Comments on document CCCTB\WP\060

Common Consolidated Corporate Tax Base Working Group

– Possible elements of the sharing mechanism –

Introduction

On 13 November 2007, the Commission issued a Working Paper setting out the possible elements of the sharing mechanism of the CCCTB. The likely revenue implications of the CCCTB for Member States make the allocation of tax revenues a key question. The BusinessEurope Task Force on CCCTB is grateful for the opportunity to give some remarks on this highly important issue. Comments have previously been submitted on an earlier working paper issued by the Commission on this topic (CCCTB\WP\047). The main conclusions from this response are reaffirmed below.

To best facilitate the discussion, the 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. As stated before, the positions taken by the Task Force may be subject to revision as other areas of the CCCTB are explored.

General remarks

With respect to the sharing mechanism, the Task Force sees the following factors as crucial for the success of the CCCTB:

1. full consolidation from the outset (no two-step approach),
2. the complete removal of transfer pricing problems within the CCCTB,
3. an allocation key with minimum tax induced incentives to shift factors (recognizing that the CCCTB must not limit fair tax competition), and
4. a uniform formula which is identical for all Member States.

The Task Force is pleased to see that the proposal presented by the Commission endorses these key principles.

As underlined by the Commission, the sharing mechanism should be as simple, fair and difficult to manipulate as possible. To achieve this, a three factor formula is suggested, where profits are split between (i) labour, (ii) capital and (iii) sales (by destination). The Task Force agrees that a multiple factor formula has merits in reaching the desired objectives. Nevertheless, the sales factor seems to create significant problems and the Task Force therefore suggests that this factor is removed from the formula.

Sales by destination (as suggested) would impose a significant shift from the current principle of attributing the ultimate taxing rights to the source state. The source principle has a strong conceptual position among the EU Member States and has been the guiding principle in the OECD work on international taxation for a long time. When allocating taxing rights in treaty negotiations, sales have not been attributed much importance.

Indeed, the sales factor would only account for one part of the factor. Nevertheless, it is questionable whether sales by destination will be viewed as fair and equitable and thus have sufficient legitimacy to find general acceptance.

Furthermore, unlike what is suggested in the working paper (para. 45), a sales factor based on destination would be rather easy to manipulate. By way of example, an independent sales agent (located in a non-CCCTB State) could be contracted as an intermediary to do the sales on behalf of the group to the relevant market, and thereby move the destination of the sales from the 'intended' state to the state of choice. Such tax planning opportunities would undermine the legitimacy of the factor and most likely trigger complex anti-avoidance rules. For reasons of simplicity and efficiency, this must be avoided.

Finally, the destination of a sale is sometimes hard or even impossible to confirm by the seller. If e.g. a sale is made ex-works (i.e. the buyer is responsible for transportation etc. from the seller) to a foreign (EU or non-EU) purchaser, the title passes in the country of origin. The seller's only VAT obligation is to make sure to have the documentation that the goods left the country. The invoice will show the purchaser's address and, eventually, its VAT registration number (if within the EU). The seller will not know, however, if the goods arrive at the purchaser's address as the purchaser may direct the transportation company to a different point of delivery, in which case the purchaser is responsible for the proper documentation. In such a case, the seller will not know with certainty the final country of destination. The sales by origin are known, but not by destination. The same applies with respect to other clauses where the seller is not responsible for the transportation – such as FCA (free carrier), FAS (free alongside ship), FOB (free on board), CFR (cost and freight), CIF (cost, insurance, freight), CPT (carriage paid to), CIP (carriage and insurance paid to), DAF (delivered at frontier). An analysis of the Incoterms 2000 published by the ICC and used in worldwide trade shows that these agreements provide for a transfer of title before the goods enter the country of destination. Only DES (delivered ex ship), DEQ (delivered ex quai), DDU (delivered duty unpaid), DDP (delivered duty paid) provide for a transfer of title in the country of destination.

The alternative approach (i.e. sales by origin) might be more in line with the source principle and therefore find better conceptual acceptance. However, as pointed out by the Commission, it is equally easy to manipulate and would duplicate much of the assets and payroll factors. Thus, we do not see this as a valid alternative.

Detailed remarks

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

Para. 14 – The Task Force strongly agrees with the Commission that the formula must be uniform across all Member States.

Para. 15 – To promote simplicity, the Task Force strongly agrees with the Commission that the formula shall cover all income covered by the CCCTB. The paragraph does, however, indicate the preference for a business purpose test. As stated repeatedly, we believe that 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 (i.e. no business purpose test). A company is a commercial profit oriented organisation and not a charity and the beneficiary of remunerations not having a business purpose typically is subject to a fringe benefit tax of some kind. In any case, the distinction between business expenses and

expenses for personal consumption is an issue that relates exclusively to unquoted closely held companies.

Para. 16 – The Task Force agrees that the tax base most likely need to be apportioned to each individual entity rather than to the taxing jurisdictions. As pointed out by the Commission, each entity needs to know its respective tax base to enable various calculations, such as pre-existing losses and possible tax credits. Such an approach also appears necessary with respect to local corporate taxes. To the extent local corporate taxes remain, it is not sufficient to know each country's portion of the tax base. In order to levy a local corporate tax on the common tax base it is necessary to know the tax base of each individual entity. Thus, it seems necessary to make the apportionment to the individual entity also for this reason.

