Agenda

- Introduction
- Determination of the tax base
- Anti tax avoidance legislation
- Consolidation and allocation
- One-stop-shop
- Political and practical perspectives
Introduction
Challenges – The Current System

- 28 domestic tax systems within the EU.
- Increasing number of international tax disputes.
- Risk of and actual double taxation.
- Vulnerable to aggressive tax planning.
- Administrative burdens.
- Language and cultural barriers.
CCCTB in a Nutshell

- Single set of rules to determine companies’ taxable income within the EU.
- Consolidation of all activities within the EU.
- Allocation of taxable income using an apportionment formula.
- The allocated taxable income will be taxed at the national tax rate.
History and Background

• Longstanding efforts to harmonize:


• CCCTB-directive proposed in 2011.

• New directive proposals in October 2016.
History and Background

- **Purpose**: Improve the internal market:
  - Reduce the administrative costs to companies:
    - Single set of rules for all MS.
    - One-stop-shop principle.
  - Companies may offset losses in one MS against profits in another.
  - Reduce risk of double taxation.
Why a New Proposal Now?

- Increased focus on fair and effective taxation:
  - The European Commission’s action plan, June 2015.

- Re-branding of the idea in a new context:
  - The fight against tax avoidance and aggressive tax planning.
  - The post financial crisis growth agenda.

- The CCCTB directive shall also:
  - Eliminate mismatches and mitigate tax avoidance etc.
  - Create transparency and reduce harmful tax competition.
  - Promote investment and growth.
Overview

• Two proposals:
  1. CCTB, COM(2016) 685 final:
     • Single set of rules to determine the tax base.
  2. CCCTB, COM(2016) 683 final:
     • Consolidation and allocation.

• Divided in order to facilitate progress in the negotiations.

• Agreement on consolidation and allocation expected to be difficult.

• Expected timeline:
  – CCTB: Entry into force, 1 January 2019.
Determination of the Tax Base
A company shall cease to be subject to national corporate tax law in respect of all matters regulated by the directive, unless otherwise stated.

Mandatory for corporations and PEs in MSs, if:

a) Listed in annex 1,
b) Subject to tax mentioned in Annex 2,
c) For accounting purposes belong to a group with a consolidated turnover > EUR 750,000,000, and
d) Constitute a parent company or a qualified subsidiary.
   • Voting rights > 50%, and
   • Capital/profit share > 75%.

PE concept in line with updated OECD version.

Other companies can opt to apply the rules for 5 years at a time, if covered by a) and b).

Exempt if covered by a tonnage tax regime.
Elements of the Tax Base

• Realization principle.

• Elements of the tax base:
  – Revenues ÷ exempt revenues, deductible expenses and other deductible amounts.

• Exempt revenues – “Principle of territoriality”:
  – Gains/losses relating to the disposal of subsidiary shares.
  – Dividends from subsidiary shares.
  – Income from PE.
Elements of the Tax Base

• **Deductible expenses:**
  
  – Expenses shall be deductible only to the extent that they are incurred in the direct business interest of the taxpayer:
    
    • Includes all costs/expenses that the taxpayer incurred with a view to obtaining and securing income, including R&D and costs of funding.
    
    • 50% additional deduction for R&D ≤ EUR 20 million (if > EUR 20 million → 25% additional deduction).
    
    • Super deduction for start-ups: Extra 100% deduction for R&D ≤ EUR 20 million.

• **Other deductible amounts:**
  
  – Depreciation of fixed assets (see below).
Elements of the Tax Base

• Allowance for growth and investment (AGI).
  – EU wide Allowance for Corporate Equity (ACE):
    • Tackle debt bias.
    • Widely endorsed by the EU Commission but only used in a few countries.
  – **Yield** on the **AGI equity base increases** shall be deductible from the tax base of the tax payer.
  – **Decrease** in AGI equity base shall be taxable.

