Comments on Document CCCTB/WP057
Common Consolidated Corporate Tax Base Working Group
Possible Elements of a technical outline

Introduction

On 10-11 December 2007, the Working Group held a meeting in Brussels to discuss the outline of a system for a Common Consolidated Corporate Tax Base. I was asked to participate in the meeting as a representative of one of the states of the United States which has had extensive experience with the division of a Consolidated (Combined) Tax Base of groups of affiliated entities that operate across jurisdictional borders.

The comments offered herein are my own and may or may not coincide with other representatives at the meeting from the United States.

Detailed Remarks

Par 9 There is a need to develop a common point of reference. Within the United States this has not been a significant problem because of the States accept United States General Accepted Accounting Principles. Several states, however, have applied something similar to the CCCTB on a worldwide basis including groups where the ultimate parent company is located in a foreign jurisdiction. In those circumstances there has been a need to conform financial accounting to United States GAAP. The experience has been that while nominally there a great deal of differences most of them are not relevant for tax purposes, are more likely to involve issues of timing rather than actual realization or deduction, or are not material. For those that are material, they can generally be adjusted for through approximations. The sharing of a common tax base does not do so on the basis of precision but rather on the basis of generally appropriate. Because the method is inherently based upon the imprecision of traditional accounting methods there is less concern with precision for the sake of precision.

Par 11 Rules need to be provided for the termination of an election in order to unwind all of the transactions that have been accounted for on a consolidated basis which disregards intra-group transactions.

Par 17 Because the use of a consolidated tax basis with a sharing mechanisms is intended to be a source based system there is no need for withholding taxes or credits for other jurisdiction taxes within the group.

Par 24 Requiring tax deductions for corporations to have a "business purpose" is a common piece of most tax codes.

Par 25 If there is to be a uniform tax base there needs to be uniformity with respect to deductions. If there is a need to provide specific treatment for some items by a Member State this could be accomplished through a credit against taxes mechanism after the base has been shared.

Pa 40 and 41 Bad debts can be accounted for under several methods. If it is deemed appropriate a reserve method can be used. If a reserve method is used it should be applied on an overall, or at least large class basis. It should not be based on a review of each individual loan. If each loan is to be considered then it would make more sense to allow a deduction on a specific charge-off method.

Par 49 Gains or losses with respect to foreign currency accounts should be taken into account only when there is a realization event.

Par 60 If the income base is calculated on a group basis it does not matter who is assigned the depreciation. It will all be deductible in computing group income.

Consolidation Par 85-95 The complexities of these rules can be eliminated by adoption of a simple more than 50% of combined voting power rule. Determinations of control should be made on an all or nothing basis, that is a 60% ownership of and entity that owns 60% of a second entity does not mean that tier 1 company owns only 36% of the tier 3 company. Tier 1 controls tier 2 which controls tier 3, therefore tier 1 controls tier 3.

Par 87-88 California uses the rules proposed. That is ownership can be established through an entity that is not itself included in the consolidation. This applies both in a parent situation and through an intermediate company.

Par 103 and 105 Losses should be attributed to a member leaving a group. There appears to be no reason not to share losses out to individual entities. The sharing mechanism would apply for the year in which the loss was incurred. The reason for leaving the group or the termination of the group does not matter. This requires application of the sharing mechanism. From my perspective this means that losses are assigned to each group member in a year when there is a loss and this carries forward as its attribute to the next year. Then a choice would have to be made whether the loss stays with the member to be offset against its share of the profits for that year or whether the losses of each member of the group would be cumulated and offset against the group income for the year with the resulting amount then shared out to the group members. If that is done then when a company leaves the group it takes losses with it or when it joins a group it brings its losses with it.

Par 111-115

The method described in paragraph 112(i) appears to be equivalent to the old federal and California elimination and basis transfer mechanism, and 112(ii) appears to be equivalent to a deferral mechanism, where gains and losses of the individual selling member are calculated but held in suspense. The EU should familiarized itself with the rationale that led the U.S. Treasury to abandon elimination and basis transfer in 1967. In general, the elimination and basis transfer created potential loss of income, created inequities if the buyer and seller disaffiliated, and was much more susceptible to tax planning and manipulation.

1. Tax-free reorganizations

    a. Elimination: In some circumstances certain corporate tax-free transactions where basis is disregarded, the built-in gain (represented in the transferred basis) could disappear.

    b. Deferral: In a deferred system, the gain is always preserved, and triggered if the asset is sold to an outsider or the parties disaffiliate, even through corporate reorganization.

2. Disaffiliation:

    a. Elimination: In the case of a disaffiliation, the seller would receive cash from the intercompany sale but not owe tax (because its income is eliminated), while the buyer will owe tax from the sale to the outsider (because of basis transfer) despite having paid full value for the property. If buyer and seller are disaffiliated before the sale of the property to a third party, this rule works an inequity to the intercompany purchaser.

    b. Deferral: Gain is attached to the selling member on the intercompany event. If the intercompany buyer sells the asset later, it recognizes its own gain from appreciation while it held the asset.

3. Indefinite Deferral

    a. Elimination: Creates the potential for indefinite deferral of income even well after buyer and seller disaffiliate.

    b. Deferral: Intercompany gain is restored on disaffiliation, limiting the potential for indefinite deferral.

4. Manipulation

    a. Elimination: Creates potential for manipulation, allowing shifting of tax or deferral of tax from high tax to low tax jurisdictions.

       For example, assume an entity has an asset it wishes to sell that has a $10 basis, and a $1000 value, representing potential income of $990 if sold. Assume that instead the seller first contributes cash in the amount of $1000 to a new subsidiary. Then it has the subsidiary buy the asset from it for $1000. It then sells the STOCK of the subsidiary to a third party for its value of $1000.

       The contribution of cash is not a tax event, and the $1000 basis in cash attaches to the subsidiary’s stock. The income from the intercompany event is eliminated, and the subsidiary takes over the parent's $10 basis in the asset. Because the parent's basis in its subsidiary is $1000, no gain or loss is recognized on the sale of stock. The parent corporation has the same cash it would have had the asset been sold, and the potential gain is transferred to the subsidiary in the hands of a new parent. The new parent can continue use the asset and defer the gain and if it wishes to sell the asset, repeat the process to a new buyer. Or, if it chooses, it can sell the asset in a low tax rate jurisdiction.

b. Deferral: In the example, the intercompany seller has a deferred gain of $990 on the intercompany sale. If the parent sells the stock of its subsidiary, the gain is triggered.

Par 130 Dividends within a group should be eliminated provided the dividends are paid from earnings and profits that accrued when the consolidated return was being used. Dividends from outside the group do not need to be eliminated and might be eligible for a deduction on some other basis. If a deduction is allowed with respect to dividends then no deduction should allowed for expense, such as interest, relating to the acquisition of the stock which gave rise to the dividend, in the same manner that expenses related to exempt income should be disallowed.

It is recommended that single threshold for consolidation be established at more than 50%. The dual structure proposed with different rules dependent on ownership level is complex and will lead to disputes. The difference between75.1% ownership and 74.9% ownership is operationally insignificant. The differences between 50.1% and 49.9% is very likely to be significant, because at the former level the owner is in a position to control the vote of the board of directors of the subsidiary. A simple rule relating to ownership of voting stock appears to be the least susceptible to disputes.

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