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Questions and Answers on the CCCTB

What is the Common Consolidated Corporate Tax Base (CCCTB)?

The Common Consolidated Corporate Tax Base is a single set of rules that companies operating within the EU could use to calculate their taxable profits. In other words, a company or group of companies would have to comply with just one EU system for computing its taxable income, rather than different rules in each Member State in which they operate. In addition, under the CCCTB, companies active in more than one EU Member State would only have to file a single tax return for the whole of their activity in the EU.

How would CCCTB work in practice?

The CCCTB would make it possible for companies or groups of companies to consolidate all profits and losses across the EU, thereby recognising their cross-border activity. The single consolidated tax return would be used to establish the tax base of the company, after which all Member States in which the company is active would be entitled to tax a certain portion of that base, according to a specific formula based on three equally-weighted factors (assets, labour and sales). This would all be done through the tax authorities of the company's principal Member State (i.e. through a one-stop-shop system).

Under the proposed Directive, clear procedural rules are set out on how companies should opt-in to the CCCTB system, how they should submit their tax returns, how the relevant forms should be harmonised and how audits should be coordinated. For each company or group, the tax return for the whole of their activities within the EU would be filed through the tax authorities in their principle Member State, and this same Member State would be responsible for coordinating the appropriate checks and follow up on the return.

What does each element of CCCTB mean?

To explain each of the individual elements of CCCTB:

<u>Common</u> – One single set of rules that could be applied across the EU.

<u>Consolidated</u> – Consolidation means adding up all the profits and losses of a company / group of companies from different Member States, to arrive at a net profit or loss for the whole of its activity in the EU. This would then be used to decide the final taxable base of the company or group.

Example: A CCCTB group consists of companies A, B, C and D. Companies A and B have revenues equal to €10 million each; Company C has revenue equal to €5 million; Company D has a loss equal to €8 million.

The consolidated tax base for this group is A+B+C-D = €17 million.

Corporate – Relating to the taxation of companies

Tax Base – The amount of a company's profit that will be taxed. The tax base is calculated as: the company's revenues, minus the amount that can benefit from tax exemptions and deductions such as wages and depreciation. Each Member State has a different set of rules for calculating this tax base. For example, Member State A may allow assets to be depreciated over 10 years while Member State B might allow deprecation only over 5 years. Or Member State A might allow all entertaining expenses to be deducted from profits whereas Member State B might not. A single EU tax base would mean that companies only need to do their calculations in line with one set of rules.

Example: Company has revenues of €10m (e.g. sales of goods) Less Expenses of €3m (e.g. wages and costs of the good purchased to sell) Less Deductions of €2m (e.g. depreciation costs of the delivery vehicles) =Total tax base of €5m.

Why do we need the CCCTB in the EU?

The CCCTB would make things far cheaper and simpler for businesses by creating one set of rules for calculating the tax base of a company or group, and by setting up a one-stop-shop system for filing tax returns. Currently, companies have to deal with 27 different rulebooks for calculating their taxable profits, and must file returns with the tax authorities in each Member State in which they are active. This results in high compliance costs, administrative burdens and complex re-adjustments. The complicated transfer pricing system which is currently in place for intra-group transactions is particularly expensive and burdensome for businesses operating within the EU, and can lead to disputes between Member State administrations and result in double taxation of companies.

Furthermore, by allowing the consolidation of profits and losses at EU level, the CCCTB would enable the cross border activities of businesses to be fully taken into account and would avoid over taxation.

Is the CCCTB a first step towards harmonisation of tax rates?

No. The CCCTB is not about tax rates, and the Commission has no plans to harmonise Member States' corporate tax rates. Member States will continue to decide their own corporate tax rates, as is their sovereign right. Where this does not lead to distortions, differences in tax rates allow a certain degree of tax competition to be maintained in the Internal Market. What the CCCTB will do, however, is create more transparency with regard to the effective corporate tax situation in Member States, thus creating fairer tax competition within the EU. The CCCTB will also be far more effective in boosting EU competitiveness globally than any measure related to uniform corporate tax rates.

