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COMMON CONSOLIDATED CORPORATE TAX BASE WORKING GROUP (CCCTB WG)

CCCTB: possible elements of a technical outline

ANNOTATED

Meeting to be held on 10, 11 & 12 December 2007

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WORKING DOCUMENT

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I. Purpose of the paper

This working document reproduces the Working document WP057 and is annotated by the Commission Services with a view to pick up on the main points raised in the written comments of 11 Member State experts received by the date of this document and Business Europe on the original Working Document WP057. These annotations reflect the Commission Services' understanding of these comments. They appear in shading and in italics.

Some MS made some general comments on the CCCTB and it is worth noting that one MS raised the possibility that if a 'corridor' i.e. a range of acceptable tax rates were to be established this would assist in the implementation of the CCCTB. Another commented that the controversial issue of tax rates should not be allowed to 'block' progress. One MS commented that enhanced cooperation should be examined as a possibility if unanimity were not possible. One MS wanted consolidation to be deferred to a 'second' stage, another thought that consolidation was an integral part. One MS suggested that 'tax principles' be re-visited with a view to including them in the Directive.

This method of presenting summarised comments highlights a range of views on some specific points from those Member State experts who have contributed in writing and these areas will require careful consideration and discussion as the work progresses. There are currently twenty seven different sets of rules and during the process of agreeing a single common approach it is inevitably the areas of disagreement which are highlighted rather than the areas of agreement, as it is these differences which require the most work.

Throughout the document the terms 'members', 'experts', 'State', 'Member States' and MS are used. In common with other documents these should be understood to refer to individual experts participating in the meeting. They do not indicate any formal position or view of a MS. Similarly where comments are included from the 'Commission Services' (CS) these do not indicate any formal position or view and are included for clarification purposes.

1. Based on work done to date in the CCCTB Working Group (WG) and its various Sub-Groups, this paper sets out a possible outline of the principles of a Common Consolidated Corporate Tax Base (CCCTB) by beginning to bring the various structural elements of the base together into a coherent set of rules. It also seeks to take account of the discussions with business and academics.
2. The purpose of the paper is to prompt comment and discussion on key issues in order to assist the Commission Services in taking the work forward and to highlight a number of areas on which further guidance from the WG would be helpful.
3. The paper merely represents work-in-progress and does not purport to be comprehensive. It lists a number of areas (throughout and at the end of the paper) which the Commission Services consider to be outstanding. Guidance from the WG on further outstanding matters would be welcome. The ideas presented in this paper are meant for discussion and do in no way pre-judge the contents of a possible future Commission proposal.

4. The paper sets out a number of preliminary conclusions. Where more than one approach to a particular issue has been discussed in the WG and the paper recommends one approach only, the Commission Services are particularly interested in comments on the consistency of the choices taken as a whole.

II. Basic Structure of paper

5. The paper covers first the basic rules for a single company before moving on to rules for groups of companies which qualify for consolidation. These consolidation rules would take precedence over some of the basic rules for the single company, for example transactions between consolidated companies would not have to be valued at arm's length. Some of the rules related to consolidation (and to the sharing mechanism) would however be relevant for single companies with a permanent establishment (PE) in another Member State (MS). It should be noted that the particular situation of financial institutions and how the CCCTB might need to be adapted to take their needs into account is currently being reviewed and this paper does not cover any possible special provisions which might be recommended.
6. In shaping the rules it will be necessary to consider a number of situations¹:
 - (i) single resident company in an EU MS,
 - (ii) single PE in the EU of a non-EU-resident company,
 - (iii) single resident company with one or more PEs in the EU,
 - (iv) single non-EU-resident company with more than one PE in the EU,
 - (v) groups of companies – where companies are related companies (>20% but <50%)
 - (vi) groups of companies – where companies are related and although more than 50% owned are not consolidated (>50%, but <75%),
 - (vii) consolidated companies (>75%).

The paper identifies >20% owned companies as related companies; companies which are >50% but < 75% owned as members of a 'group' for the purposes of opting or not opting for the CCCTB but not for the purposes of consolidation: and companies >75% owned as members of a consolidated group.

Three MS remark that they do not see any purpose to a double threshold.

III. Basic structure of a possible CCCTB

1. General form

7. A proposal for a CCCTB would² take the form of a proposal for a Directive under Art. 94 ECT, which requires unanimity in the Council³. It will be impossible to lay down every detailed rule in the basic instrument. The Directive should therefore provide for implementing measures to be adopted under the Comitology Decision⁴.

¹ There may also be combinations of some of the situations referred to above.

² Although the terms "would", "should", etc are used throughout this document, it should be emphasised that this document simply outlines Commission Services' preliminary ideas and does not engage the Commission politically.

³ There is no legal basis for a regulation as suggested by some commentators.

⁴ Council Decision of 28 June 1999 laying down the procedures for the exercise of implementing powers conferred on the Commission (1999/468/EC, OJ 2006 C255/4). References to the comitology decision or

- 8 MS commented on Comitology.

These MS all referred to constitutional requirements that the basic elements of a tax base (scope, calculation, incentives,...) are to be set by primary law and this includes even technical changes where they have an impact on the size of the tax base. Two States take the view that Comitology should not be used at all. Thus, they recommend laying down all fundamental rules in the basic instrument (directives).

One MS however remarks that its understanding of Comitology is that it is not to define rules when these rules have a direct impact on the size of the tax base (for example depreciation rates) but to leave to Comitology only implementation measures of existing rules laid down in primary law in the same way as at national level a decree may provide for detailed technical implementation provisions in compliance with the main principles laid down in legislation. Another MS sees some benefits if the Comitology procedure were limited to situations specifically mentioned in the legislation and were for example aimed at giving a common definition to some terms the legislation would refer to.

- *Business Europe commented that to maintain commonality, the directive should be as detailed as possible and cover all the fundamental features of the common base. Moreover, the use of the Comitology vehicle might be needed to ensure sufficient flexibility provided this approach does not contravene MS constitutions and that this procedure would allow for sufficient consultation among the various stakeholders.*
- *Commission Services: acknowledge that the scope of measures to be taken under Comitology will need to be further clarified, although it should be stressed that the Comitology process would be strictly limited to the issuing of detailed provisions made necessary to implement existing provisions laid down in a CCCTB Directive – i.e. it would appear to be possible to satisfy the 'constitutional issues' as mentioned by MS.*

8. In order to allow the base to be adapted and kept up to date more easily, it would be wise to make provision in the Directive for some of its more detailed rules to be modified under the Comitology procedure. This would be in addition to providing for more detailed implementing rules to be finalised under that procedure.
9. In the work on the CCCTB constant reference has been made to IAS/IFRS. As the Commission has stressed in the past⁵, it is not possible to make a formal link between the base and IAS/IFRS. Such a link would, it is true, provide a common starting point and have the advantage of allowing the base to evolve over time in line with IAS/IFRS. However, many MS currently do not permit the use of IAS/IFRS for individual company accounts and not all IAS/IFRS are considered suitable for tax purposes. One therefore has to accept that most companies would start from accounts prepared in accordance with a number of different national GAAP (Generally Accepted Accounting Principles) and would be required to make a number of adjustments on key elements to satisfy the rules and definitions of the CCCTB in arriving at a uniform base. The rules for the CCCTB in the Directive would therefore define the tax base itself but would not define the methodology for adjusting the accounts (sometimes called the 'bridge') to arrive at the tax base – this is not possible as companies will potentially be starting from accounts prepared under twenty seven different national GAAP. Thus, to be clear, unless uniform treatment is explicitly provided for in the legislation the tax base would be computed by reference to national GAAP.

- 7 MS commented on this paragraph

procedure in this paper are to be understood as references to the regulatory procedure under article 5 of that decision.

⁵ See COM(2006)157, page 7

On the reference to local GAAP: if no common treatment is provided for in the CCCTB legislation, such a reference would not lead to a consistent calculation of the tax base. For one MS, in such a case, the CCCTB legislation would have to be interpreted (for example under the Comitology procedure) to arrive at uniform understanding. For another MS the CCCTB legislation would have to provide for the tax base to be calculated independently from the local accounting rules.

On the methodology of determination of the taxable income: one MS agrees that national GAAP constitute the only possible starting point when calculating the CCCTB. However if the CCCTB were not to define the methodology of reconciliation between the accounts and the tax base, this State understands that it would be left to national implementing measures.

Two States recommend establishing a tax balance sheet.

