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Common Consolidated Corporate Tax Base (CCCTB)
TAXUD.E.TF1
Taxation and Customs Union
European Commission
B-1049 Brussels
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Via email: taxud-ccctb@ec.europa.eu

Dear Mr. Neale:

A task force established by the Directorate-General Taxation and Customs Union of the European Commission has been studying the benefits and costs of implementing a common consolidated corporate tax base (CCCTB) in the European Union (EU). The task force has issued numerous consultation papers defining and analysing the potential scope, technical structure, and administrative framework for the CCCTB; a formal legislative proposal is expected to be released soon by the Commission.

Tax Executives Institute has monitored CCCTB developments since the inception of the project, submitting our initial views on critical elements of the CCCTB for business taxpayers in May 2007. On behalf of TEI, I am pleased to submit the following comments elaborating on those views and providing additional comments on technical issues in the CCCTB.

TEI Background

Tax Executives Institute was founded in 1944 to serve the professional needs of business tax professionals. Today, the organization has 54 chapters in Europe, North America, and Asia. As the preeminent international association of business tax professionals, TEI has a significant interest in promoting tax policy, as well as in the fair and efficient administration of the tax laws, at all levels of government. Our 7,300 members represent 3,200 of the largest companies in the United States, Canada, Europe, and Asia.

In 1999, TEI chartered a chapter in Europe, which today encompasses employees of a wide cross-section of European and multinational companies. TEI members are accountants, lawyers, and other corporate and business employees responsible for the tax affairs of their employers in an executive, administrative, or managerial capacity. The Institute espouses organisational values and goals that include integrity, effectiveness and efficiency, and dedication to improving the tax system for the benefit of taxpayers and tax administrators alike. The comments set forth in this letter reflect the views of TEI as a whole, but more particularly those of our European constituency.

General Comments

The Commission's objective in introducing a CCCTB is to reduce the tax obstacles that hinder the competitiveness of the internal European market. Among the tax obstacles that arise from the challenges of complying with 27 different tax systems are two especially critical items: burdensome transfer-pricing and documentation rules that engender disputes between Member States and taxpayers over the proper allocation of profits among the Member States and the inability to offset losses incurred in one Member State against profits in another. Both produce double taxation and thus economic inefficiency. Conflicts in respect of transfer-pricing rules are especially burdensome since business taxpayers are frequently stakeholders in disputes between Member States over the respective share of income allocable to the states. Finally, the costs of complying with 27 different tax systems — including preparing and filing returns, paying the tax liabilities, responding to tax authority inquiries or inspections, and managing tax audits and appeals — impose substantial burdens on businesses.

In previous comments, TEI noted that the support of business taxpayers for the CCCTB depends on five elements. First and foremost, the CCCTB *must remain optional*. From the outset, the proposal has been characterised by the Commission as a voluntary system. Suggestions by commentators or Member States that the system should *initially* be optional, but become compulsory at a future date would diminish business support for the proposal.[1] Thus, we encourage the Commission to reiterate that taxpayer participation in the CCCTB is voluntary and will *remain* so.

Second, the national tax regimes of many Member States draw distinctions between business and non-business income and assets, generally to prevent closely held companies from paying personal expenses of their shareholders. TEI believes the CCCTB should be based on the presumption that an entity liable to corporate taxation is carrying on a business activity for CCCTB purposes. Hence, TEI recommends against distinguishing between business and non-business income or requiring allocation of costs among different sources of revenues (*e.g.*, business or non-business). A requirement to segregate business and non-business income and costs would introduce subjectivity and uncertainty into the determination of taxable income and

[1] *See* section 3.4 of *Implementing the Community Lisbon Programme: Progress to date and next steps towards a Common Consolidated Corporate Tax Base (CCCTB)* (COM (2006) 157 final), which states, in part:

> *The Commission, together with the European Parliament, also continues to believe that the CCCTB should initially be proposed as optional for companies given that the primary goal is to improve the operation of the internal market rather than Member State domestic economies.* (Emphasis in the original.)

Some commentators have seized on the "initially be proposed" language of the Working Group report as an indication that the CCCTB should eventually be compulsory. Those views are not shared by business taxpayers.

increase the compliance costs of large multinational enterprises and the administrative (and auditing) costs of Member States without providing commensurate protection for the Member States' tax bases. Moreover, to ensure that taxation under the CCCTB is determined on a *net* income basis, all current, non-capital costs should be fully deductible.

