



**EUROPEAN COMMISSION**  
DIRECTORATE-GENERAL TAXATION AND CUSTOMS UNION  
Analyses and tax policies  
**Analysis and Coordination of tax policies**

Brussels, 18 November 2005  
Taxud E1, MH, RP

**CCCTB\WP\019\doc\en**  
Orig. EN

## **COMMON CONSOLIDATED CORPORATE TAX BASE WORKING GROUP**

### ***International aspects in the CCCTB***

**Meeting to be held on Thursday 8 December 2005**

Centre de Conférences Albert Borschette  
Rue Froissart 36 - 1040 Brussels

**WORKING DOCUMENT**

## **I Introduction and purpose of the paper**

1. Each national tax system has rules for the tax treatment of income earned by its tax residents from sources abroad and for the taxation of income earned by tax non-resident companies on their territory (international tax rules). The CCCTB will have to deal with these issues as well. Ideally international tax or "third countries" rules in the CCCTB will cover relations between the CCCTB tax jurisdictions, i.e. all 25 EU member states (hereafter "MS") and non-EU member states (hereafter "third countries").

2. The "Draft Work Programme" (CCCTB/WP/003) identified the technical implications of partial implementation by MS (enhanced cooperation), and the extent to which the CCCTB is compulsory or optional for companies under the heading "application issues" and suggesting these should be addressed only after the initial discussions on the structural elements. These application issues are relevant for a full discussion of international aspects because the scope of participation in the CCCTB has implications for interactions between different tax systems. First, if all twenty five MS introduce the CCCTB and all companies participate in it the main issues concern non EU member states. Second, if some MS remain outside the CCCTB then issues arise between EU MS inside the CCCTB, and MS outside the CCCTB. Third, if some companies opt to use the CCCTB, and some opt to continue to use the national tax bases then issues arise between those within the CCCTB and those outside the CCCTB.

3. This paper concentrates on the first group of issues. The term "CCCTB jurisdiction" as used in this working document means the tax jurisdictions of MS participating in the CCCTB project. As noted above it is possible that initially less than twenty five MS will participate in the CCCTB but the main focus in this working document is on relations between EU and non EU countries, which are also referred to as third countries. Issues related to implementation by less than twenty five MS and/or use by some, but not all, companies are only mentioned briefly and will be addressed more fully at a later stage in line with the Work Programme.

4. The need for some specific rules in cases where a third country element is involved has already emerged during the on-going discussions of the Common Consolidated Corporate Tax Base Working Group (hereafter the "CCCTB WG" or the "Group") and sub-groups (e.g. capital gains on assets which leave the CCCTB jurisdiction). Members of the Group agreed that it is more practical to look for the solution for these "third countries" issues together in order to find a consistent solution.

5. It should be noted that the CCCTB work on this element is different from previous or ongoing discussions held by the Commission Services with MS on interactions between different corporate income tax systems. This working document does not concentrate on relations between national MS systems and the possible effects on them of the EC Treaty but concentrates on relations between national MS systems and third countries. Similarly this working document does

not analyse either the specific position of European Economic Area countries or the application of the free movement of capital in relation to third countries. Members of the Group may wish to discuss these in conjunction with application issues (e. g. legal and policy) at later stage.

6. While the elimination of tax obstacles in the Internal Market and the making of its functioning more efficient should remain the major priority it is also important that the new system is fully operational and capable of fulfilling the main tasks of a corporate income tax system. MS participating in the CCCTB must have sufficient tools to fight any erosion of the tax base. It has to be taken into account that in general there exist many different corporate income tax systems outside the EU and the distribution of taxing rights between them has been done through the territoriality principle rules in most cases. The traditional goal of international taxation rules is to create a system that does not act as an obstacle to international trade and transactions. The CCCTB should also aim to achieve this objective.

7. The purpose of this working document is to give an overview of what issues as regards international tax rules may have to be covered by the CCCTB and to outline how the CCCTB could deal with them. The working document is structured in six sections, this introduction, a section on basic principles and four sections on some specific technical details. Several questions are raised in each section and members of the Group are kindly requested to express their initial views on them at the meeting and follow up with written comments.

