

# Public consultation on the Re-launch of the Common Consolidated Corporate Tax Base (CCCTB)

European Commission

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Notice: Headings 2 and 3 refer to general information about the Cologne Institute of Economic Research and the publication of the responses.

## 1 Introduction

European Commission (EC): Europe's priorities today are to restore growth and promote investment and job creation within a fairer and deeper Single Market. Europe needs a framework for fair and efficient taxation of corporate profits, in order to distribute the tax burden equitably, to contribute to the sustainability of public finances, to promote sustainable growth and investment, to diversify funding sources of the European economy, and to strengthen the competitiveness of Europe's economy.

Corporate taxation is an essential element of a fair and efficient tax system. It is an important source of revenue for Member States and an important factor in influencing companies' business decisions, for example on investments and research & development (R&D) activities.

Recent developments have shed light on the widely shared view that the current rules for corporate taxation no longer fit the modern context. Corporate income is taxed at national level, but the economic environment has become more globalised, mobile and digital. Business models and corporate structures have become more complex, making it easier to shift profits.

For instance, corporate tax rules which are conceived to exclusively function in a domestic framework may increasingly run the risk of leading to market distortions if taxpayers can easily circumvent them when they operate internationally. These distortions often derive from differences in tax laws and take the shape of aggressive tax planning practices whereby taxpayers can take advantage of disparities between national tax systems to derive tax benefits against the spirit of the law. Such a playing field no longer contributes to 'healthy' tax competition.

Given that Europe's priority today is to promote sustainable growth and investment within a fairer and better integrated Single Market, a new framework is needed for a fair and efficient taxation of corporate profits.

On 17th June 2015, the Commission published an Action Plan for a Fairer and Efficient Corporate Tax System and proposed five key areas for action in the coming months (COM (2015) 302). The Action Plan, which takes the form of a Communication, contributes to the aim of establishing a system of corporate taxation whereby business profits are taxed in the jurisdiction where value is actually created. The re-launch of the CCCTB lies at the heart of the Action Plan. It is presented as an overarching objective which could be an extremely effective tool for meeting the objectives of fairer and more efficient taxation. It features as the main tool for fighting against aggressive tax planning, incorporating recent international developments, attributing income where the value is created.

The Action Plan calls for a renewed approach to the pending proposal whereby the main amendments will be the following:

- Firstly, the re-launched CCCTB will be a mandatory system, which should make it more robust against aggressive tax planning practices.
- Secondly, it will be deployed in two steps because the current proposal is too vast to agree in one go; efforts will first concentrate on agreeing the rules for a common tax base, and consolidation will be left to be adopted at a later stage.

In practical terms, the Commission is planning to table two new Proposals: the first instrument will lay down the provisions for a Common Corporate Tax Base (CCTB) whilst the second will add the elements related to consolidation (i.e. CCCTB). Once this new legislative framework (henceforth referred to as CCTB/CCCTB) has been adopted by the Commission, the currently pending proposal will be repealed.

There is no doubt that a fully-fledged CCCTB would make a major difference in reinforcing the link between taxation and the jurisdiction where profits are generated. Yet, it is clear that it would take time to reach agreement on such an extensive piece of legislation. Bearing this in mind, the Action Plan suggests that Member States continue working on some international aspects of the common base which are linked to the OECD project on Base Erosion and Profit Shifting (BEPS) while the 're-launch' proposals are under preparation. According to the Action Plan, agreement to convert these BEPS-related elements into legally binding provisions should be achieved within twelve months.

The fully-fledged CCCTB would offer cross-border loss relief within the group as an automatic outcome of consolidating the tax bases of two or more group members. To compensate for the absence of consolidation in the first step (CCTB), the announced initiative to re-launch the CCCTB is planned to include enacting a facility for giving temporary cross-border loss relief. According to this, groups would be able to set off their profits in a Member State against losses incurred in another Member State until the loss-making group member goes back into making profits. This would remove a major tax obstacle for businesses.

A new impact assessment is being prepared to assess the impacts of the CCCTB; it is envisaged to build on and refine the previous economic analysis. The impact assessment will, in particular, analyse separately the CCTB and CCCTB, i.e. a corporate tax system without and with consolidation. In addition, the analysis will be expanded to take into account the effects anticipated through certain new developments, such as addressing debt bias in corporate taxation and further promoting R&D.

The Commission has shown its strong commitment for fairer corporate taxation in its Action Plan of 17th June 2015. Consulting the public is one of the major steps in the process of proposing legislation in the EU. This consultation will help the Commission gather information and analyse the necessary evidence, in order to determine possible options for attaining the objectives of the re-launch of the CCCTB.

