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## **COMMON CONSOLIDATED CORPORATE TAX BASE WORKING GROUP (CCCTB WG)**

### ***Progress to date and future plans for the CCCTB***

**Meeting to be held on Tuesday 12 December 2006 and Wednesday 13  
December**

Centre de Conférences Albert Borschette  
Rue Froissart 36 - 1040 Brussels

**WORKING DOCUMENT**

## I Introduction: Purpose of the Paper

1. Similarly to last year<sup>1</sup>, the European Commission plans to issue a Communication to the Council, the European Parliament and the European Economic and Social Committee in early 2007 to report on progress to date in the Common Consolidated Corporate Tax Base (CCCTB) Working Group<sup>2</sup> and future plans for the CCCTB. To this end, the Commission Services have decided to organise a joint meeting with business and academics on December 12, the day before the next meeting of the CCCTB Working Group. A similar meeting was held last year and it is the Commission Services' firm opinion that the participation and support of the academic world and of the business community in the CCCTB project is invaluable.
2. The Commission Services have prepared this paper to facilitate an open debate during this meeting and will take into account the views expressed in their future work. As usual, comments made by experts present at the meeting will be treated as comments by individuals and not as the formal position of Member States, business organisations or academic institutions.
3. The following section of this paper illustrates the main issues discussed by the CCCTB Working Group since the last Communication, as follows: *a. taxable income*; *b. international aspects*; *c. personal scope* (including the sub-topic financial institutions); *d. consolidation/group taxation*; *e. financial assets* (including participation exemption and dividends); *f. administrative and legal framework*. Neither general information on the CCCTB Working Group nor specific information on the work carried out before is presented in this paper. If further detail is required on the issues raised, all the past Commission Services' papers presented at the Working Group meetings can be found on the DG Taxation and Customs Union web-site. The paper includes three further sections on apportionment, on the work to be carried out in 2007 and on conclusions.
4. Finally, it should be highlighted that throughout this Working Document the expressions 'members of the Group agreed', 'consensus was achieved among MS experts', etc. are used. These expressions represent the Commission Services understanding of the current status of discussion within the Group. However, this report has been prepared under the sole responsibility of the Commission Services and should not be seen as a report agreed by the Group.

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<sup>1</sup> See Commission Communication COM(2006) 157 final on 'Implementing the Community Lisbon Programme: Progress to date and next steps towards a Common Consolidated Corporate Tax Base (CCCTB), which can be found , at the following address:

[http://ec.europa.eu/taxation\\_customs/resources/documents/taxation/company\\_tax/common\\_tax\\_base/COM\\_2006\\_157\\_en.pdf](http://ec.europa.eu/taxation_customs/resources/documents/taxation/company_tax/common_tax_base/COM_2006_157_en.pdf)

<sup>2</sup> The work of the Group can be followed via a series of dedicated web-pages which contain details of the WG meetings and the working documents, at the following address:

[http://ec.europa.eu/taxation\\_customs/taxation/company\\_tax/common\\_tax\\_base/index\\_en.htm](http://ec.europa.eu/taxation_customs/taxation/company_tax/common_tax_base/index_en.htm)

## II Topics dealt with by the Group in 2006

### *a. Taxable income*

5. On the basis of a working document on taxable income<sup>3</sup> which the Commission Services presented at the Working Group meeting in September 2005, the topic of taxable income has been discussed both in the main Group and in a sub-group (Sub-group on taxable income or SG3), which met four times. The following items were examined: (i) definition of taxable income; (ii) definition of expenses and conditions for deductibility in the tax base; (iii) principles to apply as regards recognition of income; (iv) general treatment of previous losses and (v) methodology to calculate taxable income (by means of profit and loss account, or tax balance sheet, or both).

6. Experts from MS generally agreed that the definition of taxable income should be as wide as possible, with very few items of exempt income (such as dividends and capital gains on the sale of qualified participations). They also agreed to make use of similar criteria on recognition of income as illustrated in IAS 18 while a number of experts were of the opinion that only realised income should be taxed. The adoption of a business purpose test for the deductibility of expenses was deemed to be appropriate.

7. In the area of non deductible **expenses**, it was generally accepted that expenses connected to exempt or non taxable income should not be deductible (although a method to distinguish between expenses linked to taxable and to non-taxable income was not found; for instance a 'pro-rata' method<sup>4</sup> for this purpose did not meet with consensus). Fines and gifts were identified as non-deductible items (except for gifts if directly connected to the business or some donations to non-profit organisations). However the most problematic issues in this area appeared to be social contributions and taxes other than corporate income taxes.

8. As for social contributions, it was acknowledged that existing social security systems vary significantly in the EU and the correlated tax rules interact closely with the taxation of pension funds and beneficiaries. It was considered as inevitable that the level of social security welfare and contributions are not same in all MS, in the same way that price levels (for example property rents) differ and it is not the purpose of the CCCCBB to harmonise national social security and welfare systems or personal income taxation. However, from a CCCTB perspective, if some MS finance their social security system through distinct (deductible) contributions while other MS through their general tax system, this would impact on the consolidation and sharing out of the tax base.

9. In addition, although it was generally accepted that mandatory social contributions should be in principle fully deductible, contributions made by employers on a voluntary basis may create some opportunities for tax planning if they were tax

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<sup>3</sup> CCCTB\WP\017 of 7 September 2005 'Taxable income', in [http://ec.europa.eu/taxation\\_customs/taxation/company\\_tax/common\\_tax\\_base/article\\_2339\\_en.htm](http://ec.europa.eu/taxation_customs/taxation/company_tax/common_tax_base/article_2339_en.htm)

<sup>4</sup> Such a method would imply that if – for example – 20% of the company's total income is exempt, also 20% of its global expenses should be exempt.

deductible without any limitation (especially contributions paid to funds which benefit from tax exemptions or a specific low tax rate).

