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WORKSHOP ON THE COMMON CONSOLIDATED CORPORATE TAX BASE (CCCTB)

Business Reorganisations in the CCCTB

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Disclaimer

This paper has been prepared to facilitate discussion on possible rules to be included in a possible proposal for a CCCTB Directive. For convenience, use is often made of phrases such as "the rule will apply", "interest will be deductible where..." etc. It should however be noted that such wording is meant to represent only the latest technical expert views which may be subject to change and in no way pre-judges the contents of a possible future Commission proposal.

Business Reorganisations in the CCCTB

Introduction

1. This paper explores the key elements of business reorganisations in the CCCTB focussing on the tax treatment of trading losses and hidden reserves. The underlying principle is that, each time that a group undergoes a reorganisation, trading losses and hidden reserves should be treated by the Member State(s) in which they were incurred or generated, as the case may be.

A. Rules for companies joining a CCCTB group ('entering rules')

2. An 'all-in all-out' rule applies to determining group membership under the CCCTB[1]. This means that a company will be under the obligation to join a CCCTB group if, as a result of certain operations, it fulfils the 3-part test for consolidation.

3. Once a company joins an existing CCCTB group, a number of adjustments have to be made to accommodate this change of tax system. Two matters that require special regulation are trading losses and hidden reserves (i.e. unrealised capital gains/losses) generated over the pre-consolidation period[2].

a. Pre-consolidation trading losses

4. Losses incurred by a taxpayer before joining a CCCTB group will not be offset against the consolidated tax base. Such losses will be deductible against the share of the consolidated tax base which is apportioned to the joining company (in accordance with its national rules on loss carry forward).

5. This ring-fencing of pre-consolidation losses is a policy choice that takes account of national interests. Thus, losses remain attached to the domestic tax system in which they originate, to be set off against the share of the consolidated tax base apportioned to that Member State.

What are your views about the ring-fencing of pre-consolidation trading losses?

b. Hidden reserves

(i) Fixed assets (include purchased intangibles; but not self-generated intangibles)

6. As a matter of principle, capital gains/losses are taxable when realised (i.e. disposal of assets). The proceeds form part of the consolidated tax base which is then shared across the group through a formula.

7. However, a company may join a CCCTB group with assets that incorporate significant built-in underlying gains. In those cases, a set of rules should protect the taxing rights of the Member State in which the hidden reserves were generated. Therefore, the CCCTB

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[1] Commission, Working document 'CCCTB: possible elements of a technical outline' CCCTB\WP\057\doc, 26 July 2000, para. 85 (WP 057).

[2] The same rules also apply to the exercise of the initial option (i.e. where a group of companies opts for the CCCTB for the first time).

rules provide, by way of exception, where fixed assets[3] are sold outside the CCCTB group within 5 years of their entry, the realised capital gains/losses are not added to the consolidated tax base. Instead, they increase the share apportioned to the group member which held the economic ownership over these assets at the time that those joined the CCCTB group. The proceeds of any disposal of assets taking place after the end of the fifth year become part of the consolidated tax base to be shared amongst the members of the group according to a formula consisting of 3 equally-weighted factors (FA).[4]

What are your views about the 5-year rule for adjustment?

(ii) Self-generated intangible assets

8. Where a company with self-generated intangible assets joins a CCCTB group, the system should safeguard the taxing rights of the Member States where the intangibles were created before those started to generate profits. If those assets have already reached a certain level of maturity by the time of their entry, they are likely to start generating profits in the short run and without special rules those profits would typically be shared through the FA. Yet, the Member State where those values were created in the pre-consolidation period would have already given tax relief for the expenses incurred for the purpose of creating those assets.

9. Self-generated intangible assets are very difficult to identify and value[5], unless they are registered. Still, it is reasonable to attribute a fair share of the profit to the group member which created those profit-making intangible values and held the economic ownership over the assets when it joined the group. The system therefore uses a proxy for the profit that is expected to be earned: the costs that a taxpayer incurred for research, development, marketing, and advertising over the 5 years which precede its group entry will be added to the asset factor of the relevant group member for a period of 5 years.

What do you think of the proposed proxy as a response to the difficulties of including pre-CCCTB intangibles in the asset factor for sharing purposes?

