

CEA position on the Delineation and Apportionment of an EU Consolidated Tax Base for Multi-jurisdictional Corporate Income Taxation

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| Contact person: | Cláudia Sousa, Policy Advisor | E-mail: | sousa@cea.assur.org |
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The Comité Européen des Assurances ("CEA") is very interested in the European Commission's ("EC") work on the delineation and apportionment of a European Union ("EU") Common Consolidated Corporate Tax Base ("CCCTB"). CEA welcomes the opportunity to take an active part in the discussions with the EC DG TAXUD on this subject.

In October 2006, the EC issued the Taxation Paper No 9 – "The Delineation and Apportionment of an EU Consolidated Tax Base for Multi-jurisdictional Corporate Income Taxation: a Review of Issues and Options" by Ana Agúndez-García ("the Study"). The paper sets up the starting point for the development of the conceptual and practical analysis of the EU Consolidation and Apportionment system.

The author groups and develops the main design problems for the EU Consolidation and Apportionment system into the following central issues:

1. What is the tax base for each taxpayer (group of companies) to which the apportioning mechanism will be applied? – *The Delineation of the Apportionable Consolidated Tax Base*
2. How should that CTB be apportioned between those tax jurisdictions? – *The Apportioning Mechanism*

More recently, the EC published on its website the Working Document on "An overview of the main issues that emerged during the discussion on the mechanism for sharing the CCCTB", under reference CCCTBWP\052\doc\en, which was used at the meeting which took place on March 13, 2007 (Working Document). This document thoroughly covers the practical questions that emerge from the discussion on the CCCTB apportionment system at the level of the CCCTB Working Group discussions.

In light of the available information on a CCCTB consolidation and apportionment system and taking into account its conceptual and practical standpoints, as well as the course of the discussion at the CCCTB Working Group level, as defined by the above referred documents, CEA is pleased to submit the following comments on the delineation of the apportionable consolidated tax base and apportionment mechanisms under the CCCTB system.

The Delineation of the Apportionable Consolidated Tax Base

The definition of the group

It is the CEA's opinion that the definition of the group should be clearly based on participation requirements, under a legal definition approach. As the 75 % threshold would lead to additional work load as compared to 50 %, CEA defends the percentage of 50% ownership threshold eventually combined with a majority of votes criteria as the participation requirement to define a group under the CCCTB regime.

In line with the Study, CEA understands that the legal definition method is simpler and clearer than the "unitary business" criteria. Indeed, it would avoid the overwhelming complications arising from the latter, such as the previous requirement of a clear definition of control, the agreement on the criteria and tests to measure the degree of the economic integration of the affiliated entities and its sensitiveness to transfer pricing strategies seeking to move profits out or into the taxable group.

In case a group opts for the CCCTB, including all entities which fulfil the conditions for consolidation should be mandatory, under the "all-in" principle. Should non-EC entities be in between the participation chain, they should be (partially) consolidated as well (at least the "holding-activity"). In any case, this should not exclude the EU-based subsidiaries from being consolidated

Distinction between apportionable and non-apportionable elements of the tax base

It is the CEA's conviction that the full consolidation is clearly preferable as it is simple and clear and would allow eliminating the intra-group transactions.

In particular as regards the income of less than 100% owned affiliates, CEA understands that it should be subject to full consolidation, for example by means of compensation under a civil law basis agreement between the involved shareholders.

The distinction between different types of income such as "business" and "non-business", enabling the exclusive consolidation of business income, could be difficult to implement as the concept of "core business" of a company is easily variable and is not always straightforward. On the other hand, the referred distinction would remove the advantage of full consolidation resulting from the loss offsetting across all categories of the group's income. Should the CCCTB Directive opt for this distinction, the expenses associated with "non-apportionable" income should be identified and deducted from it through a separate calculation, resulting in additional complexity for the CCCTB system.

The territorial scope of the consolidated tax base

CEA has not yet formed an extensive opinion on the subject of the territorial scope of the consolidated tax base.

As regards the topic under analysis, it is generally accepted that the company tax system under analysis should have its nexus on the taxpayer's residency as a worldwide territorial scope principle and limit the multijurisdictional group taxation to the water's edge of the European Union.

In this regard, CEA shares the Study's view that it must be assumed that foreign (non-EU sourced) income obtained by non-resident affiliated of multinational groups headquartered in the EU should not be brought into the CCCTB system and obviously the apportionment factors of these affiliated should not be included in the apportioning procedure either. It seems in fact realistic at this stage not to bring non-EU-resident affiliates into the group and so not to consolidate their income in general in the EU groups' consolidated tax base.

