Comments on document CCCTB\WP\057
Common Consolidated Corporate Tax Base Working Group
– Possible elements of a technical outline –

Introduction

In July 2007, the Commission issued a Working Paper setting out a first possible outline of the technical elements of a CCCTB by beginning to bring the various structural elements of the base together into a coherent set of rules. The purpose of the paper is to encourage comments in order to assist the Commission Services in taking the work forward and to give input on a number of technical areas on which further work may be needed.

The BusinessEurope Task Force on CCCTB is grateful to have the opportunity to give some preliminary remarks on this impressive working paper. To best facilitate the discussion, the current paper is divided into two main parts – the first giving some general remarks on the fundamentals of the CCCTB and the second providing more detailed comments on specific issues.

Given the large number of issues covered in the Working Paper, the Task Force would like to come back with additional in-depth comments in due time. As usual, the positions taken by the Task Force may be subject to revision as other areas of the CCCTB are explored (such as the sharing mechanism, administrative aspects and anti-abuse measures).

General remarks

The Task Force would like to congratulate the Commission Services to a very promising outline which includes some of the most important features for a competitive CCCTB. As has been stated previously, the Task Force regards a number of features as being of key importance for the support of a CCCTB. We have particularly stressed that the CCCTB must:[1]

1. be ***optional*** for business,
2. be based on ***Capital Import Neutrality*** by means of exemption,
3. assure net taxation though ***consolidation from the outset*** and thereby,
4. remove ***transfer pricing*** and ***economic double taxation*** within the CCCTB, and
5. reduce compliance costs by allowing for a single compliance of a single set of rules in a single location (***one-stop-shop***),

The Task Force welcomes that most key elements are included in the outline (recognizing that it does not cover the issue of 'administrative aspects' and thus the proposed one-stop-shop).

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[1] The supporting arguments for the importance of these features can be found in the previous Task Force position papers available on the EU Commission website: http://ec.europa.eu/taxation_customs/taxation/company_tax/common_tax_base/index_en.htm

In this context, the Task Force would like to reiterate that the CCCTB must provide for a comprehensive and exclusive tax base without any 'fall backs' to domestic taxation. If not, the CCCTB would not fulfil the core objective of replacing the current 27 parallel systems with one common consolidated system. It would rather add an extra layer of rules on top of the current ones.

In addition, the Task Force would like to stress the need for simple and competitive rules. Some of the indicated thresholds and rates are clearly not competitive and they need to be revised.

<u>Detailed remarks</u>

The Task Force would like to give some more detailed remarks:

Para. 5 – As pointed out, the particular situation of financial institutions needs to be recognized. In this context, it is important also to recognize the existence of industrial groups which have significant financial activities (treasury functions, insurance and banking) attached.

Para. 7, 8 – To ensure a truly common system that removes double taxation within the CCCTB-territory, there is no room for domestic flexibility or deviation within the CCCTB. Likewise, the regulatory framework must ensure that the risk of deviating interpretations is kept to a minimum. It is unclear how a CCCTB based on a Directive will cope with these requirements. Further analysis is advisable. In any case, the Directive must be very detailed to minimize the risk of differences in implementation and interpretation.

The Comitology Decision vehicle appears to provide for reasonable flexibility and allow for a system that is kept up-to-date in a practical way. The details of such a system must, however, be explored further. E.g. could such a system give rise to any constitutional problems and if so, how should those be dealt with? Also, how can such a procedure allow for proper consultation among the various stakeholders (including business)?

As a general note, it is important that the fundamental features of the CCCTB (most notably the ones listed in the previous section), are not pushed into the Comitology procedure. As indicated by the Commission, only more detailed rules must be allowed to be introduced/modified that way.

Para. 9 – The reference to local GAAP in the last sentence is somewhat unclear. Given prior discussions, we take it that the CCCTB would provide for a comprehensive 'stand alone' legislation that defines how to calculate the tax base itself.

