Inside The EU CCTB/CCCTB Proposals

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There is a lot going on...
Topics

• History
• General policy objectives
• Personal and material scope
• Main characteristics of the tax base
• Specific ‘balance sheet’ items
• Anti-BEPS aspects
• Consolidation and formulary apportionment

History

• 1999 EU Council provided a ‘revolutionary’ mandate to the Commission
• 2004-2008 Technical Working Group
• 2011 CCCTB proposal
• 2012-2015 Discussions in preparatory Council bodies
• 2016 Relaunched CCTB/CCCTB proposal
General policy objectives

• Stimulating growth and investment
  – Reducing administrative burden for companies
    • No transfer pricing
    • One-stop-shop
  – Super-deduction for R&D expenses
  – Allowance for growth and investment
  – Cross-border loss relief

General policy objectives

• Enhancing the fairness of the corporate income tax
  – Mandatory for large companies
  – Sharing formula ensures ‘taxation where value is created’
  – TP cannot be used as aggressive tax planning tool within EU
  – Strict anti-beps measures
My request (ATAD1) under the EU transparency regulation

- ‘Although the decision-making process related to the adoption of that Directive is finalized, as you recall in your request, the negations on these issues are not totally completed.
- The issues covered by these documents, namely controlled foreign companies, are controversial among Member States but remain key to achieving the objectives of the Commission's corporate tax initiatives.’
Yellow cards

<table>
<thead>
<tr>
<th>Member State</th>
<th>2011</th>
<th>2016</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bulgaria</td>
<td>2</td>
<td>-</td>
</tr>
<tr>
<td>Denmark</td>
<td>-</td>
<td>2</td>
</tr>
<tr>
<td>Ireland</td>
<td>2</td>
<td>2</td>
</tr>
<tr>
<td>Luxembourg</td>
<td>-</td>
<td>2</td>
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<td>Malta</td>
<td>2</td>
<td>2</td>
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<tr>
<td>The Netherlands</td>
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<td>2</td>
</tr>
<tr>
<td>Poland</td>
<td>1</td>
<td>-</td>
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<tr>
<td>Romania</td>
<td>1</td>
<td>-</td>
</tr>
<tr>
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<td>United Kingdom</td>
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<td>-</td>
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<tr>
<td>Sweden</td>
<td>2</td>
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<tr>
<td><strong>Total</strong></td>
<td>14</td>
<td>12</td>
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</table>

Mandatory system for large companies

- Legal form requirement
- Subject to tax requirement
- Size requirement
  - Consolidated worldwide group revenue
    > EUR 750 MIO
- Group requirement
Optional system for SME’s

- Legal form requirement
- Subject to tax requirement
- No cross-border element required
- Option to apply CCTB for 5 years
- CCTB requires no all-in/all-out approach
- CCCTB requires additional choice
  - All-in/all-out (!)

Multiple CIT systems

1. National CIT
   - Incl. ATAD

2. CCTB
   - Mandatory large groups
   - Optional SMEs

3. CCCTB
   - Mandatory large groups
   - Optional SMEs
Example 2CTB

Example 3CTB
Material scope CCTB

1. MS
2. MS
3. 3RD

Worldwide income
CCTB defined PE concept
PE definition left to tax treaty

Issues subject to national corporate income tax

• Flexibility
  – Tax rates
  – Deduction for gifts and donations to charitable bodies
  – Deduction of in-house pension funds
  – Definition third country PE

• Non-regulated issues
  – Specific interest deduction limitations
  – National group taxation regimes?
A few general principles and no link to IAS/IFRS

- Autonomous profit definition
- Not linked to IAS/IFRS
  - No starting point
  - No fall back system
- Self-proclaimed principles
  - Realization principle
  - Accruals principle
  - Consistent manner principle
Calculation of the tax base

• Profit & loss account based definition
• Tax base = revenues -/- exempt revenues -/- deductible expenses -/- other deductible items
• No tax balance sheet
• Business purpose test for deductibility of costs
• Arm’s length standard

Foreign income and participation exemption

• Three categories of foreign income
  – PE income
  – Income from major shareholdings (10%)
  – Interest, royalties and income from portfolio shares
• Relationship with double tax treaties
  – Intra-EU
  – Tax treaties with third countries
    • Article 351 TFEU?
Treatment of foreign income under CCTB

