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SUMMARY RECORD BY THE CHAIR OF THE MEETING OF THE COMMON CONSOLIDATED CORPORATE TAX BASE WORKING GROUP

Held in Brussels on 10-11 December 2007

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I. OPENING OF THE MEETING

1. The twelfth meeting of the Commission Working Group on the Common Consolidated Corporate Tax Base (hereafter the CCCTB WG) was divided into two parts: the first part took place on 10 and 11 December 2007 and, in addition to experts from Member States (hereafter MS), it was extended to academics and representatives from the business sectors. This CS (Commission Services) Working Document contains the report by the chair of the first two days of the meeting held on 10 and 11 December 2007. For the meeting held on 12 December 2007 a separate report has been prepared.

2. Representatives from the following interested parties participated in the meeting: EU AMCHAM (American Chamber of Commerce), CEA (Comité européen des assurances), CEPS (Centre for European Policy Studies), CFE (Confédération Fiscale Européenne), EATLP (European Association of Tax Law Professors), EBIT (European Business Initiative on taxation), EUROCHAMBRES (Association of European Chambers of Commerce), FBE (European Banking Federation), FEE (Fédération des Experts Comptables Européens), UEAPME (European Association of craft & small and medium sized enterprises), BUSINESSEUROPE and the OECD secretariat. In addition, several experts on formulary apportionment from the US and the EU were also invited and all MS attended. The meeting was chaired by the CS. A full list of attendees is attached in an annex.

3. The Chair welcomed the participants and explained that the purpose of the meeting was to provide academics and stakeholders with an opportunity to comment and contribute to the work of the CCCTB WG, in line with the Commission's policy of consulting widely all stakeholders before finalising any legislative proposal. Similar meetings took place in December 2005 and 2006. Experts from MS[1] were also invited to participate actively as usual.

4. The Chair drew attention to the Working Documents 'CCCTB: Possible elements of a Technical Outline' (CCCTB/WP/057 - annotated), annotated with a summary of written comments received on the original document, 'CCCTB: Possible Elements of the Administrative Framework' (CCCTB/WP/061) and 'CCCTB: Possible Elements of the sharing mechanism' (CCCTB/WP/060) covering the work done so far which had been prepared and circulated in advance to facilitate the discussions. The last two documents had not yet been discussed with CCCTB WG members and presented the current views of the CS. A Chair's report of the meeting would be prepared and published by the CS – which would not commit the participants on its content – including a list of participants. This summary record would not report individual

[1] Throughout the document the terms 'members', 'experts', and 'Member States' (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 an organisation or Member State. References to the Chair include participants from the Commission Services, and do not indicate any formal position of the European Commission.

contributions but would attempt to summarise the main points that emerged during the meeting.

5. As a preliminary remark, no MS expert took the floor during the meeting. Therefore, the views summarised in this document only reflect comments from experts other than MS administrations and the CS.

II. ADOPTION OF AGENDA

6. The chair presented the draft agenda to the meeting.

7. The agenda was adopted by consensus.

8. As a general comment, the business community reiterated their support for a comprehensive and long term solution to the tax obstacles business is facing in the EU which are: double taxation, increasing transfer pricing requirements, lack of cross border loss relief and administrative complexities. More specifically, the business community restated their preference for optionality, consolidation and the one-stop-shop approach. They also referred to a recent KPMG survey, which provides evidence that companies are not satisfied with the current corporate tax system within the EU and would welcome a new comprehensive pan-European company tax system.

III. DISCUSSION ON WORKING DOCUMENT 'CCCTB: POSSIBLE ELEMENTS OF A TECHNICAL OUTLINE ' (CCCTB/WP/057 annotated)

9. The CS (Commission Services) introduced briefly the Working document CCCTB/WP/057 - annotated and mentioned that the original version of this working document was discussed at the WG meeting held in September and had been annotated afterwards with summarised comments received from the MS and Business Europe. A short background document on Comitology (CCCTB/WP/062) had also been circulated.

General comments

10. As a general comment and in response to a request for clarification from one expert from the financial sector, the CS explained that due to limited time resources the paper does not contain provisions concerning the possible special treatment of financial institutions but emphasised that it was intended that the CCCTB should also cover this sector. However, for reasons of practicality, specific measures relating to financial institutions might be covered in a separate proposal to be made soon after the main proposal in case the preparatory technical work does not progress quickly enough for inclusion in the main proposal.