10. As for deductibility of taxes other than corporate income taxes, the issue was debated in depth due to its implication on the consolidation and sharing out of the tax base. First of all, a distinction should be drawn among taxes on income (profit), taxes on production factors (e. g. payroll or property) and taxes on specific services (public collection of waste) which are charged even though the taxpayers do not require and do not make use of such services.

11. Within a single tax jurisdiction, the deductibility of all these taxes can be accepted on the basis that the tax or charge paid by the company is an expense actually incurred and connected with business. However, from a CCCTB perspective, if some MS impose taxes other than corporate income tax that affect the CCCTB (by reducing the base that can be apportioned among the participants) and others do not impose such taxes, the former MS would receive a tax revenue in addition to their share of the CCCTB, whereas the latter MS would only tax their (reduced) share of the CCCTB. One possible solution would be to not allow deductibility of taxes (except for taxes charged for specific services provided by the MS concerned), or to allow deductibility of such taxes only after apportionment of the tax base (the deductibility would affect only the domestic share of the base).

12. As regards the treatment of **losses**, the preferable approach seemed to be unrestricted loss carry-forward, while loss carry-back was ruled out.

13. As regards **methodology** to determine taxable income, two options were discussed: either calculating the difference between income and expenses relevant for tax purposes – the 'Profit and Loss method' – or calculating the difference between the opening and the closing balance sheet values – the 'Balance Sheet method' –. The two methods should lead to the same result but a choice should be taken on which one would work best for the CCCTB, taking into account all the implications of each method and also that a different approach to the drafting of the relevant legislation would be required.

14. The 'Profit and Loss method' would require a common definition of items of taxable income and deductible expenses, including rules for recognition and timing. Companies would adjust their accounting profits following tax rules, by adding back items that decrease their accounting profit but are non deductible for tax purposes and subtracting items that increase the accounting profit but are tax exempt.

15. The 'Balance Sheet method' would require establishing a common structure of a balance sheet and rules for recognition and measurement of all its elements for tax purposes. Being completely independent from companies' accounting books and records, the tax balance sheet option would require that companies maintain an additional set of account for CCCTB purposes.

16. It should be noted that members of the group remained divided on this issue and discussion needs to be deepened in conjunction with discussions on the administrative framework of the CCCTB (*see below*).

**Experts are invited to comment on any of the above points. In particular the Commission Services are interested in views on:**

**(i) the concept of business purpose test;**

**(ii) the deductibility of certain items related to specific domestic situations (social contributions, taxes other than corporate income taxes);**

**(iii) the methodology for calculating taxable income.**

*b. International aspects*

17. On the basis of two Working Documents on 'International aspects in the CCCTB'<sup>5</sup> and 'The territorial scope of the CCCTB'<sup>6</sup> which the Commission Services presented at the Working Group meetings, respectively, in December 2005 and March 2006, the topic of international aspects has been discussed both in the main Group and in a sub-group (Sub-group on international aspects or SG4), which has met three times. The following items were examined: (i) definitions (such as the definition of tax residence and of permanent establishment); (ii) the possible CCCTB tax treatment of foreign income earned by companies who are resident in the EU<sup>7</sup> - both active income (business profits earned through permanent establishments outside the EU) and passive income (e. g. dividends, interest and royalties), and (iii) the possible CCCTB tax treatment of income earned by companies resident outside the EU (non-residents) from sources in the EU. The discussions were held bearing in mind the existing guidelines developed at OECD, particularly those contained in the OECD Model Tax Convention on Income and capital (the 'Model Convention') and the relationships between the existing bilateral Tax Treaties concluded by Member States and the prospective CCCTB.

18. As a general remark, it should be noted that on a number of discussion points experts insist that OECD principles have to be followed. The Commission services agree and have always seen the OECD principles as an invaluable starting point. At the same time they have stressed that the common practices following from the OECD Model Convention leave more space open for different national policies than the CCCTB will be able to. MS currently negotiate details in the individual treaties. Some MS do not even apply the same principles consistently in all their tax treaties and they approach negotiation of individual treaties on a case by case basis (e. g. choice of the method for elimination of double taxation). The CCCTB will require a greater level of commonality including perhaps a common line in respect of relations with third countries. On some concrete examples where more than one possible solution within the OECD principles is possible, practical nuances of how they are applied remain unclear. In addition to that

<sup>5</sup> CCCTB\WP\019 of 18 November 2005, in [http://ec.europa.eu/taxation\\_customs/taxation/company\\_tax/common\\_tax\\_base/article\\_2340\\_en.htm](http://ec.europa.eu/taxation_customs/taxation/company_tax/common_tax_base/article_2340_en.htm)

<sup>6</sup> CCCTB\WP\026 of 17 February 2006, in [http://ec.europa.eu/taxation\\_customs/taxation/company\\_tax/common\\_tax\\_base/article\\_2453\\_en.htm](http://ec.europa.eu/taxation_customs/taxation/company_tax/common_tax_base/article_2453_en.htm)

<sup>7</sup> The Working Group focussed only on situations where 'third countries' are involved, i.e. those outside the EU. The situation where some MS do not apply the CCCTB has not been dealt with at this stage.

there are ongoing discussions on some important issues in the OECD (e. g. the new set of rules on allocation of profits to permanent establishments) and it is difficult for some experts to comment on how the CCCTB should approach these before this work is completed.

19. As regards the **definition** of tax residence, the CCCTB will not introduce a concept of a CCCTB area tax residence and companies will remain resident of a particular Member State, so that they are able to continue to receive benefits under the existing tax treaties. However, most experts agreed that having common criteria for tax residence in the CCCTB legislation would ensure a broad and common definition of tax residence at national level and would be more beneficial than relying on existing, domestic definitions. The most likely criteria for establishing tax residence in such a common definition would be incorporation, registered office or place of effective management. Situations when double or dual residence would occur would be resolved through the respective treaty 'tie-breaker' provision, as in the case today. In addition to that Commission Services advised that a common policy on the tie-breaker rules negotiated in the treaties would simplify dealing with double or dual residence cases in future.