Para. 10 - It would be advisable to include an open provision mentioning that the Directive will be applicable to each new form of companies which would be recognised by the legislation of a Member State. This avoids unnecessary updates.

Para. 11 – As stated above, we strongly endorse the proposal of creating a system that is optional for business. This should be ascertained by a rule that requires an active choice to be included in the pan-European system and thereby be subject to consolidation and apportionment. Passivity must in no cases trigger such treatment – a business should make a formal election to opt for the CCCTB regime.

Para. 17 – To ease administration and provide simplicity, we prefer the alternative of eliminating withholding taxes on payments between taxpayers in separate consolidated groups (rather than introducing common rules and relieve the subsequent double taxation in the hands of the recipient).

Para. 20 – It is unclear to us what happens if a country refuses to refund VAT (or where it takes many years to get a refund). Further analysis would be appropriate.

Para. 24 – Here we would like to repeat that the CCCTB must not be based on a general "business purpose test" (i.e. that only assets acquired and used for business purposes shall be deductible for tax purposes). Such a subjective test would provide for harmful uncertainty and lead to complex evaluation processes both for business and for tax administrations. It should be stressed that a company is a commercial profit oriented organisation and not a charity. It must also be recalled that the beneficiary of remunerations not having a business purpose typically is subject to a fringe benefit tax of some kind. Therefore, the CCCTB should be based on the presumption that an entity which is liable to corporate taxation is carrying on a business activity for CCCTB purposes. In any case, the distinction between business expenses and expenses for personal consumption is an issue that relates exclusively to unquoted closely held companies.

Bribes, fines and similar penalties may merit special rules. If non-deductible, any such items should be clearly listed for reasons of certainty.

Para. 25 – Based on the above, it is unclear to us why deduction of entertainment cost and (certain) management costs should be limited. This seems to infringe on the principle of net taxation (i.e. all expenses are deductible). It may be added that such a limitation is even less relevant when the tax jurisdiction is extended and many companies are present in the group.

As for staff expenditures, we would like to emphasize that deduction of such expenditures should also include costs for remunerations in the form of options and shares.

Para. 26 – The ceiling of EUR 1000 is way too low and unworkable in practice. Furthermore, in an economy with price stability as an objective in economic policies, the reluctance to increase the amount that can be expensed is significantly reduced. Then, the importance of simplicity must be emphasized since the revenue implications are very limited. The ceiling should be linked to a price index.

Para. 28 – See our comments in para. 24 (i.e. company planes etc. are not for leisure and if regarded to be used for private purposes their use will be subject to income taxation in the hands of the beneficiary).

Para. 29 – We welcome an opportunity to depreciate tangible assets such as land when the taxpayer can demonstrate that it has permanently decreased in value. Land has traditionally been seen as not being subject to wear and tear and obsolescence. In several areas, this is no longer true as land often has to be maintained to uphold its value.

Para. 36-39, 55 – The recognition of income should be based on the principle of prudence, so as to avoid taxation of unrealized gains. Based on the same principle, we welcome the proposal to deduct cost as incurred.

Para. 40 – With respect to bad debts, the prerequisite that the taxpayer must take 'reasonable steps' to be allowed a deduction need to be clarified to provide sufficient certainty.

Para. 44 – To clarify, no arm's length rules must be introduced within the CCCTB area. We therefore take it that this paragraph only refers to loans made to third parties. In this respect, the suggested rule appears to introduce a new and broader concept of transfer pricing. If the arm's length rule is to apply not only to the level of interest but also to the amount of the loan, a limitation of the freedom of the business operator to finance its investments is introduced. Also, it seems virtually impossible to find a benchmark to justify the arm's length amount of a loan. Thus, such a provision is not acceptable. If there is a concern about abuses, this should be dealt with under a general anti-abuse rule (and not by introducing thin/fat capitalization rules).

Para. 45 – The suggested approach of having to make non-monetary gifts at market value seems highly questionable. Take for example a donation to a third world state – how should you estimate the market value of that donation? How to find a benchmark? On this basis, we suggest that the transaction is made at tax book value.