Basic structure and scope

11. Because of the importance of the subject at stake and in order to guarantee a uniform implementation throughout the EU, it was suggested that the proposal should take the form of a regulation instead of directive. The CS acknowledged that a regulation would indeed provide more uniformity but explained that, to their knowledge, there was no legal basis for a regulation. According to art 94 of the Treaty establishing the European Community, the proposal could only take the form of a directive. However, it is in EU interest to ensure that the transposition of the directive into national law is done in a uniform way.

12. In response to some remarks on Comitology, the level of detail to be provided for by the directive and the impact of changes in the IFRS, the Chair explained that the directive would contain a self standing set of rules and that any change to the rules laid down in the directive would only be made through the normal legislative process and not under Comitology. Comitology would be used to implement the measures laid down in the directive and not to create new measures. The CS invited the participants to comment and focus on specific areas where, in their view, Comitology would or would not be suitable for this.

13. A concern was raised regarding the tax treatment of a particular transaction where by assumption the directive's rules would not explicitly provide for a precise treatment. The outline paper is suggesting referring to the 27 different national general accounting standards (GAAPS). However, one might fear that it could result in a non-uniform tax base. The CS pointed out that there are a number of other alternatives including defaulting to the international accounting standard treatment (although companies could opt for the CCCTB without having to apply IFRS) and defaulting back to the national tax treatment. In the working document CCCTB/WP/057, the CS suggested a default to national GAAP but acknowledged, as suggested by some experts, that including a set of clear general tax principles to be referred to in the directive rather than defaulting to external rules, should be examined further.

Tax base for individual companies

14. Including a business purpose test was considered inappropriate by one business organisation since the control of business expenses should be made by shareholders of the company and not the tax administration. Furthermore, if this first level of control were to fail, any benefits regarded as personal use could be taxed at the level of personal income tax. In addition, since there is no uniform view on what a business expense is, it would be subject to interpretation and litigation. However, specific rules were considered necessary to deal with closely held companies.

15. It was also suggested to introduce a general tax principal on recognition and timing. The matching principle (deduction of cost follows recognition of revenues) was put forward as the best approach to deal with that issue. According to the matching principle, all costs accrued related to revenues recognised and allocated to a given tax year should be allocated to the same tax year.

16. The discussion revealed that some areas covered in the working document would need further detail and clarification when drafting the legislative proposal e.g. tax treatment of gifts (including gifts granted via a sale of asset for a price different from the market price), provision for bad debts, foreign currency gains or losses, business reorganisation and impact on the pooling mechanism, non deductible expenses (having in mind that these items are a sensitive issue when tax auditors check the accounts of a company), the dividing line between the assets to be pooled and those to be individually depreciated (the 5 million euros and 25 years of useful life should be adjusted).

Consolidation

17. There was general consensus among the participants on having one single threshold for both opting and consolidation as it would avoid the complexities of having one principal taxpayer for opting purposes and a principal taxpayer for each consolidated 75 % sub-group in a 50 % opting group.

18. In response to one expert's request for clarification on consolidation, the CS explained that the CCCTB would not apply proportional consolidation. Where a subsidiary is held with an interest of 75 % or more, 100 % of the subsidiary's results would be included in the consolidation (and not only 75 %).

19. The Chair explained that the suggested 75 % threshold for consolidation was actually a kind of compromise between all thresholds utilised in the EU (between 50% and 95 % and above 75 % in most MS). However, a business expert stressed that an average is useful for making a decision but determining the threshold only by an average is certainly not the base for good policy. In addition, all business representatives and US experts suggested lowering the 75% threshold for consolidation to a level close to 50,1 %. Such an approach would offer very many advantages but does, however, have at least one notable drawback: the minority shareholders interest.

20. An intense debate followed on the pros and cons of having a lower threshold than 75 %.

21. Suggested advantages of a threshold lower than 75 %:

- Manipulation of the "all in/ all out" principle. A 75 % threshold could be subject to manipulation since a group could decide to include or exclude a company from consolidation simply by changing the participation level. Thus a parent could sell a small percentage of its participation in a 75 % owned subsidiary to exclude it from the consolidated group without loosing the control of this subsidiary. A 50,1% threshold would not be subject to this manipulation since selling 0,1 % of a company to exclude it from consolidation would also mean loosing control of that company.

