



THE EUROPEAN UNION COMMON CONSOLIDATED CORPORATE TAX BASE (CCCTB)

ICAEW Tax Faculty Memorandum submitted to the Treasury Select Committee on the draft Directive and its 'utility and advisability'

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THE EUROPEAN UNION COMMON CONSOLIDATED CORPORATE TAX BASE (CCCTB)

The Brief from the Treasury Select Committee

1. ICAEW Tax Faculty has been asked to prepare a short memorandum setting out the implications of the CCCTB proposal and the potential advantages and disadvantages for the UK. This is further to the request from the House of Commons European Scrutiny Committee for the views of the Treasury Select Committee:

‘...we would like, given the importance of the matter, the Treasury Committee meanwhile to let us have an Opinion, in accordance with paragraph 11 of Standing Order No. 143, on the utility and advisability of the draft Directive.

Para 2.19 – Twenty-Seventh Report of Session 2010-2012

The background to the Draft Directive

2. The European Commission began work in earnest in 2004 to develop a system for the taxation of groups of companies operating in more than one EU member states so that such groups would be able to determine their aggregate EU group profit and that profit would then be allocated to the different countries in which the group operates.
3. This differs from the current taxation system where individual companies are taxed directly and the group accounts and results are not relevant. See below for further details on the current, and proposed new, systems.
4. Under the proposed new system the rate of corporation tax applied by individual member states to those allocated profits will remain to be determined by the member state. The CCCTB project only relates to the tax base, the determination of the taxable profits, and not to the rate of tax to be applied to those profits.
5. The European Commission has a website where all the material relevant to the project can be accessed. This is at http://ec.europa.eu/taxation_customs/taxation/company_tax/common_tax_base/index_en.htm

A general overview of CCCTB

6. An article published in the June 2011 issue of ICAEW Tax Faculty magazine TAXline, explains the background to CCCTB, and the current proposals.
7. The article is reproduced in Appendix 3.
8. For the purpose of the present note we have explained the major implications of the CCCTB by reference to a hypothetical group of companies operating in UK, France, Germany and Ireland. Our analysis is set out in Appendix 4.

Two potential advantages of CCCTB

9. If one group company makes a loss then it is generally not possible to get immediate relief for that loss against the profits made by other group companies based in other countries. The effect of CCCTB will be to aggregate the results of all the companies in the group which will, de facto, have the effect of setting company losses in one country against company profits in another country.

10. The majority of world trade now takes place between companies that are associated, under common control, and which are members of groups of companies. They can fix the prices for these intra group transactions and will try to ensure that as much as possible of the profit ends up in lower tax countries. Countries have introduced transfer pricing rules so that they can substitute the arm's length price, what unconnected companies would have charged and paid, in place of the price used by companies in the preparation of their accounts. Because of the increasing complexity of international trade these transfer pricing rules can be extraordinarily difficult to apply in practice and disputes can often take an enormous amount of time and resources to resolve. CCCTB would potentially eliminate transfer pricing concerns because the taxable profit is determined at the group level which de facto eliminates the prices, and profits, made on sales between the companies in the group.
11. Transfer pricing would still remain an issue for transactions with group companies that are outside the CCCTB regime.

