EUROPEAN COMMISSION

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C(2017) 2354 final

Dear President,

The Commission would like to thank the Kamra tad-Deputati for its Reasoned Opinions on the Commission's proposals for Council Directives on a Common Consolidated Corporate Tax Base {COM(2016) 683 final} and a Common Corporate Tax Base {COM(2016) 685 final} that it considers do not comply with the principles of subsidiarity and proportionality.

The Commission takes these concerns seriously and welcomes this opportunity to respond. Before addressing the specific points of the Reasoned Opinions in detail, however, the Commission would like to make some general remarks about the political context of the proposals and their compliance with the principles of subsidiarity and proportionality.

In the explanatory memorandum that accompanies each of the proposals for a Common (Consolidated) Corporate Tax Base, the Commission set out its arguments on why the objectives of these proposals cannot sufficiently be achieved through initiatives undertaken by each Member State on an individual basis. The Commission also explained how EU-wide action could more effectively tackle distortions of a cross-border nature that result from the interaction of national tax systems.

The objectives sought to be achieved through the proposed system essentially aim to tackle problems that reach beyond a single Member State and therefore require a common approach. The proposals respond to the needs for increased growth and job creation in the internal market and also for countering aggressive tax planning. In the Commission's considered view, these challenges do not have a domestic focus, but arise in a cross-border framework. It is namely the interaction between different tax systems that generates opportunities for abuse or facilitates taking advantage of mismatches in the interaction of national corporate tax rules.

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The Commission agrees with the Kamra tad-Deputati that tax policies constitute a policy area of shared competence between Member States and the Union. Article 115 of the Treaty on the Functioning of the European Union[1] *provides the legal base for EU measures in this area, in line with the principles of subsidiarity and proportionality. It is on this basis that the Commission adopted the proposals re-launching the Common (Consolidated) Corporate Tax Base, with the aim of improving the functioning of the internal market through reducing tax-related distortions caused by mismatches, harmful preferential tax regimes, double taxation and non-taxation, selective rulings and sweetheart deals. As explained above, individual uncoordinated initiatives at the national level cannot achieve these objectives. To the contrary, they are likely to exacerbate disparities. The proposals would harmonise the corporate tax base, which is a prerequisite for rectifying the identified distortions in the internal market, but Member States would remain free to decide which tax rate to apply to the share of the base that they are allocated through the formula.*

In response to the more technical comments in the Reasoned Opinions, the Commission would like to refer the Kamra tad-Deputati to the attached Annex.

The Commission hopes that the clarifications provided in this letter address the issues raised by the Kamra tad-Deputati and looks forward to continuing our political dialogue in the future.

Yours faithfully,

Frans Timmermans *First Vice-President*	*Pierre Moscovici* *Member of the Commission*

[1] Article 115 of the Treaty on the Functioning of the EU states that "without prejudice to Article 114, the Council shall, acting unanimously in accordance with a special legislative procedure and after consulting the European Parliament and the Economic and Social Committee, issue directives for the approximation of such laws, regulations or administrative provisions of the Member States as directly affect the establishment or functioning of the internal market.", OJ C 326, 26.10.2012, p. 95.

ANNEX

The Commission has carefully considered each of the issues raised by the Kamra tad-Deputati in its Reasoned Opinions and is pleased to offer the following clarifications.

Implications on domestic tax revenues for Malta

The Kamra tad-Deputati expresses the view that the proposals will inevitably affect domestic tax revenues and the fiscal regime in Malta. It furthermore criticises consolidation and apportionment for influencing national fiscal and budgetary sovereignty. It also points out that some aspects of the Common Corporate Tax Base such as the cross-border loss relief can reduce the tax base significantly, leading to a loss of revenue.

The Commission would like to clarify that, in the absence of detailed actual revenue data from national tax administrations, gathering quantitative evidence on the impacts of the Common (Consolidated) Corporate Tax Base on individual national revenues would be particularly challenging and require the use of both representative and accurate data in the quantification of the future tax charge.

It is worth explaining that the subsidiarity check under Article 115 of the Treaty on the Functioning of the European Union primarily focusses on determining the necessity for enacting a certain envisaged measure at the level of the EU, instead of nationally, in order to ensure that the envisaged objectives can be fulfilled. This does not necessarily include taking into account very detailed national information pertaining to each Member State. Nevertheless, the impact assessment and the three external studies that have been published alongside it provide extensive country-specific results.