- "Transfer pricing issues". The lower the threshold for consolidation, the more group companies would be included in consolidation and then the more transfer pricing issues would be avoided. It would be beneficial for both business and tax

administrations and would achieve one of the mains goals the CS wish to attain. It was stressed that transfer pricing issues already arise as from a 20 % holding participation for related companies and that a 50,1% threshold would mitigate the consequences of having to apply two systems: the separate entity approach and the consolidation and formulary apportionment.

- "Anticipated transfer pricing compliance costs". The higher the threshold for consolidation, the more likely a company could leave the scope of consolidation and thus the more consolidating companies will therefore be likely to continue to maintain full arm's length transfer pricing in case they subsequently left the CCCTB and had to reintroduce arm's length pricing.

- Widening the scope of the CCCTB. A low threshold would widen the scope of the CCCTB and achieve a fairer balance between business concern (optionality) and MS concern (compulsory for all companies). In addition, a 50,1 % threshold would allow for inclusion in the CCCTB of all controlled distributors (to the final consumer) and all controlled intermediate companies in the EU for the purpose of having an effective sales by destination factor in the formulary apportionment that would take into account the actual final destination of sales.

- "Unfair level". One business expert pointed out that a 50% group would be required to acquire up to 25% shares to take the benefits of consolidation, which could imply complex re-organisation.

- "Consistency". Under IFRS rules, 50 % is already applied for consolidation. It would therefore be relevant to align both from a practical standpoint.

22. Suggested disadvantages of a threshold less than 75 % :

- "Protection of Minority shareholders interest". It was noted that a lower threshold would increase the potential problem concerning the protection of minority shareholders interest. One expert suggested attributing compensations for company losses used by the group, which should be not taxable and not deductible. More generally, according to many experts, it is worth trying to resolve that problem. Besides, it does not seem to be insurmountable for example in the US. The CS repeated its request for further concrete details of what these difficulties are. Although raised by a number of experts in meetings, their concerns have not yet been substantiated by detailed explanations of when and where minority shareholders would require compensation.

  According to a US expert, analytically, the problem arises only if we assume that the pre-existing system is the right system. However, if one starts with a clean page and state that the benchmark is actually a sharing mechanism, in a real sense the minority issue disappears. The problem is therefore not legal but only political. Another business expert could not even understand the problem. In his opinion, the reason for dealing with minority shareholding in company law is to protect them. The current lack of consolidation leads to over taxation of the overall profit for the group and also for the minority shareholders since group

companies cannot offset cross-border losses. Having a net result through a broader consolidation (a lower threshold) would certainly not be to the detriment of the minority shareholders' interest.

- "Transitional compliance costs". Some groups and some business organisation raised the possibility to include not all the entities for a transitional period for compliance reasons when opting for CCCTB. A low threshold would worsen the situation for groups who fear that too many entities involved would increase the compliance burden of applying the new system. The CS pointed out that groups could simply wait until they are capable of opting as an entire group for the CCCTB.

- "MS interest". It was pointed out that the interest of the MS had to be taken into account as well. MS might be concerned that more cross border loss relief would narrow the base at least in the short run. However, for the EU as a whole, increasing the scope for cross-border loss relief would remove more tax obstacles to cross border activity and benefit the internal market, which is the main goal of the CCCTB.

Foreign income

23. The concept of switch-over mechanism was generally well received but some remarked that a fixed rate of low taxation (e.g. 10 %) would be preferable in practice to the average method suggested in the working document. An expert however criticised the switch over clause because it would be harmful for the competitiveness of the CCCTB (if it were to be implemented one should at least provide for ensuring that the credit for foreign tax covers all the chain of participation of the foreign entity).

24. Some stressed that CFC rules would not increase the competitiveness of the base. But it was also underlined that the issue of undistributed profits in a low tax country would never be tackled if CFC rules were not put in place and thus consolidation together with switch-over and CFC rules were considered as an adequate mix.

25. The rule of granting full deduction of financial costs as a principle (even though most dividends were to be exempt) (Working document WP057, n° 130) was welcomed as a very attractive feature of the tax base.