- *Business Europe: rather than referring to local GAAP in the case when common treatment is not provided, the aim should be to provide through the CCCTB a comprehensive "stand alone" legislation defining how to calculate the base.*
- *CS: uniformity is highly desirable having in mind that the base should be consolidated ; thus the CCCTB legislation should aim to be as precise as possible for that purpose. However legislation generally needs some interpretation or may in some cases not cover every situation or transaction. A practical way to resolve these issues has to be agreed (e.g. interpretation on the basis of the terms of the directives and on the basis of general tax principles to be mentioned in the legislation as suggested by one MS, or as suggested in the original WP057 by reference to existing GAAP)*

2. Scope

10. The Directive would apply to EU companies listed in an annex which are subject to MS corporate income taxes (or similar subsequently introduced taxes) listed in a further annex. It would also apply to third country companies which have a similar form to EU companies and which are subject to one or more of the abovementioned MS taxes. In the interest of legal certainty a (non-exhaustive) list of third country forms would be created and updated annually under the comitology procedure in the light of experience gained by tax authorities in applying the foregoing rule. Consideration will also have to be given to the situation of companies incorporated in third countries but tax resident in a MS. Companies to which the Directive would apply are referred to below as eligible companies.
11. Eligible companies resident in the EU may opt for the CCCTB. Eligible companies not resident in the EU may opt in respect of their EU PEs. Unless eligible companies are joining an existing consolidated group they may only opt with effect from the beginning of the tax year. The option would be valid for 5 years and be automatically renewed for successive periods of 3 years unless notice to the contrary was given by the company. Companies within a group where each company is linked by at least more than 50% common ownership must either all opt or all remain outside the common base⁶, subject

⁶ The conditions for calculating the ownership threshold would be defined in the same way - ie based on ownership of voting rights - as the (higher) ownership threshold for consolidation, which is dealt with below. This 50%+ threshold is to determine which companies qualify as a group which has to either opt, or not opt. The threshold for companies to consolidate within an opted group is suggested as 75%. A alternative would be to set the level for group companies covered by group opting for the CCCTB at the same level as the level for consolidation ie only group companies >75% would be required to opt for CCCTB.

to the same validity periods. An opted group must also opt, for the remainder of the relevant period, in respect of new companies joining the group⁷.

4 MS commented on the optionality + Business Europe

- *Most of them regard optionality as a potential danger in terms of compliance costs and of tax planning. They also consider that this decision is mainly a national decision to be taken when transposing the directive. In addition, one State suggests introducing a mandatory CCCTB with an optional consolidation.*
- *Business Europe strongly endorses the proposal for creating a system that is optional for business. A business should make a formal election to opt for the CCCTB regime.*

12. Where a CCCTB company or group is taken over by another group which has not opted for the CCCTB, the CCCTB company or group option would remain in operation until the end of the validity period, after which the new enlarged group must either all opt in or all opt out. The alternative of requiring the non-CCCTB company or group to opt immediately does not seem reasonable (although it could be permitted to do so⁸). On the other hand, it seems reasonable to respect the option for the remainder of the validity period in respect of the acquired group. This also has the advantage of preventing CCCTB groups from being able to opt out early by the device of a re-organisation.
13. Where the term 'taxpayer' is used in this paper it refers to companies who have opted for the CCCTB.
14. Resident taxpayers would be subject to corporate tax on their worldwide income (subject to double tax relief: see below).
15. Non-resident taxpayers would be subject to tax on business income attributable to an EU PE, as defined in the OECD Model (subject to existing treaty obligations with third countries).
16. The legislation would set out initial definitions of a PE based on those in the OECD Model but would also provide for the adoption under the comitology procedure of detailed definitions and guidance to reflect the specific nature of the internal market.
17. There would be no withholding taxes or other source taxation on payments of any kind made between taxpayers of the same consolidated group. The question arises whether source taxation should continue to be imposed on payments made between two single taxpayers or separate consolidated groups. Here the choice would seem to be between (a) eliminating source taxation on such payments and (b) introducing common rules on source taxation and for relieving double taxation in the hands of the recipient⁹. Comments are specifically requested on this issue.
18. Withholding taxes and other source taxation on payments made by a taxpayer to a non-taxpayer, whether EU resident or not, would continue to be governed by domestic and tax treaty arrangements. However, it would be important to work as soon as possible towards common arrangements in order to prevent distortions in patterns of investment.
 - *5 MS commented on the personal scope*

⁷ It would also be necessary to make provision for re-organisations. The Commission Services' general approach would be to prevent the breaking of the option through re-organisations.

⁸ In which case detailed rules governing the starting date for the option for the enlarged group would apply.

⁹ This would in turn raise the question of sharing of the withholding tax and, in the case of a consolidated recipient, the cost of giving the credit.

Three MS remark that a list of entities covered by the CCCTB directive is not appropriate or is at least not entirely clear: for one of them a better approach would be to simply cover any entities subject to corporate income tax or alternatively to leave it to MS to determine which types of entities would be covered. The other recalls its preference for a general definition with common criteria rather than a reference to liability to tax according to national legislation. The third one would welcome detail on how the CS intends to draw up such a list. One State notes that for reasons of equality of treatment, it could be obliged to extend the scope of CCTB to entities operating at national level. The directive may not therefore contain provisions prohibiting this extended application.

Third State entities: one State considers the approach taken the CS as sensible. For another, there could be an issue in the case when a non EU parents holds a subsidiary in MS 1 and another in MS 2 if these 2 States were to have a conflicting approach over whether this parent is of a similar form as an EU entity and whether it is transparent or opaque. [CS: WP057 assumes a common list – applicable to in all MS] More generally, to avoid cherry picking the CCCTB should cover EU entities even though they are owned by entities like trusts or funds no matter whether these entities are regarded as opaque or transparent.

On the transparent entities, the mutual recognition approach is not a matter linked to the scope of CCCTB and it should remain up to MS to determine whether the transparent entities are subject to corporate tax or to treat them as transparent.

On PE definition, two MS make clear that even if the CCCTB legislation were to give a common approach, the definition agreed by the different MS in their treaty arrangements with third States would prevail.

- 4 MS commented on withholding tax (WHT)

One agrees that transactions between 2 entities subject to CCCTB and belonging to the same group should not trigger WHT. This State would also recommend abolishing WHT in the case when the two CCCTB entities involved in the transaction are NOT part of the same group.

In contrast, two States consider that source tax should remain in force in this case and one notes that source taxation is outside the scope of this project.

Besides, one MS notes that when a DTA with a third State preserves the right to tax at source for an EU State, a unilateral elimination of WHT would not find support not only for budgetary reasons but also because of a lack of reciprocity.

- Business Europe: the CCCTB should apply to any form of companies which would be recognised by the legislation of a MS (this principle would make updates unnecessary)

On WHT, a preference is expressed for the elimination on payments between CCCTB taxpayers even if they belong to the different groups.

IV. Tax base of individual companies

19. This section deals with the basic rules which apply to taxpayers which are not eligible for consolidation. They also apply to taxpayers who are eligible for consolidation unless stated otherwise in the specific rules for consolidation. The tax base would be calculated as the difference between¹⁰

Income subject to tax less exempt income; and
Deductible expenses and other deductible items.

¹⁰ This assumes there is no separate tax balance sheet.

20. For the sake of clarity income would be net of VAT and other taxes and duties collected on behalf of government agencies. Deductible expenses would be net of VAT unless the VAT is partly or wholly non-deductible.
21. The tax base would be calculated on an annual basis. A tax year would be any 12 month accounting period. Detailed rules on opening and closing years and change of tax year would be required.
22. Income would be broadly defined to include income of any kind, whether monetary or non-monetary, including not only trading income but also proceeds from disposal of assets and rights, interest, dividends and other profit distributions, royalties, subsidies and grants, gifts, compensation and ex-gratia payments. Income would not include equity or debt raised by the taxpayer.
23. The following would be exempt income:
- subsidies directly linked to the acquisition, construction or improvement of a depreciable business asset¹¹;
 - proceeds from the disposal of pooled assets¹²;
 - certain dividend and PE income and capital gains (see rules on participation exemption below).

3 MS commented on this point

One MS remarks that subsidy under this paragraph should be understood as a subsidy granted by an external entity and not an intra group subsidy. In the later case, such a subsidy would be eliminated in consolidation and would never reduce the tax base.

Another recommends allowing companies to opt (as in IFRS) for exemption (and reduced depreciable value) or taxation (and depreciation on the full price) in order to eliminate the need for an adjustment to their accounts in this respect.

One State considers that it is not appropriate to consider subsidies linked to assets as exempt income.

24. Deductible expenses would mean all expenses incurred by the taxpayer for business purposes in the production, maintenance or securing of income including costs of research and development or in the raising of equity or debt for business purposes.

Business Europe: strongly opposes any 'business purpose test' which could trigger harmful uncertainty and lead to complex evaluation processes both for business and administration. However, for closely held companies such a distinction should be maintained.

25. The Commission Services suggest that the definition would be accompanied by a list of non-deductible expenses, to include
- profit distributions, repayments of equity or debt or any payment to or expenditure incurred for the benefit of shareholders or persons related thereto,
 - expenses relating to assets treated as non-business (see below),
 - 50% of entertainment and representation costs,
 - appropriation of retained earnings which forms a part of equity (reserves),
 - corporate income tax,
 - bribes,
 - fines and penalties payable to a public authority for breach of any legislation,
 - management costs to the extent to which they are incurred by a company in deriving dividend and PE income and capital gains which are exempt income,¹³

¹¹ A corollary of the exemption of the subsidy is a reduced depreciation base.

¹² The proceeds from the disposal of pooled assets reduce the balance of the pool to be depreciated in future years. Full details about pooling rules are given below.

- monetary gifts and donations except to charitable bodies meeting common criteria to be established under the comitology procedure,
- costs relating to the acquisition, construction or improvement of fixed assets except those relating to research and development¹⁴.

All expenditure on staff, including directors, would be treated as a business expenditure on the assumption that MS would subject, if deemed necessary, any private element/benefits in kind to personal income taxation. Similar considerations apply to assets purchased wholly or partly for the benefit of an employee (see business assets below).

▪ *MS' comments*

As a general comment one MS notes that under the principles set out in this chapter the tax base would not be broader than its current national tax base but in fact narrower.

Several States consider that the definition criteria of a 'charity' should be detailed in the directive itself.

Several insist on the need to give more detail on the definition of "entertainment and representation costs".

One State stresses that hidden distribution (which represents a key anti avoidance measures in a number of tax systems) should be explicitly mentioned on the list of non deductible expenses.