Third, the success of CCCTB depends on an allocation key that avoids reintroducing transfer-pricing disputes. Shielding businesses from transfer-pricing documentation requirements, penalties, and transfer-price adjustments on intra-group transactions occurring within CCCTB jurisdictions may be the single most important benefit promised by the proposed system. Thus, the allocation key should be as simple as possible, be easily determined based on readily available financial information, and apply uniformly across the EU to similarly situated businesses. The allocation key should *not* be aimed at implementing new, complex transfer-pricing guidelines. Thus, for example, a requirement to annually restate the balance sheets of companies included in the consolidated group in order to derive an allocation key would lead to significant compliance burdens for businesses, audit challenges for tax authorities, and disputes between taxpayers and Member States similar to those arising under current transfer-pricing rules.

Fourth, the tax base must be a *consolidated* tax base, permitting the consolidation of intercompany accounts in the determination of the group's taxable income as well as offsetting of overall losses from entities in one Member State against the income earned in other Member States. A consolidated regime is far different from adopting a uniform or common tax base where Member States would be permitted to make additional adjustments to the profits allocated to individual Member States. Permitting Member States to make further adjustments to reach a particular Member States' national tax base or requiring taxpayers to comply with transfer-pricing documentation requirements (because the group is not consolidated) would maintain the distortions and inefficiencies that the CCCTB would eliminate.

Finally, to be successful, the CCCTB must have a system of centralised management and administration. In other words, there should be a "principal tax authority" or "one stop shop" for filing the consolidated return and making a self assessment; verifying the taxable income allocable to the Member States; issuing reassessments (or filing amended returns); making inquiries, inspections, and examinations; and filing administrative or judicial appeals. Experience from transfer-pricing and other multijurisdictional disputes teaches that without centralised tax authority management, double taxation is likely to occur. Thus, to the extent there are disagreements among Member States about the application of CCCTB, they should be resolved by the principal tax authority rather than being addressed by the taxpayer on a one-to-one basis with each of the individual tax authorities. Although details remain to be developed, TEI believes the administrative regime described in task force working paper 061 provides a workable approach to the "one stop shop."[2]

Implementation Process

A. *Staged Implementation.* The task force, Member States, and commentators have discussed the prospects for a multistage implementation of the CCCTB. Thus, for example, there might be "soft" law introducing a common tax base, followed by a directive on a common tax base coupled with "soft" law on cross-border loss compensation, followed by a directive on cross-border loss compensation, and finally a directive on cross-border consolidation. Although

[2] *CCCTB: possible elements of the administrative framework*, CCCTB/WP061 (13 November 2007).

this might be politically expedient, the benefits to business taxpayers would be substantially delayed if not vitiated. Moreover, a staged or sequential implementation will create confusion. Indeed, without immediate availability of consolidation and loss offsets, the only advantage of the CCCTB is a common tax base and even that benefit would be eroded by the burden of frequent modifications of information and recordkeeping systems and transfer-pricing documentation that a staged implementation would require. As important, if the common tax base is not based on International Financial Reporting Standards (or another commonly accepted accounting base) and thus requires yet another set of accounts to be maintained for (or reconciled to) multiple countries' local GAAP, the potential for reducing compliance costs under the CCCTB will prove illusory. TEI believes that the option to consolidate entities from a common accounting base must be permitted from the outset.

B. *Adoption of CCCTB.* If only a limited number of Member States adopt the CCCTB (*e.g.*, through the enhanced cooperation procedures) the benefits of the proposal will be diminished. Taxpayers that opt in will be able to apply the new consolidation system for only a portion of their EU businesses while still being required to maintain information systems and transfer-pricing documentation to facilitate compliance in the non-adopting Member States. Hence, we encourage the task force and Commission to continue working toward the issuance of a Directive supported by all Member States.

It is also essential that the task force and Commission confirm that Member States adopting the proposal cannot compel CCCTB-eligible taxpayers to adopt the CCCTB for all or a portion of the group's business in the CCCTB-adopting jurisdictions. For example, assume a group consists of only a parent company in France and a subsidiary in the Netherlands and that France and the Netherlands are among eight Member States adopting the CCCTB under the enhanced cooperation procedure. Neither France nor the Netherlands should be able to compel the group to adopt the CCCTB. In addition to contravening Article 7 of the Dutch-French tax treaty, a forced combination of the French and Dutch companies would contravene Article 48 of the European Commission Treaty relating to free establishment. We request that the task force confirm this view.