26. Finally most experts supported a general exemption on portfolio dividends.

IV. DISCUSSION ON WORKING DOCUMENT 'CCCTB: POSSIBLE ELEMENTS OF THE ADMINISTRATIVE FRAMEWORK' (CCCTB/WP/061)

27. The chair reminded that the paper on the administrative framework had not been discussed with MS prior to the meeting.

28. As a general remark, support was expressed for far-reaching harmonised rules on the administrative framework so as to avoid a tax administration shopping.

29. Many remarks and questions were raised relating to the various bodies the CS (Commission Services) had suggested in its paper as well as the need to regulate the panels, their functioning, the possible interactions between panels and the people who could sit on different bodies. The CS acknowledged that further details would be needed but explained that the panels are performing quite different tasks: the dispute panel is adjudicating between tax authorities and the administrative appeals panel between the PTA (principal tax authority) and the PTP (principal tax payer); the latter panel being subject to the judicial appeals process.

30. As regards the possible central body for issuing interpretation of the directive, many questions were raised as to its scope (general interpretation, guidelines or kind of advance rulings for individual cases) and the binding effect of decisions (for tax administration, for Courts, legal certainty for taxpayers). According to US experts, a single central body issuing common, uniform, even non-binding, interpretation decisions made by true experts could be of enormous benefit, both to the taxpayer's community and also to tax authorities since different sources of interpretation from different MS would simply be unmanageable. The unique aspect of this body would be the expertise it would build up. It might also be an invaluable reference for domestic courts and the ECJ who will be in a position to issue binding decisions.

31. As regards the administrative appeals body, the CS explained that the purpose of this body was to provide an opportunity for an administrative appeal in order to try to avoid cases going to court. However, if the group were not satisfied with the decision of the administrative body, the existing legal domestic remedy would remain in place. One expert was concerned that the decisions of the PTA would in practice almost always be confirmed (and the company would be then left to the option of going to court) if the administrative appeals body due, for example, to lack of resources were not to react within 6 months. The CS acknowledged the problem but pointed out that there seemed to be only two alternatives: either to lengthen the 6-month period or, if no decision is issued within 6 months, then to deem the company's appeal successful. Neither seemed likely to be acceptable. Other experts pointed out that the system would gain consistency and certainty if the administrative appeals body were bound by the decisions of the interpretation body if a centralised body were established. However, this could of course not be the case for taxpayers and courts.

32. The CS also explained that it was not its intention to harmonise judicial appeals since setting up an EU Court would be too time consuming, might need changes to the Treaty and did not seem to be a proportionate response.

33. Some clarification of the role of national courts and the European Court of Justice (ECJ) was requested. The CS confirmed that the working paper was suggesting that appeals against administrative decisions should be to the national courts of the principle taxpayer, i.e. those of the Principle Tax Administration. Final appeals would where applicable be to the ECJ. The application of the directive itself would be subject to potential review by the ECJ under article 230 (consolidated version of the Treaty establishing the European Community) but individual decisions by the administrative panels would not appear to be covered by the review powers under article 230.

34. As regards jointly determined audits, many questions were raised as to the relationship between the principal tax authority and the other competent authorities in an audit setting. The CS explained that a fair balanced relationship has to be established so as to prevent the principal tax authority from deciding everything.

35. In response to one expert's request for clarification on accessibility of data base (DB) only for CCCTB purposes, the CS explained that the purpose of the directive is not to change existing rules concerning the ability or prevention of MS' tax authorities from passing information from one department to another. Information that is relevant in one MS and can currently be collected by tax authorities could continue to be used by some other authorities within that State. Equally where a state applies very strict rules (if information is collected for tax purposes and cannot be used for any other purposes) the proposed administrative framework is not suggesting changing those rules.

36. A US expert emphasised the importance of having a central DB and reporting mechanism, which is critical to the operational success of a formulary apportionment system. Such DB is missing in the US and the experience shows that it raises many difficulties. However, a business representative highlighted the risk of possible exchange of information provisions in double tax treaties with third-countries that would give those third-countries' tax administrations access to the whole EU database. The CS acknowledged this could be a potential problem and asked MS experts to consider whether it arose in any of their treaties.

