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**COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN
PARLIAMENT, THE COUNCIL AND THE EUROPEAN ECONOMIC AND SOCIAL
COMMITTEE**

**Implementing the Community Programme for improved growth and employment and
the enhanced competitiveness of EU business:
Further Progress during 2006 and next steps towards a proposal on the Common
Consolidated Corporate Tax Base (CCCTB)**

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1. BACKGROUND

This Communication outlines progress to date on the CCCTB under the outline Work Programme established in 2004. It concentrates on the work done during 2006, highlighting some of the more noteworthy issues which have arisen and recapping on some of the key strategic issues related to the CCCTB.

The 2006 Communication¹ explained the background to and objectives of the CCCTB and announced that a further progress report would be prepared in 2007. These objectives remain valid, as there have been few decisive developments since then to remove the tax obstacles in the Internal Market.

The Council discussed the Communication in June 2006 but adopted no conclusions. The Commission made a further oral report on progress to the Council in December 2006. The CCCTB is an ambitious objective which poses a number of technical difficulties for Member States. Further efforts are needed to reach a consensus. There has been some progress in some very specific areas, for example the adoption of a Code of Conduct on documenting transfer pricing² and Guidelines for Advanced Pricing Agreements in the EU³, and the Commission issued three Communications in December 2006⁴ on the need for increased coordination between Member States as regards their tax systems and one on tax incentives in favour of research and development⁵. However, the Commission remains convinced that although these targeted measures will go some way to reducing some of the obstacles, a comprehensive approach via the introduction of the CCCTB can provide the largest overall benefits as regards the taxation of companies' profits in the Internal Market. Thorough preparation is however necessary.

The implementation of the CCCTB could make a significant contribution to the success of the Internal Market, to improved growth and employment and to the enhanced competitiveness of EU business in the world in line with the renewed Lisbon strategy⁶. In addition, the EU could become a more attractive market for investment and this should lead to increased intra-EU investment and foreign direct investment.

¹ Implementing the Community Lisbon Programme: Progress to date and next steps towards a Common consolidated Corporate Tax Base (CCCTB) - COM(2006) 157.

² Code of conduct on transfer pricing documentation for associated enterprises in the EU (EUTPD), published with the Commission Communication on the work of the EU Joint Transfer Pricing Forum on transfer pricing documentation for associated enterprises - COM(2005) 543, 7.11.2005 - adopted by the Council on 27 June 2006.

³ Communication on the work of the EU Joint Transfer Pricing Forum in the field of dispute avoidance and resolution procedures and on Guidelines for Advance Pricing Agreements within the EU - COM(2007) 71.

⁴ COM(2006) 823, COM(2006) 824 and COM(2006) 825, 19.12.2006.

⁵ COM(2006) 728, 22.11.2006.

⁶ Implementation of the Community Lisbon programme – Communication from the Commission to the Council and the European Parliament – The contribution of tax and customs policies to the Lisbon Strategy - COM(2005) 532, 25.11.2005.

The objectives of this Communication are:

- to keep the Council, Parliament, the European Economic and Social Committee and the public at large informed of progress,
- to outline the plans for continuing the work, and
- to recap on and to draw attention to some of the specific technical points which require particular attention and a number of particularly important issues which have a more strategic dimension.

2. PROGRESS TO DATE

2.1. Activities of the Common Consolidated Corporate Tax Base Working Group (CCCTB WG)

The CCCTB WG has continued to meet on a quarterly basis. In addition to the first four sub-groups (assets and depreciation, provisions and reserves, taxable income, international aspects), two further sub-groups, dealing with group taxation and the sharing mechanism, have been set up. The main issues discussed in the WG (in addition to the reports from the sub-groups) were summarised in a Working Document⁷ presented to the December 2006 meeting.

Part of this December 2006 meeting was held in "extended" format with representatives from business and academia in attendance to discuss the CCCTB. This followed a similar extended meeting in 2005. A more specialised extended meeting was held in June 2006 with business experts from the financial sector to discuss the particularities of this sector. The purpose of these meetings has been to ensure that there is adequate consultation and that the Commission and Member State experts are able to benefit from the collective expertise of business practitioners and academic experts.