8. The territorial scope of the CCCTB will have to be analysed closely. It needs to be determined what income according to its source, and what companies (and permanent establishments), should be covered by the CCCTB. This limitation of the territorial scope of the CCCTB can be described as the "CCCTB (EU) *water's edge*". It determines the CCCTB jurisdictions' source income which is to be shared by participating MS and represents the geographical connection of the income and expenses and the respective territory. Under a worldwide taxation of tax resident companies any income of tax residents is taxable in the state of residency. It would be very ambitious to include all such income within the CCCTB. The income covered by the CCCTB, and which is therefore to be 'shared' between MS, has to be somehow limited to the "*water's edge*" boundaries of the CCCTB jurisdictions. The precise definition of the water's edge principle requires further detailed examination and a clear understanding of all its implications. It will therefore be dealt with in a further Commission Services working document prepared for a later Group meeting.

9. In order to create a complete and functional system it will be useful to agree on common approaches on the following issues.

- Liability to taxation of tax resident companies (worldwide / territoriality)
- Definition of tax resident companies

- Double taxation<sup>1</sup> relief
- Scope of tax non-resident companies covered by the CCCTB
- Definition of source income and/or the way of establishing of a taxing right
- Determination of a tax liability of a tax non-resident
- Coordination and possible extension of existing common (e. g. OECD Model) practices

Members of the Group may also wish to consider whether a deeper analysis of the topic and a detailed discussion of all technical aspects in a sub-group would be useful after the preliminary debate on the issues raised in this working document.

10. This working document does not attempt to analyse basic terms and principles. It uses terminology and builds on what has been done so far at the level of the Organisation for Economic Co-operation and Development (OECD). The OECD has contributed significantly in the field of international taxation and developed a considerable common practice as well as established a common terminology widely used not only by its members. Most of it has been incorporated in the Model Tax Convention on Income and on Capital and the Commentary on it<sup>2</sup> (hereafter the "OECD Model"). As 19 MS are members of the OECD and the remaining MS use the OECD Model and apply its principles as well, it would make no sense to duplicate this work. The CCCTB should benefit from existing guidelines and concentrate on areas where specific guidance or more harmonisation may be necessary in order to establish common rules.

11. This working document also refers to some of the different approaches currently taken by individual MS in their national tax legislation. These references illustrate the range of possible solutions to be achieved in a CCCTB. Some further elements of international tax rules currently applicable in MS are also given in the Annex.

12. It is worth pointing out that some of the issues may arise only as a result of consolidation. For example where there are differences between national treatments in relation to the exact taxation of the foreign permanent establishments of EU MS (CCCTB) tax resident companies it could be argued that without consolidation there would be no issue to resolve. It is only when the bases are consolidated and then 'shared out' that the implications of there being a series of different national rules which affect the size of the base to be shared out become apparent. As the Group is considering a consolidated base these issues need to be addressed. Even if a two stage approach were envisaged (a common

---

<sup>1</sup> Double taxation in the context of this working document should be understood as a double taxation of one income in hands of one taxpayer called a juridical double taxation in the OECD Model terminology.

<sup>2</sup> Last version published by the OECD Committee on Fiscal Affairs in July 2005.

base, followed by the introduction of consolidation) the design of the common base must take into account the implications of consolidation from the beginning.

## **II Basic principles**

13. International tax rules have to address two main categories in all areas of corporate taxation. First there is a taxation of companies from outside of a country or the CCCTB jurisdiction earning income in this territory (taxation of source income of tax non-residents) and second there is a taxation of companies belonging to a country or a CCCTB jurisdiction earning an income from outside of this territory (taxation of foreign income of tax residents). The determinant between "belonging to the country" and "from outside of a country" is a tax residence, although in some systems both categories of taxpayers are put on the same level (for the territoriality principle see the following paragraph).

14. Taxation of worldwide income of tax residents (also referred to as a general tax liability of tax residents) and source taxation of tax non-residents (also referred to as limited tax liability) has currently been the most commonly applied approach amongst MS. The territoriality principle, in which both tax residents and tax non-residents are taxed on income earned from the source of the respective country only, which is currently applied by France and Denmark, is another option<sup>3</sup>.