The Commission would like to point out that assessing the impacts of a cross-border corporate tax system where more than one jurisdiction is involved is an inherently complex exercise. In fact, this can mainly be done through a model which brings together national data originating in disparate corporate tax systems. Although the modelling exercise that has been undertaken is state-of-the-art, it is clear that there are inherent limits to all such models. Notably, they cannot incorporate all elements of a proposal, including some of the important revenue-raising features, such as the absence of intellectual property box regimes in the common tax base or the impact of eliminating the possibility to reduce taxes through debt shifting. In addition to the work of the Commission, national Ministries of Finance may also use the models and tax return data at their disposal to complement the analysis provided in the impact assessment.

The Commission also wishes to note that Member States' budgetary choices are likely to depend on a variety of factors, all possible combinations of which cannot be modelled and assessed. However, the impact on the revenues of Member States of the Common (Consolidated) Corporate Tax Base will ultimately depend on national policy choices with regard to possible adaptations of the mix of different revenue collection elements. Member States will hence have all the flexibility to control the impacts on tax revenues.

Semi-optional feature

The Kamra tad-Deputati claims that groups with global revenues below the threshold of EUR 750 million will not only be faced with 28 different rulebooks but also with the Common Consolidated Corporate Tax Base and thus may find themselves in difficulty to choose which system is the best for them to apply.

Corporate taxpayers have so far been structuring their business in the EU based on the assumption that they have to comply with a different corporate tax system in each Member State where they maintain a taxable presence. If the Common Consolidated Corporate Tax Base were one of their available options, it would not be just an additional system to the 28 existing ones, as it would have to apply to all EU-resident companies of a single Common Consolidate Corporate Tax Base group. It follows that the choice for groups outside the mandatory scope of the Common Consolidated Corporate Tax Base would be between keeping the current status quo (i.e. continue structuring their business in the EU through a combination of tax systems) or going for the Common Consolidated Corporate Tax Base, i.e. one set of rules for all operations in the EU. The possibility to benefit from this single rulebook will therefore bring about considerable simplification.

Additional administrative burden on tax administrations

The Kamra tad-Deputati criticises the common tax base for placing an additional burden on tax administrations through the co-existence of a mandatory and optional scope in the proposals. Thus, Member States would be encumbered with operating two corporate tax systems in parallel.

The argument of administrative simplicity is primarily relevant to taxpayers and in particular, to those with cross-border activity in the internal market because they will be given the opportunity to settle their tax obligations through one single corporate tax system. When it comes to administrations, it is inevitable that in the first years following the introduction of the Common Corporate Tax Base, they may need to dedicate some additional resources to running it. In the mid-term, however, administrations should be in a position to benefit from the reduction in workload in other areas, e.g. tasks related to transfer pricing compliance within the European Union.

Administrative procedures – interaction with the principal taxpayer

The Kamra tad-Deputati expresses the view that the proposals create a wrong impression that each taxpayer will only be dealing with one tax administration. In reality, individual companies will still need to interact with the principal taxpayer, both in consolidation and during audits.

The "one-stop-shop" approach under the Common Consolidated Corporate Tax Base proposal means that a group uses only one "shop"/"hub" in the European Union for settling its tax affairs and this is the so-called principal tax authority, where the top member located in the European Union of the group is resident for tax purposes. This would inevitably imply that all companies which are members of a Common Consolidated Corporate Tax Base group interact with the "top" group member on the various matters set out in the proposal.

In fact, this is still part of how the "one-stop-shop" approach works. Thus, the principal taxpayer remains the point of contact of a Common Consolidated Corporate Tax Base group with the tax authorities. The fact that, within the group, individual companies have the obligation to keep every record and document bearing proof is primarily linked to compliance with financial accounting, which is not touched upon by the proposal.

No elimination of transfer pricing

The Kamra tad-Deputati rightly points out that transfer pricing formalities will remain in force when it comes to relations with associated enterprises outside a single group, whether in the same or another Member State or outside the EU. It is also correct that these associated enterprises may be applying the Common Consolidated Corporate Tax Base system or not.

The Commission has always been clear that the Common Consolidated Corporate Tax Base eliminates transfer pricing only within a single group and indeed, we are confident that this facility involves a large amount of the overall number of transactions and dealings which are reviewable for compliance with transfer pricing. Eliminating transfer pricing within groups, which is one of the main vehicles for profit shifting, will have a major impact in the fight against corporate tax avoidance.

No further anti-tax avoidance action is required

The Kamra tad-Deputati insists that no extra work is needed combat tax avoidance since there is sufficient input in this field as a result of the outputs of the Code of Conduct on Business Taxation alongside the recently adopted Council Directive laying down rules against tax avoidance practices that directly affect the functioning of the internal market[2] and the pending proposal for a Council Directive amending Directive (EU) 2016/1164 as regards hybrid mismatches with third countries.[3]

The Commission disagrees with the statement that no further action against tax avoidance is needed at Union level. The Commission's Action Plan of June 2015 sets the context for the Directive against tax avoidance practices and the Common (Consolidated) Corporate Tax Base initiatives. The Directive only provided for immediate action to deal with urgent needs within the context of existing national tax systems. The Common Consolidated Corporate Tax Base will eliminate mismatches and loopholes between national systems which are exploited by tax avoiders, including by removing transfer pricing within groups.

