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# CEA position on the CCCTB: possible elements of a technical outline

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The Comité Européen des Assurances ("CEA") is very interested in the European Commission's ("EC") work on the Common Consolidated Corporate Tax Base ("CCCTB") and the possible elements of a technical outline. As previously stated, CEA welcomes the opportunity to take an active part in the discussions with the EC CCCTB Task Force on this subject.

In October 2007, the EC issued the Working Document on the CCCTB: possible elements of a technical outline (Meeting to be Held on Thursday 27 and Friday 28 September 2007)" dated 26 July 2007 ("the Working Document"). This paper provides us with a possible outline of the principles of the CCCTB by starting to bring its several structural aspects together into a coherent set of rules.

The Working Document includes the basic CCCTB rules for a single company at a first stage and develops the rules for groups of companies which qualify for consolidation at a second stage. However it also states that the particular situation of financial institutions and how the CCCTB might need to be adapted to take their needs into account is still being reviewed. In this context, the Working Document does not cover any possible special provisions on financial institutions.

At the CEA Taxation Liaison Committee meeting held in October, the EC CCCTB Task Force kindly made a detailed presentation on the most recent developments on the ongoing debate at the CCCTB Working Group ("WG"). The EC also kindly invited the CEA to share its thoughts on the Working Document, as regards in particular the need of special provisions to apply to insurance companies.

In the light of the Working Document and of the invitation expressed by the EC CCCTB Task Force at the CEA Taxation Liaison Committee in October, CEA is pleased to submit the following insurance specific comments on the possible elements of a technical outline of the CCCTB system.

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## 1. Scope of the CCCTB system

### Section 5

Notwithstanding the fact that the Working Document does not cover any possible special provisions recommended to financial institutions, CEA is of the opinion that they should be covered by the CCCTB since the beginning of the implementation of the new taxation system. Otherwise this omission would represent not only the exclusion of a significant part of the European based multinational companies, but also the common tax base fracture of several mixed financial and non-financial European based groups of companies. It is worth noting that rules with regard to financial institutions should follow the rules applicable to all other companies; however, as far and only as far as the different business models demand deviating or additional rules, specific provisions should be included in the normal set of taxation rules.

## 2. Insurance Technical Provisions

### Section 32

The Working Document states that *"(…) the expense should be established and the amount be known in order to be accrued. However when an amount arising from a legal obligation or a likely legal obligation relating to activities or transactions carried out in the current or previous tax years (…) 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).* The CCCTB WG further clarifies that this approach was partially based on IAS 37, but excludes constructive obligations, i.e. non-legal obligations arising from a pattern of behavior for instance.

As previously expressed by CEA, the insurance technical provisions are in line with general rules and mandatory not only if legally but also if economically incurred. In this regard, CEA finds rather restrictive the reference to the exclusive deductibility of provisions based on a legal obligation and recommends a special attention to the tax treatment of provisions of financial institutions, namely insurance companies.

This understanding had already been expressed and considered in previous versions of the CCCTB WG's working documents. Indeed, the CCCTB WG had already recognized and accepted that certain industry sectors, namely insurance, require different detailed rules and that although there is no reason why the CCCTB should not cover these sectors, they do represent a "special case" and it is suggested that any specific provision and reserve policies be considered separately from the more general policies[i]. In addition, the CCCTB WG has already stated that companies from these sectors have to recognize provisions in relation to the requirements of specific regulations applicable to them.[ii]

On the other hand, taking the insurance sector specificity into account, the CCCTB WG has already acknowledged the areas where - possibly - the insurance sector requires a special treatment in the CCCTB Working Document on tax treatment of financial institutions (Meeting to be held on Thursday, 9 March 2006), dated 1 March 2006 (page 7). Among the above mentioned areas, once more CEA would like to bring your attention to the following ones.

Several insurance reserves may be necessary – dependent on the business written by the insurer. Reference is made to Council Directive 91/674/EEC of 19 December 1991 on the annual accounts and consolidated accounts of insurance undertakings that determine the constitution of insurance reserves, as well as to the national accounting regulatory rules that comply with the referred directive. It is the CEA's conviction that all the technical reserves created for prudential reasons under the legislation above referred should be tax deductible.

Additionally, CEA recommends – as far as valuation of the provisions is concerned – to base future studies on the European Insurance Directives and regulatory requirements as well. In this context, CEA is happy to assist and explain the needs of deviating or additional valuation concepts.