37. As regards the procedure of tax collection and tax penalties, the CS explained that the paper does not cover that area since there was no plan to introduce a common approach on those issues. It should remain at national the level because the directive is only intended to cover the base.

38. The deadline for issuing an exceptional assessment extended from 6 to 12 years was considered to be too long in terms of practicality and of obtaining certainty for companies taking into consideration that management can change in the meantime. The three-year period to finalise an ordinary assessment was also considered too long by some participants on the side of the business community.

39. As regards the option to apply the CCCTB, one expert suggested that each individual group company should provide written confirmation of its option. The CS services explained that, in a one-stop shop system, the PTP should take the responsibility on behalf of the whole group by ensuring having received appropriate confirmation from all companies in the group. Furthermore, the CS wondered in what way it would be useful to involve Tax Administrations in checking up to hundreds of written confirmations from individual group companies. In addition, the paper suggests a procedure for dealing with an incorrect election to opt in case the "all in" principle is not respected.

40. It was also discussed whether the 5-year option was too long since the situation might change in 5 years. The system should provide for an opt-out clause in case a group has specific reasons to exit earlier. The CS reminded that the working document is dealing with groups' re-organisations but acknowledged not having covered every possible case and invited experts to provide specific examples where the option should cease before the expiry of the 5-year period.

41. The 3-month period before the relevant tax year for the notification of the option was considered inconsistent with the 6-month period to reject the notice to opt and since a group could potentially simply not know during the first 3 months of the tax year whether it will be allowed to apply the CCCTB. The CS answered that if a group or single company wants to be notified by the beginning of the tax year whether its election has been accepted, it can simply file it 6 months before the beginning of the tax year.

42. Another question was raised concerning the option for the CCCTB. An expert wondered whether groups would have the capacity to be able to amend the tax reporting systems of all their subsidiaries from the inception of the CCCTB and whether enough capacity will exist in the consultancy industry to deal with all groups across the whole of the EU opting at the same time. The expert suggested allowing groups to defer the inclusion of certain subsidiaries so they can be brought in on a "staggered" system. The CS invited MS to comment on that issue but considered the concept of introducing certain companies in certain MS over time as overly complex. Which companies in which MS are they going to choose first? It would be preferable that groups defer opting until they are able to bring all group companies in.

43. As regards the interaction between personal income tax and corporate income tax, an expert raised the issue of exchange of information and the choice of the appropriate income tax to which income would be subject. The CS reminded that there was not plan, in addition to having a common corporate tax base, to have a common personal tax base but acknowledged that the issue of exchange of information has to be considered.

V. DISCUSSION ON WORKING DOCUMENT 'CCCTB: POSSIBLE ELEMENTS OF THE SHARING MECHANISM' (CCCTB/WP/060)

44. As a general comment, a business expert pointed out that a simple formula could be very different to the current business reality and the actual way of sharing income under the separate entity approach in multinational groups. However, an US expert explained that experience from unified integrated economies like the US, Canada and Swiss cantons shows that formulary apportionment is reasonable and preferable to the separate entity approach. The existing system in the EU will become increasingly less appropriate as the EU moves towards a fully integrated EU economy.

45. US experts and experts from the business sector participated actively. All speakers agreed that the suggested formula should be uniform and identically applied by all MS in order to avoid the problem of double taxation or double non-taxation that exists in the US. All participants also agreed that a single threshold for opting and consolidation is preferable and, in general, that the formula should allocate all income since considering a different treatment for passive income or non business income would add complexity and could trigger economic distortions. It could also give rise to a lot of litigation and controversy.

46. At the beginning of the discussion, one US expert took the floor on behalf of all participating US experts and stressed that while each of them had their own views on the preferred apportionment system, all of them, both from the tax administrations and from Universities, agreed on a number of points: the principle of formulary apportionment is essential as transfer pricing cannot be done correctly in highly integrated economies; formulary apportionment is therefore inexorable; there should only be one threshold (50%); including intangibles in the property/asset factor is conceptually a good idea, but it should be kept out for practical reasons; conceptually a 3-factor formula is preferable and might facilitate agreement; it is an open question of whether to use a 2-factor (payroll; assets) or a 3-factor formula; including sales would have the advantage that it is more difficult for companies to manipulate their markets; if sales are included in the formula, it should be sales by destination; it will not be possible to have only one formula applying to all industries.

