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**WORKSHOP ON THE
COMMON CONSOLIDATED CORPORATE TAX BASE
(CCCTB)**

*Transactions and dealings between the group and
entities outside the group*

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Disclaimer

This paper has been prepared to facilitate discussion on possible rules to be included in a possible proposal for a CCCTB Directive. For convenience, use is often made of phrases such as "the rule will apply", "interest will be deductible where..." etc. It should however be noted that such wording is meant to represent only the latest technical expert views which may be subject to change and in no way pre-judges the contents of a possible future Commission proposal.

Transactions and Dealings between the Group and Entities outside the Group

Introduction

1. An essential part of the CCCTB provisions deals with the relations (i.e. transactions and/or dealings) between the group and entities outside the group. The following areas are explored in that context: (i) the interaction between international agreements signed by Member States and the common rules; (ii) the ways of giving relief for double taxation; (iii) the treatment of withholding taxes charged on dividends, interest and royalties in the Member State of source; and (iv) the rules for the attribution of taxable profits from transactions between the group and entities outside the group which are associated enterprises.
2. A focal objective in drafting common rules has been to create a harmonised framework which reflects the principles of best practice in international tax law and also remains compatible with EU law.

A. International Agreements and the CCCTB

3. In conformity with the principle of supremacy of EU law, the common rules will generally take precedence over rights and obligations arising from (bilateral or multilateral) agreements between Member States. A different treatment is envisaged for agreements between Member States and third countries concluded before the Directive enters into force. To the extent that they may incorporate rights and obligations which are not in line with the Directive, those agreements will not be affected.
4. For example, a Member State may conclude a Double Tax Convention (DTC) which allocates revenues to an EU-located permanent establishment (PE) owned by a company resident in a third country according to the arm's length principle. Given that the DTC is concluded prior to the Directive, the 'arm's length' rule will override the apportionment of revenue by formula (FA), **as regards the obligation of the third country to give relief for double taxation**. In practical terms, a third country which relieves double taxation by the credit method will have to give a credit only up to the level of an 'arm's length' allocation of revenues to the PE.

B. Relief for Double Taxation

(i) Exempt Income

5. As a starting point, the following types of revenues will be exempt from taxation:
 - received profit distributions (i.e. both portfolio dividends and direct investment);

- proceeds from the disposal of shares held in companies outside the group or companies which are group members and have to leave the group as a result of the disposal; and
 - income from permanent establishment(s) (PE) situated in third countries.
6. Member States will be free to take those revenues into account for the purpose of determining the applicable tax rate.
7. Considering that, when exempting group revenues from tax, the consolidated tax base can be prone to undue erosion and harmful tax planning, it will be necessary to operate anti-abuse rules to disallow tax exemptions in specific circumstances. As a matter of principle, the following anti-abuse provisions are envisaged:¹

(a) Switch-over clause

8. The purpose of the rule is to limit tax exemption to situations in which a certain minimum level of taxation was incurred in a third country where an inbound profit distribution or PE income originate or where the entity of which the shares are disposed of is resident. Specifically, there should be a minimum statutory corporate tax rate, in the third country, of at least 40% of the average statutory corporate tax rate applicable in the Member States and no special tax regime available in the third country that would allow for a substantially lower level of taxation than the general regime.
9. As explained above, agreements between Member States and third countries concluded before the CCCTB enters into force shall not be affected by conflicting common rules, ie existing DTCs with third countries will take precedence over any conflicting CCCTB rules. For example, if switch over from exemption to credit is not foreseen under a DTC with a third country (because double taxation is relieved by exemption) then this 'CCCTB' rule will not be applied in the context of that DTC. Member States would be expected to undertake the necessary steps to generally align their existing international agreements with the Directive to remove these differences.

(b) Disallowance of the participation exemption in share disposals

10. Tax-exempt disposals of shares resulting in a taxpayer leaving the group could give rise to practices which contradict the general aims of the CCCTB Directive. Specifically, assets with significant hidden reserves could be taken out of the group free of tax if they were transferred, through an intra-group transaction, to a group company which could then be disposed of by way of a tax-free sale of shares. Considering that the gain on sales of assets will generally be taxable under the CCCTB, this anti-abuse provision will aim to tax the capital gain accruing on the assets transferred to the leaving company during the current or previous tax year.

¹ Please note that this paper is not meant to discuss anti-abuse rules in detail. For a thorough analysis of the anti-abuse framework in the CCCTB, see CCCTB/RD\004\doc\en.