20. As regards **permanent establishments** (PE), experts agreed to make use of the work carried out in the framework of the OECD, not only concerning the definition, but also concerning the attribution of profit to it. Experts agreed that there should be common rules for CCCTB purposes, following the OECD principles (mainly the separate entity approach) but introducing more detailed guidelines to avoid diverging interpretations of such principles. However, the details and practical nuances of applying the existing OECD principles in the context of the CCCTB were not discussed by the Group.

21. As regards companies resident in the EU a vast majority of experts would favour taxation of their world-wide income while companies tax resident outside the EU would be taxed on income with the source in the EU only. This means that any income earned by tax resident companies from sources in or outside the EU would be taken into account for CCCTB purposes. Other experts would prefer the territoriality principle for CCCTB purposes, meaning that income from sources outside the EU would not be subject to tax in CCCTB. However, many experts point out that the choice of the policy of (i) worldwide taxation or (ii) territoriality system represents a fundamental element of their fiscal policy. Therefore, a system that presupposes an obligatory switch to a different principle might limit the number of Member States interested in joining the CCCTB. It was also pointed out that in certain circumstances combining exemption with a worldwide approach produces similar results to territoriality.

22. Experts discussed a wide range of possible solutions of this problem<sup>8</sup>. The two main questions to be answered in this context have been: (i) should the income earned by residents from sources outside of the state of residence be covered by the CCCTB (hereafter the foreign income) including the common rule on whether it is subject to tax

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<sup>8</sup> For more details and description of the possible solutions see the Working Document 'An overview of the main issues that emerged at the second meeting of the subgroup on International aspects (SG 4)' CCCTB\WP\033\doc\en discussed by the Group on 1<sup>st</sup> June 2006.

or not, and (ii) if such income is taxable in the state of residence, but not included in the consolidation, should the common rules apply to:

- Calculation of taxable income (e.g. method of allocation of profits to foreign PEs in case of business profits),
- Elimination of double taxation,
- Addition of such income to the share on CCCTB, if the credit method is used for elimination of double taxation.

23. Whereas the rules of how the taxable income should be calculated and the way it should be added to the share of the CCCTB after apportionment should be common, for the elimination of double taxation the majority of experts seem to prefer applying the national rules modified by bi-lateral tax treaties in force. In other words these experts were not in favour of a common approach to the elimination of double taxation.

24. For practical reasons, and particularly because such an approach would enable MS to maintain the existing bilateral tax treaties, experts seemed to prefer to exclude foreign income from the consolidation. However the method of calculation of taxable foreign income (e. g. rules on allocation of profits to foreign PEs in case of business profits) would have to be common, and would probably have to be done on the arms length basis. As excluding foreign income does not avoid several complications (e.g. retention of arms length basis) the Commission Services advised that the apparently more complex approach of including foreign income in the CCCTB should not be completely dismissed because of the benefits that it would bring if a satisfactory method could be defined.

25. With reference to **passive foreign income** earned by EU residents from sources outside of the EU (e. g. interest, royalties, dividends paid to a resident by a non-resident), the preferable approach appeared to be to include it in the CCCTB. However such an approach would require further discussion of the method to eliminate double taxation (if incurred in the source country). A withholding tax imposed on passive income received by CCCTB companies from sources in third countries may occur when the relevant tax treaties permit it. A number of experts were of the opinion that if the income is to be included in the CCCTB and consolidated the sharing out mechanism has to be applied to double tax relief for which the credit method is usually used in case of passive income.

26. As for passive income paid between CCCTB companies from different MS and included in the CCCTB (where it is not covered by the Parent/Subsidiary Directive) it would not be possible to continue to impose withholding tax after adoption of the CCCTB unless MS wished to keep the revenues from potential withholding tax collected at source by the CCCTB and the respective income and expenses separate. This would affect not only dividends/interest and royalties within the consolidated group, but all dividends, interest and royalties paid by the company applying the CCCTB.

27. The imposition of a withholding tax on passive income paid by a CCCTB company to a non CCCTB company would be possible (if the relevant tax treaty allows so), but if such an amount were to be included in the CCCTB (as an expense) the tax withheld would have to be shared out according to agreed mechanism.

28. Another possibility would be the elimination of withholding tax within the EU completely or the keeping of the income subject to the withholding tax, and the revenues of such tax, separate from the CCCTB.

29. As regards taxation of companies resident outside the EU there is a wide agreement that business income earned through permanent establishments situated in the EU should be covered by CCCTB. Whether included or excluded from the consolidation it is likely that the arms length basis for calculating the profits of such non-resident PEs will be required under existing tax treaties with third countries, and again a common method would be desirable. The possible solution of how to include this income in the consolidated base, compatible with the existing tax treaties and practices, may be to determine the profit of a non-residents permanent establishment at arm's length when included in the CCCTB. This allocation would be also relevant for the third state, where the company is tax resident. The CCCTB including non residents' arm's length profits would be consequently apportioned according to CCCTB allocation mechanism (very likely different from the arm's length principle). Appropriate treatment of how to deal with the difference between results of the two allocation methods would have to be agreed.

**Experts are invited to comment on any of the above points. In particular the Commission Services are interested in views on:**

**(i) the definition of residency and PE;**

**(ii) the main principle for taxation of residents (world-wide or territoriality) and elimination of double taxation (if occurs) in the CCCTB**

**(iii) the inclusion/exclusion of foreign income from the CCCTB;**

**(iv) the application of the CCCTB to EU sourced income earned by non residents.**

*c. personal scope (including the sub-topic financial institutions)*

30. Among the issues that arise when designing the CCCTB, an important question to be dealt with is the type of entities to which it applies or, in other words, whether CCCTB should be reserved to (or denied to) some specific entities on the base of their legal form, activities etc. This issue has been identified as the 'personal scope' to differentiate it from the 'income scope' (to which income the CCCTB applies) and from 'territorial scope' as discussed above. Discussions on the personal scope of the CCCTB started very recently when the Commission Services presented a Working Document<sup>9</sup> to the Working Group in September 2006.