Para. 18 – As suggested by the Commission, it appears suitable that a positive consolidated tax based is shared immediately, whereas a negative consolidated tax based conversely is carried forward at the group level and set-off against future consolidated profits.

Para. 25 – For reasons of simplicity, we believe that the cost of labour should be calculated based on the deductible expense for the purpose of calculating the tax base (as suggested by the Commission).

Para. 26 – The Task Force supports the position that there should be no adjustment to account for lower average level of wages in some Member States. The Task Force do, however, advice against a labour factor which refers to the number of employees. Such a factor would add complexity, in particular since the measurement of employment varies significantly among countries (e.g. differences in treatment of part-time workers, rented staff, consultants etc.). Furthermore, the link between the number of employees and the productivity in a given state is doubtful. It is also questionable whether such a factor is needed. As wages and productivity increases in the countries presently having lower per capita income, a labour factor with only wage costs is likely to fully capture the labour production factor. Even in the shorter term, the number of employees might be higher in these countries but the total wage costs account for this.

Para. 30 –The Task Force recognizes that the location of intangible and financial assets is less stable than fixed tangible assets. The geographical volatility of intangible and financial assets should, however, not be exaggerated. Given the high value of these assets and the high level of income-generation they often account for, any consideration of excluding them from the asset factor should be preceded by a thorough impact analysis. Also, a sector specific formula for the financial sector should be considered (as suggested).

Para. 36 – For reasons of simplicity, the tax written down value appears to be the most appropriate valuation method. In any case, a market based valuation must be avoided since this will give rise to valuation difficulties similar to the present problems in the transfer pricing area.

Para. 38 – To reflect the fluctuations of assets during the tax year in a fair way, an average valuation of the assets based on the tax written down value at the beginning and at the end of the tax year could be considered. This would most likely not impose too much of a compliance burden.

Para. 39 – As for the location of an asset, the suggested approach of making the assessment based on where it is used will be difficult from a compliance perspective (as it is not always clear who is the user). Also, it might lead to demarcation problems where if an asset is used by more than one of the group members. For reasons of simplicity, it is preferable to assign

the location of an asset to the legal owner or, alternatively, to the taxpayer who has the right to depreciate the asset.

Para. 42 – It is important to note that the purpose of the CCCTB is to increase the function and competitiveness of the internal market by removing tax obstacles to better allow for an efficient allocation of business activities within the Union. As confirmed by the ECJ, the allocation of business activities to a Member State must be allowed, even if the purpose is to reap the benefits of a more advantageous tax climate. It is in this perspective the discussion on so-called 'factor-shifting' must be viewed. Any 'factor-shifting' that could be considered as clearly abusive (ECJ - 'wholly artificial') should primarily be prevented through a stable allocation key. Any specific rules against factor-shifting must be kept to a minimum and only apply to 'wholly artificial' situations. If not, they will be in conflict with EC-law (Cadbury Schweppes).

Para. 43 – 60 – For the reasons above, we recommend that sales is removed from the factor.

Para. 48 – If sales nevertheless are to be included in the formula, it is absolutely crucial that intra-group sales are excluded to prevent transfer pricing problems within the CCCTB-system. As has been stated repeatedly, this is one of the core benefits of the CCCTB and must be adhered to if the system is to have support from the business community.

Para. 59 – If sales are to be included in the formula, the suggested spread throw-back rules seem appropriate.

Para. 61 – We agree with Commission that an apportionment should be based on a physical presence in a Member State (not on economic presence). The introduction of a "nexus" based on economic presence would most likely lead to uncertainty and possible conflicts between Member States regarding the existence of economic presence. Furthermore, such an approach would be in conflict with international tax principles and lead to increased compliance costs, especially for small and medium-sized businesses. This might in turn deter companies from opting for the CCCTB.

Para. 69 – The Task Force sees the need for having specific formulae for some sectors. It should, however, be underlined that any such exceptions will lead to difficult demarcation problems, especially with respect to groups with multiple sector activities (e.g. manufacturing, financial, transportation, insurance, re-insurance etc.). Such groups are common and therefore any deviations from the standard formula should be kept to a minimum. Also, for reasons of simplicity, a *de minimis* rule should be considered, stipulating that a sector-specific formula should only apply where the relevant activity accounts for a substantial part of the overall business activity (e.g. 25 % or more).

Para. 71 – The Commission is recommending that the allocation key is introduced together with a safeguard clause to enable re-apportionment in cases where the key leads to obvious unfair results. The Task Force agrees with the merits of having such a valve for exceptional cases. It is crucial, however, that such a clause is not used by a single Member State to increase its tax revenue to the detriment of the taxpayer (double taxation, tax uncertainty, litigation costs etc.). Therefore, the clause should primarily be triggered at the request of the taxpayer. The only exception is where a request is issued by all concerned tax administrations jointly. In such cases, there should be a strict time limit stipulating when an agreement must be reached (e.g. 1 year). If this is exceeded, the original allocation should be deemed to apply.

As suggested by the Commission, the clause must under no circumstances be applicable in cases where only one or a few of the tax administrations request a re-apportionment.

Conclusions

To conclude, we welcome the report by the European Commission on the allocation key. The Task Force is of the opinion that the sales factor should be removed from the formula. Hence, a two factor formula based on assets and labour is recommended.

On behalf of the BusinessEurope Task Force on CCCTB

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