The ICAEW Tax Faculty views of the CCCTB proposal

12. The ICAEW has been supportive of the project since it began in 2004 and has participated at the annual meetings which took place in 2005, 2006 and 2007 when outside bodies were invited to attend a meeting with European Commission officials and representatives from all the member states to review the progress to date of the project and to make comments and recommendations.
13. The Directive is only draft at this stage and the various studies into compliance costs and the effect of the proposal on the tax base do not provide any clear indication as to what would happen were CCCTB to be adopted in Europe. So we believe that there is much more work to be done before anything like an informed judgement can be reached.
14. Nevertheless we are very supportive of the efforts of the European Commission to provide a better system for the taxation of groups of companies that operate in several EU member states.
15. We believe that it is important that the UK government continues to be involved in the continuing debate on CCCTB and we are encouraged by the remarks of Justine Greening in the House of Commons debate on the draft Directive in May 2011 in which she clearly stated the UK Government's intention to continue to participate in the work on the CCCTB project. Even if the UK does not join the CCCTB system its multinational groups of companies will be affected by the fact that the system may be adopted by other EU member states in which those groups operate.
16. There are a number of potentially significant benefits amongst them automatic, and immediate, cross-border loss relief, removal of the need for transfer pricing documentation studies in relation to intra-EU trade, the ability for business to centralise its internal tax teams in a low cost location where they can deal with CCCTB from that single location.
17. But there are also a number of difficult areas in the current proposals and we set out below a few of the more major ones:
 - The administration arrangements under which each member state will be responsible for agreeing the aggregate profits of groups based in their country;
 - The difficulty of making changes to the system once it has been introduced as this will need the agreement of all the participating member states;
 - The way in which the aggregate profit is to be allocated amongst the member states by reference to the three factors: assets, number of employees/payroll and sales. This may be to the disadvantage of some types of business for example some IP or 'digital' groups that have few fixed assets. It may also not be to the advantage of countries like the UK which has attracted less asset intensive, high workforce businesses than other member states.

- The fact that CCCTB will, in effect, represent an extra tax system in addition to the tax systems of the member states.

18. In the light of the above, and our other comments in this paper, we believe it is too early to conclude as to the 'utility and advisability' of CCCTB were it to be introduced in Europe.
19. We believe that further work is required to provide a better understanding of the likely implications and more detailed research should be carried out with groups of companies that operate in several EU member states and that would be eligible to opt in to a CCCTB system.
20. ICAEW proposes to seek to work with Government and with the European Commission to use its own expertise and that of its members to ensure that the possibilities offered by CCCTB are better understood and that there is more evidence on which to base a judgement as to whether it is sensible to go ahead with CCCTB or not.

The view of the UK government

21. In an Explanatory Memorandum from the Exchequer Secretary David Gauke and which is quote in the House of Commons European Scrutiny Report, mentioned in the next paragraph, he states:

- set out in the Coalition agreement, the Government will ensure "that there is no further transfer of sovereignty or powers to the EU over the course of the Parliament";
- the Government will not agree to a proposal that might threaten or limit its ability to shape the UK's own tax policy;
- the Government recognizes, however, the proposal's potential impact on companies operating across the EU, notably if taken forward by a smaller group of Member States under enhanced co-operation; and
- it will engage in discussions to help shape a CCCTB that does not undermine the competitiveness of the EU or the UK.

22. The draft Reasoned Opinion that we understand has now been submitted, in final form, to the European Commission was reproduced in the [House of Commons European Scrutiny Report](#) published on 11 May 2011 and sets out the Government's Opinion as follows:

'The UK Government believes there are significant shortcomings in the Commission's estimates of the impact of the proposal on the UK and in the impact assessment as a whole. It does not accept the assumption that a CCCTB is necessary to address the broader objectives of the proposal or that 27 different national corporate tax systems inherently impede the proper functioning of the internal market. It is not convinced that a CCCTB is necessary to improve the simplicity and efficiency of corporate tax systems in the EU. It considers that the fiscal impediments to cross-border activity that the proposal claims to tackle — compliance costs, double taxation, and over-taxation — can be addressed through other routes, such as informal coordination or bilateral solutions. It remains to be convinced, therefore, that the Commission has provided a sufficiently strong justification that action at EU level is required and that the proposal is compliant with the requirements of subsidiarity and proportionality; when negotiations begin the Government will be pressing the Commission for any further analysis it is able to provide on compliance with subsidiarity and proportionality.'