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### Provisions for Claims Outstanding

As previously stated, these provisions reflect legal and/ or economic third party obligations and are sometimes independent of knowledge on a single case basis (i.e. IBNR's). Their calculation can be done on a single case basis or mathematical/ actuarial calculation on a best estimate approach.

### Equalisation Provisions

As already discussed, the purpose of these provisions is to equalize fluctuations in loss ratios over the time (premium levied might be on average sufficient, but experience shows that claims payments in one year can by far exceed the premiums earned, e.g. hail and storm). In "good years" a certain amount has to be set aside in order to be able to cover those losses. In this context, the equalisation provisions reflect the ability to pay taxes principle.

### Catastrophe Provisions

As previously stated, these provisions are necessary in order to comply with business needs. In fact, some risks such as earthquake, nuclear risks, some pharmaceutical risks, terrorism, would not be insurable if provisioning were not allowed since there is no sufficient experience in the past (no possibility to calculate premiums properly), nor are they cyclical businesses.

### Provisions for Bonuses and Rebates

These provisions reflect third party obligations, allowing the compensation of direct claims by one policyholder or claims of the insurance collective. Regarding their deductibility, it should be foreseen where the amounts are already attributed to a single policyholder or to a specific collective of insured. Deductibility should be granted even if the amounts which are (already) attributed to policyholders – but not yet distributed – can – in a worst case scenario – (partially) be taken in order to level the insurance company's operating losses situation.

### Actuarial Reserves

These provisions comprise the actuarially estimated value of an insurance undertaking's liabilities including bonuses already declared and after deducting the actuarial value of future premiums.

## 3. Financial Assets

### Section 22

It is worth noting that apart from debt and equity, there exist certain financial instruments which may not result in income, e.g. juissance rights, silent partnerships or cash collaterals.

Besides, rules for qualifying payments as profit distribution (non-deductible) or interest (deductible) and therefore for distinguishing between debt and equity should be defined. In CEA's opinion, each instrument that grants the participation in profits and additionally in liquidation proceeds should qualify as equity.

### Sections 29 and 77

CEA believes that a financial asset should be depreciated when the taxpayer is able to demonstrate that it has suffered a long term decrease in its value. In this regard, CEA would welcome the discussion on the criteria used to define the permanent character of a decrease in value.

### Section 31

Section 31 states that income and expenses would be recognized on an accruals basis in the year to which they relate. In CEA's opinion it would be necessary to define exactly the "realization principle".

Section 34

It is also CEA's conviction that double deduction should be avoided. In parallel, however, any (partial) non-deductibility due to legislative changes (i.e. the expenses that according to the CCCTB system would have arisen earlier than according to national tax legislation) should be avoided as well. The consequences of the legislative changes may result in a one-time effect, which should be split over a certain period of time (e.g. 5 years).

As far as valuation of reserves is concerned, past experience does not seem the adequate estimation basis in any case. Especially in the insurance industry where long-term effects play a major role, using of generally accepted mathematical and actuarial methods, which take e.g. inflation, trends in demography etc. as well into account, should be allowed. On the other hand, it is worth noting that these methods are applicable in IFRS / US GAAP as well.

Section 40

As suggested in section 40 combined with footnote 22, the deduction of bad debts is vital for financial institutions. With regard to mass risks, deductions for bad debts may not be calculated on a single case basis – with the mentioned prerequisites fulfilled in any single case – but rather on a percentage basis fixed according to past experience, including potential trends. The envisaged "preferable" individual approach should only be applied in case of high debts outstanding (i.e. non-mass business).

Section 47

Even though this is not an insurance specific topic, in CEA's opinion it is not adequate to include gifts at market value in the taxable income. The solution would be allowing depreciation in case of limited period of usage, since the gifts contribute to income generation when used in business as well.

Section 66 and 67

A useful life of 25 years is assumed for long-term tangible assets (ships, planes etc.). This understanding is also valid for assets with acquisition or construction costs of more than 5 million €. In the CEA's opinion, the latter does not seem consistent, since several tangible assets with acquisition costs higher than 5 million € present a useful life of less than 25 years. Should such a presumption be considered under the CCCTB, the taxpayer should at least be granted with the possibility to prove a useful life shorter than 25 years (useful life on average according to business experience).

Section 68

As regards intangible assets like client basis, it is worth noting that their useful life is very often shorter than 15 years, sometimes only 5 years. Therefore, the taxpayer should be granted with the possibility to prove a shorter useful life of these assets.