As explained in the 2006 Communication, no formal agreement on issues is sought in the sub-groups or the Working Group but it is possible to identify those issues where there is a reasonable degree of common ground and those issues which will require hard decisions when the Commission comes to finalise its legislative proposal. Additional expert opinion from beyond the Commission and Member State administrations on these latter points can be particularly helpful.

The Working Document included progress reports on the work on Taxable Income, International Aspects, Personal Scope, Financial Institutions, Consolidation, and the Administrative Framework. Some specific technical points relating to each issue were singled out for particular attention. Some of these technical points are summarised in Annex 1. The full details are available on the relevant web pages.

⁷ CCCTB/WP/046 20 November 2006 'Progress to date and future plans for the CCCTB'; available on the following web-page:
http://ec.europa.eu/taxation_customs/taxation/company_tax/common_tax_base/article_3147_en.htm.

In order to consolidate the base a method for sharing the base has to be agreed. The subject was first raised at the December 2006 meeting and discussions have only recently started. It has to be ensured that the mechanism produces fair and equitable results.

2.2. Progress outside the Working Group – Impact Assessment

In accordance with current practice, the legislative proposal will be preceded by an Impact Assessment drafted in accordance with the key analytical steps laid down in the 'Impact Assessment Guidelines'⁸. The Impact Assessment will describe the corporate tax obstacles that deter EU companies from exploiting all investment opportunities across the Internal Market in their EU-wide cross-border activities, and the scope for tax avoidance and tax evasion that the current system offers to companies. The difference in compliance costs between small and medium sized enterprises and multinational enterprises will be one of the elements of the assessment. It will define the objectives to be achieved by the tax reform, ranging from the general objective of making corporate income taxation systems simpler and more efficient, so that the Internal Market works better, to the specific and operational objectives, such as reducing the compliance/administrative costs of corporate taxation for firms and tax administrations, favouring the emergence of new cross-border activity, including particularly of small and medium sized enterprises, promoting tax neutrality between purely domestic and EU-wide investments, and minimizing distortions to the international allocation of investment and tax bases.

A number of alternative policy options will be identified and their respective economic, environmental and social impacts assessed in-depth, in qualitative and where possible quantitative terms. The alternatives will include at least a 'no-change' scenario, a common base without consolidation and a common consolidated base. It will aim to assess the most relevant macroeconomic and microeconomic impacts as well as the impact on tax revenues of the alternatives. Several possible pathways towards achieving the CCCTB will be assessed, based on an evaluation of its key components. Due consideration will be given to the principle that any step towards the CCCTB should have a fair impact on the Member States' public finances, possibly leading to an overall increase of revenues reflecting an enhanced dynamism of the EU economy.

Work on this started in 2006 and the final Impact Assessment will be published when the proposal is made. The depth of the quantitative assessment will depend to a certain extent on how much quantitative data Member State administrations and companies are willing and able to provide in time.

3. THE NEXT STEPS

With work on most of the major structural elements of the tax base, consolidation and the sharing mechanism underway the next step would be to bring together all these different areas to discuss how these different parts can fit together. This 'second round' of the work will be aimed at ensuring that there are no

⁸ SEC(2005) 791, 15.6.2005, with March 2006 update.

inconsistencies and the base as developed can be considered a workable proposition, 'fit for purpose'.

As discussed in the 2006 Communication, the creation of a single base inevitably means that there will be differences between this new base and the current individual tax bases. Member States will have to accept that the CCCTB cannot replicate all the features of all their existing tax bases, and will in some cases propose a different treatment of specific items from their existing base.

For many of the detailed technical issues the Commission will have to make a clear choice between one or more specific possibilities and will do so on the basis of the ongoing work in the WG, internal research and consultation with business and academia. Some detailed technical issues which have been discussed in the Working Group and which the Commission is still reflecting on are included in Annex 2.

There is also a second category of choices which the Commission will have to make where there is clearly a greater 'political' element to take into account in choosing one approach or another. Both general economic policy and the best interests of the European Community, particularly with regard to the programme for improved growth and employment and enhanced EU business competitiveness and a stable development of government finances, will be fundamental elements of these decisions. Some of the choices to be made were outlined in the 2006 Communication and the Commission indicated its position, explaining how it had arrived at its conclusions. Some of the main issues highlighted were that:

- the Common Corporate Tax Base should be accompanied with consolidation to fully reap the benefits of this process,
- the CCCTB should be optional (companies should be able to remain within the existing rules where these are maintained alongside the CCCTB by Member States, or opt for the CCCTB, providing the rules on State aid are observed).