Functional Currency System

To date, task force working papers have not discussed the treatment of companies operating in Member States where the Euro is not the functional currency. In view of the likelihood that non-Euro Member States will participate in the CCCTB, the legislative proposal should address how the income, expenses, assets, and liabilities in such countries should be reported in the consolidated group results. In the absence of a functional currency reporting regime, taxpayers may be taxed on unrealized currency gains or denied deductions for realized currency losses (as occurred in the *Deutsche Shell GmbH* decision[3]). Taxpayers should neither be liable for tax on unrealized currency gains nor denied losses for realized currency losses. Hence, we urge the task force to propose a functional currency reporting regime for consolidating the results from non-Euro countries that participate in the CCCTB. A number of Member States have functional currency regimes and should be able to assist the task force in developing a proposal.

[3] *Deutsche Shell GmbH v Finanzamt für Großunternehmen in Hamburg*, Case C-293/06 (28 February 2008).

Anti-Abuse Rules in the CCCTB Legislation

A. *General.* In working paper 065, the task force summarizes approaches to anti-abuse legislation (*e.g.*, general vs. specific anti-abuse rules and controlled foreign corporation (CFC) regimes) adopted by Member States and invites comments on provisions that should be considered for inclusion in the CCCTB.[4] TEI acknowledges that anti-abuse legislation is likely necessary in order to protect Member States' tax bases. That said, where such measures are incorporated in tax regimes, the European Court of Justice has ruled (*e.g.*, in *Halifax plc*,[5] *Cadbury Schweppes*,[6] and *Part Service Srl*[7]) that they must be *proportionate, i.e.*, they must be effective (preventing the specific abuse) and be no more restrictive than necessary to achieve the government's purposes. To be consistent with those rulings, the task force should eschew recommending anti-avoidance measures that lead directly to economic double taxation.

B. *CFC rules vs. a "switch-over" rule*. Task force working paper 065 notes that some Member States have adopted CFC rules to combat the diversion of passive income to a foreign company located in a low-tax rate country controlled by a resident company. The application of CFC rules generally causes the undistributed income of the CFC to be included in the tax base of the resident shareholders. Paragraph 120 of working paper 057 states that in respect of "third country income, dividends received from major shareholdings and PEs would be exempt subject to a *switch over* to the credit method where the corporate tax rate in the source country was low."[8] TEI notes that a "switch over" from a participation exemption to a credit system for income earned in low tax jurisdictions is a form of anti-abuse measure and believes that only one anti-abuse provision is necessary: either a CFC system or a switch-over rule. The UK government reached a similar conclusion in enacting its CFC legislation. TEI recommends that the task force consider the UK example and adopt either a CFC regime or "switch over" rule but not both.

Scope of the Consolidated Group

Paragraph 85 of working paper 057 states that consolidation would be mandatory for all companies opting for the CCCTB that have a qualified subsidiary or a permanent establishment in another EU state.[9] Paragraph 86 adds that consolidation would extend to 100 percent of the tax base of included entities (subject to special rules for apportioning the income of transparent entities). Hence, a company or a PE is either "all in or all out" of the CCCTB. These rules preclude taxpayers (and tax authorities) from "cherry picking" the companies included in the consolidated group.

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[4] *CCCTB: anti-abuse rules,* CCCTB/WP065 (26 March 2008).

[5] *Halifax plc v Commissioners of Customs & Excise*, Case C-255/02 (21February 2006).

[6] *Cadbury Schweppes plc, Cadbury Schweppes Overseas Ltd v Commissioners of Inland Revenue,* Case C-196/04 (12 September 2006).

[7] *Ministero dell'Economia e delle Finanze, formerly Ministero delle Finanze v Part Service Srl*, Case C-425/06 (21 February 2008).

[8] *CCCTB: possible elements of a technical outline,* CCCTB/WP057 (26 July 2007) (Emphasis supplied).

[9] To be considered a qualified subsidiary, 75 percent or more of the voting rights of a subsidiary must be held directly or indirectly by other group members.

The ultimate success of the CCCTB depends on the number of taxpayers willing to opt in and TEI supports as broad a scope as possible for the application of the CCCTB. Hence, as long as the threshold ownership requirements are satisfied, taxpayers with businesses in specialized industries such as natural resources (mining or oil and gas), utilities, financial institutions (banks, brokerages, and insurance), and shipping must be permitted to opt in. Although the task force ultimately may decide against prescribing specialized industry rules for the CCCTB legislative proposal (and thus spawn uncertainty for some taxpayers that would otherwise opt in), taxpayers with specialized lines of business should not automatically be precluded from participating in the CCCTB.