Sales by destination (in summary business were against sales by destination and US experts in favour)

47. Some business experts were sceptical about the inclusion of a "sales by destination" factor in the formula because it would not be consistent with the way taxing rights under the current system of taxation and double tax Treaties among the EU are allocated and thus with what the EU traditionally considers as the origin of income. However, they recognised that a new element should not be systematically considered as a wrong one and that discussion might highlight the potential advantage of this factor.

48. "*Try to make profits if you cannot sell anything*". According to the US experts, conceptually, a sales factor in addition to assets and labour is desirable since

it represents the demand, the market and in other words the realisation of the income. Income cannot be created only just with capital and labour with no market to sell the product. Both supply and demand is needed to generate profit. Sales are therefore integral to the creation of profit.

49. In addition, sales by destination is a factor that brings fairness to the apportionment. It does not make sense for market States that do not have a lot of property and payroll not to receive a share of the base. It would be unfair for example if businesses could enter a market from outside and compete with the market place without paying a portion of the corporate tax reflecting their participation from the perspective of the local businesses. Not only local companies should pay taxes for the services that are helping to support the market place that benefits all enterprises that are active in a particular market.

50. However, the business sector feared that sales by destination could be subject to manipulation for a number of reasons. For example, unlike the USA where sales could be allocated to destinations on a "nexus" basis, in the EU a PE (permanent establishment) would be necessary. Therefore, sales could be directed to States where no PE existed via an independent (or non-consolidated) distributor, thereby manipulating the sales by destination factor. Some kind of anti-avoidance rules would therefore be necessary (in the VAT system we can for example keep track of invoices) to take account of the final destination in the sharing mechanism but these could lead to an excessively complex system.

51. US experts provided many arguments and solutions to mitigate the possible problem of room for avoidance and manipulation: e.g. companies attach value to their customer relationship and therefore maintain direct control of it and would unlikely be ready for the sake of tax planning considerations to turn their customer relationship over to an independent seller; any independent party would keep part of the profit margin; - a lower threshold for consolidation would include as many "controlled intermediate companies or distributors" as possible; the actual physical delivery and transactions costs (transportation costs) could make it prohibitive; the benefit from excluding sales by destination is not certain since the formula would only revert back to other two factors and finally, in the opinion of the US experts business do not primarily base their activities upon tax considerations.

52. Finally, a US expert pointed out that sales should be included in the formula even if it introduces interpretation problems because a three-factor formula is more difficult to manipulate than a two-factor formula.

53. As regards nexus, according to US experts one should look at what it means to do business in the 21st century. Why is a PE necessary to allocate profits to the final destination? According to current literature, the nexus is the place where customers are, whether there is a PE or not. The request for physical presence of a group to allocate profits by destination leads to the risk for market States of losing a substantial part of the tax base, which is not realistic in terms of how business is really done.

54. However, as mentioned by a business expert, the PE approach is consistent with the current way of allocating profits under the OECD model convention. Furthermore, the business sector noted that the situation in the US is not completely comparable to the EU one. For example, US states do not enter individually into treaties and the nexus used by the US states is not appropriate as a test in terms of national States dealing cross border. The US States tax consumption through sales tax at a far lower level than EU MS (VAT in EU is levied at higher rates) and therefore tax consumption via the corporate income tax as well. In the EU, sales by destination would not ultimately equal final consumption since the CCCTB is not compulsory (and might not apply to all distributors) and a PE would be required to allocate income (nexus) to a market State. Differences in corporate tax rates are much bigger in the EU and therefore give more incentives for tax planning.

55. Furthermore, the current three-factor formula including a sales factor would, it was argued, only fit for integrated business and is therefore assuming that all functions (R&D, manufacturing and sales) are performed by the same group. Currently many industries work differently by for example offshoring R&D and/or outsourcing manufacturing, distribution, which could be out of the scope of CCCTB.

56. However, a US expert pointed out that, apart from the fact that it would not be compulsory, the EU system would be superior to the US one since it would provide for a uniform sharing system across the EU. The opportunities for tax planning arise primarily in the US out of the differences between states that do not similarly consolidate or use different sharing formulas.