15. When companies earn income in more than one jurisdiction the main problem is the potential for double taxation or less than single taxation<sup>4</sup> if more (or less) than one country seek to tax the same income of the same taxpayer or none of the countries does so. If tax residents are taxed on worldwide income in the country of their residency and on source income in the country of source double taxation normally occurs. Most MS applying the worldwide system currently provide their tax residents with a double taxation relief in their national tax legislations, i.e. the double taxation of tax residents is wholly or partially eliminated even where there is no tax treaty with the source state<sup>5</sup>. The elimination of international juridical double taxation and avoidance of less than single taxation is currently provided for by MS in their national legislation and Double Tax Conventions<sup>6</sup>. In theory it could be argued that this should continue

---

<sup>3</sup> In order to forestall possible confusion it should be noted that what the ECJ appears to read into the term 'territoriality principle' in differs to some degree from the internationally accepted meaning of the term "territoriality", e.g. in the Case C-250/95 Futura Participations and Singer.

<sup>4</sup> The term less than single taxation is used in this document for situations when one income related to two or more tax jurisdictions is not taxed by any of them. The same situation may also be referred to as double non taxation.

<sup>5</sup> In fact all MS but the Czech Republic

<sup>6</sup> In most cases bilateral international conventions on elimination of double taxation or conventions with respect to taxes on income and on capital. Double tax conventions are referred to also as "tax treaties" in this working document.

and the CCCTB should not address these issues but this does not seem to a very efficient approach. The CCCTB should itself also contribute to this aim of the whole or partial elimination of double taxation. Double taxation relief for companies tax resident in the CCCTB tax jurisdictions should be available regardless of double taxation conventions network. Less than single taxation should be eliminated by the system of efficient anti-avoidance rules.

16. In order to avoid double taxation the distribution of taxing rights between residence and source state as well as double taxation relief is defined by tax treaties. Tax treaties are negotiated as bilateral international treaties and they are normally intended to take precedence over national legislation. The exact interaction between tax treaties and the national legislation and how this is affected is a matter for the constitutional law of countries concerned. The interaction between potential future CCCTB legislation and existing tax treaties will have to be analysed closely. There have been some ECJ decisions concerning existing EC legislation adopted in the corporate tax area and how this interacts with tax treaties. However, this document concentrates on relations between EU (CCCTB) and non-EU member states (third countries).

17. Tax treaties between CCCTB jurisdictions and third countries may also influence the treatment given by the CCCTB, although the relationship between tax treaties and current national legislation and tax treaties and the CCCTB legislation will not necessarily be exactly the same<sup>7</sup>. On one hand MS are obliged to implement EC legislation which prevails over their national legislation and on the other hand in respect of third countries they have to fulfil obligations following from tax treaties they have entered into, which in turn are normally intended to take precedence over national legislation. Another aspect of the problem would be that the tax base of different companies within the same group might be affected by a number of different treaties in different ways which could lead to problems at the consolidation stage. Therefore, in future it might be practical for CCCTB jurisdictions to coordinate some articles of tax treaties relating to corporate taxation to make the common tax system more functional. This refers particularly to a common understanding and interpretation of key terms and principles for business taxation and income being received by companies.

18. As regards the tax treaties between the MS participating in the CCCTB project some articles may become obsolete in relation to companies within the CCCTB and some principles may need to be changed. Some provisions of such bilateral tax treaties may be adjusted by the CCCTB legislation (i.e. EC

---

<sup>7</sup> Article 307 of the EC Treaty provides that *rights and obligations arising from agreements concluded before 1 January 1958 or before the date of accession between one or more MS on one hand, and one or more third countries on the other shall not be affected by the provisions of the Treaty. However, to the extent that such agreements are not compatible with the EC Treaty, the Members States shall take all appropriate steps to eliminate the incompatibilities established.* It is unlikely that for tax treaties it could be argued that real incompatibilities would occur, because it is more a question of possible effects of tax treaties on the CCCTB, than EC Treaty incompatibilities.

legislation) in a similar way to what happened when, for example, the Parent Subsidiary Directive<sup>8</sup> entered into force.