This consultation seeks to gather views in particular on the following:

- To what extent the CCCTB could function as an effective tool against aggressive tax planning, while contributing to a favourable investment climate.
- Which criteria should determine the companies subject to the rules of a mandatory CCTB/CCCTB.
- Whether companies not subject to the mandatory CCTB/CCCTB (i.e. those which do not fulfil the conditions on which the CCTB/CCCTB becomes mandatory) should be given the possibility to opt for applying the common rules.
- Whether the staged approach, as announced in the Action Plan, whereby priority will be given to agreeing the tax base before moving to consolidation, would be preferable, es-

pecially if one considered that the currently pending CCCTB proposal is an extensive piece of legislation on which progress has been very slow.

- Whether, in the short-term, it would be useful to agree common rules for implementing certain international BEPS-related aspects of the common tax base based on the current proposal until the Commission adopts the new (revised) CCTB/CCCTB proposal.
- Which more detailed parts of the common tax base should be reviewed.
- How the debt bias issue should be addressed. Corporate tax systems usually favour debt over equity by allowing the deductibility of the cost of debt only. Such debt bias could be addressed either through tax deductions for costs of both equity and debt financing or neither source of financing could benefit from tax deductions (Details about solutions are discussed in this Taxation Working Paper).
- Which types of rules would best foster R&D activity. The vast majority of Member States and other advanced economies offer fiscal incentives for expenses on R&D. Their design differs across countries, for example in how the incentive is applied and what type of expenditure is covered, e.g. salaries of researchers, R&D equipment and other costs (A recent study on R&D tax incentives commissioned by DGs TAXUD and GROW compares design of R&D tax incentives across countries).
- Whether a cross-border loss relief mechanism aimed to balance out the absence of the benefits of consolidation during the first step (CCTB) would promote business interest and support for the CCCTB.

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## 4 Policy directions

**EC: The Commission believes that the CCCTB system can be an effective tool against aggressive tax planning and at the same time retain its attractiveness to the business.**

Cologne Institute for Economic Research (IW): It would be highly appreciated if corporate tax regimes were mainly based on economic principles. In contrast, taxation schemes are often based on political reasons and suffer from inadequate economic incentives. Therefore, we support the general idea of profit taxation in accordance with the location where economic value is generated. This could help reducing aggressive tax avoidance since taxation would be based on evident economic figures that are hardly subject to planning approaches.

The crucial aspect is how the added value can be measured from an economic perspective. The general approach to use a combination of sales, number of employees and capital invested seems reasonable. However, it does not reflect relevant differences between industries or business circumstances such as the price level or the availability of skilled labour. Therefore, from a company perspective this rather broad allocation key might be misleading. As a consequence, companies should be allowed to choose at least among a couple of different allocation keys. In this regard, other key financials or criteria such as R&D expenses, number of patents, etc. could be considered.

The main goal of any new tax policy regime should be to promote competition and economic growth by ensuring a fair and transparent system within the EU but also compared to regions

outside the EU since globalization leads to global competition. This means a level playing field for companies operating worldwide.

EC: The Commission envisages re-launching the CCCTB in a staged approach which will consist of two steps: Firstly, agreement on the tax base, secondly, moving on to consolidation.

### **What are your views on the staged approach?**

IW: From an economic perspective there is no reason for a staged approach. Both steps belong together. Therefore, in general it is recommended to prepare a convincing system and to implement it as a whole. This minimizes the risk of failure to implement step two.

However, we understand that political support would eventually not be sufficient to implement the CCCTB system in one integrated step. Hence, the main argument for a staged approach is a politico-economic one.

Assuming that only the CCTB without the consolidation concept will be implemented in the beginning, it has to be ensured that a cross-border-loss-relief is part of the CCTB. If not, double taxation might occur and European companies would be at a disadvantage in the global competition.

EC: It is a priority of the Commission to promote discussion in Council of certain BEPS-related international aspects of the common base before the re-launched CCCTB is proposed. The aim will be to arrive at consensus on how to implement certain OECD anti-BEPS best practice recommendations in a uniform fashion across the EU. The intention would be to create a common playing field in defending the Single Market against base erosion and profit shifting.

### **What are your views on agreeing on such a common approach?**

IW: It is quite obvious that a formulary apportionment as the CCCTB would significantly change the rules of international taxation. It is a completely different approach compared to the existing scheme based on the arm's length principle and transfer prices. In many countries which follow the OECD Transfer Pricing Guidelines, e.g. Germany, only the so called standard methods are allowed in order to calculate transfer prices. Any profit split methods based on a formulary apportionment are not accepted by the tax authorities.