Three States express concerns regarding the deductibility of financial costs and one makes a parallel with participation exemption (regarding capital gains on shares) and consolidation in this respect.

Two States insist that local taxes and incentives should not be taken into account for the calculation of CCCTB and thus be left at national level for potential deduction after apportionment.

- *Business Europe: disallowing entertainment costs and management costs is in contradiction with the principle of net taxation (i.e. all expenses are deductible). On staff expenditures, the deduction should also include costs in the forms of options and shares.*

26. Fixed business assets would be tangibles, intangibles, financial assets and proprietary benefits acquired by the taxpayer for value where they are capable of being valued independently and are used in the business in the production, maintenance or securing of income for more than 12 months. Such assets would be depreciated in accordance with the rules below. However, where the cost of its acquisition, construction or improvement was less than EUR 1000 an asset would not be treated as a fixed asset and would be immediately deductible.

One State would recommend establishing a maximum amount per tax year because the total amount of all these less than 1000 € items could be significant in the end.

For Business Europe, the 1000 € limitation is too low and should at least be linked to a price index.

27. Acquisition, construction or improvement costs would be recorded for each individual asset separately.¹⁵

¹³ Interest on, and costs of loans taken up for the acquisition of shareholdings from which the exempt distribution of profits is derived would not be a non-deductible expense – ie would in principle be deductible

¹⁴ This effectively gives 100% deduction of research and development expenditure even when of a capital nature.

¹⁵ A fixed asset register is required with details of original costs, improvement costs and year of purchase.

28. Traditionally certain assets, such as yachts, hunting and fishing rights, leisure accommodation and facilities and expensive cars, are sometimes considered to be inherently non-business, or partly non-business (unless they form part of the core business). The members of the CCCTB WG are invited to consider whether a similar approach should be followed under the CCCTB which would require common definitions.

- *4 States commented on this paragraph*

Most of those States support this approach

One State would recommend adding aircraft to the list of non business assets.

One State however would rather examine on a case by case basis the connection to business of every asset.

One MS does not see the need for such a definition for technical reasons. The only deductible expenses would be those which would fulfil the requirement of business purpose test and this is already mentioned in the general definition of deductibility of expenses.

- *Business Europe: strongly opposed; notes that non business expenses could be simply regarded as fringe benefits to be taxed in the hands of the recipient.*

29. Tangible assets not subject to wear and tear and obsolescence such as land, fine art, antiques, or jewellery and intangible assets with an indefinite life and financial assets would not be depreciated unless the taxpayer demonstrates that it has permanently decreased in value¹⁶; in any event, financial assets in respect of which any gain would be exempt would not be depreciable.

30. Inventories are not fixed assets and would not be depreciated. Inventories are current assets held for sale, in the process of production for sale or in the form of materials or supplies to be consumed in the production process or in the rendering of services¹⁷.

1. Recognition and Timing

31. Income and expenses would be recognised on an accruals basis in the tax year to which they relate. This reflects general accounting practice and corresponds to the IFRS Framework, under which the effects of transactions and other events are recognised when they occur (and not at the moment when cash or its equivalent is received or paid).

One MS remarks that the concept described in this paragraph might not lead to a uniform treatment especially if it turns out to be in practice based on national accounting rules.

32. Generally speaking, the expense should be established and the amount known in order to be accrued. However, when an amount arising from a legal¹⁸ obligation or a likely legal obligation relating to activities or transactions carried out in the current or previous tax years, such as potential warranty claims, can be reliably estimated, the expense would be deductible in the current tax year (provided that the eventual settlement of the amount would result in a deductible expense)¹⁹. Where the obligation relates to an activity or transaction which would continue over future tax years, such as an obligation in relation to final clean-up costs, the deduction would be spread over the estimated duration of the activity or transaction.

¹⁶ If exceptionally it proved that the write-off were not justified it would be reversed.

¹⁷ IAS 2, para. 6.

¹⁸ Legal is used in the sense of either contractual or statutory.

¹⁹ This is partly based on IAS 37, para. 10 definition but excludes “constructive” obligations, i.e. non-legal obligations arising from e.g. a pattern of behaviour.

33. It may be noted that under the preceding paragraph obligations that have accrued in current or previous years in respect of future pension payments would be deductible. This would ensure uniform treatment of pension arrangements, whether they take the form of statutory or occupational contributions to an external fund or an internal fund within the company.

States who commented on this point (paragraphs 32 & 33) welcome the restriction to the legal obligations regarding the deductibility of provisions.

Regarding pension schemes, one State expresses concerns regarding deductions allowed in respect to voluntary schemes especially when such a scheme would only benefit to the directors of the company. This State also remarks that in the case of voluntary pension schemes where contributions are paid to an internal fund, deductibility should be carefully considered having in mind that such payments could be compared to the constitution of a reserve (retained earnings).

One State which currently disallows the pension scheme provision deduction insists on the need for a transitional measure for budgetary reasons.

34. Amounts deducted under the preceding paragraphs would be reviewed and adjusted on an annual basis. In calculating the tax base in future years account would be taken of amounts already deducted and any necessary adjustments made in order to prevent double deduction. A reliable estimate would be based on past experience and the factors to be taken into account would include any past experience of the company, the group and the industry.

35. The total amount of deductible expenses for a tax year would be increased by the value of inventories at the beginning of the tax year and reduced by the value of inventories at the end of the tax year²⁰.

36. Special rules would be required for long-term contracts. It is suggested to follow the principle in IAS 11, para. 22, i.e. recognising both income and expenditure by reference to the stage of completion in each tax year.

One MS stresses that the stage of completion criterion contradicts in practice the realisation principle.

37. Costs relating to a long-term contract would generally be deductible in the tax year in which they are incurred under the normal rules above. However, as the normal stock adjustment would defer these deductions until completion of the contract, costs on such contracts must be removed from the definition of inventories in order for the costs to be deductible as incurred.

38. Income relating to a long-term contract would similarly be recognised in the tax base on an ongoing basis during the life of the contract²¹. The amount of income to be brought in each year could be determined either on the basis of the ratio of costs of the year to the overall estimated costs or on the basis of an expert valuation of the stage of completion at the end of the tax year.

39. A long-term contract would be a contract
- for manufacturing, installation or construction; or the performance of related services,

²⁰ This is standard accounting practice and serves to match income with the relevant expenditure. The effect is to deduct opening stock from income and add closing stock to income.

²¹ Although this appears to tax income before it is received long-term contracts would normally involve stage payments and it seems unreasonable to allow deduction of all costs but to tax no income.

- the term of which exceeds or is likely to exceed 12 months.
40. A deduction would be allowed for a bad debt²² if the following conditions are met:
- an amount corresponding to the receivable was previously included in the tax base and
 - the taxpayer has taken reasonable steps to pursue the payment and reasonably believes that there is a serious risk that the receivable would not be paid wholly or in part.
41. In determining whether the steps in pursuing the payment have been reasonable the following would be taken into account:
- Proportion of the debt which the costs of collection would represent,
 - The prospects of successful collection,
 - Whether it is reasonable in the circumstances to expect the company to pursue collection.

The above approach would appear preferable because, although requiring consideration of individual debts, it would be more likely to reflect commercial reality than a fixed rate approach.

▪ *MS' comments*

On bad debts provisions some States together with Business Europe express concerns regarding the interpretation of the concept of "reasonable steps".

Two States suggest adopting a fixed rate approach (deduction based on a maturity test) to avoid possible diverging interpretation by up to 27 administration of the "reasonable steps" concept. One of these States also recommends disallowing any bad debts deduction in respect of transactions between related parties. Another State would recommend excluding such deduction in respects of loans between companies and to apply it only in respect of other receivables.

▪ *Business Europe recommends clarifying this concept in order to provide more certainty.*

42. The tax base would be increased during a tax year by any amount deducted as a bad debt in previous tax years to the extent that the respective claim is settled during the year.

2. Measurement

43. Income and expenditure would be measured by reference to:
- the monetary consideration for the relevant transaction, such as the price of goods or services,
 - the market price where the consideration for the transaction is wholly or partly non-monetary,
 - the arm's length price in the case of transactions between related parties²³.
44. In relation to loan transactions the arm's length price would mean an arm's length price based on an arm's length amount. In other words, both the amount of interest and the amount of the loan must be arm's length.

Business Europe expresses concerns on this provision as it appears to introduce a new and broader concept of transfer pricing. From a practical point of view, it seems virtually impossible to find a benchmark to justify the arm's length amount of a loan. If there is a

²² Special rules may be required for certain financial institutions.

²³ Related parties are further defined below.

concern about abuses, this should be dealt with under a general anti-abuse rule (and not by introducing thin/fat capitalization rules).

45. A taxpayer making a non-monetary gift (including a gift for a token payment) would be treated as if a disposal has been made at the market value of the gift. The cost of making the gift would remain deductible.
46. An exception would apply to gifts to charities meeting common criteria to be laid down by the comitology procedure in that the deemed disposal at the market value would not be taxed and the cost would remain deductible. Monetary and non-monetary gifts to such bodies would thus be placed on the same footing²⁴.
47. A taxpayer receiving a non-monetary gift, including a gift for a token payment, would include this in taxable income at market value. Where the gift is a depreciable asset it would not however be treated as a purchase of a depreciable asset and depreciated.

- *MS' comments*

On paragraphs 46 & 47, one State insists on the setting of a limitation regarding the tax deductibility of gifts and supports that the donation should not be taxable in the hand of the charity receiving the gift. One State expressed doubts as regards non-monetary gifts and the need to encourage such transactions.