19. MS have negotiated tax treaties with most other MS; however the EU network of treaties is not yet complete and there are several cases of non-treaty situations as well. Although most of the treaties follow the OECD Model, some divergences may occur as each bilateral treaty is negotiated with regard to the specifics of the two respective tax systems. The OECD Model leaves some space open to actual negotiations and takes into account various national particularities expressed by OECD MS as reservations or observations. The CCCTB seeks a higher level of uniformity. Although tax treaties create a substantial part of international tax rules, it may be more useful to work on the "internal" rules and principles of the CCCTB first, whilst keeping in mind the treaty implications.

► *Would members of the group find it appropriate for the CCCTB to*

*(i) tax worldwide income of tax residents and source income of tax non-residents or*

*(ii) source income of both or*

*(iii) adopt another rule as a basic principle;*

*and why?*

► *Would Members of the Group agree that the elimination of double taxation should be*

*(i) an implied principle of the CCCTB, or*

*(ii) explicitly provided for and incorporated in the CCCTB rules? (More questions on this particular issue in the following section).*

► *Do Members of the Group agree with the statement that rules and principles developed within the OECD and contained in the OECD Model create a useful starting point for common practices in relation to third countries? Which areas need to be further analysed and existing practices precised for the CCCTB purposes?*

### **III Taxation of tax residents and method of elimination of double taxation**

20. If tax residents are taxed on their worldwide income relief for double taxation has to be provided. In principle the exemption and/or credit method or a combination of the two methods can be used. The combination of the two methods should mean that credit is used for some kinds of income and exemption for others, not application of both methods at the same time within the CCCTB

---

<sup>8</sup> Council Directive of 23 July 1990 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States (90/435/EEC)

jurisdiction. Some MS currently use the credit method others use the exemption method as illustrated in the Annex. In the CCCTB it does not seem possible to leave the participating MS an option of which of the two methods is to be used if there is to be a common treatment. However exemption and credit methods can be combined in respect of different types of income if MS find it the most viable approach. It may also be examined whether it is possible to apply different methods to different third countries, for example the exemption method in respect of third countries with a similar level of taxation as in CCCTB jurisdictions and the credit method in respect of tax jurisdictions with lower level of taxation. Practical details and technicalities of which and how the method is applied in practice should be analysed in detail by the Group or a respective sub-group.

21. Double taxation should not occur in the CCCTB area if a tax resident of one participating MS performs an activity (e.g. has a permanent establishment) in another participating MS, because the tax base would be calculated as common and consolidated according to one set of rules. Provisions for double taxation relief may need to apply only to companies earning income from outside of the CCCTB jurisdiction. How this is resolved depends on the scope of the CCCTB, for example, should the income of permanent establishments situated outside the EU belonging to EU MS (CCCTB) tax resident companies be taxed in accordance with CCCTB rules. An additional issue is whether the income of permanent establishments in the EU of tax non-resident companies should be taxed in accordance with CCCTB rules?

► *If double taxation of tax residents occurs, should the CCCTB provide for a relief? If so, would Members of the Group have a general preference for exemption or credit method or would they think that the two should be combined and how? Members of the Group are invited to explain why?*

► *In respect of third countries should the double taxation relief be provided to tax non-residents (in situations where a permanent establishment situated in a CCCTB jurisdiction of a tax non resident company incurs a double taxation in respect of transactions with non-related CCCTB entities) as well?*

#### **IV Residence**

22. For worldwide taxation it is central to distinguish between tax resident and tax non-resident taxpayers. Residence rules establish a relationship between a tax jurisdiction and a taxpayer with a general tax liability (on worldwide income). Residence rules are currently given by the national legislation and tax treaties provide for a tie breaker rule in case of a dual residence. The most common criteria for residence are incorporation, registered seat and the place of effective management. The latter is also the most common tie breaker criterion used in tax treaties with reference to dual residence. In internal legislation the definition of

tax residents usually covers as wide a group of companies/entities as possible. According to internal legislation a company may become a tax resident if it is incorporated or if it has a registered seat on the territory of the respective state or if it has a place of effective management there.