B. Rules for companies leaving the group ('leaving rules')

10. If, as a result of a reorganisation, a taxpayer no longer fulfils the requirements for consolidation, it will be out of the CCCTB group.

a. Group trading losses

11. If a CCCTB group is loss-making, its losses remain at group level and nothing is attributed to leaving taxpayers. The losses are retained at the level of the group, to be carried forward and set off against future consolidated profits.

b. Hidden reserves

(i) Fixed assets

[3] The following fixed assets are subject to the 5-year adjustment rule: non-depreciable and individually depreciable (fixed assets), including financial assets with the exception of shares in affiliated undertakings, participating interests and own shares.

[4] Assets purchased by group members in the course of a group's life and subsequently sold outside the group are not subject to the 5-year rule.

[5] A key difficulty is to identify the existence and location of such assets because those do not often appear on the public register. Neither are they recorded in the books of a company.

12. Generally, taxpayers which leave the group with fixed assets will be taxed on capital gains/losses derived from any future sale of those assets. Along the lines of the treatment of hidden reserves under entering rules, a specific rule is needed where part of the underlying values has been generated over the period of consolidation. If the disposal takes place within 3 years of group exit, the proceeds will not be taxed by the Member State of the leaving taxpayer but will be added to the consolidated tax base, as it stands in the year of disposal. The chosen period (i.e. 3 years) is shorter than under 'entering rules' because, after a company has left the group, it is potentially more difficult to keep track of its assets.

(ii) Self-generated intangible assets

13. In line with entering rules, if a group member leaves the group, being the economic owner of one or more self-generated intangible assets, the costs incurred for research, development, marketing and advertising in the previous 5 years, limited to the value of those assets, are added back to the consolidated tax base of that year. Those costs will be attributed to the leaving taxpayer and treated in accordance with national corporate tax law or the CCCTB rules[6]. This is to ensure that the Member States of the CCCTB group do not effectively give relief for expenses on intangible assets the future exploitation of which is taxable by a single Member State.

What do you think of the leaving rules?

C. Business reorganisations within a group

14. Business reorganisations within the group taking place across national borders are carried out in a tax neutral manner. Given that a consolidated group is treated as a unity, tax neutrality is justified by the absence of business profit in operations within a single framework of consolidation.

a. Trading losses

15. Trading losses incurred over the period of consolidation prior to the reorganisation are not affected by internal restructurings since losses remain at the level of the group (and there is no allocation to individual group members).

16. The general rule on pre-consolidation losses (i.e. losses incurred under a national tax system prior to consolidation) is still applicable here. Thus, pre-consolidation losses will continue to be deductible against the share apportioned to the group member which generated those losses (in accordance with its national rules on loss carry forward).

17. However, it is possible that a group member with pre-consolidation losses ceases to exist as a separate legal person following a reorganisation and, as a result, a PE or no taxable presence is left behind. In the first case, pre-consolidation losses will continue to be deductible against the share apportioned to the PE (which is treated as an individual group member under the CCCTB). If there is no taxable presence in the "departing" Member State to attract part of the consolidated tax base, the existence of a PE will be deemed to address issues linked to hidden reserves (see paragraph 21 below). By implication, unrelieved pre-consolidation losses would also be attributed to that deemed PE.

[6] The latter applies if, having left consolidation, the taxpayer continues to apply the CCCTB rules solely for the purpose of calculating its tax base.

What is your opinion about the way that trading losses are ring-fenced?

b. Hidden reserves

18. Disposals of shares or assets within a group as well as transfers of assets to (a PE in) another Member State will be tax neutral.

19. The possibility to move assets free of tax within the group could encourage tax planning. Thus, if substantially all assets were transferred from a PE which in the aftermath of a reorganisation has remained in the Member State of a "departing" group member, the asset factor of the PE would decrease and this would consequently reduce the share allocated to the respective Member State. To counteract such planning, a specific rule would adjust the asset factor of such a PE by attributing the transferred assets of the "departing" taxpayer back to the PE for a period of 5 years.

