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NEW PERSPECTIVES OF EUROPEAN GROUP TAXATION
ON A CONSOLIDATED BASIS

Summary

The thesis has the aim of examining the recent proposals of the European Commission concerning multinational group taxation on a consolidated basis, with particular reference to the projects of *Home State Taxation* and *Common Consolidated Tax Base*, in relation both to the juridical legitimization, as models of tax consolidation, and to the economic legitimization, as instruments of multinationals' taxation.

The first chapter, “*The evolution of EC law concerning group taxation*”, deals with the problem of the particular position that the tax law occupies in the context of the EC law.

Subjects of the research are mainly EU corporate groups, structured in various legal entities (i.e. companies or permanent establishments) resident in different European countries, but subject to a single group's business strategy. For the time being, these entities are treated, for legal and tax purposes, as separate and independent entities and not as an organic business unit, structured in different legal entities, but subject to a unitary business strategy aimed at pursuing a common goal and, as such, may be considered as a single taxable entity.

During the years, this approach of taxation has evidenced numerous negative aspects, causing quite a lot of obstacles when carrying out intra-group transactions in the internal market. These problems gotten worse due to the Euro and will also increase in consideration of the progressive EU enlargement process.

With regard to these matters, the European Commission has pointed out many times the necessity of removing the obstacles that the European multinationals have to face in their business activities, in order to create an effective and efficient internal market. The main solution, from a tax perspective, is surely represented by the adoption of a European tax scheme based on the consolidation model.

The second chapter, “*Group taxation from the economic theory perspective*”, represents a reconstruction of the main international economic doctrine regarding the optimal taxation for multinationals, with the objective to identify the structural elements of an ideal group taxation system, with particular reference to the neutrality, equity and efficiency principles.

In particular, even if the economic doctrine has drawn up many theories in the field of the optimal taxation, a sufficiently complex model able to consider all the tax variables involved in the multinationals’ investment decisions has not yet been elaborated. In any case, some considerations can be obtained through the analysis of the economic theory, which provides that the whole tax burden supported by companies affects their investment decisions and the international location of their business activities. Therefore, the optimal tax system is one in which the tax variable does not affect the economic decisions or, in other words, the optimal tax system has to be efficient and neutral for companies. In this sense, a tax system should provide for: (i) a profit taxation based purely on a residence principle (i.e. profits should be taxed only in the holding company’s country of residence); (ii) the abolition of the deferral principle (i.e. profits should be taxed when produced and not when repatriated); (iii) a full foreign tax credit; (iv) the same treatment for foreign and domestic dividends.

However, equity should also be taken into consideration, in particular with reference to the correct allocation of the taxable base among the countries in which the multinational carries out its business activity. In this sense, therefore, a tax system which provides for an appropriate apportionment formula should be the optimal one, since the taxation right would be granted to those countries that have taken part in the creation of the group’s profits.

In the third chapter, “*The legal model of tax consolidation*”, a comparative analysis of both the domestic tax consolidation model, adopted by numerous European countries, and the worldwide tax consolidation model, adopted by few European countries, is carried out. From the comparative analysis of the domestic tax consolidation models it emerges that, even when European countries adopt different models (i.e. fiscal unit, Organschaft, group contribution and group relief), some structural elements are common to all the consolidation systems applied. First of all, the main effect of all the models is the intra-group offset between profits and losses. Moreover, considering the subjects eligible to the consolidation system, all the models provide for the application substantially to resident corporations only (i.e. partnerships and other entities cannot apply for the tax consolidation regime and non resident entities can form part of the consolidated group only in special cases). A minimum period of

validity is always foreseen and in case of exit from the consolidation regime before the expiry of the minimum period, some negative consequences necessarily occur, mainly in terms of recapture of the benefits granted by the consolidation regime. Once more, a certain degree of integration between the consolidating entity and the consolidated bodies is always required and is generally set forth in the majority of the voting rights or in the majority of the shares, at least. Finally, all the adopted models provide for some anti-elusive rules, for example preventing the carryover of tax losses borne before joining the tax consolidation regime.

As far as the worldwide consolidation regime is concerned, only France, Italy and Denmark provide for this system and the high degree of complexity of the adopted scheme determines its actual limited application. However, the difficulty in meeting all the requirements is justified by the fact that there is no reciprocity between countries' consolidation system, therefore each country is forced to provide for a lot of anti-elusive provisions in order to prevent an abusive use of the worldwide regime. Instead, in a context of reciprocity, at least within Europe, all these requirements would not be needed, with the natural consequence that more and more multinationals would require to join the worldwide consolidation regime.