- *Business Europe regards the suggestion of having to make non-monetary gifts at market value highly questionable and would favour a book value valuation for such transactions.*

48. Tax base, income and expenses would be measured in EUR or translated in EUR on the last day of the tax year at the average exchange rate issued by ECB / central bank of the State whose currency is being translated.
49. Gains and losses incurred on conversion of foreign currency to EUR would be included in the tax base in the tax year when they are incurred.
50. Matching of gains and losses on transactions including hedging: detailed rules would be required. A description of these will be prepared for a future meeting.
51. It is necessary to lay down some principles of stock valuation. However, the most important principle is that the taxpayer should be consistent from one year to the next in the principles applied.
52. Inventories would be valued on the last day of the tax year at the lower of cost and net realisable value²⁵.
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.

Business Europe would like the option for the LIFO method to be allowed. As a group elect to enter the CCCTB regime, it should include in that election whether FIFO or LIFO will apply for the period of the election.

²⁴ Where the gift is of a pooled asset, the pool value would be reduced by the open market value of the gift unless it is to a charity.

²⁵ Where net realisable value is less than cost, the difference is effectively written off through the stock adjustment.

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.

One State expresses doubts on the inclusion of indirect costs for the valuation of inventories and regards it as discriminatory to require that the taxpayers who wish to include them would have to have been traditionally using this method.

55. Work in progress on long term contracts (see above) would be excluded from the value of inventories for the purposes of the stock adjustment.

3. Depreciation

56. The Commission Services suggest a system under which long-term assets such as buildings would be depreciated on an individual basis whereas short to medium term assets would be pooled for depreciation purposes.

- *6 MS commented on this point.*

One MS mentions that generally the system suggested by the CS seems reasonable.

For one MS: having pool and individual depreciation adds complexity. Simplicity can not be used as an argument in favour of pooling because several MS have expressed their willingness to draw up uniform tables of depreciation rates. However another MS in favour of the individual approach admits that procedures to simplify evaluation (e.g. pooled depreciation) for particular types of assets may be allowed.

Two MS remark that the pooling method is problematic in business reorganisations, especially in divisions and transfer of business because it is not possible to calculate the tax written down value of a single asset if the sale proceeds are deducted from the value of the pool. Thus, it would be rational to use the pool method for assets that are quite short term and usually not sold (assets with a short or medium term useful life are not usually sold or even if they were, the sale proceeds would probably be close to the tax written down value of that asset. A reasonable limit for the useful life of assets to be included in the pool would be e.g. 8 years and the depreciation rate could be higher, e.g. 25 %. Assets with a useful life of more than 8 years would be depreciated individually.

Another State expresses same concerns regarding the potential difficulties raised by the pooling system and highlights the implicit tax deferral granted on the capital gains implied by such a method. In any case, this MS recommends that there should be more than one category of pooled assets in order to approximate tax and economic depreciation.

- *Business Europe: welcomes the proposal based on pooling as it adds simplicity (pooling should be used at least on short and medium term assets).*

57. The depreciation base would comprise the cost of acquiring, constructing or improving a fixed business asset. Directly linked ancillary costs such as professional and legal fees, transportation and installation costs would be included.

Business Europe: it seems reasonable to use the 'clock starts again' approach for the improvement costs and to treat them as a new asset for depreciation purposes.

58. Tax written down value of a business asset or assets pool would mean the depreciation base less total depreciation deducted to date.

59. The depreciation base of a depreciable business asset would be reduced by any subsidy directly linked to the acquisition, construction or improvement of the asset as referred to above in the paragraph defining income.

60. Depreciation for business assets would be deducted by the economic owner. The economic owner would mean the person who has substantially all the benefits and risks attaching to an asset, regardless of whether that person is the legal owner. A taxpayer who has the right to possess, use and dispose of an asset and bears the risk of its loss or destruction would in any event be considered the economic owner²⁶.

61. A business asset would be depreciated by no more than one person at the same time. If a single economic owner cannot be identified then depreciation would be deducted by the legal owner.

One State expresses its openness to the concept of "economic owner" but insists on the stipulation that only one taxpayer should be allowed at a given moment to depreciate and that the asset will never be depreciated for more than its acquisition cost.

62. The overall depreciation for each asset would amount to the maximum 100% of its original acquisition, construction or improvement costs.

63. Improvement costs would mean any subsequent expenditure on a business asset that materially increases the capacity of the asset or materially improves its functioning.

64. As the above rule may be difficult to apply consistently, one might for the sake of simplicity consider adding a rule to the effect that any expenditure representing more than 10% of the initial depreciation base of a business asset be treated as improvement costs.

65. Under the system considered for long-term assets (i.e. straight-line depreciation at specified rates) there are two ways of dealing with improvement costs: either the improvement cost is depreciated at a higher rate over the remainder of the depreciation period for the underlying asset; or the clock starts again for the improvement costs, i.e. the improvement cost is treated as a new asset. The latter would appear preferable as it is consistent with the treatment of pooled assets (on pooled assets generally see below). Where a pooled asset is improved, the improvement cost would be added to the pool and depreciated with the rest of the pooled assets at the relevant rate.

Long Term (individual) Assets				
	Asset		Improvement depreciated at 4% as asset 'clock starts again'	Improvement depreciated at higher rate over remaining life
Cost	100			
Depreciation Yrs 1-10 at 4%	- 40			
Tax Written Down Value (TWDV)	60			
Cost Year 11			50	50
Depreciation in Yr 11 at 4%	- 4		- 2	

²⁶ More detailed rules might be necessary for the application of these principles to certain categories of transactions, eg financial leases.

25 yrs - 10yrs = 15yrs at 6,67%			- 3,3
TWDV	56	48	46,7

Pooled Asset			
	Asset	Improvement depreciated at 20% in pool 'clock starts again'	Improvement depreciated at higher rate over remaining life
Cost	100		Not applicable
Depreciation Yr 1 20%	- 20		
TWDV	80		
Depreciation Yr 2 20%	- 16		
TWDV	64		
Depreciation Yr 3 20%	- 12,8		
TWDV	51,2		
Cost Year 4 added to pool	50		
TWDV	101,2		
Depreciation Yr 4 20%	- 20,24		
TWDV	80,96		

Assets depreciated on an individual basis

66. The acquisition, construction or improvement costs of a business asset would be depreciated individually on a straight line basis
- at 2.5% per tax year in case of buildings,
 - at 4% per tax year in case of long term tangible assets.

A long-term tangible asset would mean a tangible asset the useful life of which is 25 years or more, or the acquisition or construction costs of which exceed EUR 5,000,000²⁷.

- *5 MS commented on this*

1 MS: considers 5,000,000 € as being too high.

2 MS: the cost does not have any relation with the useful life.

3 MS: 25 years is too long

1 MS: 2.5% for buildings is correct

- *Business Europe: 5,000,000€ is too low. There is no relation between the cost and the period.*

²⁷ Detailed rules defining what a single asset is would be required either in the Directive or under the Comitology procedure.

67. Certain types of asset would in any event preferably be deemed to be long-term assets, such as planes, ships and hovercrafts.
68. The acquisition costs of intangible business assets would be depreciated individually on a straight line basis over the period for which the asset enjoys legal protection or for which the right is granted or, if that period cannot be determined²⁸, 15 years.

One MS commented on this

This MS welcomes the CS proposal regarding intangible assets.

69. A full year's depreciation would be deducted in the year of acquisition or entry into use. No depreciation would be deducted in the year of disposal. This is suggested with a view to keeping the rules as simple as possible and there does not appear to be any particular benefit in time apportioning depreciation when assets are purchased or sold during the year. This would also be consistent with the treatment of pooled assets.

Business Europe endorses this proposal as it promotes simplicity.

70. Where an individually depreciated asset is disposed of (whether voluntarily or involuntarily) during a tax year, its tax written down value would be deducted from the taxable base in that year. This is a corollary of the taxation of the sale proceeds.
71. Where the proceeds are re-invested in a replacement asset within a certain period the excess of proceeds over tax written down value should be deducted from the tax base in the year of disposal and the depreciation base of the new replacement asset should be reduced by the same amount. This means that the taxation of gains on asset disposals can be deferred over the life of replacement assets – the same would apply for pooled assets.

Two MS commented

For one MS, it could be considered not to allow replacement in assets outside the EU.

The other MS expresses doubts on this mechanism given its potential complexity.

Assets depreciated on a 'Pooled' basis

72. The suggested approach is to use the reducing balance method at a rate of 20% per annum and for disposal proceeds to be deducted from the available pool balance, thereby effectively deferring capital gains on assets.
73. Business assets other than those referred to above (and depreciated individually) would be depreciated together in a single assets pool at the rate of 20% per tax year of the depreciation base.
- *One State would agree on a 25 % depreciation rate provided that only short terms assets are treated according to the pool method.*
 - *Business Europe suggests an increase of the rate to 30 % (and explains that under a declining balance method, the effective depreciation rate declines in practice; thus 20 % would impose a too long period to achieve a full depreciation).*

²⁸ I.e. purchased goodwill depreciated over 15 years.