Moreover, the Common Consolidated Corporate Tax Base sets objectives that also reach beyond anti-tax avoidance action: it is by itself a fully-fledged corporate tax system, which is designed to have a cross-border dimension and improve the functioning of the internal market. Indeed, an equally critical aspect of the Common Consolidated Corporate Tax Base involves business facilitation, as part of which the new scheme would be expected to promote growth and lead to job creation in the internal market. As far as the Code of Conduct is concerned, it is essential to stress that while this Group has made an important contribution

[2] Council Directive (EU) 2016/1164, OJ L 193, 19.7.2016, p. 1.
[3] COM(2016) 687 final.

to eliminating harmful preferential tax regimes, it does not pass binding laws, which can be legally enforced.

The formulary apportionment is distortive

The Kamra tad-Deputati puts forward the view that the structure of the formula favours labour-intensive economic sectors whilst penalising economies of a limited size with high productivity rates and activities of high added value.

The Commission does not share the view that the formulary apportionment would be distortionary. It should be recalled that the Commission, in the choice of formula factors for the Common Consolidated Corporate Tax Base, based its proposal on a tried and tested methodology. These three equally weighted factors (assets, labour and sales by destination) constitute the so-called 'Massachusetts formula', which the States in the USA have been using – in numerous variations – since the beginning of the twentieth century, for the purpose of charging Franchise Tax (i.e. tax on trading profits at State level). Prior to the proposal of 2011, the Commission modelled different combinations and weights of the formula factors and the results clearly demonstrated that the proposed combination of the three equally-weighted factors offers the best option. It was found that this scheme offers the fairest results and that these are the most resilient to attempts of manipulation and tax avoidance practices.

The allocation of profits through this formula is likely to guarantee a more efficient way for allocating profit within an integrated group that operates in a single market, as compared to traditional transfer-pricing methodologies. This is because the factors have a direct relevance to the real economy since they relate to the key income-producing elements of a company: assets, personnel and sales.

The Commission acknowledges that the formula focuses on elements which are not easy to shift across jurisdictions so that the formula can remain robust and resilient to aggressive tax planning manipulations. Yet, it is also true that, in modern economies, intangible assets play an increasingly important part in the generation of profits. Considering this, the Commission would like to clarify that although intangibles are not included in the assets factor of the formula, they are not ignored either. Specifically, intangibles are taken into account where it is necessary to ensure that the Member State(s) which contributed to the creation of those intangibles (for instance, through giving deductions for research and development) can subsequently secure a taxing right on the profits generated by such successful assets. The Commission remains confident that the proposed formulary apportionment is appropriate and fair, and that it can offer satisfactory solutions to many of the current complications in attributing profits amongst Member States.

The proposal does not preclude an increase in tax competition

The Kamra tad-Deputati puts forward the view that the Common Consolidated Corporate Tax Base does not preclude the possibility of an increase in tax competition since Member States will still be likely to resort to tax rate reductions to attract foreign investment.

Where there is a harmonised tax base, tax competition tends to be transparent and without concealed harmful features. This is because the national nominal and effective rates would roughly coincide. In terms of impact on national tax revenues, a hypothetical increase of

competition on tax rates would have a comparable effect to interventions that limit the scope of the tax base, while the latter create opportunities for aggressive tax planning and tax avoidance. Competing solely on tax rates against the background of a harmonised base would be more transparent, compared to the current situation. The elimination of tax avoidance opportunities would also reinforce citizens' confidence in the way companies are taxed and ensure a more level playing field in the internal market.

The proposal would place additional administrative burdens on tax administrations

The Kamra tad-Deputati puts forward the view that the tax administrations would need to fully cooperate and coordinate their activities to achieve fiscal control, placing additional administrative burdens on tax administrations.

It should be clarified that the argument of administrative simplicity is primarily relevant to taxpayers and in particular, to those with cross-border activity in the internal market because they will be given the opportunity to settle their tax obligations through one single corporate tax system. When it comes to tax administrations, it is inevitable that in the first years following the introduction of the Common (Consolidated) Corporate Tax Base, they may need additional resources but in the mid-term, tax administrations should be in a position to benefit from the reduction in workload related to transfer pricing compliance within the EU.