31. The basic principle followed in the Working Document was that the CCCTB as a tool to remove existing tax obstacles to the internal market should be made available to

<sup>9</sup> CCCTB\WP\040 of 26 July 2006 'Personal scope of the CCCTB', in [http://ec.europa.eu/taxation\\_customs/taxation/company\\_tax/common\\_tax\\_base/article\\_2832\\_en.htm](http://ec.europa.eu/taxation_customs/taxation/company_tax/common_tax_base/article_2832_en.htm)

the largest possible number of entities. The CCCTB could define directly such entities, or more realistically rely on domestic definition of entities subject to corporate income tax at domestic level. However, there may be entities not subject to corporate income tax at domestic level which could sensibly be covered by the CCCTB, and vice versa some entities currently subject to domestic corporate income tax may be excluded from the CCCTB. It goes without saying that similar activities should be subject to the same rules and that any inclusion or exclusion should apply across-the-board.

32. Existing community legislation in the direct tax field makes use of lists to define its scope (list of national legal forms subject to national taxes which are also listed) and this method could also apply in the CCCTB. Using a list to define the personal scope of the CCCTB would have the advantage of simplicity and certainty but requires constant updating and may be used as a tax planning tool to avoid the all-in/all out approach in case of consolidation, as described below in this document. On the contrary a general inclusion of any entity carrying out business could bring within the scope of the CCCTB taxpayers who are, for example, currently subject to personal income tax in certain Member States.

33. Having in mind the main goal of the CCCTB (the removal of tax obstacles in the internal market), it has been sometimes suggested that CCCTB should be made available only to entities operating cross-border. However the Commission Services do not support this approach both because it is difficult to define when a company operates cross-border and because such a selective approach could be affected by competition rules.

34. The Working Document referred to above raised the question of whether transparent entities (entities the income of which is not taxed as such, but flows through and is attributed directly to the associates/partners) should also be covered by CCCTB. Two main issues arise from transparent entities, namely the apportionment of the consolidated base to the associates/partners and the qualification of the transparent entity itself, which could lead to hybrid situations where an entity is considered as being 'transparent' in accordance with the rules of one MS and 'opaque' in accordance with the rules of another MS.

35. Related to this topic is the tax treatment of **financial institutions**, which has been presented by means of a Commission Services Working Document<sup>10</sup> and discussed at the CCCTB Working Group meeting on 2 June 2006, the morning session of which took place in an extended format with the participation of representatives from the associations of the financial sector in addition to experts from MS<sup>11</sup>.

36. In principle, it was recognised that since financial institutions are business entities they should be covered by the CCCTB; however the general rules concerning the structural elements of the tax base, the attribution of profit to the permanent

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<sup>10</sup> CCCTB\WP\027 of 1 March 2006 'Tax treatment of financial institutions', in [http://ec.europa.eu/taxation\\_customs/taxation/company\\_tax/common\\_tax\\_base/article\\_2453\\_en.htm](http://ec.europa.eu/taxation_customs/taxation/company_tax/common_tax_base/article_2453_en.htm)

<sup>11</sup> Representatives from the following associations attended the meeting: FBE (European Banking Federation), EFAMA (European Fund and Asset Management Association), CEA (European Federation of National Insurance Associations), ESBG (European Savings Banks Group), EFRP (European Federation for Retirement Provisions), and EACB (European Association of Co-operative Banks). The minutes of that meeting are available at the following address: [http://ec.europa.eu/taxation\\_customs/taxation/company\\_tax/common\\_tax\\_base/article\\_2648\\_en.htm](http://ec.europa.eu/taxation_customs/taxation/company_tax/common_tax_base/article_2648_en.htm)

establishments and the factors for the apportionment of the tax base may require some adjustments<sup>12</sup>. The discussions held in the group focussed on which financial entities deserve specific rules; and which elements of the CCCTB should be treated in a different way compared to non financial business.

37. Among the various financial entities analysed (credit institutions, insurance undertakings, collective investment vehicles, pension funds and venture capital institutions), the group recognised that the first two could be relatively easily covered by CCCTB, but not the others due to their specific nature.

38. As regards the elements of the tax base, the **valuation** (at historical cost or at fair value) of the **financial assets** held by financial institutions was analysed. Differences emerged between credit institutions (who would favour evaluating their trading financial assets at market value<sup>13</sup>, even if this implies showing unrealised capital gains) and insurance undertakings that, mainly due to the different pattern of financial assets held by them (medium to long term assets) would favour – for tax purposes – retaining the historical cost evaluation method for such assets.

39. As concerns **provisions for bad debts**, it was noted that since the banking and insurance sectors are highly regulated at EU and domestic level, any provision required for prudential purpose should be tax deductible, even though such a provision might not meet the general criteria set out for 'standard' provisions (such as a legal obligation towards a third party).

40. Most of the discussions focused on the **deductibility of technical provisions** for insurance undertakings, and in particular the equalization and catastrophe provisions which may not fulfil the general criteria for deductibility. The importance of provisioning certain amounts for future possible events is closely linked to the possibility of carrying back losses; otherwise insurance undertakings would pay more taxes in early years and would not be able to cover all the risks in future years.

41. Since current domestic systems present different rules, the Group discussed various options, such as harmonising the provisions and also the way how to calculate them; allowing for a mutual recognition of domestic rules, similarly to what had been previously discussed as regards 'standard' provisions, such as for environmental 'clean-up' costs.