The Commission also confirmed that it does not intend to extend the work on the base to include the rate and this is still the case. It also stated that it believed that the CCCTB should be uniform and should generally simplify and broaden the corporate tax base. Uniformity and simplification are therefore guiding principles of the work to date and the new base should be 'broad' rather than 'narrow'.

It is generally accepted by many economists that a broad tax base with low tax rates is the most economically efficient, having both the least and fewest potentially distortionary effects. The practical implications of this approach are that there will be fewer incentives and exceptions, given in particular that provision for cross border consolidation will itself result in a slight decrease in the size of the taxable base as relief for losses is more consistently and rapidly available than at present. Thus, specific reliefs and incentives should be limited in number and properly targeted and justified and these, such as research and development tax incentives, will be discussed in the Working Group. Fines of a sanctioning nature would not be deductible.

Two key policy issues to emerge during 2006 concerned the financial sector and the administrative framework for the CCCTB. As regards the financial sector, the

extended meeting attended by experts from the sector in June 2006 confirmed that there is a degree of support for including the sector in the CCCTB. The alternative of a separate system, or complete exclusion, does not currently attract a great deal of support. However, there is less consensus over the nature of the specific rules needed within the CCCTB to take into account the characteristics of the sector. Further work on this is needed. In particular, it seems very likely that any general method used for the sharing mechanism would also have to be amended to take into account the particularities of the sector.

As regards the administrative framework, work is still at a relatively early stage. There have been some discussions in the Working Group on possible approaches and some sections of business have strongly advocated some form of 'one stop shop' so that EU groups of companies only have to deal directly with one administrative authority. Within the individual sub-groups, the issue of which authority should be responsible for which aspects of tax compliance has also been raised and during 2007 further work will be carried out. These two issues will have a major impact on the form of the proposal and the Commission will therefore be seeking to draw conclusions on:

- the extent to which, and manner in which, the financial sector should be incorporated into the CCCTB from its inception,
- the administrative framework of the CCCTB, in particular how cooperation and mutual assistance can be improved and how the necessary new working methods at Community level can be introduced.

The proposal presented in 2008 will reflect the conclusions that the Commission reaches on these issues in the light of the ongoing work.

4. CONCLUSIONS

The CCCTB Working Group has been set up and provides the necessary mechanisms for discussions with experts from Member State administrations, business and academia. In addition, the Commission will continue to consult outside experts on an ad hoc basis to further the work. As noted in 2006, the work requires significant staff resources from both the European Commission and Member States. This requirement continues but the European Commission continues to prefer to involve Member State experts in technical work to the greatest extent possible.

To conclude:

- The need for the CCCTB remains, both for small and medium sized enterprises, where compliance costs are of particular importance and for large multinational enterprises. The Commission is committed to making rapid progress towards the abolition of corporate tax obstacles in the internal market while also taking account of the Member States' concerns on the process and remains committed to presenting a legislative proposal in 2008.
- The Commission will continue to work with the Working Group and outside experts on a technical basis to resolve these specific issues and arrive at a balanced proposal. Several specific issues are highlighted above and in the

Working Document CCCTB/WP/046 20 November 2006 'Progress to date and future plans for the CCCTB'.

- The Commission would like to draw the attention of the Council, Parliament and the European Economic and Social Committee to the more major general elements of the CCCTB particularly the following as described in this Communication:
 - the consolidation component of the CCCTB and the necessary fair and equitable sharing mechanism and its impact on Member States' revenues,
 - the optional nature of the CCCTB,
 - the treatment of the financial sector,
 - the administrative and judicial framework for the CCCTB.

Further input from the Member States would also be welcome on how the process towards creating the CCCTB can best address their concerns.

The final proposal will reflect several decisions concerning the overall approach taken in the CCCTB and input at this stage is important. However, the Commission confirms that it does not intend to extend the work to cover tax rates.

ANNEXES

ANNEX 1

SOME SPECIFIC TECHNICAL POINTS DISCUSSED IN THE DECEMBER 2006 EXTENDED CCCTB WORKING GROUP MEETING

The deductibility of certain items related to specific domestic situations such as social contributions and taxes other than corporate income taxes. As the base will be consolidated and shared out between Member States, the question is whether these specific items should be deductible from the consolidated base, and therefore shared out, or deductible only from the relevant Member States' individual shares.

