

**Commission Non-Paper to informal Ecofin Council, 10 and 11 September 2004**

**A COMMON CONSOLIDATED EU CORPORATE TAX BASE**

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**INTRODUCTION**

The European Union is still lagging behind the Lisbon-goals and in particular its self-set objective of becoming, by 2010, the most competitive economic zone in the world. It is therefore essential that the Union adopt as quickly as possible a common consolidated definition of taxation on company profits covering all EU company activities. This definition is currently still lacking for the Internal Market as this strategic measure to increase our competitiveness has not got off the ground because of a lack of political will. However, as the Commission concluded already in 2001 and confirmed in 2003, in order to take full advantage of the Internal Market companies need to have the possibility of using a common consolidated corporate tax base for their economic activities in the EU. Without such a tax base their rivals from the USA and also Japan will retain a distinct competitive advantage. The European business community is broadly supportive of this approach and its leaders are consistently calling on EU Finance Ministers to take action. Many Member States have initially been very cautious, if not hostile in some cases. However, recently a number of Member States have expressed their strong support for the objective of a common corporate tax base. The purpose of the present document is to gauge Member States' support for the Common Tax Base and explain the underlying conceptual issues from the Commission's perspective. A separate non-paper is available on the Commission's complementary initiative concerning a possible Home State Taxation (HST) pilot project for SMEs.

**CONCEPTUALISATION OF THE COMMON CONSOLIDATED CORPORATE TAX BASE**

***Basic approach***

A Common Consolidated Corporate Tax Base would provide companies with establishments in at least two Member States with the possibility to compute their group taxable income according to one set of rules, those of the new EU tax base. This would reduce the tax-related compliance costs and effectively tackle most of the tax obstacles that are currently still hindering companies in developing their EU-wide activities, e.g. as resulting from transfer pricing rules, the lack of cross-border loss-compensation etc. At the same time, it would in many areas effectively reduce the risk that Member States' tax laws are declared to be unlawful restrictions to the fundamental freedoms of the Treaty by the European Court of Justice.

This new approach would go some way to abolishing the current system of separate accounting for EU cross-border transactions within a group of companies. Under separate accounting Member States have the impression of being able to exercise full sovereignty in deciding which tax rules to apply. In reality, however, Member States' decisions on their respective tax bases have been dependent on each other already for many years and this interrelation is only going to increase. As things stand today, Member States' tax systems are also increasingly vulnerable to tax evasion and fraud

which exploits precisely the weaknesses of separate accounting in the Internal Market's legal context. Moreover, the current system is costing both companies and tax authorities dearly in terms of administrative and compliance costs. The varied and manifold problems in the area of transfer pricing exemplify this very well. Targeted initiatives such as Joint Transfer Pricing Forum are very useful but they will never be able to completely resolve these problems. For all these reasons it seems compelling to give companies an EU tax base, thereby recognising that their home market is now an EU Market, the Internal Market.

### ***Compulsory vs. optional tax base?***

From a purely economic perspective, a compulsory Common Tax Base that could ultimately even replace the existing tax bases constitutes a sound and efficiency-enhancing approach. Moreover, a compulsory system is less exposed to tax avoidance opportunities for businesses. However, comparable attempts at tax base uniformity have been unsuccessful several times over the last decades. It is therefore difficult to realistically expect Member States to suddenly agree to this procedure and even they did, finding the "common denominator" or compromises between the differing national rules would be a time-consuming, daunting task. In comparison, an optional system leaving companies the choice between the existing national base and the common EU tax base presents a number of practical advantages. Moreover, applying the new system as an option in parallel to existing national bases would avoid a potentially risky "big bang" changeover, leaving more control with Member States. Finally, an optional system matches the rationale of the common tax base concept which is only a concern for companies active cross-border. It is not the intention to strive for across-the-board harmonisation even of domestic tax rules just for the sake of uniformisation. In any event, the work on the common tax base can be started before there is any need to decide on the details of which companies should have the option, under which conditions etc.

### ***Common Corporate Tax Base for all vs. for specific categories of companies?***

The Common Tax Base will de facto be mostly attractive for larger companies. This is particularly true if it will be somehow derived from the International Accounting Standards (IAS) / International financial Reporting Standards (IFRS) as the starting point. Furthermore, the Internal Market tax problems of SMEs who trade in more than one Member State could be effectively addressed by the Home State Taxation approach described in a separate non-paper. If Member States so wish, the limitation of the Common Tax Base to larger companies, e.g. those quoted at a stock exchange or above a certain turnover threshold, could thus be envisaged.

### ***Common Tax Base vs. Common Consolidated Tax Base?***

For companies cross border tax consolidation is a major attraction and decisive advantage of the Common Tax Base. Having the same tax rules in each state but without consolidation (a 'simple' common tax base) by definition provides fewer benefits to businesses, for example transfer pricing remains a major issue. There are admittedly some practical downsides: consolidation requires the drafting of detailed rules, and more importantly the drafting and agreement of a mechanism for sharing the tax base between Member States. This is a challenging task. In particular there

seems to be agreement that accounting consolidation methods such as provided for in the International Accounting Standards are not suitable for tax purposes. Moreover, with full consolidation the immediate revenue consequences for Member States would be higher, although partly clawed back over time. At the same time, a 'simple' common tax base still brings considerable advantages in terms of lower compliance costs. Therefore one could, if need be, split the process into two phases: (i) development of the Common Corporate Tax Base and afterwards (ii) development of a consolidation method. Whether implementation should also follow this two stage approach is an open point depending on the rate of successful progress on the project. Work on an allocation mechanism (formula apportionment) should in anyway continue separately. However, in spite of the above-mentioned challenges the Commission is strongly in favour of consolidation as a necessary long-term correlative of the Internal Market as it is associated with significant economic benefits.