**Experts are invited to comment on any of the above points. In particular the Commission Services are interested in views on:**

**(i) the general approach according to which the CCCTB should apply to as many entities as possible;**

<sup>12</sup> However the discussion focused only on the structural elements, while other aspects such as apportionment were not discussed.

<sup>13</sup> However this position is not representing the unanimous view of all the credit institutions within the EU

**(ii) in particular, if there are specific entities or sectors for which the CCCTB should be available (or excluded);**

**(iii) specific comments on partnerships, transparent entities, hybrid entities, financial institutions.**

*d. Consolidation / group taxation*

42. On the basis of a working document on group taxation<sup>14</sup> which the Commission Services presented at the Working Group meeting in June 2006, the topic of consolidation/group taxation has been discussed both in the main Group and in a sub-group (which met two times). The following items were examined: (i) definition of the group; (ii) treatment of losses (both pre-existing losses and losses occurred during the life of the CCCTB group); (iii) the issue of entities entering and leaving the CCCTB group; (iv) the termination of the group; (v) the methodology of consolidation and (vi) the treatment of minority interests. Moreover, in the course of the discussions, it emerged that some of the issues raised are interconnected with other topics such as the administrative framework and the personal scope.

43. The Commission Services made it clear - when the topic 'group taxation' was introduced for the first time - that it was preferable to design a tax base which was able to be consolidated (even if the final, 'political' decision might be not to apply consolidation from the beginning of the introduction of the CCCTB).

44. Discussions in the main group and in the sub-group have covered the advisability (i) to include in the scope of a group as many entities as possible, and (ii) to design mandatory consolidation even though CCCTB would be optional for companies (in other words, companies can opt for CCCTB, but if they do so, they are obliged to consolidate the results of the various members of the group which meet the conditions for consolidation). In doing so, the so-called 'all in' principle should apply (as opposed to the 'cherry-picking' principle, whereby a group can choose which entities to include in the consolidation and which to exclude).

45. It emerged that a **high threshold** (75 % or more) of shareholding possession as a requirement to consolidate would be preferable to a lower one. It was also recognised that regardless of the concrete methodology of consolidation, this would imply elimination of intra-group transactions (to remove/reduce transfer pricing compliance requirements). Finally, as regards the treatment of **pre-existing losses** (ie losses incurred by companies before entering a CCCTB group), the prevailing idea was to ring-fence such losses (they could then be offset against the share of the common tax base that company in each MS would get after apportionment).

46. In other areas, more contrasting views were expressed. As regards the **scope of the group**, some experts maintained a very reluctant approach concerning the

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<sup>14</sup> CCCTB\WP\035 of 5 May 2006 'Issues related to Group Taxation, in [http://ec.europa.eu/taxation\\_customs/taxation/company\\_tax/common\\_tax\\_base/article\\_2648\\_en.htm](http://ec.europa.eu/taxation_customs/taxation/company_tax/common_tax_base/article_2648_en.htm)

consolidation of the EU entities of the group when a non EU company is involved, both when the non EU entity is the ultimate parent and when it is an intermediary element of the 'chain'.

47. Some experts argued that effective auditing would not be possible if one entity in the chain were to be outside the EU. In particular, it was suggested by one expert that access to information and proper implementation of the 'all in/all out' principle would require that the ultimate parent be an EU resident (to be able to check all the direct and indirect participations it might hold).

48. In addition, some experts feared that in the absence of anti-abuse clauses concerning related companies, double deductions might be possible. However, the Commission Services considered that not granting the benefits of the CCCTB to all situations when a non EU entity is involved (which might be extremely frequent) could weaken the attractiveness of the CCCTB, raise discrimination issues and raise the possibility of a group of companies having more than one 'CCCTB group'. Therefore, it would be sensible to examine how to overcome potential difficulties and prevent potential abuse (double dips).

49. As regards the treatment of **ongoing losses** (assuming that the overall tax base is negative in year one), two possible approaches were discussed. The first possibility would be to carry forward such loss at the group level and only allocate (via the apportionment mechanism) the consolidated profit to the group when the group itself becomes profitable. The second possibility would be to allocate (via the apportionment mechanism) the consolidated loss to each MS concerned, and to compensate this share in future years with the share of future consolidated profit. Experts were equally divided on this issue. The first option seemed preferable to avoid that losses get stranded in one MS. However, some experts noted that the same risk would exist with loss compensation at the level of the group if some categories of income were to be excluded from the CCCTB (foreign income, share of transparent entities' income).

50. As regards **methodology**, several possible methods of dealing with intra-group transactions were envisaged (such as: (i) ignoring them for tax purposes; (ii) recording them at cost; (iii) recording them at an internal price and then eliminate unrealised internal profit or loss), but no general agreement was reached. Some experts stressed that any further progress would require simultaneous progress on the methodology of the determination of taxable income, the sharing mechanism and the administrative framework.

51. Finally, most experts seemed to favour a **full consolidation** system (meaning that 100% of the income should be consolidated, even though the entity was owned at less than 100%) as a proportional consolidation did not appear to be workable. Overall, the experts seemed to consider that the treatment of **minority interests** should not be regarded as an issue to be dealt with via tax provisions. It should be ignored for tax purpose and left to either company law or to the individual entities themselves to provide for a system for compensating minority shareholders for any (negative) consequences arising from consolidation and the apportionment mechanism. Under this assumption, CCCTB legislation would only have to consider tax neutrality of such compensation (non

taxable in the hands of the receiver/non deductible in the hands of the payer) provided that their calculation could be reliably estimated.