The main principle for the taxation of residents (worldwide or territoriality) and how double taxation should be eliminated (credit or exemption method). Currently Member States do not have a common approach and a method must be devised which provides sufficient commonality to safeguard the common tax base, while bearing in mind the existing network of bilateral conventions which Member States have entered into with third countries.

The definition of the CCCTB group for consolidation and the mechanism for consolidating the group companies. Which related companies should be permitted and/or required to consolidate their profits and losses? How should intra-group transactions be eliminated to avoid arm's length pricing complexities?

ANNEX 2

SOME DETAILED TECHNICAL ISSUES WHICH HAVE BEEN DISCUSSED IN THE CCCTB WORKING GROUP AND WHICH THE COMMISSION IS STILL REFLECTING ON

Discussed in 2005:

Fixed assets and depreciation. Qualifying assets may be depreciated either on an individual basis, which would require that the useful life of every individual asset be estimated when purchased (in line with common rules applicable across the EU) and depreciated individually over its useful life, or qualifying assets may be depreciated in one or more 'pools' with a common assigned life. In the Commission's view there are significant advantages to developing the pooling method in the CCCTB.

Deductions for provisions. Provisions may be generally non-tax-deductible, supplemented by a list of tax deductible exceptions, or provisions may be generally tax deductible, supplemented by a list of non-tax-deductible exceptions. In the Commission's view, tax deductible provisions should be defined, supplemented by a list of non-deductible exceptions.

General methodology. The initial starting point for the calculation of the tax base of a company may be by reference to the comparison of opening and closing balance sheets or by reference to the profit and loss account of the company. The former requires the preparation of a 'tax balance sheet' under commonly defined rules, including the profit and loss account. The latter requires only the profit and loss account to be commonly defined in the CCCTB legislation; balance sheet information can be verified by reference to the financial accounts. In the Commission's view, a tax balance sheet is not necessary and represents an additional administrative burden.

Discussed in 2006:

Local taxes. In some Member States there are local taxes, set at a relatively high level. These can be either deductible against the consolidated base, and hence included in the sharing mechanism, or retained at national level and deducted only against the relevant Member State's share of the consolidated base. In the Commission's view, it is generally preferable to provide for as comprehensive a set of rules as possible, avoiding national 'derogations' or additional taxes as much as possible. However, the full implications require further study as 'sharing' the deductions related to local taxes across the EU but not 'sharing' the national taxes levied on the base could create inconsistencies.

Foreign income. Foreign income can either be excluded completely from the CCCTB, or it can be incorporated in the CCCTB and a method devised for including it in the consolidation and sharing mechanism. The question arises because the different methods of avoiding double taxation currently followed by Member States under their existing legislation and bilateral treaties with third countries must be taken into account. In the Commission's view, it is preferable to design a method which incorporates foreign income in the CCCTB, supplemented where appropriate by a form of relief to avoid double taxation. The Commission is still reflecting on the precise arrangements for relief.

Group definition. A detailed definition of what constitutes a group of companies for consolidation will be required. In addition to defining a common acceptable level of ownership the range of possible ownership structures creates difficulties. Where, for example, a foreign company owns a series of EU companies, and is itself owned by an EU company, it seems preferable that all the EU companies in the group should be consolidated. However, some experts prefer to keep EU companies separate when the chain of ownership is broken by a foreign entity and a way of resolving this issue must be found.

Intra-group transactions. The avoidance of transfer pricing problems is a major benefit of consolidation. However, there are a number of ways of eliminating intra-group transactions when consolidating the base. They could be ignored, recognised at cost or recognised at the current arm's length price. Each has advantages and disadvantages and the Commission must decide which method is preferable, or whether it would be possible to permit each group a choice of methods.

Sharing mechanism. In addition to the fundamental question of whether a macro, value added, formula or combination approach should be adopted, there are several detailed definitional questions. For example, under a formula approach the weightings of each possible factor and the exact items to be included in each factor need to be examined in more detail before any decision can be taken. Even the apparently 'simple' factor of labour raises questions such as how 'outsourced' labour should be treated and in which Member State labour costs should be recognised as a factor for employees who work in more than one Member State.