Are there figures to show the benefits that the CCCTB could bring?

For businesses operating cross border in the EU, the CCCTB unequivocally translates into savings in compliance time and costs. It is estimated that the current compliance costs could be reduced by 7%, which is equivalent to a saving of €0.7 billion across the EU.

The new system will also bring tangible benefits for companies that wish to expand into other Member States. Currently, it costs a large enterprise over €140,000 in tax related expenditure alone to open a new subsidiary in another Member State. The CCCTB will reduce these costs by €87,000 or 62%. Medium sized enterprises stand to gain even more, with their average tax-related costs of expanding within the EU dropping from €127,000 to €42,000 (a decrease of 67%). If even just 5% of SMEs were to decide to expand on this basis, overall savings would be of the order of €1 billion.

In addition, by allowing businesses to offset losses in one Member State against profits elsewhere in the EU for tax purposes (i.e. consolidation), the proposal could result in additional savings of €1.3 billion for companies across the EU.

In summary, the CCCTB would save businesses €0.7 billion in reduced compliance, €1 billion in reduced costs to expand cross-border and €1.3 billion through consolidation.

Why has the Commission proposed that the CCCTB should be optional for companies?

The CCCTB would be optional, allowing companies that felt that they would truly benefit from this harmonised system to opt-in, while other companies could continue to work within their national systems. This is a common sense approach, as it means that companies that have no intention of expanding beyond their national borders, and therefore will only ever work within one system, do not have to shift needlessly to a new tax system. The Commission also believes that a compulsory CCCTB would be out of line with the principle of subsidiarity, as it would mean that EU measures were being introduced to cover purely domestic, as well as EU-level, activity.

Why is consolidation an important part of this system?

Consolidation is a crucial aspect of the CCCTB because it means that a company's cross-border activity within the EU will be fully recognised.

For example, today a group can add the profits of one subsidiary in Member State A to the losses of another subsidiary in the same Member State A to arrive at a net profit or loss. However, the same group cannot take into account losses it may accrue in another Member State B. This means that, even if the group's losses in one Member State were bigger than its profits elsewhere in the EU (i.e. there was a net loss), it would still have to pay tax in the Member States where any profits were made. There is no cross-border loss relief. Under the CCCTB, the group would be allowed to add its profits and losses from all subsidiaries throughout the EU together, to reach a net figure. Tax would then be paid on the group's net profit for the whole of the EU. This reflects the true spirit of a Single Market.

In addition, consolidation would eliminate the need for the complex transfer pricing system that is currently in place for cross-border intra-group sales. Given that transfer pricing is one of the most burdensome and most expensive aspects of corporate taxation for enterprises, its elimination will lead to significant benefits for companies and groups within the EU.

How did the Commission arrive at the apportionment formula?

Under the CCCTB, once the company's tax base is determined, it will then be shared out (apportioned) to all Member States in which the company is active on the basis of a fixed apportionment formula. This formula will be based on three factors, equally weighted:

- Assets: All fixed tangible assets, including buildings, airplanes and machinery will be covered. The costs incurred for R&D, marketing and advertising in the 6 years prior to a company entering the CCCTB will also be included as a proxy for intangible assets for 5 years.
- Labour: Two factors will be taken into account under the heading of labour: 50% payroll costs and 50% the number of employees.
- Sales: This will be calculated on the basis of where the goods are dispatched to / destined for. For services, this will be where the service is physically carried out.

Example:
Companies A, B and C form a CCCTB Group. The consolidated tax base is 900.
Company A has capital of 100, wages of 100, 1000 employees and sales in MS A of 10000.
Company B has capital of 200, wages of 200, 2000 employees, and sales in MS B of 20000.
Company C has capital of 300, wages of 300, 3000 employees, and sales in MS C of 30000.