**Experts are invited to comment on any of the above points. In particular the Commission Services are interested in views on:**

**(i) the general approach according to which the CCCTB should be optional for companies and that if chosen consolidation of all eligible companies should be compulsory;**

**(ii) in particular, the definition of a group, its scope and other principles of consolidation (all in – 100% consolidation also for not 100% owned entities, minority interest, etc.);**

**(iii) the tax treatment of losses borne by entities before applying the CCCTB and/or before joining a given CCCTB group; and the tax treatment of ongoing losses;**

**(iv) the various methods of consolidation and the treatment of intra-group transactions.**

*e. Financial assets (including participation exemption and dividends)*

52. When the CCCTB Working Group started discussing the structural element of the tax base 'assets and tax depreciation', the topic 'financial assets' was temporarily put aside to be discussed at a later stage. A working document<sup>15</sup> was introduced at the meeting on 8 December 2005 and discussed in depth at the meeting of a sub-group ('SG1') in Berlin on 3 and 4 April 2006 (together with other issues such as intangible assets and leased assets). The outcome of such discussions is contained in a further Commission Services Working Document<sup>16</sup>.

53. The main issue linked to **financial assets** was their **evaluation at fair value** following international accounting standards (in particular IAS 39), with possible recognition in profit and loss (and consequences on the tax base) of accrued but unrealised capital gains (or deduction of accrued but unrealised capital losses). If it seemed agreeable that unrealised profit should not be part of the taxable income due to the commonly accepted 'ability to pay' and 'prudence' principles, experts were divided whether unrealised capital losses should be taken into account (due to the imparity principle, which would lead to an asymmetric treatment of unrealised profits and losses).

<sup>15</sup> CCCTB\WP\023 of 30 November 2005 'Tax treatment of financial assets', in [http://ec.europa.eu/taxation\\_customs/taxation/company\\_tax/common\\_tax\\_base/article\\_2340\\_en.htm](http://ec.europa.eu/taxation_customs/taxation/company_tax/common_tax_base/article_2340_en.htm)

<sup>16</sup> CCCTB\WP\032 of 19 May 2006 'An overview of the main issues that emerged at the fourth meeting of the sub-group on assets (SG1), in [http://ec.europa.eu/taxation\\_customs/taxation/company\\_tax/common\\_tax\\_base/article\\_2648\\_en.htm](http://ec.europa.eu/taxation_customs/taxation/company_tax/common_tax_base/article_2648_en.htm)

It should be noted that in this respect the discussions concerning financial assets were similar to those concerning tangible and intangible assets.

54. Another topic of great importance linked to financial assets was the so-called '**participation exemption**'. This expression covers two distinct situations: (i) realisation of capital gains from the sale of qualified participations and (ii) taxation of qualified distribution of dividends (the latter is also called 'dividend exemption'). The common feature of both situations is the attempt to avoid the economic double taxation that could stem, respectively, (i) from taxing capital gains on the sale of shares the value of which is increased because the underlying company has recognised reserves from undistributed profits that had already been taxed (or due to the expectation of future profit that will be taxed at a later stage); and (ii) from taxing dividends in the hands of the parent company, which are distributions of profits already taxed in the hands of the subsidiary.

55. As regards participation exemption of capital gains stemming from the sales of qualified shareholdings, more and more Member States have introduced such a mechanism in their domestic tax system to avoid or limit economic double taxation and to improve the attractiveness of the tax environment in general, and in principle the experts agreed that a similar mechanism could be introduced in the CCCTB. It was also accepted that to benefit from such a regime certain requirements should be fulfilled (minimum threshold ownership, minimum possession duration, etc.).

56. Two issues linked to the participation exemption did not meet with a general consensus: (i) whether specific anti-abuse measures should be designed, to avoid for example that taxpayers circumvent taxation of capital gains on tangible assets by incorporating such assets in a company and selling the shares of the company instead (the counter argument being that such a choice would stop a company, for example, from deducting depreciation allowances or maintenance costs for the underlying assets and therefore would not be convenient from a tax point of view, ie tax the asset gain and purchaser depreciates asset, or exempt the share gain and purchaser cannot depreciate shares), and (ii) whether expenses linked to exempted income (for example passive interests incurred to borrow money used to purchase participations in companies, when the sale of such participations is tax-exempt) should be deductible. This second issue was deemed to belong to the more general category of non-deductible expenses.

57. As regards dividend exemption, this issue was raised - together with other more general issues linked to dividends - in a paper<sup>17</sup> which was tabled at the most recent meeting on 12 September 2006. The starting point of the Commission Services' analysis was that dividends are for the receiver a source of income which should be included in the taxable base of a company similarly to other sources of income (sales, services, interest, royalties, etc.). However when dividends represent the distribution of profit which have been already taxed in the hands of the payer (which is not always the case) it may be appropriate to eliminate or reduce the resulting economic double taxation. The so-called 'Parent/Subsidiary' directive allows for the elimination or reduction of double taxation (provided that certain conditions are met) by not allowing withholding taxes on

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<sup>17</sup> CCCTB\WP\042 of 28 July 2006 '*Dividends*', in [http://ec.europa.eu/taxation\\_customs/taxation/company\\_tax/common\\_tax\\_base/article\\_2832\\_en.htm](http://ec.europa.eu/taxation_customs/taxation/company_tax/common_tax_base/article_2832_en.htm)

the distribution of dividends and by giving the choice between credit and exemption method to avoid double taxation for the receiver.

58. Assuming a consolidated tax base, dividends paid to a company applying the CCCTB to another company applying the CCCTB and which is member of the same group (intra-group dividends) would be eliminated through the consolidation process. In any other situation where dividends are paid to or by a company applying the CCCTB there should be a mechanism to mitigate double taxation, and it should be common (either credit or exemption, without a choice). However, this issue has not been discussed in depth by the Group.