Additional Technical Comments

A. *Inventory*

Task Force working paper 057 states, in part:

> 52. Inventories would be valued on the last day of the tax year at the lower of cost and net realisable value.
>
> 53. The cost of inventories of items that are not ordinarily interchangeable would be assigned by using specific identification of their individual costs. The costs of other inventories would be assigned by using the first in first out or weighted average cost method.
>
> 54. The cost of inventories would comprise all costs of purchase, costs of conversion and other direct costs incurred in bringing the inventories to their present location and condition. Taxpayers who have traditionally included indirect costs in valuing inventories could be permitted to do so provided that they do so consistently.

TEI questions why the First-in First-out (FIFO) or weighted average cost methods would be the only acceptable inventory valuation methods under the CCCTB. Many Member States permit other inventory methods, including Last-in First-out (LIFO) and the base stock methods, for tax purposes. Where the LIFO or base stock method is permitted in national tax regimes, the key limitations are that they be acceptable under company law (and perhaps be used in the commercial accounts) and, most important, that the method be used consistently from year to year.[10] The principal advantage of the LIFO or base stock methods is that they permit taxpayers to better match the current replacement cost of inventory with current revenues in an environment of rising prices. As a result, during periods of inflation a better picture of a company's true costs and profitability emerge. In addition, the tax on the purely inflationary component of inventory value is deferred, just as the tax on any other asset's inflationary appreciation is deferred until the asset is sold.

TEI believes that requiring European group companies and businesses to convert to the FIFO inventory method in order to be eligible for CCCTB poses a significant burden that will

[10] Austria, Belgium, Finland, Germany, The Netherlands, Spain, and Italy, among other countries, permit the use of such methods.

impede adoption of the CCCTB, especially if taxpayers were compelled to bring the LIFO reserve — the difference between the value of the inventory under the FIFO accounting method and the value of the LIFO-based inventory — into income on the restatement of the inventory to FIFO value. The tax on the recapture of the accumulated LIFO reserve would be a prohibitive barrier to opting into the CCCTB.[11] We recommend that the task force reconsider permitting LIFO or base stock methods of accounting for inventory.

B. *Current Tax Attributes — Transition Rules Needed*

Paragraph 100 of working paper 057 states that country-specific losses incurred by companies prior to opting in to the CCCTB will be quarantined and offset solely against future profits allocated to that country under the CCCTB. The working paper, however, does not address other entity- or country-specific tax attributes, such as unused investment or foreign tax credits. In the absence of transitional rules, such attributes may be lost upon a group's adoption of the CCCTB. The task force has acknowledged that the potential loss of tax attributes will increase the economic cost of adopting the CCCTB, thereby diminishing its attractiveness and causing companies to — temporarily or permanently — decline to opt in. TEI notes that Member States that have adopted consolidated tax systems or other special taxing regimes (*e.g.*, tonnage tax systems) generally refrain from imposing onerous conditions for adopting such regimes. Hence, TEI recommends that the task force develop transitional rules that would either preserve entity- and country-specific tax attributes or otherwise afford compensatory relief to companies adopting the CCCTB. We believe the transitional rules implemented by many Member States to preserve tax claims or attributes upon adoption of a consolidated tax system or other special tax regime can serve as models for the Commission in developing transitional measures for the CCCTB.

Conclusion

TEI appreciates this opportunity to present its views on the CCCTB. These comments were prepared under the aegis of TEI's European Direct Tax Committee whose Chair is Johann Müller. If you have any questions about the submission please contact Mr. Müller at +45 3363 4374 (or johann.muller@maersk.com), or Jeffery P. Rasmussen of TEI's legal staff at +1 202 638 5601 (or jrasmussen@tei.org).

Respectfully submitted,

Tax Executives Institute, Inc.

Robert J. McDonough
International President

[11] The cash that affected companies would pay in higher taxes on the recapture of the LIFO reserve or on ongoing operations under the FIFO method would not be available to replenish the inventory sold. In order to maintain the same level of physical inventory, companies would be compelled to borrow additional money to pay the higher replacement cost. The increased debt loads to finance the higher tax bills in addition to the higher cost of inventory would adversely affect the financial condition and competitiveness of European businesses.