23. For the CCCTB, a company would remain a tax resident of its respective country and residence in any of the participating MS will create a link to the CCCTB. It is not intended to create a CCCTB residence category, because this would lead to unnecessary complications in relation to existing tax treaties applicable to tax residents of respective MS. At the same time Members of the Group will need to consider whether a common definition of a tax resident should be applied by CCCTB jurisdictions. If participating MS determine tax residency differently at national level, a different scope of companies will be implicitly covered by the CCCTB in respective MS. This may then affect the consolidated base to be shared. For instance, a company may be tax resident and therefore within the CCCTB under one MS's rules, but if it were to move to another MS it might become tax non-resident in both and hence outside the CCCTB. Another example would be that a company might become a resident of a third country under the domestic law of one MS, while it would have continued to have been considered an EU resident under the residence provisions of the other 24 MS. This would lead to a reduction of the common tax base to be shared out under the CCCTB. It would also mean that companies would have to apply up to 25 different sets of rules for determinations of tax residency.

24. If a common rule determining tax residency is adopted then some work on a common interpretation of the term place of effective management may be necessary. The OECD Model acknowledges and accepts two different approaches, the central management and control test applied in Anglo-Saxon countries that look at where the board of directors meets and the concept of place where the day to day decisions (of the middle management) are taken.<sup>9</sup> Some countries have rules denying deductions to dual resident companies. In some cases, however these rules belong to the group of anti avoidance rules.

► *Do Members of the Group find it important for the CCCTB to include a definition of tax residents, if so what criteria they think the CCCTB should use?*

## **V Source income rules and taxation of tax non-residents**

25. The rules on taxation of tax non-residents ensure that a tax jurisdiction will be able to tax income linked to them and derived from their sources. Source rules establish the link between the income and a tax jurisdiction. The underlying

---

<sup>9</sup> At the OECD level a preference is currently given to the 'board of directors' criterion. However the OECD has been discussing the concept of residence and a new test may be introduced.

idea is that income should be sourced (and taxing right established) in the tax jurisdiction where it has substantial economic connection. The establishment of a taxing right is very important, although a tax jurisdiction is not always able to tax the whole of a particular stream of income even when a taxing right has been established. Obviously income may have substantial connections with more than one country in which case the income has to be apportioned between more than one jurisdiction.

26. Source rules may be based on a place of taxpayer activity test in case of active income and/or a place of activity/incorporation/residence of the person paying the respective income in case of passive income. If Members of the Group find such solution useful for the CCCTB purposes the distinction between active and passive income has to be determined. The structure of current source rules is different in MS. In principle either a general definition with a reference to tax treaties or an explicit list of income sourced in the respective jurisdiction can be used. The former method seems to be more viable for CCCTB purposes. However the definition has to be done prudently in order to cover at least as broad a group of income as the existing relevant network of tax treaties.

27. The taxing rights in relation to tax non-resident companies have to be established in the CCCTB legislation or in MS national legislation. Theoretically it is possible to establish taxing rights by national legislation. However, in the case of multinational groups including both CCCTB and non-CCCTB companies, it would lead to a more uniform solution, avoiding potential inconsistencies, if there were a common definition of taxing rights agreed for the CCCTB, particularly if the common base is consolidated. For example a uniform calculation of a taxable income of a group of companies consisting of an EU parent with a non-EU subsidiary with permanent establishments in several different EU (CCCTB) states could be done only if common rules for determination of the source income exist. Otherwise the same number of sets of rules as the number of involved source states would have to be applied. Similarly, application of different sets of source rules on payments to unrelated tax non-residents may create a problem also in situations within the CCCTB jurisdictions. If for example one MS imposed a withholding tax on payments where another did not and the payment affects the tax base it would be a disadvantage to the latter MS when the tax base is shared out.

28. Taxation of business (active) income of tax non-resident companies in the source state is closely linked to activities of branches of tax non-resident companies. In corporate taxation the taxing right to profits from business activity in the source state arises if the activity of a tax non-resident is carried on through a permanent establishment on its territory. This principle is confirmed by the vast majority of tax treaties in force and should be acceptable for the CCCTB purposes as well.

29. It should also be noted that income connected with the territory of a state other than where a permanent establishment is situated may be allocated to the

permanent establishment. In this way some MS subject to corporate income (or equivalent) tax the worldwide income of a PE.