  – Defined yield:
    • Equal to the euro area 10-year government benchmark bond in December of the year preceding the relevant tax year + a risk premium of 2%-points.
    • Floor of 2%. 
Elements of the Tax Base

• Allowance for growth and investment (AGI) - continued.
  – AGI equity base:
    • Difference between the equity of a tax payer and the tax value of its participation on the capital of associated enterprises.
    • Calculated as the difference between AGI base at the end of the year and on the first day of the year (for the first 10 years).
  – Equity:
    • Capital and reserves defined in accounting directives.
    • Equity as defined in IFRS used within the EU.
Elements of the Tax Base

• Allowance for growth and investment (AGI) - continued.
  – Commission delegated to adopt acts against tax avoidance, e.g.:
    • Intra group loans,
    • Cash contributions and in kind contributions,
    • Transfers of participations,
    • Re-categorization of old capital as new capital,
    • Creation of subsidiaries,
    • Acquisitions of businesses held by associated enterprises,
    • Double dip structures, and
    • Increase of amount of loan financing receivables.
Elements of the Tax Base

• Non-deductible items:
  – Profit distributions and repayment of equity/debt.
  – 50% of entertainment costs.
  – Transfer of retained earnings to a reserve (equity).
  – Corporate tax and similar taxes on profits.
  – Bribes and other illegal payments.
  – Fines and penalties.
  – Expenses incurred for the purpose of deriving exempt income.
  – Gifts and donations:
    • MS may provide for the deduction of gifts and donations to charitable bodies.
  – Acquisition and construction costs (except for R&D).
  – Losses incurred by a PE in a 3rd country.
Elements of the Tax Base

• Income from transparent entities:
  – If an entity in a MS is transparent according to the rules of that MS → Taxpayer shall include its share of the entity’s income.
    • The income should be calculated according to the rules of the directive.
  – Entities located in 3rd countries → Determination of transparency or not to be made in accordance with the law of the MS of the taxpayer.
Timing and Quantification

• **Main rule:**
  - Revenues, expenses and other deductible items, shall be recognized in the tax year in which they accrue or are incurred:
    - Accrual at the moment that the right to receive the revenues has arisen and the revenues can be measured reliably.
    - Deductible expenses are incurred at the moment the obligation to make the payment has arisen and the amount can be quantified with reasonable accuracy.

• **Several specifications and special provisions.**
Depreciation of Fixed Assets

- Depreciation shall be deducted by the economic owner:
  - If the economic owner cannot be identified → the legal owner.
  - Commission empowered to adopt delegated acts.
- No depreciation: Financial assets and assets not subject to wear, tear and obsolescence.
- A full year’s depreciation in the year of acquisition or entry into use, whichever comes later.
- No depreciation in the year of disposal.
- Rollover relief possible for replacement assets.
Depreciation of Fixed Assets

- Forcing, linear and individual depreciation of:
  - Commercial, office and other buildings → 40 years.
  - Industrial buildings and structures → 25 years.
  - Other long-life fixed tangible assets → 15 years.
  - Medium-life fixed tangible assets → 8 years.
  - Fixed intangible assets → remaining period of legal protection or 15 years.
  - Second-hand assets → Possibility of shorter depreciation period.

- Other fixed assets → Pooled together, 25% annually of depreciation base.

- Commission empowered to adopt delegated acts to define more clearly the categories of fixed assets.
Losses

• Losses:
  – Infinite loss carryforwards for resident taxpayer and PE of a non-resident taxpayer.
    • Oldest loses shall be deducted first.
  – No carry-back (no negative amount).
  – Restricted loss carryforwards, if:
    • Change of control.
    • Major change of activity (more than 60% of turnover).
Losses

- Losses – Continued.
  - Temporary access to deduct losses in qualified subsidiaries and PEs:
    - If taxpayer is still profitable after having deducted own losses.
    - Incurred in the same year.
    - In proportion to the holding.
    - Not result in negative amount.
    - Rules on ordinary and extraordinary recapture:
      - Max. 5 years of "credit" hereafter full inclusion.
      - Full inclusion upon sale, winding up or transforming into a PE.
      - Sale of PE, winding up or transforming into subsidiary.
      - No longer parent company.
  - Losses and the Marks & Spencer Doctrine?
Entering and Leaving the CCTB

• All assets and liabilities shall be recognized at their value, as calculated in accordance with national tax rules immediately prior to applying the directive.

• Specific rules dealing with the transition (entry/exit) of:
  – Fixed depreciable assets, long-term contracts and provisions.

• Pre-entry losses may be deducted from the tax base if and to the extent that national legislation allows this.

• Unrelieved losses incurred under the application of the directive shall be carried forward in accordance with national corporate tax law.
Relief for Double Taxation

- Double taxation relief.
- Credit relief shall be allowed where the taxpayer derives income that has been taxed in another MS or in a 3rd country:
  - Decreased by related deductible expenses.
  - 3rd countries: Credit may not exceed the final corporate tax liability, unless an agreement between the countries states otherwise.
Anti Tax Avoidance Rules
Switch-over Clause

- **Switch over from exemption-relief to credit-relief:**
  - Participation exemption of distributions from 3rd country entities.
  - Participation exemption proceeds from disposal of shares in a 3rd country entity.
  - Income from 3rd country PEs (principle of territoriality).

