a uniform formula which is identical for all Member States.

On behalf of the BusinessEurope Task Force on CCCTB

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