Section 69

In the CEA's opinion the rule of full depreciation in the year of acquisition and no depreciation in the year of disposal means no simplification if the depreciation has to be especially calculated just for tax matters in another method than for accounting purposes. Therefore, the taxpayer should be allowed to calculate the depreciations in the same manner as for accounting purposes.

Section 77

As regards non-depreciable assets – especially long-term – it is also the CEA's conviction that a permanent decrease in value (in our view a long term decrease, as previously mentioned) should be deductible as depreciation as well. Otherwise the non-deductibility of these assets could result in pressure to sell them and buy them back.

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## 4. Consolidation – compensation of minority shareholders

### Section 86

The Working Document recommends the full consolidation of the tax base stating that there seems to be no need for compensation of minority shareholders under the CCCTB system.

CEA supports the full consolidation of the tax base; however, as regards the income of less than 100% owned affiliates, the absence of a legal reference to compensation should not in any case override a potential civil law based compensation agreement between the involved shareholders,[iii]. Indeed, they should be free to set up such kind of agreements if they think that it better assures and regulates their private commercial and contractual statute.

Considering the above, a private shareholders compensation agreement should not be precluded to apply. Any such agreement has to be followed for tax purposes as well.

## 5. Consolidation – qualifying subsidiaries

### Section 89

The Working Document states that to be a qualifying subsidiary its voting rights would have to be owned directly or indirectly to 75% or more. The CEA supports the CCCTB Task Force view, as long as the compensation of minority shareholders is taken into account as further detailed above.

### Section 112

In CEA's opinion, the more straight forward solution for treating intra-group transactions would be to ignore them completely. Nevertheless, an alternative option to include these transactions by each group company and then netting them off when the consolidation is carried out should be granted.

## 6. Foreign income and participation exemption – portfolio shareholding

### Section 120

The envisaged switch over from the exemption to the credit method in case of major shareholdings and PE's in low tax countries seems to the CEA not consistent with the ambition of getting a strong and competitive Common Market. Indeed, this method would put EU Member State Groups in disadvantage as compared to local competitors in the prevailing third country or companies from non EU Member States where these parts of income remain tax exempt. This is especially true if the subsidiary or branch carries on an active trade or business.

The Working Document also states that in case of portfolio dividends and other passive income (i.e. royalties, patent income and interest) only the withholding tax should be credited. Nevertheless, as the underlying corporate tax remains in these cases unconsidered, this would mean economic double taxation. As it is CEA's opinion that economic double taxation should be also avoided, we recommend granting a tax exemption for portfolio dividends as well (see section below).

### Sections 121 – 125 and 135

The Working Document affirms that income from major shareholdings would be consolidated if the ownership requirements for consolidation is met. The Working Document also clarifies 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.

It is worth noting that income from European Union ("EU") based major shareholdings would be exempt if the participation threshold was between 75% and 10%, while shareholdings below 10% (portfolio dividend income) would be taxable (with tax credit for any withholding tax). The same parallelism applies to income from third countries major shareholdings, which are exempt, and income from third countries portfolio, which are subject to taxation. In this context, the Working Document invites comments on whether it would be preferable to extend exemption also to portfolio dividend income in order to relief economic double taxation.

CEA fully supports extending the exemption additionally to portfolio dividend income in order to avoid economic double taxation and to assure the same tax treatment in the field of dividend distribution. It is also worth noting that the arguments pushed forward by some Member States to defend a different tax treatment of portfolio income, as double non taxation avoidance / proper exchange of information, are not exclusive of portfolio income in a way that would justify its exclusion from the exemption granted to income from major shareholdings.

CEA strongly supports the view of the EC CCCTB Task Force that gains on the disposal of shareholdings should as well be tax-exempt, as only this approach fully allows preventing economic double taxation. Otherwise, companies would be compelled to resolve hidden reserves and to distribute all reserves prior to a sale in order to benefit from the tax exemption.

## Section 128 and 129

Introducing a general switch over clause to the tax credit system in case of low taxation seems to CEA not appropriate. Should the CCCTB system not take into account all different taxes, overlooking the level of income effectively earned, any tax credit system, especially with regard to dividends paid in two or lower-tier corporate structures, would inevitably lead to economic double taxation. On the other hand, taking all taxes paid on different levels in complex corporate structures into account would lead to a high degree of complexity, as shown by the tax credit system experience in the United States (US).