30. Taxable income allocated to a permanent establishment should be computed according to the same rules and principles that apply to tax resident taxpayers, which have already been a current practice, applied in most MS. Permanent establishments or generally branches of foreign companies are often explicitly obliged to keep the records that allow the computation of taxable income. In some MS it is possible to use some alternative methods for calculation of a taxable income of a permanent establishment if it cannot be accurately determined from the records based e. g. on percentage of a turnover or number of employees. The OECD Model also includes the possibility of determining the profits to be attributed to a permanent establishment not on the basis of separate accounts or by making an estimate of arm's length profit, but simply by apportioning the total profits of the enterprise by reference to various formulae. However, it is considered that a method which is based on apportioning total profits is generally not as appropriate as a method which takes into account only the activities of the permanent establishment. This method should be used only where, exceptionally, it has been customary in the past and is accepted in the country concerned both by the taxation authorities and taxpayers as being satisfactory.<sup>10</sup>

31. Although the tax treatment of income earned through a permanent establishments is in principle the same as taxation of income earned by tax resident companies, some MS deny (or used to deny) certain tax benefits to taxpayers with limited tax liability in their state. Such practices have been found to be contrary to the EC Treaty<sup>11</sup> and MS cannot maintain such provisions in relation to other MS. In the CCCTB context it however remains an open question whether in relation to states and territories not covered by the EC Treaty there might be the economic need and legal scope for measures safeguarding the tax base.

32. A few MS's national legislations currently impose a broader taxation on tax non-resident companies through a special branch profits tax. In practice application of such taxation is only possible if relevant international treaties allow so. None of the MS applying such rules applies them in relation to other EU states.

33. As already mentioned above some coordination of key terms and principles related to international corporate tax, in particular permanent establishment and profit allocation rules will be desirable. The starting point should be the respective articles of the OECD Model. Members of the Group will need to discuss whether more detailed guidance is needed and how to deal with

---

<sup>10</sup> OECD Model, Article 7 Paragraph 4, Commentary on article 7, Para 25.

<sup>11</sup> e.g. Judgement of the Court of Justice in cases C-307/97 *Compagnie de Saint-Gobain*

diverging practices of a few MS expressed as reservations to the OECD Model Article 5<sup>12</sup>.

34. Although this document addresses relations between the CCCTB jurisdictions and third countries, it is useful to mention that the existing allocation principle for permanent establishments within the EU will have to be adjusted. Consolidation removes the need for "allocation" between group companies by way of separate accounting on the arms' length principle. In a similar way, the arms' length principle in relation to these permanent establishments will be replaced by another allocation mechanism, which can be used for the distribution of the consolidated tax base among the respective MS.

35. Income not earned by tax non-resident companies through a permanent establishment as for example investment (passive) income is often subject to taxation in the source state as well. Special techniques of tax collection are used in these cases, because tax non-resident taxpayers are not present in the source state's jurisdiction and enforcement of their tax liability would be very difficult. A respective tax resident taxpayer, who pays the income abroad is therefore imposed a liability to withhold the tax due by a tax non-resident taxpayer at the source. Members of the Group will need to discuss how to combine the withholding tax with the CCCTB rules, because in principle the respective type of income may be covered by national legislation and respective tax treaties. This would be in case the income of tax non-residents is not included in the CCCTB.

36. It is an open question to which extent the source rules should be a part of the CCCTB legislation or a national legislation. For this it is important to determine the scope of the CCCTB (and this question has to be answered in relation to tax non-residents as well as to tax residents), i.e. whether the CCCTB rules will be applicable to all tax residents of the relevant area including all their activities outside of the CCCTB jurisdictions and any activity of tax non-residents on their territory or whether these rules should be somehow limited to activities performed on the relevant territory only. If the CCCTB rules should replace the 25 tax systems, the new system should cover any activity of tax non-residents, regardless on which territory unless the territoriality principle is strictly applied. On the other hand this approach may lead to a situation where the CCCTB rules are applied on activities of companies performed almost exclusively outside of the CCCTB jurisdictions (e.g. the Dutch parent with US and Japanese subsidiaries and permanent establishments in Korea, China and Kuwait), which may be a bit overambitious plan. As already mentioned in the beginning of this working document the "EU water's edge" needs to be analysed very closely and is a key point for determining the scope of the CCCTB.

► *How should the CCCTB address the establishing of a taxing right? Should this be left for national legislation or should there be a basic rule in the CCCTB? Do*

---

<sup>12</sup> E.g. Portugal, Spain, Greece and Slovak Republic on building sites and constructions or Czech Republic and Slovak Republic on services.