<table>
<thead>
<tr>
<th></th>
<th>Third country</th>
<th>EU</th>
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<tbody>
<tr>
<td>Permanent establishment</td>
<td>- Exempt</td>
<td>- Exempt, but temporary relief in case of a loss</td>
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<tr>
<td></td>
<td>- Subject to CFC-rules</td>
<td>- Subject to CFC-rules</td>
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<tr>
<td>Major shareholding</td>
<td>- Exempt</td>
<td>- Exempt, but temporary relief in case of a loss</td>
</tr>
<tr>
<td></td>
<td>- Subject to switch-over, including credit</td>
<td>- &gt; 50% de facto overruled by CFC-rules</td>
</tr>
<tr>
<td>Passive income</td>
<td>Taxable, including credit</td>
<td>Taxable, including credit</td>
</tr>
</tbody>
</table>

Tax treaties with third countries?

[Diagram showing relationships between MS 1, MS 2, and 3RD with percentages and double tax treaty notation]
Allowance for growth and investment

- ‘Half-baked’ ACE
  – Modeled on *Aiuto alla Crescita Economica*
- Reduction of debt/equity bias
- Rate = interest Eurobond + 2% risk premium
- Equity increases
- Equity decreases

Example

<table>
<thead>
<tr>
<th>Year</th>
<th>Equity</th>
</tr>
</thead>
<tbody>
<tr>
<td>2020</td>
<td>200</td>
</tr>
<tr>
<td>2021</td>
<td>300</td>
</tr>
<tr>
<td>2022</td>
<td>200</td>
</tr>
<tr>
<td>2023-2029</td>
<td>300</td>
</tr>
<tr>
<td>2030</td>
<td>300</td>
</tr>
</tbody>
</table>

- Start CCTB 2020
- 100 equity end of 2019
Super deduction R&D-expenses

- Regular deduction at incurrence
- 50% additional deduction up to EUR 20 MIO R&D-expenses per year
  - 100% additional deduction for start-ups
- 25% additional deduction for R&D-expenses exceeding EUR 20 MIO
- Basic research, applied research and experimental development
  - Novelty-degree not defined

Loss relief

- Unlimited carry forward
  - However, limitations already being discussed
- Anti-loss trading rule
  - Change of ownership
  - Major change of activity
- Cross-border losses
  - First-tier subsidiaries and PE’s
  - Recapture, ultimately end of year 5
Specific ‘balance sheet’ items

- Individually depreciable assets
- Pooled assets
- Non-depreciable assets
- Stocks and work in progress
- Financial assets held for trading
- Long-term contracts
- Provisions
- Bad debts
- Hedging instruments
Individually depreciable assets

- Commercial, office and other buildings 40 years
- Industrial buildings 25 years
- Other long-life fixed tangible assets (useful life ≥ 15 years): 15 years
- Medium-life fixed tangible assets (8 ≤ useful life ≤ 15 years): 8 years
- Fixed intangible assets: legal protection period or otherwise 15 years

Pooled assets

- Germany, Finland, Lithuania, Sweden and UK already do it!
- Short-life fixed assets (1 ≤ useful life < 8 years)
- Fixed depreciation rate 25%
- Built-in roll-over relief
- Proceeds of disposed pooled asset is tax exempt
  - However, pooled deprecation basis ↓
Example

Depreciation base year 1  100.00
Depreciation year 1  (25.00)
Depreciation base year 2  75.00
Depreciation year 2  (18.75)
Depreciation base end of year 2  56.25
Sales price of asset in year 3  (15.00)
Adjusted depreciation base year 3  41.25
Depreciation year 3  (10.31)
Depreciation base year 4  30.94

Higher depreciation rate?
(35%)

<table>
<thead>
<tr>
<th>Year</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
<th>6</th>
<th>7</th>
<th>8</th>
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</thead>
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<tr>
<td>Yearly deduction</td>
<td>35.00</td>
<td>22.75</td>
<td>14.79</td>
<td>9.61</td>
<td>6.25</td>
<td>4.06</td>
<td>2.64</td>
<td>1.72</td>
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<tr>
<td>Overall deduction</td>
<td>35.00</td>
<td>57.75</td>
<td>72.54</td>
<td>82.15</td>
<td>88.40</td>
<td>92.46</td>
<td>95.10</td>
<td>96.81</td>
</tr>
</tbody>
</table>
Non-depreciable assets

