



## Policy statement

### **An optional Common Consolidated Corporate Tax Base in Europe: implications for businesses worldwide**

*Prepared by the Commission on Taxation*

#### **Background**

In March 2000, the European Council launched the so-called Lisbon Strategy, which sets out the ambitious objective for the EU of becoming, by 2010, the most dynamic and competitive knowledge-based economy in the world. The importance of improving taxation policies throughout the EU as a means to achieve the Lisbon goals has been highlighted many times. At present, the existence of 27 different and often incompatible tax systems constitutes a significant obstacle to economic efficiency and the functioning of the internal market. Double taxation, the lack of tax consolidation, tax-related hindrance of business restructuring and enormous compliance costs are just some barriers to a more competitive and open European market. Removing these obstacles would significantly spur investment and contribute to enhancing the competitiveness of the EU economy.

For this reason, in October 2001, the Commission presented a new plan for an internal market without tax obstacles, acknowledging that the issue of reforming EU company taxation is crucial for achieving the Lisbon objectives. The technical work on a Common Consolidated Corporate Tax Base (CCCTB), however, only commenced in 2004 through the creation of a Commission Working Group in which all Member States participate. As has been stated repeatedly by Commission representatives, it is the firm intention of the Commission to present a legislative proposal during 2008.

#### **Purpose and key features of the CCCTB**

The core purpose of the CCCTB is to establish a single, consolidated computation of taxable corporate income for businesses operating within the EU that may be adopted at the option of the taxpayer. Such a common tax base, which will make it possible for businesses to opt for taxation according to a single consolidated corporate tax calculation instead of the multiple national tax bases that now apply.

It should be underlined that the objective is not to harmonize tax rates among the Member States. On the contrary, tax sovereignty with respect to tax rates is instrumental to ensure a sound tax competition among Member States and thus to promote efficiency. The objective is,

rather, to create a more efficient market and tax system for companies operating within the EU by providing for a common and competitive tax base. It is likely that only some Member States in the EU will initially introduce the CCCTB. Other Member States can then join the regime at a later stage.

Nonetheless, countries joining at a later stage, and even countries outside the EU, will also be immediately affected by the adoption of the CCCTB. This should be taken into account in the process of establishing a CCCTB in the EU. The ICC would like to bring some important issues in this regard to the attention of policymakers.

### **International taxation under the CCCTB**

There are two basic options available in providing recognition for foreign taxes: the exemption system (territoriality) and the credit system (world-wide taxation). ICC believes that the CCCTB should be based on the exemption approach.<sup>i</sup>

A CCCTB based on source taxation (territoriality) would effectively not include foreign source income. The “source” of an item of income refers to the place where the income-generating activity is carried out (for example, royalties generally have their source where the licensor is situated, interest income where the lender is situated, dividends where the subsidiary resides and business profits where the business activity is performed). Such a system would be compatible with existing tax treaties Member States have with non-participating countries. Exempting foreign source income should not prevent businesses in participating Member States from deducting losses in third countries. Such a provision in the CCCTB could be accompanied by a recapture mechanism to ensure taxation of net profits.

If, on the other hand, the CCCTB is based on a world-wide rather than a territorial regime, it is important to ensure that foreign source income should not face double taxation. This can be achieved by providing for a full tax credit in respect of foreign taxes. However, such a credit method must take into account the total tax burden a company faces under the CCCTB. Since the tax burden depends not only on the tax base (CCCTB) but also on the national tax rate in the participating Member State, the credit method is complex and may not deliver single taxation of the net profit. In either case, foreign dividends must be excluded from the CCCTB to prevent economic double taxation.

In relation to third states, the CCCTB should provide for common transfer pricing rules based on the arm’s length principle and be accompanied by a clear dispute resolution mechanism. ICC encourages participating CCCTB countries to allow for mandatory arbitration.<sup>ii</sup> This could be instrumental in promoting the development of suitable arbitration mechanisms in the tax area, ensuring timely settlements. Allocation of profits and losses to a permanent establishment (PE) should follow the arm’s length principle established in the OECD Model Tax Convention (MTC).

## **Consolidation**

One of the main benefits of the CCCTB is consolidation within a group, eliminating the increasingly onerous Transfer Pricing compliance burden and reducing the number of associated cross border disputes. Consolidation furthermore allows a group to be taxed on its net profit, since cross-border loss offset would be given and intra-group transactions eliminated before taxable profit is calculated. By allowing for net taxation, consolidation will enhance economic efficiency and reduce the risk of double taxation.