- **Low taxation requirement:**
  - Statutory corporate tax rate lower than 50% of the statutory tax rate in the MS of the taxpayer.
  - Legal consequence: Taxpayer shall be subject to tax on the foreign income.
  - Credit-relief for tax paid in 3rd country (ordinary credit).
  - Not apply if tax treaty prevents a switch-over clause.

- **Not applicable to:**
  - Losses from the disposal of shares.
Switch-over Clause

• Comment:
  – Aiming at too generously applied tax-exemption regimes.
  – Impact?
    • Tax incentives on rate (but not on tax base).
    • E.g. permanent establishment in Dubai.
    • Potential double taxation: Low tax subsidiary owns high tax lower tier subsidiary.
Associated enterprises:

- Taxpayer participating in the management (significant influence), control (20% of voting rights) or directly or indirectly in the capital (20% of capital), of:
  - A non-taxpayer, or
  - A taxpayer that is not in the same group.

- The two enterprises shall be regarded as associated enterprises.
Transfer Pricing

- Transfer pricing adjustments.
  - Arm’s length principle:
    - Different wording than OECD MC article 9:
      - Primary adjustment.
      - Secondary or corresponding adjustment?
    - PEs:
      - Separate entity approach.
      - Same or similar conditions, taking into account the functions performed, assets used and risks assumed.
Exit Taxation

- Exit tax on an amount equal to the market value of the transferred assets less their value for tax purposes:
  - At the time of exit.
  - Transfer of assets from PE in a MS to head office in another MS or 3rd country.
  - Transfer of assets from PE to head office or another PE in another MS or 3rd country - if exit state does not have the right to tax.
  - Transfer of tax residence – except assets connected to PE.
  - Transfer of business carried out by PE between MS or to 3rd country – if PE state cannot tax the transferred assets.

- No mentioning of deferral, interest or guarantee.
- Entry value equals market value in the recipient state (step-up).
- Certain exemptions for temporary transfers of assets.
Interest Limitation Rule

• Borrowing costs up to the amount of interest etc. received is fully deductible.

• Exceeding/net borrowing costs.
  – Broadly defined.

• Limitation: 30% of EBITDA (tax) or for a maximum of EUR 3 million whichever is higher.
  – Option to fully deduct exceeding borrowing costs for a stand alone entity.

• Application at group level if entity member of group, which may opt for tax consolidation.
Interest Limitation Rule

- Carry forward.
  - Infinite carry forward of restricted borrowing costs.
- Financial undertakings are exempt.
- Exempt loans:
  - Concluded before political agreement.
  - Long term public infrastructure projects within the EU.
CFC-Legislation

- Very similar to model A of the ATAD CFC rule:
  - Wide control test: > 50% of voting rights, capital or profits.
  - 50% effective tax rate threshold.
- Applicable to subsidiaries and PEs – but not applicable:
  - Intra-EU/EEA if set up for valid economic reasons.
  - If “tainted income” ≤ 1/3 of total income.
  - To financial undertakings if “tainted” income from group companies ≤ 1/3 of “tainted income”.
- Tainted income: Broadly defined.
- Legal effect:
  - Parent company shall include the specifically mentioned non-distributed income (“tainted income”).
  - Calculation in accordance with the rules of the directive.
  - Inclusion, in accordance with the parent’s entitlement to profit.
  - Relief provisions.
Hybrid Mismatches

• **Definition:**
  - A situation between a taxpayer in one MS and an associated enterprise in another MS/3rd country, *OR*
  - A structured arrangement between parties in MS.
  - Where double deduction or deduction non-inclusion is caused by differences in the legal characterization of a financial instrument or entity, or in the treatment of a commercial presence as a PE.

• **Double deductions:**
  - A deduction of the same payment, expenses or losses occurs in both MSs or MS and 3rd country.
  - The deduction shall be given only in the MS where such payment has its source, the expenses are incurred or the losses are suffered in another MS.
  - 3rd countries: MS shall deny deduction.
Hybrid Mismatches

- **Deduction non-inclusion:**
  - There is a deduction of a payment in the MS in which the payments has its source without a corresponding inclusion for tax purposes of the same payment in the other MS.
  - The MS of the payer shall deny the deduction of such payment.
  - 3rd country:
    - Deny deduction.
    - Include income.