*Members of the Group think it is better to use the method of general principle definition or do they see a need for a listing of particular income?*

▶ *Do Members of the Group agree that business (active) income of tax non-residents should be taxed if earned through a permanent establishment? Members of the Group are invited to give details on how they think the CCCTB should approach the permanent establishment related issues?*

▶ *Which solutions and approaches do Members of the Group see appropriate for income earned by tax non-resident companies in the CCCTB jurisdictions in another way than through a permanent establishment?*

▶ *Would Members of the Group like to comment on the scope of the income earned by tax residents and tax non-residents to be covered by the CCCTB or do they see more appropriate to deal with this issue in conjunction with the consolidation method?*

## **VI Anti-avoidance rules**

37. The prevention of less than single taxation and/or the erosion of the tax base is particularly important when two or more different tax systems meet. At some point in the future the Group will need to discuss how anti-avoidance rules in general will work in the CCCTB. However it may be useful to discuss how to prevent less than single taxation in international situations in conjunction with third countries issues. The principal question is to what extent the existing legislation in individual MS could apply, or will need to be adapted to a common standard, to ensure that the CCCTB rules provide common and sufficient protection against any tax base outflow to third countries.

38. In the CCCTB it should be highly desirable to create common rules when the tax base is directly affected. Different standards adopted in different MS for example for deductibility of certain items would not be easily compatible with the common consolidated tax base as not only would international groups face many different sets of tax rules but there would also be a problem when the results were consolidated and the consolidated base "shared" between Member States. A State who unilaterally does not limit deductions of items that another State considers non-deductible would still have a share of the consolidated base which in general had not been reduced. Conversely States who did not allow such deductions would receive a share of the consolidated base reduced by the unilaterally permitted larger deductions.

39. Some MS do not classify some of the issues mentioned below (for example transfer pricing or thin capitalisation) as anti-avoidance. However, whether such rules are defined as anti-avoidance or not is not particularly important for the CCCTB purposes at this stage. It is more important whether the

CCCTB should offer a common solution for these situations and which would be the most appropriate.

40. Members of the Group are invited to consider whether the CCCTB should offer a common solution for transactions between related companies from different countries (i.e. one company from the CCCTB jurisdiction and another one from outside). This encompasses two main areas: thin capitalisation and transfer-pricing. The latter has been addressed by application of the arm's length principle and elaborated in great detail at OECD level as well as at the EU level at Joint Transfer Pricing Forum.

41. Although some guidance on thin capitalisation has been given by the OECD, the current rules among MS vary. Some of them seek an arm's length ratio between debt and equity while others limit interest deduction by fixed debt to equity ratio. More over some MS do not have any thin capitalisation rules.

42. Another issue to be addressed is the situation when a company or an asset leaves a CCCTB jurisdiction. In current tax systems a disposal of an asset is often deemed to arise at the moment when an asset leaves the tax system (e. g. change of residence status). Disposal would not be deemed when an asset moves within CCCTB countries, but only if it leaves the CCCTB jurisdictions. Members of the Group should however make sure that the selected solution is compatible with the EC Treaty, especially if not all MS participate in the project. This question has already been raised in connection with capital gains and Members of the Group agreed it should be discussed in conjunction with other "third countries" issues.

43. Members of the Group may also wish to consider whether some common rules in relation to low tax countries (outside of the EU) should be included in the CCCTB. Some MS prevent the sheltering of passive income in controlled entities located in low tax jurisdictions through "Controlled Foreign Companies" rules. Leaving this area for the national legislations without any coordination creates a risk of inconsistent provisions and the unnecessary complication of the CCCTB. Therefore it may be worth considering the possibility of agreeing a common approach.

44. Another rule in respect of "tax havens" exists in a few MS according to which expenses on services related to transactions carried on, directly or indirectly, with persons or entities tax resident in a tax haven, or services paid through persons or entities tax resident in a tax haven are not tax deductible. The taxpayer is usually allowed to avoid such provisions if he can prove that the expense is related to a transaction carried on by valid economic reasons. Tax havens are usually determined by the use of an explicit list of low tax countries and territories.