It is also worth noting the need to coordinate the methods of double taxation relief used in calculating the CCCTB and the actual tax liability. As explained in the Study, conflicts could arise from the application of different double taxation relief methods in the calculations of the consolidated tax base (before apportionment) and of the tax liability (after apportionment). Therefore, it is the CEA's conviction that a common double tax treaty between the Member States applying the CCCTB and third countries would be an absolute requirement to the operation of the CCCTB system.

The Apportioning Mechanism

As a preliminary note, it is the CEA's conviction that the definition of the CCCTB apportionment mechanism is of the intrinsic responsibility of the Member States taking part in the same system. As the topic under discussion is far from being focused on the management / economical reality of a taxpayer company, CEA as an industry counterpart within the CCCTB project debate, proposes to provide the EC with a straight and general approach to the several apportioning methods, without prejudice of a further involvement of the industry in an ulterior discussion stage.

Sector Specific Formulae

CEA broadly agrees with some CCCTB Working Group experts when it comes to the requirement of as little differences as possible as regards a CCCTB formulae concept. In the CEA's view, the need for a special formula for the financial sector has not proved to be concrete at the current stage of the discussion and therefore CEA would invite the CCCTB Working Group to carefully analyse this issue and require its further involvement in the sector specific formulae debate at a later stage.

Macro-based apportionment

CEA understands, in line with the Study and with the CCCTB Working Group, that the macro-based apportionment presents the basic downside of disconnecting the real economic activity performed by a company in a country with its tax liability in that country. As this would conflict with the idea of a fair distribution of the tax base, CEA agrees with the CCCTB Working Group that this feature makes of the macro-based apportionment method an unacceptable option by definition.

It is also the CEA's conviction that the use of macro-factors to apportion groups' tax base between all Member States could trigger a "race to the top" of the tax rates, since all Member States would get a fixed share of any participating group. In line with some opinions in the CCCTB Working Group, CEA understands that the macro-approach would only be feasible in a context of more harmonized corporate income taxation at the EU level and therefore, the macro-based sharing mechanism would not be a realistic solution for the CCCTB apportionment system.

Finally, CEA shares the CCCTB Working Group's opinion that macro-based sharing mechanism should be regarded as a last resort to be considered only after the extensive analysis of the other sharing mechanisms and if these prove to have more flaws.

Value Added approach

The economic concept of Value Added (“VA”) and the various definitions that would follow to apply this approach are rather unfamiliar to the EU companies.

In this respect, it is worth noting that the VA concept should not be confused with Value Added Tax (“VAT”) and, as pointed out by the CCCTB Working Group, if the VA for apportionment is retrieved from VAT returns, it would require a series of basic data and a series of subsequent adjustments which would introduce additional complexities, against the purpose of simplification and reduction of compliance costs for companies, underlying the CCCTB project.

On the other hand, as the VA approach would require the valuation of all intra-group transactions at arm’s length price, this apportionment method would entail the need of transfer prices, which is one of the main issues the whole reform proposes to avoid. It is also the CEA’s conviction that, should the documentation requirements be reduced or eliminated as a natural consequence of the consolidation at the tax base level, there could be some scope for veiled transfer pricing manipulation.

Finally, CEA shares the opinion in the CCCTB Working Group that the apportionment of income could be prone to manipulation through VA shifting towards low tax countries, namely by transferring staff to the group companies situated in those countries.

Given the above, CEA concludes that the VA approach would not be a suitable CCCTB apportionment method and should also be discounted for the time being.

Formulary Apportionment approach

At this stage of the discussion, CEA would consider the Formulary Apportionment (“FA”) approach as the most feasible method for sharing the consolidated group profits between different jurisdictions. In this regard, some remarks must be made to the general approach under the CCCTB apportionment system of *labour, property and sales*, as the three factors normally used in FA methods.

Payroll factor (labour)

The payroll factor is meant to reflect the contribution of labour as a production factor in the generation of corporate income. It is a significant income-generating factor and in principle should therefore be included in the CCCTB apportionment system.

However the differences in labour costs across the member countries have increased in the EU since the last two enlargements and could present a disadvantage to this factor from an equity stand point. On the other hand, some definition issues might arise regarding how to treat other forms of labour compensation, who should be counted as on the payroll and who should be treated as independent contractor.

In the light of the above, it is the CEA’s conviction that the number of employees could be used instead of payroll to avoid the problem with differences in wage levels such as suggested by the author of the Study. In addition, it is worth noting that firms with a larger number of employees possibly benefit more from public services, such as the legal system, infrastructure and economic regulation and as a result, this method presents also a reasonable component of the benefit principle under the equity evaluation criteria.

As regards in particular the impact on the formula of outsourced labour and the correlated possibility for manipulation, CEA would agree with the CCCTB Working Group when it comes to the distinction between transactions with third parties as opposed to intra-group dealings as described in the Working Document, the former requiring the re-computation of this cost as a deemed labour cost.