### **CORPORATE TAX RATES**

Any Community initiative in the field of company taxation has to be seen in the light of the above-mentioned Lisbon objectives. Furthermore, in its Tax Policy Communication of May 2001 the Commission stressed that *"Reducing the overall tax burden offers the opportunity to remove disincentives to employment, entrepreneurial activity and growth."* The Commission also concluded that *"tax systems must be made simpler and more transparent. In this context it is important to recognise that, while harmful tax competition must be addressed both at EU level and at the broader international level, notably within the OECD, and the State aid provisions of the Treaty must be respected, a reasonable degree of tax competition within the EU is healthy and should be allowed to operate. Tax competition may strengthen fiscal discipline to the extent that it encourages Member States to streamline their public expenditure, thus allowing a durable reduction in the overall tax burden."* Finally, the Commission pointed out that *"The efforts to curb harmful tax competition through the Code of Conduct on business taxation (...) will allow Member States to consolidate their tax revenue raising capacities, thus offering scope for reducing the high average tax burden on labour."*

The Commission stands by its analysis presented above. It is nevertheless mindful of the fact that, whilst a number of Member States seem to be supportive of work on a common base, this is linked in some instances to work on tax rates. Even the introduction of an EU minimum rate of corporate taxation has been proposed. Others seem to be hostile to a common base, and are in any event clearly opposed to work on rates. In the direct tax area, the Treaty only provides for the approximation of national rules when this is necessary for the proper functioning of the Internal Market. While it is true that many Member States have recently reduced their statutory tax rates, no significant reduction of effective tax rates or even decrease of corporate tax revenues has been observed. The Commission considers that efforts should be concentrated on developing a Common Consolidated Tax Base, thereby reducing the compliance burden of companies.

### **NEXT STEPS**

The Commission intends to step up the work on a common corporate EU tax base. It is now urgent to commence work on the definition of this tax base. The Commission

thus intends to examine the possibility of creating an appropriate working group with Member States. The possible alternative, an independent expert committee ('wise men group'), is unlikely to be successful and would risk resulting in a report outlining a possible common base which would simply be ignored. However, this does imply active assistance from supportive Member States will be required in the working group.

One of the first subjects to be considered by the group will be the basic approach to take for developing the common tax base. The Commission considers that despite some conceptual disadvantages (e.g. the move towards fair value and towards calculation of profit by comparing balance sheets rather than by measuring profits through the year; the uneven extension beyond consolidated accounts in Member States) the IAS can be used as a tool for designing a tax base, at least as general starting and reference point. However, discussions should ultimately be guided by appropriate tax principles which would be discussed at an early stage, taking particular account of similarities to and differences from accounting principles. These tax principles should also reflect the Lisbon-objective and in particular the need to boost the international competitiveness of EU companies by striving for a modern tax base that encourages investment and economic risk-taking. It should also be stressed that the Common Corporate Tax Base, once established, would not be systematically linked to accounting standards as any further development or evolution would be primarily driven by tax and not accounting needs.

The working group should preferably include all Member States but, subject to further discussion, potential sub-groups or informal parallel groups could be operated among a smaller number of interested Member States. As regards participation from private sector experts, excluding them would mean losing their valuable technical and practical expertise and it would be more difficult to maintain business interest if they were not directly involved. It should however be emphasised that the purpose of a common tax base is not to reduce the level of taxation in any way but rather to create a more efficient method of taxing EU companies in a broadly revenue neutral manner. The Commission therefore proposes to devise flexible meeting modalities that will allow involving business representatives and private sector tax experts.

#### **ENHANCED CO-OPERATION**

On the basis of the above-described work the Commission will examine the possibility for an appropriate legislative initiative addressed to all Member States or, if this cannot be attained within a reasonable period of time by applying the relevant normal Treaty provisions, the possibility for an enhanced cooperation for the introduction of the Common Corporate Tax base. The Commission further considers that, given their differing national rules and experiences, the technical input of all Member States would be most useful for the preparation of the common tax base. This last resort approach could be used following an appropriate Commission proposal and after approval within the Council by qualified majority. It would allow as small a group as eight Member States to co-operate more closely on the common tax base project. The approach is subject to the conditions outlined in Article 43 – 45 EU Treaty.

## **CONCLUSION AND ISSUES FOR DISCUSSION**

At this stage the Commission does not seek detailed agreement or support. But it needs an indication of how many Member States are broadly supportive in principle of the Commission extending its work in the area of a corporate EU tax base and how many are willing to provide resources and actively participate in the necessary work of designing a common corporate tax base. The more technical issues raised in the present paper are intended to illustrate the kind of topics which will need to be addressed in the subsequent political debate among Member States and with stakeholders.

Ministers are invited to

- indicate their degree of support for the Commission's proposal to start developing a common corporate EU tax base; and
- express any views they may already have on the key options and choices described in this paper, even though decisions on these will only have to be made at a later stage.