(ii) Relief by Credit

11. Interest, royalties and any other type of income which does not qualify for exemption will benefit from a deduction from the tax liability of the taxpayer (i.e. relief by credit), provided that they have already been taxed at source (i.e. in another Member State or a third country). In line with the overarching principle of allocating taxable profits to the members of the CCCTB group according to a formula, the credit will also be shared through the formula of the tax year that it refers to.
12. Another question is whether relief for double taxation should be limited to ordinary credit or extend to full credit. Best practice in international tax law indicates that most national tax systems operate schemes of ordinary credit, which means that the relief for tax charged at source shall not exceed the actual tax liability of a taxpayer in the state of residence. Under the CCCTB, any outstanding credits will not be available to carry forward for future years. Relief by ordinary credit appears a better approach than the introduction of a unilateral rule for full credit, in particular when taxes are charged in third countries.² Given that DTCs with third countries which pre-date the CCCTB are not affected by conflicting provisions of the Directive, an exception to the general rule will apply in any case if such a DTC provides for a more generous relief than ordinary credit.
13. Another issue is whether the tax credit should be calculated for each source (i.e. Member State/third country) and each type of income separately or some type of pooling should be allowed. Considering the tax practice in most Member States and the principles reflected in their DTCs with third countries, it appears appropriate to calculate the allowable credit individually for each Member State/third country and each type of income.
14. The fact that withholding taxes charged at source on interest, royalties and other types of income are commonly imposed on the gross amount creates discrepancies since such amount is then taxed as net income in the hands of the recipient taxpayer. It is thus necessary to adjust the income for related expenses because, otherwise, the credit capacity would not be computed correctly. A pragmatic and appropriate way of doing this would be to deem that related expenses represent a fixed percentage of the inflow (e.g. 2%), provided that the taxpayer retains the right to prove that it incurred lower related expenses.

C. Withholding Tax in the Member State of Source

² A situation in which EU Member States would grant full credits to domestic companies in regard to withholding taxes levied in third countries while the same benefits would not be available for companies resident in third countries in regard to withholding taxes levied in the EU would result in reduced tax revenues for Member States, weaken their negotiation position when amending DTCs and minimise the incentives for third countries to abolish or reduce withholding taxes on payments to companies resident in the EU.

15. Dividends, interest and royalties paid by a taxpayer to a recipient outside the group may be subject to a withholding tax in the Member State of source. The CCCTB rules envisage that the proceeds from withholding taxes on outbound interest and royalty payments will be shared across the group using the formula. The proceeds from applying withholding tax on dividend distributions will be dealt with at the national level and will not be shared across the group. The rationale behind this difference in treatment lies with the fact that interest and royalty payments are generally tax deductible at source and it should thus be assumed that the relevant cost will have already been shared among the group members. This is not the case for dividends, which are after-tax payments and have normally led to no shared deduction of costs. It seems therefore reasonable that dividends do not lead to any similar sharing of the revenues from withholding tax.

D. Associated Enterprises

16. An important feature of corporate tax systems relates to the concept of 'association' between taxpayers, companies, entities, etc. The content of these rules is critical because, in practice, it also delineates the scope for the application of transfer pricing rules. As a matter of principle, if two or more enterprises qualify as 'associated' but are not part of the same CCCTB group, they have to apply transfer pricing rules, which implies that transactions and/or dealings among themselves will have to be priced at 'arm's length'.

17. The rules under the CCCTB follow in general the principles of Article 9 of the OECD Model DTC. No explicit reference to the OECD Model is made because not all Member States participate in the OECD and further the text of the Model is not available in all languages. In defining the concept of 'association', it is noteworthy that the Directive goes further than the OECD Model and gives more details on what ownership and control shall mean. In line with the recent OECD approach, PEs and Head Offices are dealt with as separate entities.

18. It is envisaged that the following structures create 'associated enterprises':

- A taxpayer participates directly or indirectly in the management or control or capital of a non tax payer or a tax payer not in the same group.
- The same persons participate directly or indirectly in the management or control or capital of a tax payer and a non tax payer or a tax payer not in the same group.
- The relations between a head office and its permanent establishments (situated in a Member State or in a third country).

19. For the definitions of control, participation in the capital and in the management the following thresholds will apply:

Control – a holding exceeding 20% of voting rights

Capital – a participation exceeding 20% of ownership rights and

Management – a position to exercise significant influence in the management of the associated enterprise.

20. In indirect participations, the above requirements relevant to capital and control will be fulfilled if the thresholds are reached by multiplying the rates of holding through successive tiers. For the purpose of calculating voting rights, a holding of more than 50% of the voting rights shall be deemed to qualify as a holding of 100%. In calculating indirect participations, this would better reflect the reality than the actual rate of holding.
21. Concerning the specific issue of influence or control exercised by an individual, it is necessary to assign the same consequences when family members are involved. It could thus be defined that influence or control exercised by the spouse and lineal ascendants and descendants has the same effect as if it were exercised by the individual itself.

Do you have comments or remarks regarding the approaches outlined above?