57. A last remark was made as regards natural resources. Many exporting MS currently regard natural resources as theirs to tax. At the moment, at least 90 % of the profit is on a source basis. If one moves to sales by destination, a significantly lower proportion of the profits would be taxed at the origin of the resources. The expert suggested MS would not be prepared to give up the ability to tax the resources that are located in their territory. In response, a US expert pointed out that in the US, very diverse States with very different economies have been using the traditional three-factor formula for decades without facing major problem.

Sales by origin

58. Taking into consideration the current drawbacks of a sale by destination factor, according to a business sector representative, if a sales factor had to be included in the formula, it should be sales by origin. However, other experts recognized that it could be manipulated as well since group companies could simply choose the place of their establishment and therefore the origin of sales. Furthermore, to a certain extent, such a factor would effectively duplicate what assets and pay roll already bring to the formula.

Labour factor (wages only versus combination of wages and staff number)

59. Several experts agreed that due to differences in wages across the EU, it could make sense to have a combination of wages and number of employees.

However, since such differences could disappear over time, the head count factor will become less necessary and should therefore be considered only as a transitional factor.

60. However, some argued against the inclusion of the headcount in the labour factor because productivity should be reflected in the wages paid and also because the apportionment should not distort the allocation of tax revenues. If high wage countries are high price countries, the price of the public services the administration has to provide is higher. Thus a formula including headcount might unfairly reduce their share of the consolidated profit since this part of the factor would not take price into consideration.

Assets

61. Several experts agreed that inventory should not be included in the formula.

62. As regards tangible assets, a US expert suggested to value them at original (historical) cost as otherwise a fully depreciated asset would no longer be included as a factor but would also however still have an economic value to the business. Nevertheless, it was mentioned that an old asset does not produce as much value as a new one. Both methods have therefore drawbacks.

Intangibles

63. All speakers agreed that theoretically intangibles should be included in the property factor of the formula but for practical reasons. US experts were of the opinion that since the location of that factor is subject to manipulation and valuation is problematic, it would be advisable to exclude them from the formula for practical reasons.

64. According to a US expert, overall consolidated profits are geographically indeterminate and allocated to States by geographically based factors such as destination sales, labour and physical assets. However, taking something that is geographically indeterminate (income) and assigning it by something else that is also geographically indeterminate (intangible) does not make sense.

65. Furthermore, the traditional three-factor formula already reasonably reflects the value of intangibles. Intangibles could improve the productivity of labour (which may be reflected in labour cost) or of the capital employed (which increases the value of the capital) or improve the utility and nature of the product for the consumer (which is reflected in the sales and the income that is produced). One could argue that intangibles are used both where the product is manufactured and in the market where goods are sold. If one has to try to understand the role of intangibles, would one conclude that the profit made by a famous beverage trademark is coming from sales or from some secret formula and advertising? Should those profits be attributed to intangibles or to the place where the people drink it, where the trademark has value, where advertising occurs, etc ?

66. As a final remark on the formulary apportionment, one professor from a university emphasized that there is no one "correct formula" and one should not even try to identify the location of profits. However, whichever formula one uses, it will have real economic effects.

The effect of formulary apportionment on tax competition

67. It was noted that contrary to the separate entity approach where no shifting of business is necessary to benefit from tax competition (for example through paperwork like for instance transfer pricing issues), a consolidated approach with formulary apportionment would however require groups to transfer real activity (assets, staff) in order to take advantage of lower rates in specific MS.

68. Many experts welcomed the consolidated approach with formulary apportionment since it was generally agreed that tax competition consisting of shifting of tax on income with no shift of economic activity is undesirable. However, one expert pointed out that if groups were to get the benefits of tax competition, the economic consequences would be worse under a consolidated approach for the less attractive MS since on top of losing corporate income tax they would also lose economic activity (employment, etc). Nevertheless, another expert pointed out that tax competition is not intended to trigger economic distortions since it makes perfect sense, from an economic point of view, for more remote EU countries to adopt favourable tax regimes to compensate for their remoteness.

VI. CONCLUSIONS

69. The Chair concluded the meeting thanking all experts for their contributions to a very interesting debate and in particular US experts for their first participation in the Working Group in extended format and their very enlightening comments. He also invited all experts to send written comments if they wish to provide additional comments or suggestions.