- PEs.
GAAR

• Legal effect:
  – Arrangements etc. shall be disregarded for the purposes of calculating the corporate tax.
    • Calculated by reference to economic substance.

• Requirements:
  – “Arrangement or series thereof”.
    • An arrangement may comprise more than one step or part.
  – Having been put in place for the essential purpose of obtaining a tax advantage.
  – That defeats the purpose or object of the otherwise applicable tax provision.
  – “Non-genuine”.
    • Not put into place for valid commercial reasons, which reflect economic reality.

• Tax authorities should carry the burden of proof.
Consolidation and Allocation
Consolidation and Allocation

- Stage 2.
- The tax bases of all members of a group within the EU shall be added together into a consolidated tax base.
  - Intra-group transactions are eliminated.
  - No withholding taxes or other source taxes should be imposed on intercompany transactions.
  - As a main rule business reorganizations within the group shall not give rise to profits or losses.
  - If negative tax base → Carried forward and offset against any subsequent and positive consolidated tax base.
- If positive tax base: Allocation by formula.
Formula Apportionment

\[ \text{Share A} = \left( \frac{1}{3} \text{Sales}^A_{\text{Group}} + \frac{1}{2} \text{Payroll}^A_{\text{Group}} + \frac{1}{2} \text{No of employees}^A_{\text{Group}} + \frac{1}{3} \text{Assets}^A_{\text{Group}} \right) \times \text{Cont'd Tax Base} \]

- **Formula based on company-specific factors:**
  - Sales (destination-based).
  - Labor (payroll and number of employees).
  - Assets (fixed tangible assets).

- **Safeguard clause:**
  - If the formula does not fairly represent the business activity of a group member, one may request use of alternative formula – agreement required.

- **Special industry-specific rules:**
  - Financial institutions, insurance, oil & gas, shipping and air transport.

- **Commission may lay down detailed rules.**
One-stop-shop Principle

• One-stop-shop principle.
  – Groups should be able to deal with one single tax administration.

• Principal tax authority:
  – The competent authority of the MS in which the principal taxpayer is resident for tax purposes.
  – Initiates and coordinates audits.
One-stop-shop Principle

• **Principal taxpayer:**
  - Main definition: A resident taxpayer that forms a group with its qualifying subsidiaries, with one or more PEs located in MS, or with one or more PEs of a qualifying subsidiary located in a 3rd state.
    - Shall give notice to the principal tax authority upon creation of a group.
    - Shall file the consolidated tax return with the principal tax authority.

• **Administrative and judicial appeals.**
  - Should be made to the administrative body or court of the MS of the principal taxpayer.
Political and Practical Perspectives
Political Perspectives

- The proposals have to be unanimously adopted.
- Some national parliaments have raised formal objections → Not in line with principle of subsidiarity:
  - Ireland, Malta, The Netherlands, Luxembourg, Sweden and Denmark.
  - Not enough for the evocation of the "yellow card procedure".
  - True concerns or "bad excuses"?
- Will be difficult to reach agreement unanimously (soon):
  - But: The Commission has some momentum.
  - "Enhanced corporation procedure" a possible alternative.
- The current Maltese presidency intends to start examination of the CCTB proposal with a view to stabilise the text by the end of June 2017.
Political Concerns

- **Loss of tax sovereignty:**
  - Loss of flexibility and of tax system as MS policy tool.
  - Loss of possibility to "undercut" each other.

- **Possible decline in tax revenues for some MS.**
  - More narrow tax base?

- **The allocation formula not fair:**
  - May favor larger MS with manufacturing industries and huge consumer markets?
  - "Old school formula" not taking intangibles into account.

- **Risk of facilitating a race to the bottom on tax rates.**
  - Some MS asks for a minimum tax rate.
Practical Concerns

• Transfer pricing issues still present with respect to 3rd countries:
  – Unclear how much be the administrative burden will be reduced.
  – ”Transitional costs” for businesses and authorities.

• The rules of the proposals are not as detailed/comprehensive as the national tax codes:
  – Initially, no case law will be available.
  – Will MS, tax authorities and courts be able to interpret the rules consistently?
  – How will the Commission use its competence to adopt delegated acts?

• What if stage 1 is adopted but not stage 2?
Benefits

• Only one set of rules!!!
• Only one tax authority to deal with.
• Risk of double taxation significantly reduced.
• Cross-border loss utilization.
• Fully coordinated anti-avoidance rules.
• Higher transparency of tax systems.
• Enhanced stability, as changes require unanimity.