23. In the House of Commons debate on 11 May 2011 the Economic Secretary to the Treasury, Justine Greening, presented the Government's overall conclusions as follows:

'The UK Government believes there are significant shortcomings in the Commission's estimates of the impact of the proposal on the UK and in the impact assessment as a

whole. It does not accept the assumption that a CCCTB is necessary to address the broader objectives of the proposal or that 27 different national corporate tax systems inherently impede the proper functioning of the internal market. It is not convinced that a CCCTB is necessary to improve the simplicity and efficiency of corporate tax systems in the EU. It considers that the fiscal impediments to cross-border activity that the proposal claims to tackle — compliance costs, double taxation, and over-taxation — can be addressed through other routes, such as informal coordination or bilateral solutions. It remains to be convinced, therefore, that the Commission has provided a sufficiently strong justification that action at EU level is required and that the proposal is compliant with the requirements of subsidiarity and proportionality; when negotiations begin the Government will be pressing the Commission for any further analysis it is able to provide on compliance with subsidiarity and proportionality.’

The work programme of the European Commission and the member states

24. All the member states participated in quarterly working group meetings from 2004 to 2008 and over that period there were a total of 13 meetings. The meetings considered the detailed framework for a corporate tax system that could be applied in each and every member state. The working group was supplemented by six sub-groups that were set up to consider specific issues such as assets and tax depreciation, group income. The sub-groups were chaired by individual member states except for the final sub-group, chaired by the Commission, which considered the way the aggregate profit should be allocated to the individual member states, which is referred to officially by the Commission as ‘formulary apportionment’.

The objectives of the CCCTB

25. The objective of the proposed solution is to make it easier for groups of companies to operate in the European Union and to overcome some of the disadvantages of the existing system of taxation whereby each individual company in a group must agree its taxable profit with the member state in which it is resident and in which it operates. This create the possibility for companies to pool profits and losses at the group level, minimize tax compliance costs by introducing a “one-stop-shop” concept and significantly reduce transfer pricing issues, whilst safeguarding the fiscal sovereignty of each Member State.

26. In the Press Release of 16 March 2011 announcing the launch of the CCCTB draft Directive Commissioner Semeta is quoted as saying:

‘The CCCTB will make it easier, cheaper and more convenient to do business in the EU. It will also open doors for SMEs looking to grow beyond their domestic market. Today's proposal is good for business and good for the EU's global competitiveness.’

The estimated savings

27. The Commission estimates that the CCCTB will save business across the EU €700 million in reduced tax compliance costs each year, and €1.3 billion through consolidation.

The proposed new tax rules

28. The draft Directive lays down a framework for determining the tax base of groups of companies operating in different member states.

29. Chapters 1 to XV cover the substantive rules in determining the tax base.

30. Chapter XVI is the apportionment section, and in addition to the basic apportionment rules it also contains specific provisions for different industries such as financial institutions, insurance, oil and gas, shipping and air transport

31. Chapter XVII deals with the administration and procedures under the proposed new system.

The Commission sponsored studies

32. At the same time as it published the draft Directive the Commission also published an Impact Assessment and five external studies that had been carried out and which evaluate the impact of the proposal.

Compliance costs

33. Two of the studies, by PwC and Deloitte, evaluate the impact on compliance costs while the other three look at the impact on the tax base.

34. The PwC study which looked at compliance costs evaluated the impact on 17 groups. Total compliance costs were estimated to drop by 8% but that was made up by an increase in costs of 15% in the principal taxpayer country and a drop of 23% in the other member states in which the group operates.

35. The Deloitte study, which was published in November 2009, applied a standard cost methodology under which tax experts determined how much time would be needed to deal with the tax affairs of two hypothetical groups of companies under the current system and then under two potential new systems, one of which was the CCCTB system. In both cases the estimated compliance savings were extremely large, well in excess of 50% compared with the current system.

The impact on the tax base

36. The PwC study into the effect on the tax base used data from two years and was published in July 2008. It estimated that the aggregate tax base would go down about 2%, mainly as a result of losses being offset across borders, that there would be an increase in the tax base in the UK (up nearly 8%) but the tax base would be down in France, Ireland and Italy and relatively unchanged in Germany.