Also, if the transaction is made to raise good will (or any kind of non-monetary remuneration), it can hardly be seen as a gift (as there is a de facto remuneration).

Para. 53 – This paragraph suggests the use of FIFO with respect to interchangeable inventories. Given upward price pressure, it could be considered whether it is possible to accompany this with an option for LIFO. It should be noted that LIFO is accepted in a number of Member States as long as it is used consistently. As a group will elect to enter the CCCTB regime, it should include in that election whether FIFO or LIFO will apply for the period of the election.

Para. 56 – The Task Force welcomes that the Commission Services suggest a system which is generally based on the principle of pooling (at least for short and medium term assets). As stated repeatedly, this is a key element for simplicity with respect to deduction of assets.

Para. 65 – With respect to improvements costs regarding long term assets, it appears reasonable to use the approach of starting the clock again for the improvement cost and treat it as a new asset for depreciation purposes.

Para. 66 – We believe that the definition of a long term tangible asset needs to be reconsidered as there is no identifiable relationship between the amount of the investment and the minimum depreciation period. In any case, the EUR 5,000,000 ceiling is too low to approximate a useful life of 25 years or more. There are a lot of assets that have a life time below 25 years but costs well above EUR 5,000,000 (paper machines, compressors, server parks etc. etc.).

Para. 69 – The Task Force endorses the proposal of allowing for full depreciation in the year of acquisition as it promotes simplicity. A depreciation method based on apportionment would impose unnecessary complexity and a large administrative burden.

Para. 72, 73 – We believe that a reducing balance method at a level of 20% annual depreciation rate is too low. It should be born in mind that the proposed rate only imposes a depreciation of 20% the first year. The second year, the effective depreciation rate is only 16% and the following three years 12,8%, 10,2% and 8,2% respectively. A declining balance method of 20% would thus impose a too long period to achieve "full" depreciation (recognizing that declining balance never allows for depreciation down to zero). A level of 30 % is therefore suggested. [See annex 1].

Para. 78 – We agree that the definition of a "related party" should be based on a fixed threshold rather than on a case by case approach. This would provide for much needed certainty.

Para. 81, 82 – We welcome the proposal in that it suggests symmetry by recognizing for CCCTB purposes the tax treatment of an entity in its home state. In this context, we would like to repeat the importance of treating transparent entities as eligible entities, both to ensure that the system reflects the structural reality of MNEs, to promote neutrality in the choice of business form and to prevent tax planning.

Para. 85-91 – We fully endorse the suggested approach of including into the CCCTB all operations within the CCCTB-jurisdiction even where parts of the MNE are located outside this area (i.e. parent companies, subsidiaries and PEs). Such an approach is crucial if the system is to comply with reality as the vast majority of MNEs have operations not only within the EU. It would also circumvent any perceived problems of tax planning.

As for the group definition (i.e. the level of ownership required to qualify for consolidation) the suggested level of 75 % is obviously a compromise between the need to be in control of the entities, the right of minority owners, tax revenue aspects etc. To widen the scope of the CCCTB, a lower level could be considered. Further analysis is however needed. Furthermore, it is questionable whether companies and/or groups will opt for the CCCTB if they cannot take advantage of the consolidation (> 50%, but < 75%). Aligning the two thresholds should be considered.

For reasons of simplicity, we find it crucial that the consolidation is not to be made in proportion of the level of ownership. If the entity qualifies for consolidation, its entire profits or losses should be included (as applies for the federal consolidation rules in the USA). Another approach would be overly complex and burdensome.

Para. 93 – Although some further analysis would be required, a six month ownership criterion appears reasonable. However, it should be made clear that newly incorporated entities qualify from the date of incorporation.