Additionally, the switch over would lead to a competitive disadvantage of CCCTB Groups as compared to local competitors who benefit from the low taxation abroad without additional tax burden.

It is CEA's opinion that as an alternative (and not an adjunct) to a general switch over mechanism, a reasonable CFC legislation towards third countries is preferable. An adjunct would lead to taxation accumulation of the same income and therefore – depending on the prevailing corporate structure – not only to economic double taxation but in reality often to much higher taxation than the average tax burden within the EU. In case of a switch over mechanism, the rules would have to be very complex in order to avoid inadequate taxation in case of profit distributions (granting of tax credits etc.).

On the possibility of introducing a common controlled foreign corporation (CFC) legislation, CEA sets out its comments on the questions put forward by the EC CCCTB Task Force in the Working Document as follows.

### (1) Types of income a CFC regime should target

CFC legislation may only be targeted at income which is low taxed and "passive".

### Low taxation

Low taxation can only be assumed if the tax burden is less than a certain low percentage (e.g. 15%) or alternatively less than 40% of the average tax burden within the EU. In calculating the tax burden, all effectively paid taxes have to be taken into account (taxes from income and capital, use of loss carry forwards). Besides, each tax burden on the prevailing passive income – whether directly levied in the hands of the foreign company or indirectly in the hands of an intermediate company – has to be taken into account as well (i.e. withholding taxes, impact of group taxation, CFC-taxes levied in third countries on the same income, use of losses carried forward).

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### Passive income

Passive income should only be assumed in case of non-productive income, in particular income from capital investments. It is decisive that the CFC rules precisely describe the income which might be treated as "passive" – and as a consequence, declare the not mentioned income as "active" and not harmful. Taking the ECJ case law into account, it would already be possible to conclude that the only income which might be treated as "passive" is income from capital investments.

Nevertheless, should companies (especially insurance companies and banking institutions) earn per se income from capital investments as part of their businesses, this income from capital investments may not be regarded as "passive", but rather shares the qualification of insurance/ banking income as "active" income under a functional view. This understanding is at least valid as long as these companies carry on their business through an adequately built up operation with participation in the normal insurance/ banking markets.

Besides, if (parts of) businesses are outsourced (e.g. the capital investment activities), the outsourced business still qualifies as active, if and as long as this business had been qualified as active as part of the original business activities (e.g. outsourcing of capital investments by banks or insurance companies).

Finally, it is the CEA's opinion that income from foreign legal entities may only be attributed to the parent company if at least some connection of the passive low taxed income to the EU exists. This means that substance and investments must have been shifted on purpose from the EU to third low tax jurisdictions to avoid the EU taxation, or earnings which could be distributed retained in the low tax environment.

### (2) Ownership threshold for applying CFC legislation

Any CFC legislation may only be applied, if the EU parent company has enough influence on the business carried out in the low tax company. This entails a certain participation quota as a threshold for applying the CFC legislation. In CEA's view, CFC legislation may only be applied if the shareholder (alone or together with related parties) can influence the low taxed company. This would demand a participation quota of at least 20 % (parallel to the definition of "related party").

### (3) Application on undistributed profits only or generally on certain income types, whether distributed or not

In case the passive income is afterwards distributed, any double taxation under the CFC regime has to be avoided. Therefore, application may be restricted to undistributed profits only and only as long as these profits remain undistributed. Whenever CFC legislation applies and later on taxes are levied on dividend distributions, these taxes have to be credited back in order to avoid double taxation (e.g. withholding taxes). In this context, the CFC regime could only apply without further double taxation relief procedures in case the dividends remained tax-exempt in the hands of the shareholder and no withholding taxes had been levied.

### (4) Differentiation between domestic, non-consolidated EU and third country companies

It is the CEA's opinion that any CFC legislation within the EU should be abolished as a consequence of the fundamental freedoms of EU law, especially the freedom of establishment and the free movement of capital. Within the EU member states, only a general (very restrictive) anti-abuse provision, which declares especially certain harmful tax competition practices as abusive, might be applied (based on the principle of unanimity, e.g. like Primarolo-Report). The European Court of Justice ("ECJ") regularly states that those rules may solely be aimed at wholly artificial arrangements.

Only with regard to third countries, CFC legislation may therefore be envisaged and applied. As this kind of legislation leads to taxing income earned by a separate legal entity abroad, it generally hurts the principle that only the state of residence/ incorporation of a company is allowed to levy taxes and therefore, any CFC legislation should always be well-founded and reasonable.

