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By PwC Deutschland | 18 March 2011

Common Consolidated Corporate Tax Base (CCCTB)

The European Commission has published a proposed CCCBT directive to allow groups active in more than one member state to opt for taxation on a single, consolidated tax base to be allocated over member states on a set formula. Assessment and collection would be by each member state under its own rules and at its own rates.

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For some considerable time, the European Commission has been concerned with barriers faced by businesses wishing to expand within the EU caused by the necessity to follow the largely unharmonised corporation tax system of each member state where it is established with a branch or subsidiary. The problems range from the administrative – the need to follow a range of different, uncoordinated procedures – to the burdensome, with transfer pricing in all its various aspects as the prime example. The Commission suggests that the compliance costs and tax risks currently faced by multi-state businesses would be significantly reduced, if a group could taxed under a single system by a single authority. Its proposal – after numerous discussions and working groups – is for an optional system to allow companies liable to corporation tax in more than one EU country to compute and report their group income in the country of residence of the parent (or as named by a third-country group in respect of its EU activities). This income would be a consolidation of the annual results of all EU subsidiaries and permanent establishments after elimination of intra-group profits and losses. It would then be allocated over each member state under a set formula reflecting the relative importance of the units in each country. Each country would then assess and collect under its own rules and at its own rates. Member state would be free to grant their own incentives against their income allocation, e.g. to promote R&D, within the overall restrictions on state aid. In this way, the Commission hopes to simplify taxation for business without substantially interfering with the fiscal sovereignty of member states.

The tax group

The parent or „principal company" exercises the option on behalf of all its members. The decision is „all or nothing", that is, one cannot opt for group taxation with the exclusion of a qualifying subsidiary. Qualifying subsidiaries are those held as to over 50% by voting rights and as to 75% of rights to profits or capital repayment. Sub-subsidiaries follow their parents, whereby an over 50% voting right ranks as 100% whilst the profits/capital repayment rights progressively diminish down the line. Both criteria must be met for at least the last nine months of the tax year. Branches (permanent establishments) follow their immediate owners, as do partnership shares if the partnership is transparent in its country of residence. There is no distinction by reference to type of business except that shipping companies subject to „tonnage tax" are excluded, as are all companies in insolvency or winding-up proceedings.

Parent companies from EEA countries outside the EU (Iceland, Liechtenstein and Norway) may also group their EU/EEA activities. However, there is also the condition that the EEA country must be bound by an information exchange agreement with the member state of the parent or subsidiary. Liechtenstein companies will thus often be excluded from participating in either capacity. Parents from other countries may elect to group their EU subsidiaries and branches by choosing an EU subsidiary as the „principal taxpayer". If the company has EU branches only, it has a free choice of branch. If it has a single subsidiary and one or more branches, the subsidiary is the principal taxpayer.

Companies are the legal forms as listed in an annex to the directive. However, they must also be subject to corporation tax in their home country. Thus, a Hungarian limited or unlimited partnership (bt. or kkt.) is a

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company for this purpose, whereas the, for all practical purposes identical, German vehicles (KG, oHG or GmbH & Co.) are not.

The definition of permanent establishment („branch") follows that of the OECD model treaty. However, the EU definition of a building site is one lasting for more than 12 months. Thus, there may in some few cases be a discrepancy between the directive and the relevant double tax treaty. The directive definition is paramount.

Accounting principles

The consolidated combined corporate tax base (CCCTB) is to be established under a common set of accounting principles applied independently of national law or accounting rules. The basis is historical cost, accrual accounting, and valuation policies are to be consistently applied. More specifically:

Long-term contracts are to be accrued on the percentage of completion method. The estimate of completion is to be based either on the comparison of actual costs incurred to date with the estimated total contract costs, or on a professional valuation.

Provisions for current items are to be taken up at their estimated amounts at year-end. Long-term items (those not expected to lead to an actual outlay within the next twelve months are to be matched with income and then discounted at the EURIBOR twelve-month rate.

Pension provisions are to be calculated actuarially and similarly discounted. There is no funding requirement.

Bad debt provisions are to be based on the loss actually anticipated under the assumption that the company takes all reasonable steps to recover the debt. The calculation may be based on either specific, or general, provisions, or on a mixture, but must, in all cases be justified.

Hedges are to be matched with the hedged item.

Stocks (inventories) are to be valued individually, or, if interchangeable, on a FIFO or weighted average method. The basis is to be direct cost, though companies (or subsidiaries joining the group) may continue to include indirect overhead in their valuation if they have previously done so under national law.