Para. 97 – The paragraph deals with the issue of the starting point of consolidation in case a company enters or leaves the consolidated group within a the course of a year. The draft outlines two possible approaches, the first-mentioned approach providing for entering or leaving the tax group on the very same day the actual entering or leaving takes place from a legal point of view (thus splitting the transitional period in two separate tax years); the latter-mentioned approach providing for entering or leaving the tax group on the first day of the following or the first day of the current tax year. The current version of the draft seems to prefer the first-mentioned approach.

From our point of view, business should be given as much flexibility as possible with respect to business reorganisations which are rather often necessary in order to integrate subsidiaries recently acquired in M&A activities. In some member states, business reorganisations can be designed with retroactive effect for both accounting and tax purposes on an optional basis. It would be helpful if this were possible also for CCCTB consolidation purposes.

Para. 100, 101 – The suggested quarantine rule on losses incurred prior to the entering of the CCCTB group appears reasonable. Again, further analysis is required, however, to ensure that such a rule would not prove to be too complex.

Para. 106-109 – Regarding sales of assets through sales of shares we will provide for separate comments. As a general remark, however, when assets are sold, the value of the pool will be decreased by the proceeds of the sale. The proceeds are therefore taxable as future depreciation is reduced by the amount received for the asset. By this construction, proceeds exceeding the written-down value of the entire pool, will be taxed as ordinary income while proceeds less than the written-down value of the entire pool will be taxable, but immediately offset by a write-down of the value of the pool, therefore having no immediate tax consequences. Future depreciation will however be reduced. If the proceeds exceed the written down value of the individual asset in the pool, no immediate taxation result but future depreciations are reduced and higher taxes will therefore be levied. This mechanism should be sufficient to deal with sales of assets and avoiding having to identify the taxable value of each asset.

Para. 111-115 – The paper elaborates on two main consolidation methods: (i) intra-group income and expenditures are ignored or (ii) included by each group company and netted off when the consolidation is carried out.

In our opinion, the first method is the only reasonable alternative. Given that the objective is to introduce a consolidated system that removes transfer pricing problems and double taxation, the approach of reporting intra-group transactions at an entity level is in our view without merits. It is the consolidated result that is relevant for the allocation of income/losses among the MS and the subsequent taxation. The recording of intra group transactions is therefore irrelevant and would thus impose unnecessary complexities and administrative costs. Clearly, any system requiring recording for the sake of recording must be avoided at all costs.

For the same reasons, we see no merits in the alternative of recording sales at cost. In the simplified example given in the annex to WP057, this alternative leads to the same result as completely ignoring these transactions. In reality, however, this is not true as it would impose considerable administrative costs for the taxpayer which falsifies the example. Likewise, tax administration would also have a substantial cost as they would need to maintain systems to ensure that the transactions are in fact reported at cost.

We also question why (as stated in para. 113) intra-group transactions concerning depreciable assets must be recorded at tax written down value.

Para. 118 – As stated above, we fully endorse a CCCTB based on the principle of CIN by means of exemption. Apart from allowing for a level playing field vis a vis third countries, a CCCTB based on the credit method would be very difficult to apply in the CCCTB-context as it would need to reflect the actual tax rates of the various Member States. It would also impose significant complications with respect to the application of Double Tax Treaties with exemption provisions.

Para. 120, 127-129 – With respect to a choice between common CFC-rules or switch over mechanisms, the latter is preferred. Given the objectives of the internal market, a switch over should only be imposed vis a vis third countries (i.e. not in relation to Member States that chooses to stay outside the CCCTB). If this cannot be accepted, any such rules must be strictly in compliance with EC-law and only extend to the very limited concept of 'wholly artificial arrangements'. Tax authorities seeking to challenge the legitimacy of a subsidiary should be required to deliver proof that the establishment clearly falls within this concept.

Given the objective of preventing tax abuse, no bona fide activities must fall into such a regime. Thus, any such rules must only apply to companies without real activities.

For reasons of clarity, the concept of "substantially lower level of tax" must be clarified. Given the average corporate tax levels within the EU, a level of 5-10 % appears reasonable.