20. Such re-attributions would only take place when:

(i) Substantially all assets have been transferred to another Member State within the group either to a PE of the same taxpayer or to another taxpayer; and

(ii) The transfer was the result of a business reorganisation or of a series of intra-group transactions over 2 years; and

(iii) The asset factor would be substantially changed as a result of such transfer or series of transfers.

21. Sometimes, following an intra-group business reorganisation, no taxable presence (in the form of a PE) is retained in the Member State of the "departing" group member. In such a case, to ensure that the Member State continues to receive a share of the tax base, a PE will be deemed, so that a part of the asset factor, and therefore the consolidated tax base can still be apportioned to the Member State in question.

What are your views about the 5-year re-attribution rule?

D. Business Reorganisations between Two or More CCCTB Groups

22. The main legal instrument which provides a fiscal framework for tax-free cross-border business reorganisations is Directive 90/434/EEC ('Merger Directive')[7]. This sets out a number of options for restructuring which allow for the tax-free treatment of income, profits or capital gains. Tax neutrality is therefore a point of reference in reorganisations between two or more companies within the EC, where the Merger Directive is applicable.

a. Trading Losses

23. At the time of a reorganisation involving 2 or more CCCTB groups, trading losses are distinguished between those dating back to the pre-consolidation period and those referring to the period of consolidation.

(i) Pre-consolidation trading losses

[7] Council Directive (EEC) 90/434 of 23 July 1990 on the common system of taxation applicable to mergers, divisions, transfer of assets and exchanges of shares concerning companies of different Member States [1990] OJ L 225.

24. In line with the treatment of business reorganisations within the same group, pre-consolidation losses will remain attached to the taxpayers that incurred them under a national tax system. Thus, such losses will not reduce the consolidated tax base. They may only be set off against the apportioned share allocated to each group member (in accordance with its national rules on loss carry forward).

(ii) Losses incurred during consolidation

25. The question is how losses incurred by a CCCTB group should be treated if the group, or a part of it, is integrated into another CCCTB group due to an acquisition of shares or merger.

Acquisition

26. If a loss-making CCCTB group is, fully or partially, acquired by another CCCTB group through an exchange of shares, its losses will have to be allocated to each of its group members pursuant to the formula applicable at the time of restructuring. Thus, the acquired group will be treated as having terminated. At a second stage, those losses will follow the treatment of pre-consolidation losses and will be set off against the apportioned share of the relevant taxpayers.

Merger by absorption or creation of a new company

27. A merger between 2 or more CCCTB groups may involve either of the following:

(i) a taxpayer of a CCCTB group absorbs a taxpayer of another CCCTB group without liquidation;

(ii) 2 or more taxpayers of 2 or more CCCTB groups create a new company and, without liquidating, transfer all their assets and liabilities to that new company.

28. In line with the treatment of group losses in acquisitions, "pre-organisation" group losses will have to be allocated to the group members of the absorbed group or of both groups if the merger is carried out through creating a new company.

29. If no taxable presence of the group is left in the Member State of a merging taxpayer, so that part of the "pre-reorganisation" losses can be apportioned to that Member State, the losses should be allocated to the surviving taxpayer(s), according to the formula as it stands in the tax year of the reorganisation.

b. Hidden Reserves

30. In business reorganisations between two or more CCCTB groups, the tax treatment of hidden reserves attached to members of the 'non-surviving' group(s) should follow the entering and leaving rules[8]. This implies that tax neutrality will be preserved, as no tax charge will be levied on unrealised gains/losses in line with the framework applying to single companies that join or exit a CCCTB group.

(i) Fixed assets

31. If assets held by members of a CCCTB group which becomes part of another CCCTB group are disposed of within 3 years after a reorganisation, the entire realised gain/loss will be allocated to the consolidated tax base of the "pre-reorganisation" CCCTB group (according to leaving rules), as it stands in the year of assets' disposal.

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[8] Entering and leaving rules refer to moving from the "pre-" to the "post-reorganisation" CCCTB group.

(ii) Self-generated intangible assets

32. If the reorganisation results in a group member leaving a CCCTB group with self-generated intangible assets, the costs mentioned in paragraph 15 above will have to be added back to the "pre-reorganisation" CCCTB group.

What are your views about the entering and leaving rules when 2 or more CCCTB reorganise?