Against this background, CCCTB and BEPS are not fully in line with each other. Among the 15 action points of the BEPS project there are some that refer to transfer prices (e.g. Action Points 8-10 and 13). Similarly, the existence of patent boxes contradicts the idea of the CCCTB. As a consequence, a formulary apportionment system would neglect these action points and, thus, the BEPS-project. CCCTB as well as the arm's length principle are a tool to fight tax avoidance. An open discussion is needed which approach is more suitable. This should include the resulting red tape burden for companies.

Furthermore, at the moment it is absolutely unsure when and how the national governments of the EU and the G20 will implement the action points of the BEPS-project. This might postpone the CCCTB as well as CCTB significantly. However, this is not favourable. Hence, a strong coordination with the anti-BEPS initiative of the OECD and the G20 is needed.

## **5 Scope, Anti-avoidance**

### **5.1 Scope of the CCTB/CCCTB proposal**

EC: The Commission considers making the new proposal for a CCCTB obligatory for all EU companies which are part of a group. A group can be formed:

- Between parent and subsidiary companies where there is a holding of more than 50 % of the voting rights; and direct or indirect holding amounting to more than 75 % of capital or more than 75 % of the profit rights); or
- between a Head Office and its permanent establishment where a company has one or more permanent establishment in other Member States.

#### **What are your views on making the proposal for a CCCTB obligatory for all EU companies which are part of a group?**

IW: The proposal for a CCCTB means increasing red tape costs for companies, at least in the beginning. This might be justified due to the expected success in terms of fighting aggressive tax planning and lowering compliance costs in the long run. However, an important issue in this regard relates to internationally operating SME, which have to stick to transfer pricing regulation. For those smaller companies, the red tape costs might become relatively high and can hamper future investments and success.

The tax planning opportunities of those companies are already limited due to rather low international activities and turnover. Therefore, companies below a certain threshold should not be obliged to apply the CCCTB but to opt in on a voluntary base.

EC: The Commission envisages providing the following option:

Companies which would not be subject to the mandatory CCCTB – because they do not fulfil the requirements of being part of a group – could still have the possibility to apply the rules of the system.

#### **What are your views on offering non-qualifying companies the option to apply the rules?**

IW: It is suitable to give other companies the option to apply the CCCTB in order to ensure fair competition between national and multinational enterprises. This might work as a preparation for going global.

### **5.2 Anti-avoidance elements**

EC: In view of recent developments, the CCCTB system should include more robust rules to defend itself against aggressive tax planning.

## **Which of the elements of the CCCTB system would you reinforce so that the system can better respond to tax avoidance?**

IW: The CCCTB would replace the existing transfer pricing rules in general. In this regard, the following aspects have to be considered:

### **Exit taxation rules:**

Germany was one of the first countries setting up exit taxation rules when it comes to business relocation. The idea is to tax the net present value of the future profits based on planning figures. This represents a notable restriction of restructuring processes. This is a risk for jobs as well as the sustainable success of the company. In this regard, a harmonization is needed within the EU but also outside. If not, MNE headquartered in the EU would be at a disadvantage in the globalized world.

### **Debt bias:**

From an economic point of view it is important to set up the taxation system in a way that investment decisions are not distorted due to taxes. This can be achieved by guaranteeing the neutrality between debt and equity. Minimum equity requirements are useful in order to ensure a stable development of a company. Currently, debt is preferred in many countries in terms of taxation. This is not favourable.

## **6 Hybrid Mismatches, Research and Development**

### **6.1 Hybrid mismatches**

EC: Hybrid mismatches are the result of disparities in the tax treatment of an entity or financial instrument under the laws of two or more States. Currently, arrangements can be set up to exploit such mismatches for the purpose of lowering their overall tax burden. The risk of such arrangements would be removed in transactions between enterprises applying the common tax base rules within a consolidated group. It would however persist in relations with enterprises outside the common rules as well as during step 1 of the staged approach to a CCCTB, in the absence of tax consolidation amongst the companies applying the common rules.

One option to address hybrid mismatches would be to require enterprises to follow in a Member State the classification of entities and/or of financial instruments adopted in the other Member State or the third country which is party to the transaction.

### **In your view, can hybrid mismatches be effectively addressed through any other measures than the one suggested above?**

IW: Tax planning is only one reason for hybrid mismatches. In this regard, it is important to set up a straight system that ensures the same treatment in different countries. This can prevent a double-non-taxation.

## 6.2 Treatment of costs for Research and Development

EC: In the currently pending CCCTB proposal, the Commission has proposed a favourable treatment of costs for Research and Development (R&D) by making these costs fully deductible in the tax year they are incurred, with the exception of costs relating to immovable property.

### What are your views on the existing framework for R&D?

IW: R&D expenses are key for industrialised countries in order to maintain their strong position and welfare. Therefore, the governments should offer incentives for companies to spend more on research and development. We therefore approve of a favourable treatment of R&D related costs. However, the existing framework lacks a clear definition of those costs. This needs to be addressed in order to achieve the goal stated above.