Para. 134 – As stated above, we question why the deduction of (certain) management costs should be limited. Whether the costs relate to holdings that qualify for exempt distribution of profits or not, it should be deductible based on the principle of net taxation. Thus, we do not agree with the suggested 95/5 proposal.

Conclusions

To conclude, we welcome the report by the European Commission on the possible elements of a technical outline of the CCCTB. There are some elements implying that a Group would not be taxed on its net profit, but the overall direction is very encouraging. The need for simple and competitive rules must be guiding the future work amending the technical outline.

On behalf of the BusinessEurope Task Force on CCCTB

September 25, 2007

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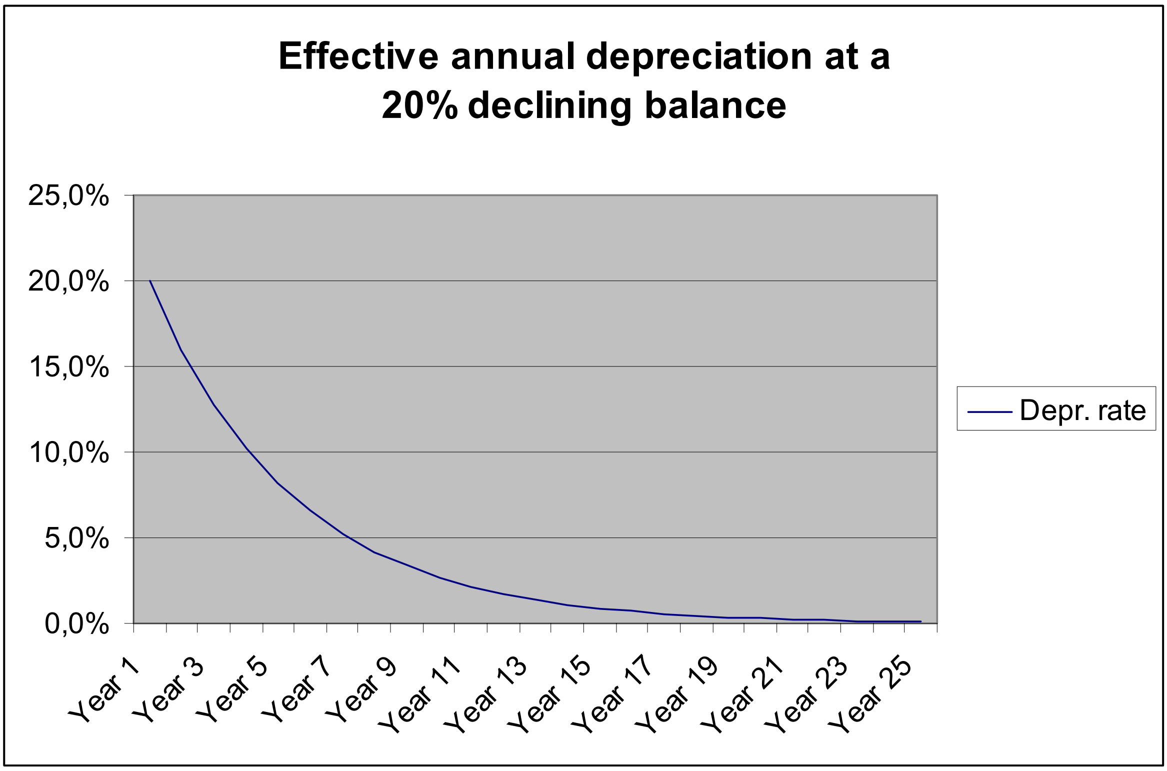
Annex 1


Effective annual depreciation at a
20% declining balance
25,0%
20,0%
15,0%
10,0%
5,0%
0,0%
Year 1
Year 3
Year 5
Year 7
Year 9
Year 11
Year 13
Year 15
Year 17
Year 19
Year 21
Year 23
Year 25
Depr. rate