37. Another of the studies, in which the Oxford University Centre for Business Tax participated, looked at the potential welfare impacts of CCCTB but it was very cautious in its conclusions as the overall impact of the proposals was difficult to gauge with any great precision. This study was published in October 2009.

38. The final study, published in September 2008 and carried out by ZEW (Centre for European Economic Research), was based on the Commission proposals as they stood in 2006 and used a computer based model firm approach for the computation and comparison of international company tax burdens over a ten year period. The study looked at the impact of CCTB, without the consolidation, on large and small groups. Under CCTB there is no cross border relief for losses so it would be natural to expect the tax base to be higher than with CCCTB and the study indicated that on average the tax base was estimated to increase 6 and 5% for large and small groups respectively.

Other evaluations of the proposals

Ernst & Young

39. Ernst & Young were commissioned by a number of Irish business organisations to evaluate the impact of the CCCTB proposals on a small group of actual multi-national businesses. The link

to their report is given in the footnote¹. They discussed the proposals in detail with 20 businesses but due to the extensive information requirements of the CCCTB, only 5 of those businesses were able to provide the needed information from their existing tax and finance functions..

40. The overall conclusion was that compliance costs would increase by 13% despite 16% savings from reduced work on transfer pricing issues between participating Member States and the effective tax rate would increase for three of the businesses, reduce in one (due to cross-border loss relief) and remain the same in the fifth.
41. A second Ernst & Young study, for the Irish Department of Finance looked at the macro economic impact of the CCCTB proposal in terms of the impact on individual country's corporate tax receipts which ranged from an increase of 6% for France to a reduction of 8% for Denmark. The study estimated that corporation tax receipts in the UK would increase by about 2%.

Further contact

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www.icaew.com/taxfac

¹ Link to Ernst & Young Irish report on CCCTB
[http://www.ibec.ie/IBEC/DFB.nsf/vPages/Economics and taxation~Key issues~common-consolidated-corporate-tax-base-\(ccctb\)-07-02-2011/\\$file/E&Y%20CCCTB%20Report%20Jan%202011.pdf](http://www.ibec.ie/IBEC/DFB.nsf/vPages/Economics%20and%20taxation~Key%20issues~common-consolidated-corporate-tax-base-(ccctb)-07-02-2011/$file/E&Y%20CCCTB%20Report%20Jan%202011.pdf)

ICAEW AND THE TAX FACULTY: WHO WE ARE

1. ICAEW is a world-leading professional accountancy body. We operate under a Royal Charter which obliges us to work in the public interest. ICAEW's regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the UK Financial Reporting Council. We provide leadership and practical support to over 136,000 member chartered accountants in more than 160 countries, working with governments, regulators and industry in order to ensure that the highest standards are maintained.
2. ICAEW members operate across a wide range of areas in business, practice and the public sector. They provide financial expertise and guidance based on the highest professional, technical and ethical standards. They are trained to provide clarity and apply rigour, and so help create long-term sustainable economic value.
3. The Tax Faculty is the voice of tax within ICAEW and is a leading authority on taxation. Internationally recognised as a source of expertise, the faculty is responsible for submissions to tax authorities on behalf of ICAEW as a whole. It also provides a range of tax services, including *TAXline*, a monthly journal sent to more than 8,000 members, a weekly newswire and a referral scheme.

THE TAX FACULTY'S TEN TENETS FOR A BETTER TAX SYSTEM

The tax system should be:

1. Statutory: tax legislation should be enacted by statute and subject to proper democratic scrutiny by Parliament.
2. Certain: in virtually all circumstances the application of the tax rules should be certain. It should not normally be necessary for anyone to resort to the courts in order to resolve how the rules operate in relation to his or her tax affairs.
3. Simple: the tax rules should aim to be simple, understandable and clear in their objectives.
4. Easy to collect and to calculate: a person's tax liability should be easy to calculate and straightforward and cheap to collect.
5. Properly targeted: when anti-avoidance legislation is passed, due regard should be had to maintaining the simplicity and certainty of the tax system by targeting it to close specific loopholes.
6. Constant: Changes to the underlying rules should be kept to a minimum. There should be a justifiable economic and/or social basis for any change to the tax rules and this justification should be made public and the underlying policy made clear.
7. Subject to proper consultation: other than in exceptional circumstances, the Government should allow adequate time for both the drafting of tax legislation and full consultation on it.
8. Regularly reviewed: the tax rules should be subject to a regular public review to determine their continuing relevance and whether their original justification has been realised. If a tax rule is no longer relevant, then it should be repealed.
9. Fair and reasonable: the revenue authorities have a duty to exercise their powers reasonably. There should be a right of appeal to an independent tribunal against all their decisions.
10. Competitive: tax rules and rates should be framed so as to encourage investment, capital and trade in and with the UK.

These are explained in more detail in our discussion document published in October 1999 as TAXGUIDE 4/99 (see <http://www.icaew.com/~media/Files/Technical/Tax/Tax%20news/TaxGuides/taxguide-4-99-towards-a-better-tax-system.ashx>).

A Common Consolidated Corporate Tax Base for Europe – is this a step nearer?²

In March 2011 the European Commission proposed, in the form of a draft Directive, that there should be a common tax base, a Common Consolidated Corporate Tax Base (CCCTB), for groups of companies operating in more than one EU member state.

Under CCCTB groups will be able to submit just one tax computation to a single revenue authority which will agree the taxable profit for the group. That taxable profit will then be apportioned (allocated) to the various member states in which the particular group operates.

The draft Directive

The draft Directive sets out the basis of the tax computation, for instance how capital allowances are to be claimed, how intra-group transactions are to be dealt with and the administrative arrangements. The draft Directive is published at the end of seven years work by all the member states which included 13 full, working group, meetings of the member states supplemented by meetings of six sub-groups established to explore specific areas in more depth. The member state meetings were supplemented by three annual meetings with non governmental bodies, which representatives of ICAEW attended, and which also considered, on each occasion, the nature and scope of CCCTB. The 135 Articles in the draft Directive, which have emerged at the end of this long and detailed deliberation, now provide a high level framework for the proposed new system.

If the Directive is introduced then individual groups of companies will still be free to choose whether they want to adopt the new system or continue to make tax returns for each company in the group to the relevant country's tax authority.

What are the benefits?

The CCCTB regime would allow losses in individual companies within the group to be automatically offset against profits because that will be a natural consequence of the consolidation. It will also remove the need for transfer pricing adjustments on intra-group transactions.

Are there any problems?

A major practical difficulty will be how you allocate the aggregate profit amongst the member states in which the group operates. The proposal is for formulaic apportionment under which the aggregate profit is attributed to individual member states based on the turnover, assets and people/payroll in each of those member states.

There are also doubts as to how simple it is going to be to administer CCCTB and for groups of companies to comply with the requirements of the system.

Will it happen?

In order to be introduced throughout Europe all the member states will have to agree.

At the moment that looks extremely unlikely not least because the UK government, amongst others, has said that it will not vote in favour.

But it will be possible for a smaller group of countries, not less than nine, to agree that they will introduce CCCTB in their countries and this will mean that groups operating in those countries will be able to opt in to CCCTB.

² This article first appeared in the June 2011 issue of *TAXline* the monthly magazine of ICAEW Tax Faculty

What does the UK government think about it?

The UK believes that it should have control, sovereignty, over its domestic tax system and it sees CCCTB as an infringement of that right. So it may ultimately veto the proposal. But the government Minister in a Parliamentary debate on 11 May 2011 did confirm that the UK will participate fully in the CCCTB debate. That is because even if CCCTB is initially adopted by a smaller grouping of member states the precise nature of the CCCTB system could still have an impact on UK groups operating outside the system.

Does ICAEW have a view?