74. The depreciation base would be the tax written down value of the assets pool at the beginning of tax year, plus the acquisition, construction or improvement costs of business assets acquired or created during the year, less the sales proceeds of business assets disposed of, and any compensation received for the loss or destruction of such assets, during the tax year (ie for both individual and pooled assets a full year's depreciation would be deducted in the year of acquisition or entry into use and no depreciation would be deducted in the year of disposal).
75. If the depreciation base as calculated above is a negative amount, an amount would be added to bring the depreciation base to zero and the same amount would be added to the tax base. If the depreciation base is a positive amount then it would be reduced by 20%, i.e. the deductible depreciation for the year, to arrive at the final year end tax written value of the pool. This would be the tax written value of the assets pool at the beginning of the next tax year.

Individual and Pooled

76. Depreciation of a business asset would start in the year when an asset is acquired or brought into use, whichever comes later.

Other

77. Where there is a permanent decrease in the value of a non-depreciable asset referred to above, the amount of the decrease in value would be deducted as depreciation. Where such an asset is disposed of it would be taxed in the same way as an individually depreciated asset (the proceeds are taxed, and cost less depreciation is deducted from the base).

1 MS commented

Deductions for a permanent decrease in value create an asymmetric treatment and add complexity.

4. Related Parties

78. It would be necessary to define related parties because transactions with related parties are measured by reference to the arm's length price (as mentioned above); unless the special rules for consolidated companies apply (see below). Parties are related where one controls the other or is controlled by the other, or they are both in common control. A controlling party may be an individual. It seems appropriate to adopt a wide concept of control including situations where there is the potential for significant influence. It also seems preferable to opt for a fixed threshold rather than a case by case approach. An effective holding or voting rights of 20% or more might be appropriate. The threshold would be determined by multiplication of the successive rates of ownership. However, for the purposes of this calculation an entity which owns more than 50% of the voting rights of another entity is deemed to own 100% of the voting rights of this entity. Related parties also include directors and relatives of related parties.

3 MS + Business Europe commented

- *For 2 MS: the definition of related parties should be derived from the OECD Model and wonder why the threshold for determination of related parties and the one for participation exemption are proposed to be different.*

1 MS is against a fixed threshold considers better to establish legal criteria.

One MS thinks that this definition should also include individuals

- *Business Europe: welcomes a fixed threshold that adds certainty.*

5. Third country income and EU income other than PE income

79. It would, at least in the short term, be possible to introduce a common base for single companies while leaving existing domestic arrangements for dealing with EU and third country income intact (even if in the longer term common arrangements would be desirable for third countries). However, for the consolidated base there is a need to introduce uniform rules as far as possible. As the Commission has frequently stressed its preference for a consolidated base²⁹, it would be a distortion to have different treatment of third country and EU income of single companies and consolidated groups. The treatment of third country and EU income for single companies is therefore the same as that for consolidated groups, and therefore the rules on foreign income are dealt with below, immediately after the section on consolidation (see chapter VII. Foreign income and participation exemption). However, any protective measures, in particular a possible switch-over mechanism (and CFC rules) in an intra-EU context would need to be compatible with EU law.

6. EU PE income

80. It would be possible, in introducing a common base for single companies, either to leave the existing domestic treatment of EU PEs intact or to opt for a common approach e.g. tax credit or exemption (with loss offset and recapture). However, to consolidate EU PEs (and subsidiaries) of groups but to exclude single companies with an EU PE from this treatment would be a distortion. Single companies with EU PEs should therefore be covered by the consolidation rules.

7. Transparent entities and hybrids

81. Where an entity is treated as transparent in the MS in which it is located, a taxpayer owning all or part of the entity would include its share of the tax base of the entity in its tax base as computed under the common rules. Where the tax base of the taxpayer falls to be apportioned (either because the taxpayer is a member of a consolidated group or because the transparent entity is located in another MS), apportionment would include the same share of the factors relevant to the entity. Transactions between the taxpayer and the entity would be disregarded as part of the consolidation to the extent of the taxpayer's share of the entity. Transactions with the entity would be treated as transactions with third parties (and subject to the arm's length rule) to the extent of the third party ownership of the entity.

²⁹ See e.g. COM(2006)157, page 7

82. Where the entity is located in a third country the income would be included in the base under the worldwide principle but subject to double tax relief under the principles laid down for foreign income (generally those for a PE).
83. Where an entity owned by a taxpayer is treated as non-transparent by the MS of the entity, this would be recognised by the State of residence of the taxpayer. The entity may or may not be a (CCCTB) taxpayer depending on whether it is a company listed under Directive, and the treatment would follow accordingly.

3 MS + Business Europe commented

- *One MS supports the mutual recognition principle suggested by the Commission. However two expresses concerns. One regards the principles set out in the outline as unclear and another one stresses that the mutual recognition should not lead to double non-taxation.*
- *Business Europe shares this view. Moreover, Business Europe insists on the importance of treating transparent entities as eligible entities.*

8. Losses for single company

84. It is suggested that CCCTB losses should be eligible for carry forward indefinitely, but that there should be no carry back of losses to previous years.

V. Consolidation

Some of the main benefits of the project are considered to arise from consolidation. By freeing companies from compliance with intra-group transfer pricing rules and allowing loss consolidation in a similar way to many internal regimes a consolidated base would contribute to creating a highly attractive area in which to do business in Europe and would help to secure a stable tax base in a competitive world environment.

2 MS recall their political position against consolidation.

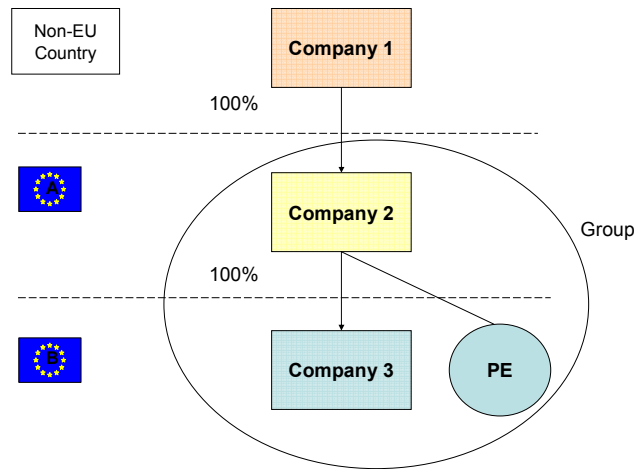
1. Groups

85. The general assumption is that consolidation would be mandatory for all companies opting for CCCTB which have a qualifying subsidiary (as defined below) or a PE in another State in the EU (ie the 'all-in' or 'all-out' principle).
86. Consolidation would extend to the entire tax base of all taxpayers of a group. In other words, consolidation implies consolidation of 100% of the tax base³⁰ of all entities belonging to the group (subject to rules for transparent entities, see above).

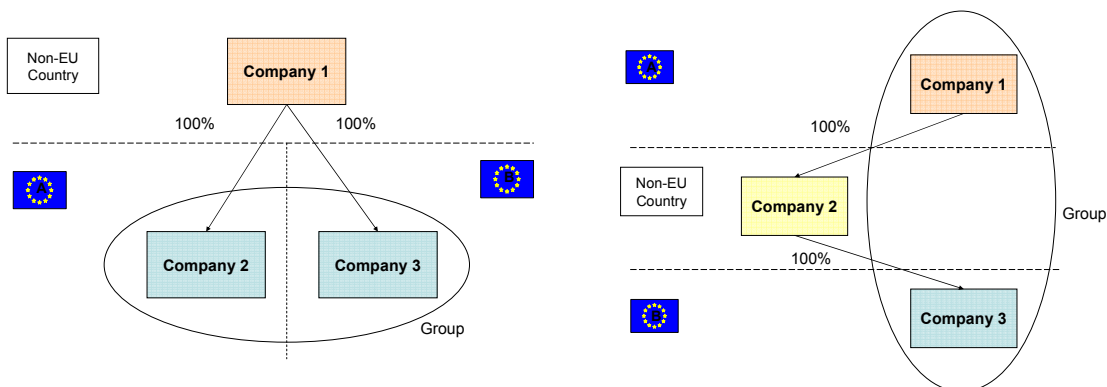
Business Europe favours full consolidation.

³⁰ So if a company owns 95% of a subsidiary it will consolidate 100%. There seems to be no need for compensation of minority shareholders under the CCCTB system as a group member receives a share in all the profits and all the losses of the group. All the group members receive reciprocal advantages and disadvantages. The system differs therefore from eg a system of group relief where compensation may be necessary because there is one way advantage where a group member surrenders a loss to the company claiming the tax relief.

87. A group would comprise an EU resident parent and its EU resident subsidiaries (including PEs), whether or not the EU-resident parent were controlled by a non-EU parent.

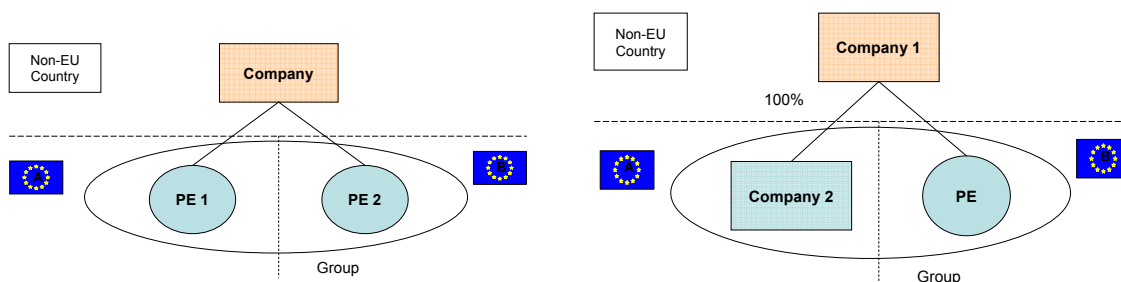


It would also cover a group of EU resident subsidiaries under the common control of a non-EU resident parent. The fact that the ownership chain of a group of EU companies includes a non-EU link company (the so called 'sandwich' situation) does not break the chain; otherwise taxpayers could split groups into multiple groups. (This also applies to the 50% threshold for opting for the common base as otherwise a group could opt for part of the group and keep part of it out of the base).