EC: One option for rendering the CCCTB more favourable to promoting R&D could be to introduce more generous provisions for deducting R&D costs, such as super deductions which are currently applied by a number of Member States (e.g. Croatia, the Netherlands and the UK)?

### What are your views on making the existing framework for R&D more favourable?

IW: While some EU member states have already established tax incentives, others do not. In countries like Germany, the government does not offer indirect incentives in a way that e.g. expenses can be deducted with a higher factor. Hence, changes are needed in order to achieve a level playing field. This is a precondition for the CCCTB as well as the CCTB.

There are several possibilities to stimulate R&D from a tax perspective. Full deductibility of R&D costs in the tax year in which they incur is a reasonable starting point. Alternative measures such as deducting the costs with a higher factor or deducting a share of the R&D costs from the tax burden should be evaluated as well in order to find the best way to boost R&D.

## 7 Debt-Equity Tax Bias, Cross-Border Loss Relief

### 7.1 Debt-Equity Tax Bias

EC: Corporate tax systems usually favour debt-financing over equity-financing by treating interest payments as a tax deductible expense with no equivalent deduction for the return paid to equity.

### Should debt bias be addressed in the proposal?

IW: The debt bias, e.g. in Germany, leads to distortions of economic decisions since it prevents financial neutrality. It makes a difference for companies if investments are financed via debt or equity. Therefore, many companies prefer financing investments by loans. However, this increases their financial exposure and means a risk for the stability of the company. Higher leverage ratios might lead to illiquidity. Furthermore, especially start-ups have to face significant

problems in financing their projects because it is more difficult for them to get loans. They depend on equity which is at a disadvantage compared to debt.

The absence of any distortions is also important from a global perspective since European companies have to compete with enterprises located outside the EU.

**EC:** The corporate tax debt equity bias could be addressed via three possible policy options:

- Option 1 is the Comprehensive Business Income Tax (CBIT) that disallows any financing costs as deductible expense.
- Option 2 is the Allowance for Corporate Equity (ACE) that allows the deductibility of actual interest payments and of a notional interest on equity.
- Option 3 is the Cost of Capital Allowance (COCA) that allows the deductibility of a notional interest on capital (equity and debt).

**In your view, which option would be best suited to address the corporate debt bias?**

**IW:** In general, CBIT would correct the debt bias by abolishing the deductibility of interests. However, CBIT would lead to higher capital costs and has therefore restrictive effects on investments and growth. Therefore, this is not a favourable approach.

COCA would ensure the same treatment of debt and equity. However, it would refer to hypothetical cost of capital for both debt and equity. Therefore, it does not take into account real figures. This might also lead to distortions.

ACE would also ensure that debt and equity are treated in the same way from a tax perspective. Since it allows the deduction of real interest payments, it is closer to the business practice and prevents distortions in a better way than the alternative approaches. Furthermore, it could boost investments since it lowers the cost of capital for investments financed by equity compared to the current situation. In conclusion, ACE might best contribute to the goal of economic growth.

## **7.2 Temporary mechanism for cross-border loss relief**

**EC:** The Commission envisages proposing a temporary mechanism for cross-border loss relief with recapture until the consolidation step (CCCTB) is agreed. The aim will be to balance out the absence of the benefits of consolidation during the first step (CCTB) of the proposal.

**What are your views on such a temporary mechanism for cross-border loss relief?**

**IW:** In general, a comprehensive implementation of the CCCTB would be favourable in order to achieve the main goals. However, if a step by step procedure is preferred due to political reasons, cross border reliefs would work as a compensation for the missing advantages of the consolidation. Therefore, such a relief is absolutely needed.

## 8 Final remarks, additional information

### EC: Is there anything else you would like to bring to the attention of the Commission?

IW: The CCCTB would mean a significant reform of the current tax regime in the EU. The concept has to be evaluated together with the anti-BEPS initiative since the two approaches are not completely in line with each other.

The stimulation of fair tax competition and economic growth should be the main goals when changing the tax regime. The competitiveness of the companies located in the EU has to be ensured also compared to companies outside the EU.

Due to the magnitude of the project and to the previous experiences it will take time to implement the new tax regime. Furthermore, the different interests of the member states might make the reform even more complex than it already is. In this regard it is most important to find an approach on which all member states agree in order to achieve the level playing field in the European Union.

It might be an idea to set up the CCCTB system temporarily as a non-binding option. This can help to identify the key aspects of the system based on empirical evidence.

In conclusion, the CCCTB regime should be created with caution and by considering many relevant details in a technical but also political way. If so, the CCCTB might work as a reliable and sustainable corporate tax regime in the future.