The calculation is as follows:
One third of 900 on capital: 100/600 to A, 200/600 to B and 300/600 to C

½ of one third of 900 on wages: 100/600 to A, 200/600 to B and 300/600 to C
½ of one third of 900 on employees: 1000/6000 to A, 2000/6000 to B and 3000/6000 to C

One third of 900 on sales: 10,000/60,000 to A, 20,000/60,000 to B and 30,000/60,000 to D.

A's Tax Base = 50 + 25 + 25 + 50 = 150 – taxed in MS at A's rate
B's Tax Base = 100 + 50 + 50 + 100 = 300 – taxed in MS B at B's rate
C's Tax Base = 150 + 75 = 75 + 150 = 450 – taxed in MS C at C's rate

Companies' profits are derived from sales, labour and assets, which is why these three criteria make up the apportionment formula. These three factors mean that the formula draws on data which is readily available, will be difficult to manipulate and will be representative of where profit is really created in a business.

How does depreciation come into play in calculating the tax base? Will this be harmonised under the CCCTB and how?

Depreciation is the declining value of an asset over time, which is taken into account as a deduction for tax purposes. For example, if you buy a machine for 100.000€ and you sell it five years later for 20.000€, the machine 'depreciated' by 80.000€. This did not happen in year five - it depreciated a little each year. When a company buys an asset, e.g. a building or car, its taxable base each year is income minus expenses, minus an allowance for the depreciation of this asset. The estimated depreciation of the asset is spread over the expected period that it will be used by the company, and on this basis, a deduction from the tax base is given each year.

There are different depreciation rules in each Member State. Some may choose to spread out the deduction over a longer period (e.g. 5% over 20 years), while others might condense the deductions into a shorter space of time (e.g. 20% over 5 years). The aim is to spread the costs of assets over the appropriate number of years and not distort the profits, e.g. by allowing all the costs to be deducted in the first year.

There will be one set of depreciation rules laid down within the CCCTB (25% over 4 years), for companies that opt-in. For those that stay outside the CCCTB, national rules will continue to apply.

How will the CCCTB benefit SMEs?

The CCCTB opens up the possibility of expansion within the EU for SMEs that may, up to now, have thought it too costly and complicated to do so. As SMEs do not tend to have the same resources (tax lawyers and experts; consultants and advisors) as larger enterprises, the obstacle of having to deal with divergent rules for calculating the tax base in other Member States is often insurmountable. The CCCTB would allow SMEs to continue to work with just one system and one tax administration, as they do now, even if they choose to expand into other Member States. It is estimated that the tax-related costs of a medium sized enterprise expanding within the EU will be reduced by 67% with the CCCTB. The Commission has worked to ensure that the proposed new rules are accessible enough for SMEs, as well as large companies, to understand and use.

Will the CCCTB help to encourage R&D and innovative companies?

The treatment of R&D expenses within the CCCTB is earmarked by generous and innovation friendly rules: for example researcher's wages and salaries are fully deductible the year which they are incurred (irrespective of the time when the result of the research will be available) and an immediate 100% deduction for expenditure on research buildings is allowed. In addition, the general depreciation rule is assuming a very fast technical progress and generates deductible cost of nearly 60% in the first three years. This method is better reflecting the fast drop of economical or technical value of fixed assets. Overall, CCCTB offers better environment for research and innovation than foreseen in the current corporate tax systems of most Member States.

Are there conditions linked to opting in and out of CCCTB?

Yes. Companies would have to opt-in to the CCCTB for a minimum of five years (to avoid them opting in and out for tax planning purposes). In addition, an annex to the proposal lists various criteria that a company must meet to be eligible for the CCCTB system (e.g. type of corporate tax rules that it must be currently covered by; type of company …).

Would CCCTB be available to non-EU companies based in Europe?

Yes. Non-EU companies with branches or subsidiaries in a Member State would be able to opt in to the CCCTB in relation to their EU activities, so long as they met the same qualifying criteria as is required from EU companies (see above).