As noted above, a taxpayer with an EU PE is also deemed to be a group for the purposes of the consolidation rules.

88. Consolidation would also extend to PEs in two MS of a non-EU resident company or group and a PE and subsidiary in two MS of a non-EU resident company or group.



89. To be a qualifying subsidiary its voting rights would have to be owned directly or indirectly (i.e. through a chain of participation) as to 75%³¹ or more. For the purpose of calculating the parent company's level of indirect ownership each respective holding % would be multiplied. When a direct holding is more than 75% it would count as 100%. This ensures that all subsidiaries in which the parent controls directly or indirectly 75% of the voting rights are included in the consolidation. Without this a chain held at 75% through a number of tiers would fragment into a number of overlapping groups. When a direct holding is 50% or less it would count as zero. This ensures group control of any companies in the indirect 75% ownership chain.

- 6 MS commented on this point.

4 MS consider that capital ownership would be more adequate than voting rights or a combination of both. One MS insists that in the situation of indirect ownership a strict multiplication should apply for the determination of the ownership and stress that this approach would be more consistent with the full consolidation system.

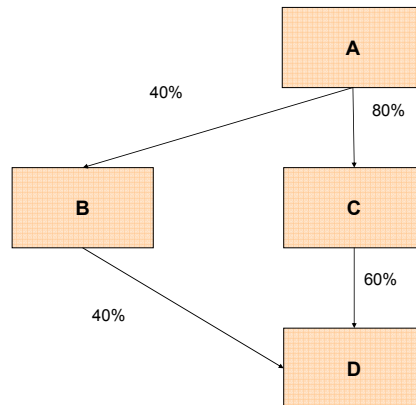
Two States stress that when non-EU entities are involved in the chain of participation, consolidation should not apply.

One MS would favour a higher threshold (90 %) contrary to another which would implicitly favour a lower threshold (more than 50 %).

- Business Europe notes that 75% is obviously a compromise but it should be borne in mind that some groups might be discouraged to opt if a substantial part of the group cannot benefit from consolidation and thus would recommend aligning the two thresholds (50 % instead of 75 %).

90. A 50% or less holding should count as zero to avoid the following situation:

³¹ This also applies where there is a non-EU link company.



Without the 50% rule D is in the group

A through C is 80% x 60% calculated as $100\% \times 60\% = 60\%$
 Plus A through B is $40\% \times 40\% = 16\%$
 76% , ie > 75%

But, A's participation in B is a minority participation. B's 40% in D cannot be controlled by A as A only has 40% of B. B could even be in another CCCTB group.

With the 50% rule D is not in the group

A through C is 80% x 60% calculated as $100\% \times 60\% = 60\%$
 Plus A through B is 40% x 40% calculated as $0\% \times 40\% = 0\%$
 60% , ie < 75%

91. For the sake of simplicity all members of a CCCTB group should have the same tax year. Rules would be laid down requiring companies joining the group to change their tax year.

1 MS stresses that all CCCTB groups should have the same tax year – the calendar year which would lead to some simplification e.g. in the case of a company being sold to another group.

2. Changes in the level of ownership

92. It is suggested that a taxpayer would be deemed to be 75% owned and therefore included in a consolidated group where the 75% test is met at the beginning and at the end of the tax year and ownership never drops below more than 50% at any time during the tax year.
93. The taxpayer would enter the group at the date when the threshold of 75% is reached. The same would apply to a taxpayer's subsidiaries which met the above tests. However, a taxpayer would not be included in a group unless the ownership conditions are met for at least 6 months.

- 2 MS commented

1 MS suggests a double condition for entering a group:

- 90% at the beginning, at the end and during 6 uninterrupted months.
- 50% minimum.

Another MS endorses the proposed 6 month "waiting period".

- *Business Europe: a 6 month ownership criterion seems reasonable.*

94. The taxpayer would leave the group on the day when the ownership of voting rights:
- falls below more than 50% at any moment, or
 - falls below 75%,
provided that it remains below 75% until end of the tax year. The same would apply to a taxpayer's subsidiaries.
95. The above is suggested despite the fact that in principle the threshold test should be satisfied throughout the whole tax year. As has been suggested on several occasions it could be useful to ensure that an insignificant variation in a holding does not trigger the exclusion of a company. This would help to ensure the stability of the group and avoid potential manipulation of the companies consolidated (which could otherwise be achieved by selling a very low percentage of shares). However, a straightforward averaging method could be difficult to implement in practice, particularly if the 75% threshold is not satisfied at the beginning and at the end of the tax year.

I MS considers that this method is too complex

96. It is therefore suggested that a company does not necessarily leave the group at the moment the holding goes below 75 % of the voting rights. However, as full consolidation would apply without adjustment for minority shareholders, it seems sensible that a company should always leave a group when a holding falls below 50% of the voting rights.
97. Entering and leaving companies should therefore start to consolidate with the rest of the group on the date they enter or leave (thus their transitional tax year is split into two parts). Another possible solution would be that joining and leaving entities are deemed to enter and to leave on the first day of the following tax year or on the first day of the current tax year. However, the suggested solution seems to better reflect the reality of such situations and allows immediate consolidation of entering companies and immediate 'deconsolidation' of leaving companies. Furthermore this approach appears to be already applied by some MS and seems to be preferred by business.
- *I MS the rules are too complicated. Breaking the tax period adds complexity. It would be preferable to apply consolidation only when the conditions are met from the beginning until the end of the tax year.*
 - *Business Europe is in favour of splitting the tax period. Some flexibility should be given in order to allow consolidation of recently acquired activities. Companies should be allowed to design the reorganisations with retroactive effect for both accounting and tax purpose on an optional basis.*

98. One potential difficulty of this approach is that at the end of the tax year the company may not know whether it has to consolidate. For example, in a group with a calendar year tax year 75% of a company is acquired in October, and six months later in March the holding has fallen to below 75% (but above 50%). For consolidation two tests have to be satisfied: (i) the ownership conditions have to be met for at least 6 months (see above), and (ii) where a holding falls below 75% if it increases again to 75% by the end of the tax year then the company remains in the group. In this example the group would have to wait until the end of the second tax year (December) to know if (ii) is met, and therefore (i) is met and the company can be consolidated in both years. This could be

avoided by consolidating companies only from the date when the conditions have been met for 6 months.

99. An additional issue to be considered is that if a company enters or leaves a CCCTB group in the middle of a tax year this may have implications for the calculation of factors in the sharing mechanism.

100. Losses incurred by a taxpayer before entering a CCCTB group would not be taken into account in the consolidation. Such losses would be offset against the share of the future consolidated profits attributed to this taxpayer in accordance with national rules.

Business Europe finds this reasonable, although it is necessary to analyse if it is not too complex

101. When the consolidation results in an overall loss for the group, this loss would be carried forward at group level and set off against future consolidated profits, before the net profits are shared out.

102. The aim of this would be to ensure that there are no 'stranded' losses. If, when the group makes overall losses, these were immediately shared out then in following years when profits were shared out there could be some unrelieved losses in some companies, whereas in others there were taxable profits.

103. No losses would be attributed to a taxpayer leaving a group. This is consistent with the idea that a group should be treated as far as possible as a single entity. Therefore when a company is sold any unrelieved losses carried forward at group level (see above) would remain in the group. The alternative of attributing losses to companies leaving the group would require that the existing company's losses be calculated in accordance with the sharing mechanism at the date of sale.

104. However, when a group terminates it can no longer be treated as a single entity so unrelieved group losses would be attributed to the taxpayers belonging to the consolidated group at the moment of termination. This attribution would be carried out according to the sharing mechanism calculations at the date of termination.

5 MS commented on this point

Some MS do not consider it consistent to treat differently the losses incurred by a group when the group terminates and when an entity leaves the group. One MS takes the example of a group taken over by another CCCTB group. If the group taken over terminates, the losses incurred by this group could not be set off against future profits earned by the companies of the former group which now belong to the new group. Such a situation seems to be unfair. Two States would favour an attribution of the losses to the leaving entities and when the group terminates but one remarks that the use of the formula used on the year of termination should be carefully considered because of potential abuse.

105. Although there might appear to be an inconsistency between the treatment of companies leaving the group and the treatment of companies when a group terminates this seems unavoidable. It seems reasonable to share out losses when the group terminates.

3. Sale of assets³² or shares

106. When a group company sells assets this would be taxed according to the normal rules. As intra-group asset transfers are carried out at tax written down value there is no effect on the consolidated base³³.
107. When a group sells shares in a group company and the company leaves the group, this would not be taxed if participation exemption rules apply (see below). Then the question arises as to whether it is necessary to have a mechanism for bringing into charge the unrealised gain on underlying assets in the departing company.
108. One extreme would be to look through the shares to the assets and treat the transaction as a sale of assets. This is consistent with the underlying principle that for tax purposes the group is a single consolidated entity and disposing of a company is in effect disposing of part of the business. Some might consider however that this pushes the logic too far.