ICC regards consolidation as a fundamental and necessary element of the common tax base. The CCCTB should provide for consolidation from the very start. A two-step approach, with first a common tax base and consolidation only at a later stage, would not find support in the business community. The main objectives of the CCCTB of removing transfer pricing concerns and providing for cross-border loss relief would not be fulfilled by only having a common tax base. ICC furthermore encourages all countries to allow for domestic group consolidation combined with the possibility for cross-border loss relief on a timely basis.

## **Anti-avoidance rules**

The CCCTB is likely to include anti-avoidance rules. Such rules should only be adopted where absolutely necessary to ensure that they do not infringe on the principle of net taxation. Countries with a lower tax rate should not face the burden of additional corporate taxation on their domestic investments undertaken by businesses taxable under the CCCTB. In particular, controlled foreign corporation (CFC) rules should be avoided and, to the extent used, only apply to wholly artificial arrangements.

## **Administration**

In order for the CCCTB to be an attractive tax system for both businesses and governments, delivering much needed simplicity, it must allow for single compliance in a single location (one-stop-shop). Hence, the taxpayer should only be required to file one tax return in one country for the entire group. The one-stop-shop approach must equally apply to the apportionment of the calculated profit or loss. The chosen single key for allocating tax revenues to participating countries must be simple, robust and avoid reintroducing transfer pricing concerns for businesses. Any disagreement among the Member States should be resolved at a common and single point of authority. Without a one-stop-shop approach, administrative costs may not be reduced sufficiently to merit support and interest from the business community.

There will still be a need to negotiate tax treaties between each Member State and third countries, since not all companies will opt for taxation according to CCCTB rules but will retain taxation under national rules. As a long term goal, common tax treaties with outside countries should be negotiated from a single location and then applied uniformly in CCCTB countries.

## Conclusion

ICC welcomes the initiative to make the European market more efficient by reducing tax distortions and compliance costs. For the CCCTB to be successful, it is vital that the system is optional to businesses, consolidated from the start with an administration of the system according to a one-stop-shop approach. Compliance costs and distortions must be reduced, also in relations to countries not having the CCCTB. Businesses in outside countries should not face tax induced distortions in their activities in the European economy.

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## About ICC

ICC is the world business organization, a representative body that speaks with authority on behalf of enterprises from all sectors in every part of the world. ICC promotes an open international trade and investment system and the market economy, and helps business corporations meet the challenges and opportunities of globalization. Business leaders and experts drawn from ICC's global membership establish the business stance on broad issues of trade and investment policy as well as on vital technical subjects. ICC was founded in 1919 and today it groups thousands of member companies and associations in 130 countries.

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<sup>i</sup> ICC concluded in its Policy Statement dated 3 October 2003 that both the exemption system and the tax credit system are useful approaches to avoiding double taxation on cross border dividend flows but, on balance, favoured an exemption system. In the context of the CCCTB, the exemption system is preferable. Whereas the exemption method relieves the double taxation at the level of the tax base, the credit method applies to the tax liability. As a result, the tax rate is reflected in the latter approach but not in the former. As the CCCTB will provide for rules on how the tax base is calculated and shared among Member States but not how the tax liability should be calculated, the application of a method reflecting actual tax rates (i.e. the credit approach) would be outside its scope.

A CCCTB based on a credit method would frequently lead to complexities triggered by the parallel application of the CCCTB and the current network of double tax treaties. As the CCCTB does not involve the renegotiation of current double tax treaties, taxpayers would presumably be entitled to request treaty benefits where the treaty gives more preferable tax relief than the CCCTB (typically in relation to exemption treaties). This would in turn require some rules to monitor the allocation of foreign income (or loss) and to ensure that the "right treaty" is applicable on the relevant income. How this would be achieved is difficult to foresee. It does, however, seem to require that the foreign income be earmarked so that it can be traced and allocated to the Member State which is to apply its double tax treaty with the relevant third country. Apart from the administrative burden this would impose, it appears very difficult to combine such a scheme with a system where all income and losses are to be consolidated in a single location.

A CCCTB based on Capital Import Neutrality would minimize the difficulties of having to apply bilateral double tax treaties in the context of the CCCTB. As double tax treaties can only reduce the tax liability, their applicability is limited to situations where the underlying tax legislation (i.e. the CCCTB) provides for a less favourable relief than the treaty. Thus, where the CCCTB provides for a comprehensive relief by means of exemption, the problems of having to apply and/or renegotiate existing treaties are kept to a minimum.

<sup>ii</sup> See ICC Policy Statements dated 3 May 2000 and 6 February 2002, and the OECD Report "Improving the Resolution of Tax Treaty Disputes" released 7 February 2007.