► *Members of the Group are invited to express their views on how the CCCTB should deal with anti-avoidance rules in cases with international element, particularly whether there should be a common set of rules?*

► *Should a common approach be taken in respect to related parties situations, exit taxation and low tax countries? Members of the Group are invited to express their ideas how the CCCTB should deal with these issues.*

**Annex<sup>13</sup>**

<b>MS</b>	<b>TAXATION OF TAX RESIDENTS territoriality / worldwide income</b>	<b>DEFINITION OF RESIDENCE incorporation (I)/ legal seat (LS)/ place of effective management (EM)</b>	<b>METHOD FOR ELIMINATION OF DOUBLE TAXATION Credit (C)/ Exemption with temporary loss deduction (EL)/ Exemption without loss deduction (E)</b>	<b>DOUBLE TAX TREATY WITH ALL MS?</b>	<b>BRANCH TAXATION</b>
<b>AT</b>	Worldwide income	Incorporation– Legal Seat – Effective management	Exemption with temporary loss deduction	No	No branch profits tax
<b>BE</b>	Worldwide income	Legal Seat – Effective management	Exemption with temporary loss deduction	Yes	No branch profits tax
<b>CZ</b>	Worldwide income	Legal Seat – Effective management	Credit	Yes	No branch profits tax
<b>CY</b>	Worldwide income	Effective management	Exemption with temporary loss deduction	No	No branch profits tax
<b>DE</b>	Worldwide income	Legal Seat – Effective management	Exemption without loss deduction	Yes	No branch profits tax.
<b>DK</b>	Territoriality	Incorporation – Effective management	Exemption without loss deduction	No	No branch profits tax
<b>EE</b>	Worldwide income	Incorporation		No	
<b>EL</b>	Worldwide income	Incorporation	Exemption without loss deduction	No	No branch profits tax
<b>ES</b>	Worldwide income	Incorporation – Legal Seat – Effective management	Exemption with temporary loss deduction	No	15% branch profits tax
<b>FI</b>	Worldwide income	Incorporation – Legal Seat	Credit	No	No branch profits tax
<b>FR</b>	Territoriality	Effective management  There is no definition of residence	Exemption without loss deduction	Yes	Branch remittance tax of 25% (or lower rates provided by treaty) on profits net of corporate income tax, whether or not remitted or distributed.
<b>HU</b>	Worldwide income	Incorporation – Effective management	Exemption without loss deduction	No	No branch profits tax
<b>IE</b>	Worldwide income	Incorporation	Credit	No	No branch profits tax
<b>IT</b>	Worldwide income	Legal Seat – Effective management	Credit	Yes	No branch profits tax

<sup>13</sup> The information for the Annex are based on IBFD databases on Company taxation

<b>LT</b>	Worldwide income	Incorporation	Credit	No	No branch profits tax
<b>LU</b>	Worldwide income	Legal Seat – Effective management	Exemption without loss deduction	No	No branch profits tax
<b>LV</b>	Worldwide income	Incorporation	Credit	No	No branch profits tax
<b>MT</b>	Worldwide income	Incorporation – Effective management	Credit	Yes	No branch profits tax
<b>NL</b>	Worldwide income	Incorporation – Effective management	Exemption with temporary loss deduction	No	No branch profits tax <sup>14</sup> .
<b>PL</b>	Worldwide income	Legal Seat – Effective management	Exemption without loss deduction	Yes	No branch profits tax
<b>PT</b>	Worldwide income	Legal Seat – Effective management	Credit	No	No profits branch tax
<b>SE</b>	Worldwide income	Incorporation (Registered)	Credit	Yes	No branch profits tax
<b>SI</b>	Worldwide income	Head office	Credit	No	
<b>SK</b>	Worldwide income	Legal Seat – Effective management	Credit	No	No branch profits tax
<b>UK</b>	Worldwide income	Incorporation – Effective management	Credit	Yes	No branch profits tax

<sup>14</sup> Following treaties concluded by the Netherlands, however, allow the treaty partner to levy such a tax at the maximum rates given in parentheses: Argentina (10%), Brazil (15%), Canada (10%), Indonesia (10%), Kazakhstan (10%), the Philippines (10%), Turkey (5%), the United States (5%), Vietnam (7%) and Zimbabwe (5%).