On the other hand, real economic activities may not be targeted by CFC legislation. In this regard, according to the basic principles of EU legislation, CFC rules might (only) be applied, if the entity abroad earns low-taxed "passive" income as defined above.

### Section 130

CEA agrees with the EC CCCTB Task Force proposal to grant full interest deductibility despite the exemption of dividends from major shareholdings. On the question of a possible "fat capitalisation" of non-EU resident or non-consolidated subsidiaries, and as a consequence, to a need for restricting the interest deductibility, it is the CEA's conviction that the interest deductibility should not be restricted, as it is at the discretion of the individual shareholder how to finance "his" company. As long as the equity would have been granted from a third party as well there is no reason for any restriction in interest deductibility. This is especially true for financial institutions as insurance companies or banks, as regulatory requirements have always to be respected.

CEA also agrees with the EC CCCTB Task Force standpoint that thin capitalization of EU Groups or subsidiaries would be covered by the general arm's length rules. It has also to be made sure that double taxation that might arise in case of any corrections of income is always prevented.

## 7. Withholding Tax - Payments between taxpayers of two single taxpayers/ different groups

### Section 17

The Working Document specifically requests comments on source taxation on payments between two single taxpayers or separate consolidated groups. It is the CEA's conviction that eliminating source taxation on such payments is simpler and easier to implement than introducing a single set of rules on source taxation and for relieving source taxation in the hands of the recipient. Nevertheless, taking this approach, potential distortions that might arise between the several Member States involved should be taken into account in the related debate. A possible solution might be included in the allocation key.

## 8. Sharing mechanism – local taxes, granting of incentives

### Section 116

The EC CCCTB Task Force suggests that local taxes should be deductible after sharing the CCCTB from the individual Member State share of the consolidated tax. For CEA, it would be important to apply the CCCTB rules to calculating local taxes as well, in order to eliminate tax obstacles in the common market or – even better – fully integrate the local taxation in the overall corporate taxation. Only these measures would be appropriate as some Member States present quite high local taxes (e.g. Germany) which would otherwise lead to considerable competitive disadvantages for groups as far as group members are located in those countries.

As far as incentives are concerned, they should be granted by way of tax credit to be set off against the tax liability in the individual Member State. With regard to avoiding harmful tax competition within the EU Member States, it seems to the CEA appropriate to set a common framework for the granting of such incentives covering namely the reasons, circumstances, preconditions and period of time incentives.

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## 9. Business re-organizations

### Section 141

The Working Document welcomes comments on outstanding areas of business re-organizations such as mergers and divisions not involving liquidation of companies, liquidations, transfer of seat, sale of partnerships. It is the CEA's conviction that the CCCTB approach on business-reorganizations should be in line with the Council Directive 90/434/EEC of 23 July 1990 (the Mergers Directive). Within the CCCTB Group, no tax consequences should arise on hidden reserves as long as they remain in the same group of companies. In case hidden reserves are transferred to non-EU subsidiaries or non consolidated subsidiaries or other CCCTB Groups, capital gains should be deferred until a later disposal of the assets.

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CEA looks forward to the joint meeting with business and academics on 10 and 11 December 2007 concerning the CCCTB. CEA is always available and looking forward to assisting the EC CCCTB Task Force in all questions mentioned above, as well as in any other questions that arise in the course of discussion.

Brussels, 7 December 2007


### About CEA

CEA is the European insurance and reinsurance federation. Through its 33 member bodies comprising of national insurance associations, CEA represents all types of insurance and reinsurance undertakings, e.g. pan-European companies, monoliners, mutuals or SMEs. CEA represents undertakings which account for approximately 94% of total European premium income. Insurance makes a major contribution to Europe's economic growth and development. European insurers generate premium income of €1065bn, employ over one million people and invest more than €6,900bn in the economy.

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[i] See page 7 in CCCTB Working Document on Reserves, Provisions and Liabilities (Meeting to be held on Thursday, 10 March 2005), dated 1 March 2005

[ii] See page 6 in CCCTB Working Document on an overview of the main issues that emerged at the second meeting of the subgroup on reserves, provisions and liabilities (Meeting to be held on Friday, 23 September 2005), dated 7 September 2005

[iii] See page 2 in the CEA position on the Delineation and Apportionment of an EU Consolidated Tax Base for Multi-jurisdictional Corporate Income Taxation, dated 7 September 2007