So far as the case of seconded employees is concerned, CEA would also be in line with the method suggested in the CCCTB Working Group meeting to attribute the cost of the employees to the two companies involved, namely taking into account the rules that would be applicable to the personal income tax of the employee according to the OECD Model Tax Convention.

Property factor (assets)

The capital is an important income-generating element and therefore is generally accepted as one apportioning factor of a formula that aims at sharing the profit of a group at an international level.

As regards in particular its measurement and location, CEA would defend, for consistency reasons, the use of the same criteria as those used for the tax base calculation.

In this regard, it is the CEA's conviction that fixed assets should not be valued according to their current market value, not only since many assets may not have a price determined by market trading, but also because it is complex to implement as price fluctuations could have an important source of uncertainty for the firm's tax liability. On the other hand, the current market value approach would not reflect the business concept of certain business sectors, such as the insurance sector, considering that normally the insurance undertakings have long-term investments, in order to comply with future claims payments (contrary to trading books of credit institutions).

Considering the above, the valuation of the fixed assets for apportionment purposes should be identified with the same value that property should have for tax purposes, i.e. the CCCTB tax written down value.

On the other hand, as regards the general discussion within the CCCTB Working Group on a possible exclusion of financial assets for apportionment purposes, CEA shares its opinion that a special regime should always be envisaged for financial and insurance companies, since financial assets are "core business" for insurance undertakings. So far as the measurement of financial assets is concerned, for the reasons above referred, it is the CEA's conviction that the historical cost approach is the only adequate valuation method.

Finally, CEA broadly shares the concerns of the CCCTB Working Group on the issue of intangible assets. It is the CEA's opinion that the discussion on the inclusion of intangible assets in a formula, in particular as regards the questions of their valuation and location, should deserve an additional and careful reflection both within the CCCTB Working Group and within the industry. In this context, CEA would require its further involvement in the debate on measurement and location of intangible assets at an ulterior discussion stage.

Sales factor

The sales factor provides the FA method with a measurement tool to the economic potentiality of a company and could equally work as a proxy of its business amount under the CCCTB apportionment system.

CEA has been following the CCCTB Working Group discussion on the several alternatives related to this factor, in particular as regards the effective inclusion of the present factor in the CCCTB apportionment system and the advantages and disadvantages of a "sales by origin" and "sales by destination" possible alternatives.

As a preliminary note, CEA would like to express a concern on the cost burden associated to a "sales by destination" basis of the CCCTB apportionment system. In this regard, it is also worth noting, in line with the CCCTB Working Group's view, that a physical presence or nexus, namely a subsidiary or a branch would be required to attribute a share of the tax base to the marketing country is conceptually inconsistent specially when there could be sales to countries where the group does not have a branch or a subsidiary at all.

On the other hand, the conceptual and practical disadvantages related to the "sales by destination" approach are commonly known. In this context, it is worth noting that demand has never played a conceptual role in remunerating tax jurisdictions for corporate taxation so far and that this factor would apportion large shares of EU Groups income to mostly consuming rather than producing states, duplicating the effect of the Value Added Tax in the EU.

It is also worth noting, from the insurance industry perspective, that the "sales by destination" factor is not advisable because of the different premium tax burden levied in the destination country. Indeed, higher premium tax rates would result in additional corporate tax base, at least when the tax is due at the policyholder country's level.

Other remarks could be made, in line with the CCCTB Working Group approach, to the potential of manipulation of the "sales by destination" factor, by means of sales intermediation placed in a specific tax favorable country. The inconsistencies arising from sales to customers placed third countries would also require a further consideration on the feasibility and coherence of the "sales by destination" factor under the CCCTB apportionment system.

CEA shares the CCCTB Working Group's opinion that the measurement of sales at origin allows taking into account the efficiency and production capacity of companies, in line with the view that profits should be counted as realized where the goods are produced (or from where the goods are shipped) regardless of where they are sold.

At this stage, without prejudice of a further and careful discussion on this topic, should the sales factor be actually included in the CCCTB apportionment system, CEA would support the "sales by origin" approach and therefore discount the "sales by destination" alternative.

Weighting

As the discussions on the choice of the weight assigned to each factor have not yet formally begun, CEA would require its further involvement in this particular discussion at a later stage.

Uniform Formula

CEA is aware of the existing literature that proves the superiority of a harmonized apportioning rule as compared to a methodology in which participating jurisdictions can freely decide the weight of the apportioning factors. Therefore, it is the CEA's conviction that, once a formula is chosen, its uniform application (i.e., uniform definition of the factors, weighting, etc) across all participating Member States must be assumed.

CEA is always available and looking forward to assisting the EC in all questions mentioned above, as well as in any other questions that arise in the course of discussion.

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