One MS supports this option

109. The other extreme would be to apply the normal exemption in full in all cases. This would however plainly be open to abuse as assets could easily be transferred into a company and the shares sold. An intermediate solution is therefore suggested under which gains realised on the disposal of such shares would not be exempted to the extent that assets were transferred to the departing company within the present or previous tax year and their disposal would have triggered a gain³⁴ (possibly with the proviso that it is open to a taxpayer to demonstrate valid commercial reasons)³⁵.

- *3 MS commented on this point*

One MS considers that it would be fair that when a company is leaving the group leads to taxation of unrealised gains on the underlying assets in the leaving company. However, the rule envisaged in the document (two year test) is too easy to manipulate.

Another MS thinks that two years is too short.

- *One MS is concerned that such a rule could put the attractiveness of the base in danger. Business Europe: will provide specific comments separately.*

4. Intra-group transactions

110. The consolidated tax base would not include any profits or losses on intra group transactions between members of the consolidated group. This would include any profits or losses on the disposal of stocks, fixed assets, shares in consolidated companies or other tangible or intangible assets. Nor would it include intra-group provisions. This is explained more fully below.

³² Transitional rules would be necessary for assets owned by group companies prior to the establishment of the consolidated group.

³³ It may be noted that if moveable assets are a factor in any apportionment formula it may be necessary to consider some form of anti-abuse rule.

³⁴ Or, in the case of pooled assets, a reduction in future depreciation.

³⁵ As there is a commercial reasons proviso there is no need to make provision for roll-over on what are proceeds from the sale of shares – ie a share sale re-characterised as a sale of assets because there are no commercial reasons would not qualify for roll-over relief.

5. Consolidation Methods

111. Group companies that belong to a CCCTB group have to consolidate their tax bases where they meet the 75% ownership. As stated above this implies neutralising intra-group transactions so that only transactions between the group and third parties and other non-consolidated group companies have any tax effect.
112. There are two basic approaches. Intra-group income and expenditure other than that related to depreciable assets can either be (i) ignored completely or can be (ii) included by each group company and netted off when the consolidation is carried out.
113. Intra-group transactions concerning depreciable assets cannot be ignored completely as they need to be recorded at tax written down value.
114. Stock valuation is more problematic. Where closing stock includes goods purchased intra-group there would be an element of intra-group profit in the valuation unless all intra-group sales and purchases have been recorded at cost to the seller. Theoretically this should be eliminated. However, to calculate this adjustment accurately it would be necessary to maintain records which allow the company holding the stocks to value them at third party cost to the group. This would involve either an integrated stock system for the group or tracking the third party costs of goods as they move through the group. It is possible that some companies already have this information available and would be in a position to make a stock adjustment easily. There seems, however, no compelling need to require companies to do so providing that they use the same method consistently.
115. The examples³⁶ in the annex illustrate how the two options would function in practice using some simple figures. Option (i) appears to be the more straightforward, even if as is shown in examples 1 and 2 it is extended to record the intra-group transactions at cost. For examples 3 and 4 cost has to be recorded, and for examples 5 and 6 there do not appear to be any particular difficulties. Option (ii) appears to be more complex in that more consolidation adjustments are required. Consequently, option (i) seems to be preferable, but comments are welcome on whether or not option (ii) should also be permitted. However, it should be pointed out that it would not make sense for individual MS to require one option or the other as this could lead to a group of companies present in more than one MS being required to follow two different methods.

4 MS + Business Europe commented

- *Two MS would favour the option 2.*

One MS does not see the need to eliminate intragroup profits and losses on ongoing transactions (sale of goods, rendering of services).

One State stresses that no choice should be offered and that all MS should apply the same consolidation methodology.

- *Business Europe thinks that the first method is preferable as it would imply a reporting of intra group transactions at entity level.. Besides, Business Europe wonders why intra-group sales of assets should be recorded at tax written down value.*

VI. The Sharing Mechanism

³⁶ The examples are not exhaustive, eg intra group bad debts would follow the same treatment.

116. Details on the sharing mechanism are not included in this paper. Details of which, if any, items should not be deducted from the consolidated tax base but be deducted after sharing from the individual MS shares of the consolidated tax will be included in a future working document. The Commission Services suggest that certain local taxes should be included amongst them. It is also suggested that any incentives should be granted by way of tax credit to be set out against the tax liability in individual MS. Comments are welcome on this and on whether there should be any common framework for such incentives.

2 MS commented

1 MS support the CS approach regarding the potential national incentives: tax credit, if granted to the taxpayer according to domestic legislation should be set out against the tax liability at the level of individual MS.

Another State gives its preliminary comments on the different factors to be included in the formula: for the labour factor, both wages and social contributions should be taken into account, regarding the assets, the exclusion of intangibles is difficult to accept, sales by destination seems preferable because sales by origin could be extremely easily manipulated.

VII. Foreign income and participation exemption

9 MS commented on foreign income issues in general

Some express doubts on the possibility to include foreign income in the CCCTB mostly for feasibility reasons and because of potential complexity. 4 MS pointed out that they need to provide double tax relief (CCCTB directive will not override treaty arrangements with third country), and will remain obliged to calculate the tax relief according to the rules laid down in the relevant treaty. One State raised the specific issue of a CCCTB group which includes an EU PE of a third State company and the potential conflict with the provisions of the treaty between the other EU States involved and a third country as these provisions might be a barrier to the allocation of this PE's profit to a MS where the third State company has no PE (impact of apportionment).

Another State stresses that derogations in respect of third country treaty arrangements should not be temporary but be without time limit as otherwise they would be in a difficult position in the negotiations with the third countries.

One State believes that foreign income would need common treatment regardless whether the tax base is just common or common and consolidated.

117. Consideration has been given to the types of arrangements existing with third countries³⁷ in formulating suggested common rules. The rules on foreign income in the Directive would seek to balance the need to provide an adequate level of protection for the base while minimising potential conflict with existing treaties. Nevertheless it would still be necessary to allow MS in certain cases to derogate temporarily in order to respect existing obligations under agreements with third countries.

118. Foreign income would be included in the CCCTB under the principle of worldwide taxation, even if much of it would be exempt.

Business Europe fully endorses a CCCTB based on the exemption method.

119. Four broad types of income need to be considered:

- Income from PEs
- Income from major shareholdings
- Income from portfolio shareholdings

³⁷ The Directive would override conflicting provisions in any agreement concluded between Member States.

- Royalties, Patent income, Interest ('passive income') etc³⁸

120. It is necessary to distinguish between income from third countries and EU income. As regards 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. Portfolio dividends and other passive income would be taxed with a credit for withholding tax paid. Where income is taxed it would, if received by a member of a consolidated group, be shared among the MS in accordance with the apportionment key and the cost of the credit for foreign tax would likewise be shared. A mechanism would be required for calculating the limit of the credit to be given by each MS.

One State expresses reservations on the sharing of WHT which seems very complex and alternatively recommends including the income for its amounts net of WHT.

121. As regards EU income when this is income from a PE it would always be consolidated with the group or single company tax base. Dividend income from major shareholdings would be consolidated if the ownership requirements for consolidation (75%) were met and otherwise follow the same treatment as for third country income³⁹. Portfolio dividend income would follow the same treatment as for third country income, as would other passive income unless the requirements for consolidation were met. EU income would include domestic income.

122.

EU Resident or EU PE of non-resident receiving	from 3 rd country	from EU (ie another MS)
Income from PE	Exempt, subject to switch over to credit, shared income (+ shared credit)	Consolidated
Income from major shareholdings	Exempt, subject to switch over to credit, shared income (+ shared credit)	> 75% → consolidated 10-75% → exempt, no switch over
Income from portfolio	Taxable, shared income + shared credit	Consolidated income and credit (WHT if applicable) to be shared
Royalties, patent income, interest (passive income)	Taxable, shared income + shared credit	Consolidated income and credit (WHT if applicable) to be shared

123. The effect of the above arrangements would be to relieve economic double taxation on major shareholdings. Comments are welcome on whether it would be preferable to extend exemption also to portfolio dividend income in order to relieve economic double taxation.

4 MS commented on this point

Two States are sceptical on a general exemption on portfolio (need to avoid double non taxation / need for proper exchange of information / short term assets hold for trade)

One State (in favour of the exclusion from CCCTB of any third country income) considers however that, if worldwide taxation were to apply in the end, portfolio dividend income should be exempt.

³⁸ Foreign income may be received by a PE situated in the EU.

³⁹ It is unclear whether this mechanism could lawfully be applied to intra-EU dividends (Columbus Containers).

One State notes that general exemption for dividend income does not improve EU countries position when it comes to negotiations of treaties (some countries may not find necessary to negotiate with an EU country if there is already some vital groups' income exempted).

124. For major shareholdings the above participation exemption conditions would be modelled on those in the parent subsidiary directive. Exemption would appear preferable to credit because credit is complex to operate in practice, implying as it does the recalculation of profits of all subsidiaries according to rules of the country giving the credit. The method is particularly cumbersome in large business structures as lower tier subsidiaries have to be taken into account as well. Moreover, current trends seem to confirm a preference for exemption.

125. It is suggested that a major shareholding should be one where the recipient taxpayer has an interest in of at least 10% of either capital or voting rights and the shareholding or participation is held for an uninterrupted period of at least 12 months⁴⁰.

Most States which commented on this point support this definition for major shareholdings. However one insisted that there should be no departure from the criteria in the recent parent subsidiary directive.

126. It is also suggested to exempt gains on disposals of shareholdings meeting the same conditions, in which case rules would also be required for dealing with related expenses. This would apply to EU (including domestic) and third country gains.