In short, therefore, it is possible to demonstrate the existence of some elements that various tax consolidation models, adopted at national level, have in common. Such elements could be literally lifted up to an over-national level, setting up a European tax consolidation model, with an unconditional juridical legitimization.

Chapters four and five present the analysis of the *Home State Taxation* and the *Common Consolidated Tax Base* models, the critical aspects of which are also examined. In particular, while the *Home State Taxation* model provides for the taxation of a multinational group on the basis of the domestic tax rules of the *Home State* (i.e. the country of residence of the holding company), the *Common Consolidated Tax Base* model provides for the creation of a new set of rules, at European level, to be applied for the taxation of multinationals on a consolidated basis. Both models require the adoption of a formulary apportionment approach in order to allocate the taxable base determined at group level between the various countries in which each group's entity is resident for tax purposes.

The implementation process of the *Home State Taxation* model is gaining ground through some Communications issued by the European Commission aimed at developing a pilot scheme to be initially applied to small and medium-sized enterprises.

However, this model is not exempt from criticism, like the risk of Home State shopping, discrimination and unfair competition, administrative difficulties and the consequential necessity of a high degree of cooperation between member States, problems of consistency with the tax Conventions in force and all the aspects linked to the choice of an appropriate apportionment formula.

The *Common Consolidated Tax Base* model, instead, is still under consideration by a panel of experts (the so-called “working group”) which is examining all the technical aspects involved. A step forward toward its implementation, in view of reaching the Lisbon agenda objectives, has been taken by the European Commission, recognizing the important role played by the International Financial Reporting Standards as a starting point for the computation of the common taxable base and pointing out the possibility of adopting the model through the enhanced cooperation instrument.

This model also presents some critical aspects however, some of which are the same analysed in the *Home State Taxation* context, while others deal with the necessity of a strong cooperation between member States in defining a new set of rules in the group’s taxation matter and with the quite limited time still available in reaching the objective of introducing the model within 2008.

The last paragraphs of the two chapters contain the main conclusions of the entire research, proving that the models analysed are substantially consistent with the conclusions emerging from the economic theory concerning the optimal taxation systems and that these have an unconditional juridical legitimization in a context of tax consolidation model’s circulation not only on a horizontal ground (i.e. among different domestic tax systems), but also on a vertical ground (i.e. from a domestic ground to a European one).

Finally, chapter six, “*The apportionment of the group’s taxable basis*”, proposes an analysis of the apportionment method, common to both the *Home State Taxation* and the *Common Consolidated Tax Base* models, verifying its main critical aspects, also by using the conclusions reached from the inherent economic theory, and identifying some guidelines on which new EU bill of laws, implementing the European tax consolidation, should be based.

The formulary apportionment method should overcome the current separate accounting method in the allocation of the multinationals’ profits among member States, since it should be more efficient, transparent and should reduce transactional costs. The apportionment

formula is a simplification of the reality and, though less accurate, it makes it easier to identify the country to which the right of taxation belongs.

How to build up the optimal formula has been debated for a long time, but, also considering the experience of United States, Canada and Switzerland that currently adopt an apportionment approach, it seems that a formula based on three microeconomic elements (i.e. sales, payrolls and investments) should be more feasible and more consistent with both practical and theoretical aspects.

However, the apportionment method is subject to an amount of criticism, to be taken into consideration, such as the potential distortions in the profits' allocation and in the location of the multinationals' business activities, in order to affect the elements of the formula and, therefore, shifting profits towards the jurisdictions in which the tax burden is lower. This leads to the necessity of a progressive convergence process in the tax rate among countries, which would grant an efficient application of the apportionment method.

In conclusion, both the *Home State Taxation* and the *Common Consolidated Tax Base* models, from a juridical point of view, can be considered as an evolution at over-national level of the domestic tax consolidation models actually adopted by numerous European tax systems and, from an economic point of view, can be considered as models which tend to an increase both of the efficiency and the equity in multinationals' taxation.

However, it is equally clear that the existence of many critical aspects has not been solved, yet. Therefore, notwithstanding the many positive aspects, there are elements on which an agreement among member States interested in adopting these new models is absolutely needed. In particular, an appropriate apportionment formula must be identified as well as appropriate criteria to define the Home State and proper solutions to the problem of foreign incomes' inclusion, also considering the Convention network in force. Moreover, there is no doubt that both taxpayers and tax administrations must change their administrative activities in the light of a different system of taxation.

In any case, the *Home State Taxation* model appears to be implemented more easily, rather than the other proposals concerning the multinationals' taxation, given the few changes to be introduced in the domestic tax legislations of the member States. For this reason, in fact, this model can represent a long-term transitional instrument towards a solution to the actual tax obstacles in the internal market.