• Fixed tangible assets not subject to wear and tear and/or obsolescence
• Financial assets
• However, deduction for exceptional decrease in value (≠ financial assets)
  – Force majeure
  – Criminal activities
• Recapture in in case of value increase

Stocks and work-in-progress

• Valuation at direct cost of net realizable value, whichever is lower
• Interchangeable goods and services
  – FIFO
  – LIFO
  – Weighted average costs
• Why does the Commission allow LIFO?
  – ≠ IAS/IFRS and US GAAP
Financial assets and liabilities held for trading

• Mark-to-market treatment
• Trading items
  – Held principally for the purpose of selling or repurchasing in the short term; or
  – Part of a portfolio of identified financial instruments and there is a pattern of short-term profitmaking
• Participation exemption switched-off

Long-term contracts

• Contract term > 12 months
  – Concluded for the purpose of manufacturing, installing of constructing, or performing services
• Percentage of completion method
• Completion percentage = cost incurred / overall estimated costs
• Expert evaluation skipped
Provisions

- Present or future legal obligation arising from previous activities/transactions
- No provision
  - Constructive obligations
  - Contingent losses
  - Future cost increases
- Reliable estimation of future expenses
  - Discount rate set at Euribor

Bad-debts

- Two conditions for deductibility
  - It is probable that the debt will not be paid off wholly or partially; and
  - The taxpayer has taken all reasonable steps to pursue payment
- Large number of similar debt-claims
  - Case-by-case approach skipped
- No deduction for related party debt!
Hedging instruments

• Gains and losses on a hedging instrument follow tax treatment hedged item
• Examples
  – Hedged item is participation
  – Hedged item is financial asset held for trading
• Two conditions hedging relationship
  – Formally designated and documented
  – Highly effective

Anti-beps measures

• General interest deduction limitation
  – Threshold EUR 3 MIO (CCCTB: EUR 5 MIO)
• Switch-over clause
  – Highly controversial
• Controlled foreign companies
  – Important to eliminate TP planning towards 3rd countries
• Mismatches
• General anti-abuse clause
Formation of a consolidated group (1)

Formation of a consolidated group (2)
Formation of a consolidated group (3)

Formation of a consolidated group (4)
Qualifying subsidiaries

Consolidation method and effects

• Adding-up individual tax bases
• Intra-group transactions are recorded at cost
  – No arm's length pricing
  – No withholding taxation
• No comprehensive ‘unity approach’
  – Case-by-case approach
    • Article 69(1) CCCTB
    • Article 9(4) CCTB
Sharing formula

- Massachusetts formula
  - Assets
  - Labour
  - Sales
- Uniform formula
  - Modified versions for financial sector, oil extraction and production sector and international transport sector
- Safeguard clause for unfair results

Labour factor

- Both payroll and number of employees (50%/50%)
- Included in the labour factor of the group member that pays salary
- Definition employee depends on local law
- Anti-factor shifting
  - Intra-group outsourcing
  - External outsourcing
Asset factor

- Fixed tangible assets owned, rented or leased
  - Value for tax purposes
- Included in the asset factor of the group member that is the economic owner
- Anti-factor shifting
  - Intangibles excluded
  - Intra-group leasing/renting
  - External sale

Sales factor

- Most controversial factor!
- Sales by destination
  - Where the dispatch of transport of goods to the acquirer ends
  - Where services are physically carried out or actually supplied
- Spread throw back rule for nowhere sales
- Passive income excluded, unless earned in the ordinary course of a trade or business
One-stop-shop

- Principal taxpayer
- Principal tax authority
  - Forum shopping?
- How to solve disagreements between Member States?
  - Principal tax authority vs. local tax authorities
- Audits and rulings
- Appeals

White paper on the future of Europe (1 March 2017)

1. Carrying on
2. Nothing but the single market
3. Those who want to do more
4. Doing less more efficiently
5. Doing much more together
White paper on the future of Europe (1 March 2017)

1. Carrying on
2. Nothing but the single market X
3. Those who want to do more CC(C)TB
4. Doing less more efficiently X
5. Doing much more together CC(C)TB