**Experts are invited to comment on any of the above points. In particular the Commission Services are interested in views on:**

**(i) the general issue of eliminating or mitigating economical double taxation within the CCCTB;**

**(ii) the introduction of a 'participation exemption regime' in the CCCTB, and the correlated issues (symmetrical non deductibility of capital losses, non deductibility of related expenses, anti-abuse measures, etc.);**

**(iii) the tax treatment of dividends, both in the same situations currently covered by the 'Parent/Subsidiary' Directive and in any other situations of dividend distribution, inbound and outbound.**

#### *f. Administrative and legal framework*

59. In the original draft work programme adopted by the Working Group at its first meeting in November 2004, the administrative and legal framework was listed as an additional element to the CCCTB, to be considered separately together with the consolidation method, the apportionment method etc. In the Commission Services' mind, an administrative and legal framework is necessary for the CCCTB to cover practical aspects such as filing of tax returns, assessment and audit of the taxable income, interpretations of the tax rules (ruling and litigations, including court cases). To this end, some preliminary technical input was sought by means of a questionnaire<sup>18</sup> which was introduced at the CCCTB WG meeting of 2 March 2006, and the contributions received by those Member States who had replied were used to prepare a more structured document<sup>19</sup> which was presented at the CCCTB WG meeting on 1 June 2006.

<sup>18</sup> CCCTB\WP\030 of 2 March 2006 '*Administrative and legal Framework – Questionnaire*', in [http://ec.europa.eu/taxation\\_customs/taxation/company\\_tax/common\\_tax\\_base/article\\_2453\\_en.htm](http://ec.europa.eu/taxation_customs/taxation/company_tax/common_tax_base/article_2453_en.htm)

<sup>19</sup> CCCTB\WP\036 of 19 May 2006 '*Points for discussions on administrative and legal framework*', in [http://ec.europa.eu/taxation\\_customs/taxation/company\\_tax/common\\_tax\\_base/article\\_2648\\_en.htm](http://ec.europa.eu/taxation_customs/taxation/company_tax/common_tax_base/article_2648_en.htm)

60. The basic principle expressed in the Commission Services' papers was that harmonising the rules for calculating the corporate tax base does not require an overall harmonisation of the tax administration and procedural rules; and indeed domestic rules on tax audit, tax dispute resolution, etc. often rely heavily on other branches of national public law which are not the target of the CCCTB. Furthermore, some activities of the tax authorities such as access to the companies' legal seats and inspection of books, premises and employees can only be performed by officials empowered to do so by law.

61. Some aspects of the CCCTB (in particular those which are not present in domestic tax systems, such as the consolidation and apportionment of the base) require an increased level of coordination. For example, the 'sharing out' of the consolidated base should be done by a single entity under the control/supervision authority to avoid diverging results in different Member States. Therefore, the efforts of the Working Group should concentrate on establishing common rules for those areas where coordination is indispensable due to the very nature of the CCCTB, while leaving the existing domestic systems to regulate the remaining areas of the administrative and legal framework as far as possible.

62. Another basic principle – which stems from one of the goals of the CCCTB (the simplification and reduction of compliance costs for companies) – is to avoid that companies have to deal with up to 25 (soon 27) different tax systems, notwithstanding a common tax base. Ideally, this would mean filing a single tax return to only one tax authority for the entire group of related enterprises (a sort of one-stop-shop system). Member States would exchange the information to perform checks and audit on the basis of existing tools (the mutual assistance directive<sup>20</sup> and the recovery directive<sup>21</sup>), possibly enhanced to improve their functioning for CCCTB purposes. How this would be possible in practice needs further work.

63. On the basis of the two afore-mentioned principles, the Commission Services' papers raised more detailed questions concerning tax returns (for example, who has to submit a tax return and to which authority, covering which period and within which deadline); audit and assessment (for example, who performs audit and assessment and what are the consequences for the - possibly already - apportioned tax base); interpretation and rulings (who is competent to deliver interpretation on CCCTB legislation and – assumed it is enacted by a Directive to be replicated into national legislation by means of implementing measures – on the transposing domestic legislation); case litigation, mutual assistance and exchange of information.

64. Unfortunately, discussions on these topics have not advanced as much as hoped. Although all Member States recognised the importance of such issues, they felt it premature to discuss such issues without having made more progress on the structural elements of the common tax base. Indeed, some of the choices still to be taken (optionality, consolidation + apportionment) can influence significantly the shape of the administrative framework.

65. However, from the replies received to the questions posed in the working document, it seems that there are two orientations: some Member States are more

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<sup>20</sup> Council Directive 77/799/ECC of 19.12.1977 as subsequently amended.

<sup>21</sup> Council Directive 76/308/EEC of 15.03.1976 as subsequently amended.

favourable to a centralised management of the common tax base (a single tax return, a single audit mechanism, a single interpretation forum etc.), while some other Member States would prefer that each entity of the group files a tax return to its Member State of residence; that each Member State audits the entities which are residence within their jurisdictions, that each Member State has the right to issue explicative circulars on the CCCTB legislation and in general that CCCTB introduces as few changes as possible to the existing the administrative and legal frameworks.

**Experts are invited to comment on any of the above points. In particular the Commission Services are interested in views on:**

**(i) the extent to which the CCCTB should harmonise or co-ordinate the existing domestic administrative and legal frameworks concerning corporate income tax;**

**(ii) the practicalities of the system (filing of tax returns, audits and assessments, interpretations and means of appeals, exchange of information and mutual assistance among Member States' tax administrations).**

### **III Consolidated Tax Base sharing mechanism**

66. Since 2001 the Commission Services have been advocating for consolidation of the tax base of a group of companies instead of the current system of separate accounting and pricing of internal transactions at arms' length because of the expected benefit in terms of reduction of compliance costs, removal of transfer pricing difficulties, possibility of cross-border loss offset and in general elimination of all those tax barriers to companies operating cross-border that represent an obstacle to the proper functioning of the internal market.

67. If – as it is Commission Services' preferred approach – the CCCTB will be a consolidated base for groups of entities, there is a need to set up a mechanism for its 'sharing out' to the various entities that have contributed to it in a fair, easy to apply and commonly agreed manner. Discussions on the 'sharing out' of the CCCTB have not started yet in the Working Group as the first Working Document<sup>22</sup> on this topic will be presented by Commission Services at the meeting on 13 December 2006.