Will the CCCTB help to attract foreign direct investment?

The CCCTB can make the EU a much more attractive market for foreign investors. For example, at the moment, companies operating in third countries such as the USA or China only have to deal with one national tax system. This is compared to a European system of 27 different sets of rules, which creates far more complexity and costs. A single set of rules for the corporate tax base, and a one-stop-shop system for filing tax returns, would make the EU a much easier place for foreign firms to invest in. Many third countries have already indicated to the Commission that the CCCTB would help to make the EU a more interesting market for foreign investment.

Will there be a different tax rate for CCCTB than for the national system?

Member States will continue to decide on their own corporate tax rates, including the rate for companies working within the CCCTB (as the CCCTB deals only with the tax base, not the tax rate). A Member State could choose to apply a different tax rate for the CCCTB if its own national base was extremely different and it wanted to maintain the same effective tax rate (i.e. the real level of tax paid once the rate, base and various deductibles are taken into account). For example, if the CCCTB base were broader than the national base, the Member State may choose to set a lower rate for the CCCTB to maintain the same effective tax rate. Another possibility is that Member States will align their national bases close enough to the CCCTB in order to avoid having different rates for the two. It will be for each Member State to decide the approach it considers best for its own national needs.

Will there be a safeguard to protect Member States against companies shifting assets to gain most from the formula?

The CCCTB proposal contains strong anti-avoidance rules to ensure that groups cannot artificially shift their profits from one Member State to another. Companies will still be able to exercise their freedom of movement and establishment for genuine commercial reasons however (e.g. building a new factory in another Member State), as they do today.

What anti-abuse measures are included in the proposal?

The proposal contains a general anti-abuse clause which is in line with what is already in place in many Member States. In addition, it contains specific anti-abuse measures such as a restriction of interest deductibility in some cases and an exception to the exemption of foreign income in other cases.

Could CCCTB contribute to greater tax competition?

In creating a uniform base, the CCCTB will provide greater transparency and should therefore ensure that competition takes place on the effective tax rate, rather than on potentially hidden elements in different bases. This should result in more open and fairer tax competition. Member States would continue to set the corporate tax rates for their territories. It will be for each Member State to decide the approach that best fits its own national budgetary needs and tax policy mix.

Would the CCCTB lead to the broadening of the tax base in most Member States?

For most Member States[1], the CCCTB base would be broader than the existing national tax base. On average, the common tax base is broader by 7,9%. This broader tax base means that Member States should not have to worry about the sustainability of their tax systems in the context of budget consolidation (i.e. the broader tax base reduces the risk of fiscal losses).

Could the CCCTB lead to companies actually being taxed more if profits fall into higher tax markets?

The CCCTB will be optional. If companies do not believe that they will benefit from it, they do not have to opt in. However, the vast majority of businesses (80%) have come out in support of the CCCTB, seeing the benefits it offers in terms of reduced administrative burden, lower compliance costs and the avoidance of transfer pricing disputes (KPMG study of 2007, "*Harmonised corporate tax base – are European business for or against it? Pan-EU survey results investigating reactions to proposed Common Consolidated Corporate Tax base*", Jeff Wagland).

Is this proposal in line with the principle of subsidiarity?

Yes. The CCCTB is about removing obstacles to the Internal Market, so that it is cheaper and easier for businesses to operate cross-border. It can only be successfully implemented at EU-level. An EU approach is needed to establish common rules and a "one-stop-shop" system for cross-border businesses; while some of the main elements of the proposal (e.g. cross-border loss relief, allocation of the tax base through a common formula) would not be attainable at purely national level.

What are the next steps?

The proposal now needs to be discussed and agreed by Member States in Council, following the opinion of the European Parliament.

See also IP/11/319

[1] Estonia is not included as the country has a distribution tax only applicable on paid out dividends and a tax base definition is not needed.