ICAEW has been fully supportive of the debate and of the enormous amount of work that the European Commission, and others, have undertaken to get to the point of producing a draft Directive.

This is not an issue that lends itself to a simple yes or no response. But if the UK is to realise its full economic potential then it does need to have a competitive tax system, and government official policy is for that system to be the most competitive in the G20 countries. We believe the UK government needs to participate fully in the CCCTB debate and only make its mind up when the precise nature of the CCCTB proposal is clear.

Whether or not CCCTB is likely to be good for the UK, as well as other EU member states, is, in our view, still a matter for debate.

Ian Young
Technical Manager, ICAEW Tax Faculty

What would CCCTB mean in practice? – A hypothetical example

To understand what happens under the current regime, and what would change under the proposed CCCTB regime, we set out below how the new system would work in a relatively straightforward hypothetical situation.

Suppose there is a group of companies that has its major business, and parent company, in the UK and then has subsidiary companies that operate in France, Germany and Ireland.

Under the existing tax rules, and for accounting purposes, the financial results of the individual companies are determined separately and form the basis for the tax liability in UK, France, Germany and Ireland.

In the UK the tax liability is calculated by reference to the accounting profit after it has been subject to various adjustments, such as a disallowance for non deductible entertaining expenses, and applying a separate system for capital assets, capital allowances, rather than the depreciation that is charged in the financial accounts. The tax liability in the other countries will be determined by reference to their own, domestic, tax rules.

For reporting purposes, eg for investors and the Stock Exchange for listed groups, the individual company accounts are then aggregated and it is the aggregated, group, accounts that are published. These show the total profits made by the group which excludes any profit made on sales within the group ie between group companies.

The basic CCCTB proposal is that it will be the aggregate group profits that will form the basis for the amount of tax that the group has to pay. This profit will be determined not from the existing group accounts but by reference to the tax 'rules' spelled out in the draft Directive. So the results in each country will be determined in accordance with the CCCTB tax rules and they will then be aggregated.

Once this aggregate CCCTB profit has been determined it then will have to be allocated to all the countries in which the group operates. The allocation will be by reference to three factors: sales, employment and fixed assets. The employment factor will be divided between the payroll expense and the number of employees and each will be given equal weight in the employment element of the calculation.

If you return to our example suppose that the German subsidiary makes 30% of the group sales, it has 21% of the payroll costs and employees, and 45% of the fixed assets. You calculate one-third of each of those factors ie $10 + 7 + 15 = 32\%$. And 32% of the aggregate profit is then allocated to Germany and will be taxed in Germany by reference to the rate of tax in Germany.

Each country will continue to fix the rate of tax that it applies to company profits. There is no suggestion that fixing the rate of company tax should pass to Europe.

The above example is intended to explain the very broad principles but there will be lots of different scenarios with different implications under the CCCTB system.

Some of the more important ones are considered below.

Not all countries may sign up to CCCTB

The current proposal is for all 27 member states to join. If some countries decline to do so the Commission will have to make a separate proposal under the terms of the Nice Treaty and the enhanced cooperation arrangements may be applied. Under that provided 9 or more member

states decide to go ahead then CCCTB will be introduced but only for those 9 or more member states.

So if France decided not to join CCCTB in the example above the consolidated results will only be calculated for the UK parent company and the subsidiaries in Germany and Ireland. Those aggregate profits will be allocated between UK, Germany and Ireland based on the sales, employment and fixed assets in those three countries. The tax payable in France will be determined, as at present, merely by reference to the taxable profit of the French subsidiary alone.

What about non EU countries

As in the example above CCCTB can only potentially apply to EU member state countries that sign up to CCCTB. A US parent company with a number of subsidiary companies in various EU member states could consolidate the results of its EU subsidiaries, or those subsidiaries in countries that are in CCCTB, and allocate that 'European' profit between the different EU member states in which the subsidiaries operate.

From the point of view of the US parent company it would have one set of rules for potentially all its European subsidiaries and it would deal mainly with one tax administration in the main European country in which it operates.