Fixed assets and investments are to be taken up at cost. There is to be no regular amortisation of land or investments. Exceptional write-downs are, however, possible. Buildings are to be amortised straight-line over 40 years and intangibles over 15. Shorter periods may be taken if the building was not bought new and is not expected to last for 40 years or the intangible is based on a legal right with an earlier expiry.

There is also a roll-over relief provision for gains on the sale of real estate or investments if the item was held for more than three years. A gain may be set against the cost of a replacement asset purchased in the year of sale, in the preceding year, or in the following two years. If not utilised within that period, the gain must be released to income and taxed with an uplift of 10%.

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Leased assets are to be depreciated by the economic owner. The Commission is to be authorised to issue regulations on the criteria for determining economic ownership and on the calculation of the interest implicit in the lease payments.

Moveable tangible fixed assets are to be pooled with the closing pool balance being written down by 25%. The closing balance is the opening written down value plus all additions during the year, less all proceeds from sale or scrap. A negative balance is to be taken to income immediately. The system is reminiscent of, though simpler than, the UK system of capital allowances.

Banks and insurance companies are subject to special rules.

Tax-free income and non-deductible expenses

The following income items are exempt:

Investment grants or subsidies

Proceeds on the sale of moveable fixed assets from the pool

Dividends and capital gains on the sale of shares, other than those falling under the anti-abuse or CFC provisions – see below.

Permanent establishment income from a non-EU/EEA country.

Correspondingly, the following items of expense are not deductible:

Charitable donations in excess of 0.5% of turnover

50% of entertaining cost

Bribes and fines

The expense incurred in earning tax-exempt income. This is to be taken at 5% of the relevant income, unless the company can show that the actual expense was lower.

A range of local taxes, capital taxes and registration fees as listed by country in an annex to the proposal.

Losses

There is no loss carry-back, but the loss carry-forward is indefinite. If a company with loss carry-forwards under its own national law enters a group, the carry-forward is transferred to the group, but only for offset against future income allocated to the country concerned. A company leaving a group receives no entitlement to any part of the group loss. If group ceases, the entire remaining loss carry-forward devolves on the parent.

Anti-abuse provisions

All transactions with the sole purpose of **avoiding tax** are to be ignored. However, the taxpayer is free to

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structure transactions with a genuine commercial intent to his best tax advantage.

All transactions with **associated enterprises** (related parties) outside the group are to be at arm's length. An associated enterprise is one under more than 20% common control or shareholding or one over which the other enterprise can exercise significant management influence.

Interest paid to a low-tax country – see CFC provisions below – without an information exchange agreement with the state of the principal taxpayer is to be disallowed.

Avoidance of double taxation

Generally, a credit for foreign withholding tax is to be granted on interest and royalty income from outside the group. Dividend and permanent establishment income is to be exempt, but to be taken into account when setting the rate to be applied to the other income (in countries with progressive rate scales). However, the credit method is to be substituted for the exemption on profit shares from low-tax countries as defined under the CFC provisions – see below.

CFC provisions

A controlled foreign corporation is held as to more than 50% by the group (voting, capital or profit sharing rights) and resident in a low-tax country. A country is low-tax if its standard rate of corporation tax is less than 40% of the EU arithmetical average standard rate (to be computed each year by the Commission) or if it allows the corporation a substantial advantage over its normal rules through a preferential regime. The undistributed income from a CFC is to be added to the tax base of the parent, where the CFC earns more than 30% of its total income from passive sources, more than half of which is paid by group companies or associated enterprises. Future distributions of income already attributed in this way are not to be taxed a second time.

Tax base allocation and tax collection

The CCCTB amount is to be allocated to the member states in which the group maintains facilities (subsidiaries or permanent establishments) included in the consolidation. Attribution is on the proportion given by one third of each of third-party sales, tangible fixed asset and employment. The employment factor is to be based as to 50% on the wages total and 50% on the number of employees. The allocation is to be calculated by the taxpayer and submitted as part of the group tax return. Assessment and payment then follow the rules of the national law of each member state involved. Thus income allocations to countries with self assessment procedures lead to a more or less immediate payment obligation, whilst those to countries with assessment notices will lead to official payment demands. Countries that routinely require payments on account prior to year end will continue to be able to do so.

Appeals against the tax base or its allocation can only be made centrally, in the country of the principal taxpayer. It is also the authorities of that country that will be responsible for verifying the accuracy of the returns filed. This includes organising tax audits and investigations, though they can of course call on their colleagues in other member states for assistance as needed.

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Entry into force and transposition

At this stage, the entry into force provision in the draft is still undated and the transposition deadline has also been left blank. However, the Commission has expressed its hope that the directive can be enacted for entry into force in 2013 with transposition in all member states within the following two or three years.

Keywords

CCCTB, EU tax consolidation