127. If one opts for exemption as outlined above there is a need for measures to protect the tax base. In this respect consideration should be given to two possibilities: (i) a switch over to credit where exemption is not justified because of the low local taxation on the profits; and/or (ii) common controlled foreign corporation (CFC) rules.

128. On switch over one could for example provide that exemption would be conditional on profits from third countries being subject to a tax on profits at a rate of not less than 40% of the average statutory corporate tax rate applicable in MS and not being subject to a special regime resulting in a substantially lower level of taxation.

▪ *MS' comments*

One MS thinks that a fixed rate (for instance 10 %) would be simpler than the average of the tax rate in the EU suggested by the Commission Services.

One MS together with Business Europe thinks that real economic activities should not be affected by the switch-over mechanism.

▪ *Business Europe: given the average corporate tax levels within the EU, a level of 5 to 10 % appears reasonable.*

129. Comments are also invited on whether the tax base should be protected by a common CFC regime and, if so, the scope of such a regime. As there is widespread discussion at present on the reform of such regimes, comments would be particularly appreciated on (i) what types of income such a regime should target; (ii) what ownership threshold should apply; (iii) whether it should apply only in the case of undistributed profits in low rate jurisdictions or should apply generally to certain income types, whether distributed or not; (iv) whether the same or different arrangements should apply to domestic, non-consolidated EU and third country companies; and (v) whether such a regime would be seen as an alternative or an adjunct to a switch-over mechanism.

▪ *6 MS commented on CFC measures*

⁴⁰ The initial treatment would be to assume it will be held for 12 months, in the event that the holding is held for less than 12 months the exemption would be retrospectively reversed.

Most States agree that CFC legislation should mainly cover passive income and should not hinder real economic activities. One State would however apply CFC on mobile activities and another would apply it when more than one third of an entity's income is financial.

On the relevant participation to be covered, one State recommends making use of a 25% threshold, another one of a 50 % threshold (voting rights or capital or any rights would be taken into accounts).

On the geographic scope of CFC, several States would like to apply CFC measures to any entities not included in the CCCTB group and thus include EU and third country entities.

One State stresses that CFC would be complementary to switch-over and should not be applied as an alternative.

- *Business Europe considers that switch-over mechanism would be sufficient. Such a clause would only apply vis-à-vis third countries and never vis-à-vis EU States (even for those which would not participate in the CCCTB).*

130. It is considered that, despite the exemption of dividends from major shareholdings, interest on loans taken up for the acquisition of such shareholdings should in principle be deductible. To deny interest deductions would make the CCCTB extremely unattractive for EU groups with subsidiaries outside the EU. However, comments are invited on whether there is a need for protective measures to ensure that EU companies do not artificially convert taxable income into exempt (dividend) income by financing non-EU or non-consolidated subsidiaries by artificially high levels of equity. Borrowing to finance artificially high levels of equity in a subsidiary would result in an interest deduction in the EU while the income from the shareholding would be entirely or almost entirely exempt (when in normal circumstances one might have expected a mixture of exempt dividend and taxable interest income). One possibility would be to look at the ratio of equity to debt for the group as a whole and restrict the deduction accordingly to deal with artificial arrangements⁴¹.

3 MS commented on this:

They welcome a strong response to the situation of tax planning based on the allocation of equity and debt and regard this issue as a major distortion in the EU economies and advocate restrictions in respect of interest deductions. Two of them would recommend making use of a fixed debt equity ratio

131. It is considered that there is an important balance to be struck here between, on the one hand, providing adequate protection for the tax base and, on the other, providing a system that is competitive, workable and not overly complex.

132. It is suggested extending the exemption for major shareholdings also to PEs as otherwise this would be distortive.

133. The above would also apply to a non-resident taxpayer if the participation is connected with activities carried on by the non-resident taxpayer through a PE in a MS.

134. As it is suggested that management costs relating to the holding from which the exempt distribution of profits is derived should be non-deductible expenses (see above under deductible expenses where it is suggested these should be included on a list of non-deductible expenses) they could be calculated at a flat rate of 5 % of the profits distributed unless the taxpayer is able to demonstrate a different figure.

⁴¹ This paragraph refers to so-called 'fat capitalisation'. Thin capitalisation, in particular relating to inward investment to the EU from third country related companies would be covered by the general arm's length rules.

Business Europe opposes this 95/5 % rule and considers that these costs should be all deductible on the grounds of the net taxation principle.

135. As regards income from portfolio shareholdings and other passive income (this income would not be exempt) it is suggested that when calculating the maximum allowable tax credit the income should be decreased by related deductible expenses. In most cases such withholding taxes are imposed on gross income by the source State and credit capacity should be adjusted. It is suggested that the expenses related to such income should be deemed to amount to 2% of the gross income, unless the taxpayer is able to demonstrate a different figure. (This is to deal with the fact that the tax base on worldwide income is calculated on a net basis, whereas the with-holding tax on passive income is calculated on gross income). The example illustrates this in more detail.

Two States note that this mechanism for the calculation of the allowable tax credit illustrates the complexity of a worldwide system.

136. For those MSs with graduated rates of tax where income derived by a resident taxpayer from sources outside the EU is exempt, a MS could nevertheless notionally take into account the exempt income in calculating the amount of tax on the remaining income of such resident taxpayer.

One State notes that this measure would cancel out in practice the positive impact of the mechanism of graduated rates of tax.

137. Example

This illustrates how a resident taxpayer deriving income other than through a PE which in accordance with existing arrangements may be taxed in the third State receives a tax credit equal to the tax paid in the third State. It should be noted that the amount of the credit excludes in the case of a dividend, tax payable in the third country in respect of the profits out of which the dividend is paid. The credit would be limited to the amount of corporate income tax, as computed before the credit is given in each respective MS, attributable to the income taxed in that third State. Both the income and the third State tax would be shared in accordance with the sharing mechanism. Where the third State tax exceeds the tax due in the MS the excess is not relieved, subject only to any existing arrangements with third countries.

The group is composed of 3 companies, resident in MS A, B and C
Each MS shares one third of the CCCTB

Corporate tax rates	MS1	20%
	MS2	15%
	MS3	30%

CCCTB: Income with the source in MS	300
Deductible expenses	(330)
Dividend (gross) with the source in a third State	100
Withholding tax on the dividend in a third State	[20]
Royalty (gross) with the source in another third State	50
Withholding tax on the royalty in a third State	[5]
Consolidated base	120

	MS1	MS2	MS3
Share on CCCTB (1/3*120)	40	40	40
* rate	*0.20	*0.15	*0.30
Tax liability in a MS before credit	8	6	12

Income with the source in a third State calculation (one third of [gross income – related expenses])	Dividend	$\frac{1}{3} * (100 - (0.02 * 100)) = 32.67$	$\frac{1}{3} * (100 - (0.02 * 100)) = 32.67$	$\frac{1}{3} * (100 - (0.02 * 100)) = 32.67$
	Royalty	$\frac{1}{3} * (50 - (0.02 * 50)) = 16.33$	$\frac{1}{3} * (50 - (0.02 * 50)) = 16.33$	$\frac{1}{3} * (50 - (0.02 * 50)) = 16.33$
Maximum credit capacity for dividend: <i>Lower of</i>	Tax paid abroad (20)	$\frac{20}{3} = 6.67$	$\frac{20}{3} = 6.67$	$\frac{20}{3} = 6.67$
	Notional tax in a MS	$0.2 * 32.67 = 6.53$	$0.15 * 32.67 = 4.9$	$0.3 * 32.67 = 9.8$
Maximum credit capacity for royalty: <i>Lower of</i>	Tax paid abroad (5)	$\frac{5}{3} = 1.67$	$\frac{5}{3} = 1.67$	$\frac{5}{3} = 1.67$
	Notional tax in a MS	$0.2 * 16.33 = 3.27$	$0.15 * 16.33 = 2.45$	$0.3 * 16.33 = 4.9$
Total credit		$6.67 + 1.67 = 8.34$	$6.67 + 1.67 = 8.34$	$6.67 + 1.67 = 8.34$
Total allowable deduction for tax paid abroad		$6.53 + 1.67$ but not more than 8	$4.9 + 1.67$ but not more than 6	$6.67 + 1.67 = 8.34$
Corporate tax due after deduction of foreign tax		0	0	3.66
Excessive credit (deduction allowed only if the full credit method is stipulated by the tax treaty)		0.34	2.34	0

138. It should be noted that when the resident taxpayer derives income from sources in more than one third States and the income is not exempt the tax credit would be calculated separately for each State (per country limitation), and for each type of income.

139. As noted at the beginning of this section although account has been taken of existing arrangements with third countries in making suggestions existing arrangements may in some instances still conflict with the suggested approaches and it would be necessary to allow MS in certain respects to derogate temporarily from the rules adopted in order to respect existing obligations (example: lower threshold for exemption for major shareholdings in existing double tax treaties than the 10% threshold suggested above).

VIII. Outstanding items

140. The Commission Services will produce papers similar to the present on administration and the sharing mechanism, respectively.

141. This paper deals with some aspects of business re-organisations. There, however, some outstanding areas, such as mergers and divisions not involving liquidation of companies, liquidations, transfer of seat, sale of partnerships. Comments are invited of further matters requiring consideration.

142. Specific areas have been identified in this paper where a need for anti-abuse rules is seen. Comments on further areas where MS see a need for anti-avoidance rules are welcome.

One State insists on the need for an exit taxation on assets transferred out of the CCCTB tax jurisdictions and on the issue of the tax values of assets brought into the CCCTB.