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<sup>22</sup> CCCTB\WP\047 of XX November 2006 'The mechanism for sharing the CCCTB', not yet on the web-site.

68. The Working Document referred to above recaps<sup>23</sup> the two main possible mechanisms to share the consolidated tax base of a multinational group as discussed in the scientific literature: a **macro-economic** approach or a **micro-economic** approach. The first method takes into account factors aggregated at national level (macro factors) such as GDP, national VAT bases, etc. The second focuses on factors which are specific to a given group of companies (micro factors), such as the value added (VA) or the formulary apportionment (FA). The VA would assign the groups' tax base on the basis of the ratio 'VA by a group member-to-total VA of the group', while the FA would assign the groups' tax base on the basis of a predetermined formula whose elements represent the factors that are deemed to generate the group income (such as assets, payroll or sales).

69. The three above mentioned mechanisms to share the tax bases have advantages and drawbacks and therefore it is not really appropriate to state that one method is in all respects better than the others. However, at the end it will be necessary to make a choice and find an agreement. The Commission Services' current views are as follows:

70. Any 'macro-factor' method, although simple and difficult to manipulate, cannot guarantee the basic requirement of fair treatment of individual corporate income taxpayers, as it may produce a large mismatch between the creation of value in a particular country by a given multinational group and its tax liability in that country.

71. As regards the micro-factor method, the VA concept is familiar to taxpayers and tax administrations and relies (partially) on *profits*, thus avoiding 'misattribution' concerns as explained earlier. However, it requires the retention of arms length pricing for intra-group transactions in order to calculate the value added and it places a heavy tax burden on labour. It would seem preferable, therefore, to make use of the other micro-factor mechanism, ie the FA. FA attributes larger shares of that group's consolidated profits to those jurisdictions in which (relative to others) there is a large presence of that group's value-creating factors. FA has been applied for many years in the USA and Canada and could be therefore applied for CCCTB purposes.

72. CCCTB Working Group experts will be requested to analyse, in the coming months, whether it is agreeable to concentrate on the formula apportionment method to share the tax base, therefore dropping out the options of a macro-based apportionment and of a VA approach. If this is the case, they will also have to analyse the various factors to be included in the formula, including definitions, evaluation and location of the factors (for instance: which labour costs should be accounted for? How should assets be evaluated? In which countries should sales be located?). It is Commission Services' firm opinion that there should be a uniform formula valid for all Member States, without letting MS freely decide the factors and the weights as it is currently the case in the USA.

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<sup>23</sup> This section summarises very briefly some of the key issues concerning the sharing out of the base. Additional information is contained in the Taxation Paper '*The Delineation and Apportionment of an EU Consolidated Tax Base for Multi-jurisdictional Corporate Income Taxation: a Review of Issues and Options*' by Ana Agúndez-García and in the Taxation Paper '*Formulary Apportionment and Group Taxation in the European Union: Insights from the United States and Canada*' by Joann M. Weiner, in [http://ec.europa.eu/taxation\\_customs/taxation/gen\\_info/economic\\_analysis/tax\\_papers/index\\_en.htm](http://ec.europa.eu/taxation_customs/taxation/gen_info/economic_analysis/tax_papers/index_en.htm).

**Experts are invited to comment on any of the above points. In particular the Commission Services are interested in views on:**

**(i) the choice between a macro or micro approach; including within the micro approach value added or 'formula apportionment'**

**(ii) the use of a common formula and weightings , or different formulae and weightings**

**(iii) the definition and choice of the possible factors under formula apportionment**

#### **IV Work Programme for 2007 and beyond**

73. Overall the initial Work Programme discussed at the first meeting remains valid. It is the intention of the Commission Services that the work carried out in the sub-groups 4 and 5 (on international aspects and on group taxation) should be broadly completed by the summer of 2007. During 2007 the Commission Services would like to see work on the administrative and legal framework completed and work on the mechanism for sharing the common consolidated tax base should be completed in 2008.

74. During 2007 work on tax incentives and anti-avoidance should also start with a view to work being completed, so that the process of 're-visiting' the elements already discussed could be started. Work on the sharing mechanism is starting and is targeted to be completed during 2008. This would enable the Commission to complete the work and present a comprehensive Community legislative measure at the end of 2008.

75. It should be noted that the term 'broadly completed' is deliberately used: no final agreement will be sought until work on all the structural elements has been completed. Even then, as the CCCTB WG is a technical expert group it will take no formal decisions. However, a 'second round' of discussions on the structural elements will need to take place within the WG before legislative drafting begins to ensure that the work on individual elements fits together in a coherent and satisfactory overall approach. The more 'political issues' such as how the base should be optional or compulsory, and how it should apply to specific business sectors or company forms etc will have to be discussed in the appropriate forum.

#### **IV Conclusions**

76. The Commission Services remain convinced that the CCCTB is an important contribution of the taxation policy to the achievement of the Lisbon objectives, since by reducing compliance costs for companies operating cross-border and simplifying and modernising the tax environment it will boost growth and competitiveness of EU enterprises. In addition, by removing existing tax barriers to the proper functioning of the

internal market, it will also eliminate distortions and discriminatory situations that infringe the fundamental freedoms enshrined in the Treaty and would otherwise be tackled by the intervention of the European Court of Justice, with the side effects in terms of budgetary consequences and legislative reactions by MS.

77. The Commission Services reiterate that the CCCTB would not interfere with MS sovereignty on tax matters, and in particular on their freedom to set the tax rates that best fit their domestic policies in terms of public expenditures, provision of services and financing of the social systems. The creation of a common tax base will not remove fair tax competition among MS, but would probably make tax competition more transparent.