



FEE working paper regarding CCCTB

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1. INTRODUCTION

FEE (Fédération des Experts Comptables Européens – Federation of European Accountants) has been following the European Commission’s activities regarding a Common Consolidated Corporate Tax Base (CCCTB) and has in particular considered the issues raised in the European Commission CCCTB Working Group document “CCCTB: possible elements of a technical outline” (Working Paper number 57 annotated dated 20 November 2007 – further cited as WP 57a).

This paper raises a number of technical issues on which we hope our comments below may be of interest.

FEE represents 43 professional institutes of accountants and auditors from 32 European countries, including all of the 27 EU Member States.

In representing the European accountancy profession, FEE recognises the public interest. It has a combined membership of more than 500.000 professional accountants, working in different capacities in public practice, small and big firms, government and education, who all contribute to a more efficient, transparent, and sustainable European economy.

2. GENERAL COMMENTS

The FEE comments made in this working paper are of pure technical nature and should not be read as expressing a positive or negative FEE position regarding a CCCTB. Similarly, it is not the intention, nor the role, of this paper to get involved into a political debate regarding the CCCTB and our comments may not be seen as providing any sort of endorsement; it would, in any case, be premature to make such recommendation.

As many other changes of policy of this magnitude, the introduction of a CCCTB in the European Union could have potential advantages and disadvantages and the views of stakeholders, including that of FEE member bodies, may naturally vary in this respect.

This paper does not aim at weighting these potential advantages and disadvantages; such a task should be left to a neutral and independent impact assessment and, to the extent possible, a field testing. However and before focusing our comments on the technicalities, it is of interest to summarise some of the potential key advantages and disadvantages perceived by stakeholders to date; these are indications of some of the key elements that will have to be taken into account in view of a comprehensive impact assessment.

2.1 Perceived possible outcome of CCCTB in general

In general, the following possible beneficial and detrimental outcomes are put forward regarding a CCCTB.

2.1.1 Possible beneficial outcome

On the one hand, a CCCTB could:

- Simplify intra-community business activities by reducing tax risks and compliance cost resulting from 27 different tax systems in case that all EU companies and permanent establishments of a given group would have access to the CCCTB system.
- Solve transfer pricing issues.
- Solve problems of transnational off-set of losses.
- Provide transparency in tax competition within the EU. Considering that the tax bases are widely different within Member States, nominal rates envisaged solely are not effective for the measurement of the tax burden. Therefore, comparing the nominal rate may be misleading for tax decisions, if the tax bases are different.
- Avoid double taxation as, by using a common taxation basis for derived incomes, European Union companies will ensure the elimination of double taxation for transactions conducted in the European Union. However, attention should be paid to the elimination of discrepancies which may come up as a result of the interaction of CCCTB application with certain conventions meant to eliminate double taxation.

2.1.2 Possible detrimental outcome

On the other hand, there are a number of points of concerns regarding a CCCTB, according to which:

- The introduction of another set of tax rules running concurrently with existing national tax codes would not constitute simplification.
- Many years of case law and practice offer EU businesses a degree of certainty on matters such as corporate residence, permanent establishment and the claim to tax, that would be dismissed except if these case law and practice are inspiring the conceptual framework according to which CCCTB can function.
- The CCCTB would demand changes in retrospective computation and adjustment, delaying the accurate prediction of tax charges by multinationals and thus influence Europe's capacity to attract foreign investment.
- Accordingly, compliance with CCCTB rules could delay basic corporate requirements such as due diligence, verification of payments of taxes and tax clearance certification to secure government contracts.

- There is a fear that CCCTB could fail to reconcile corporate tax systems designed for the specific needs of each Member State. The tax systems of Member States have evolved to reflect the demographics, geography and resources available to their governments.
- The removal of transfer pricing considerations under CCCTB would not remove the need for pricing arrangements by virtue of legal and accounting rules. This could imply revision to accounting systems and thus administrative burdens and costs.
- CCCTB could lead to unequal treatment of single companies or pure national groups (unless if access is given to CCCTB for these companies and groups, as allowed in WP 57a no. 11).
- CCCTB may constitute an incentive to the establishment by business of purely artificial arrangements in order either to gain access to CCCTB (in case single companies or purely national groups of companies will not be admitted to the system) or as far as the location of the parent company is concerned (remembering that the power to issue tax assessments¹ and the court system will be those of the country where the parent company of the group is located²).

2.1.3 Tax rate

The effects of the CCCTB system on the future nominal tax rates are unclear.

On the one hand, CCCTB could increase tax competition among Member States promoting a lowering of nominal rates considering that the tax base will be the same.

On the other hand, there could be a risk that Member States, in order to avoid such a lowering, will informally agree to maintain tax rates within a range to reduce competition among them or even try to reach a formal agreement.

2 FEE TECHNICAL COMMENTS

The technical FEE comments refer to the European Commission CCCTB Working Group document “CCCTB: possible elements of a technical outline” (Working Paper number 57 annotated dated 20 November 2007 – WP 57a). Therefore, the comments are structured in the same way using the same headers and in each header a reference to the relevant paragraph numbers of WP 57a is made.

¹ The tax audit will be performed at domestic level by the local tax auditors who will have to report to the tax authority of the parent company (principal tax authority) that will have the power to evaluate the outcome of the audit and to issue – if any – tax assessment.

² Such a problem will not be present at a level of administrative appeal, because the proposal made by the European Commission is to establish a multi-jurisdictional administrative authority that will be in charge to deal with such appeals.

3.1 Basic structure of a possible CCCTB

A legislative measure on CCCTB should include a provision according to which the European Commission will have to review the CCCTB system and its practical impact after five years and provide a report to the Council. The respective report should contain the proposal for any amendment that the practical experience will highlight.

In order for the common tax base to actually determine a simplification, it is recommendable to agree also on a common or at least comparable documentation to record the activity of a group of companies on the territory of several Member States. When finding the most appropriate general framework for CCCTB, obstacles which may come up as a result of discrepancies between accounting and applicable tax regulations in each of the 27 Member States must also be eliminated.

3.1.1 General form (WP 57a no. 9)

According to WP 57a, companies should prepare their accounts in accordance with national GAAP which requires additional tax adjustments.

3.1.1.1 Accounting and tax value

In principle, independence between accounting and tax value is required for two reasons. Cost and revenue should not have to be included in financial statements in order to be cost or revenue for tax purposes so that any tax pollution of financial reporting is avoided. Companies need to be free to adjust their accounts to the CCCTB in different Member States according to different means, because of the different starting points in each country.

3.1.1.2 Adjustments

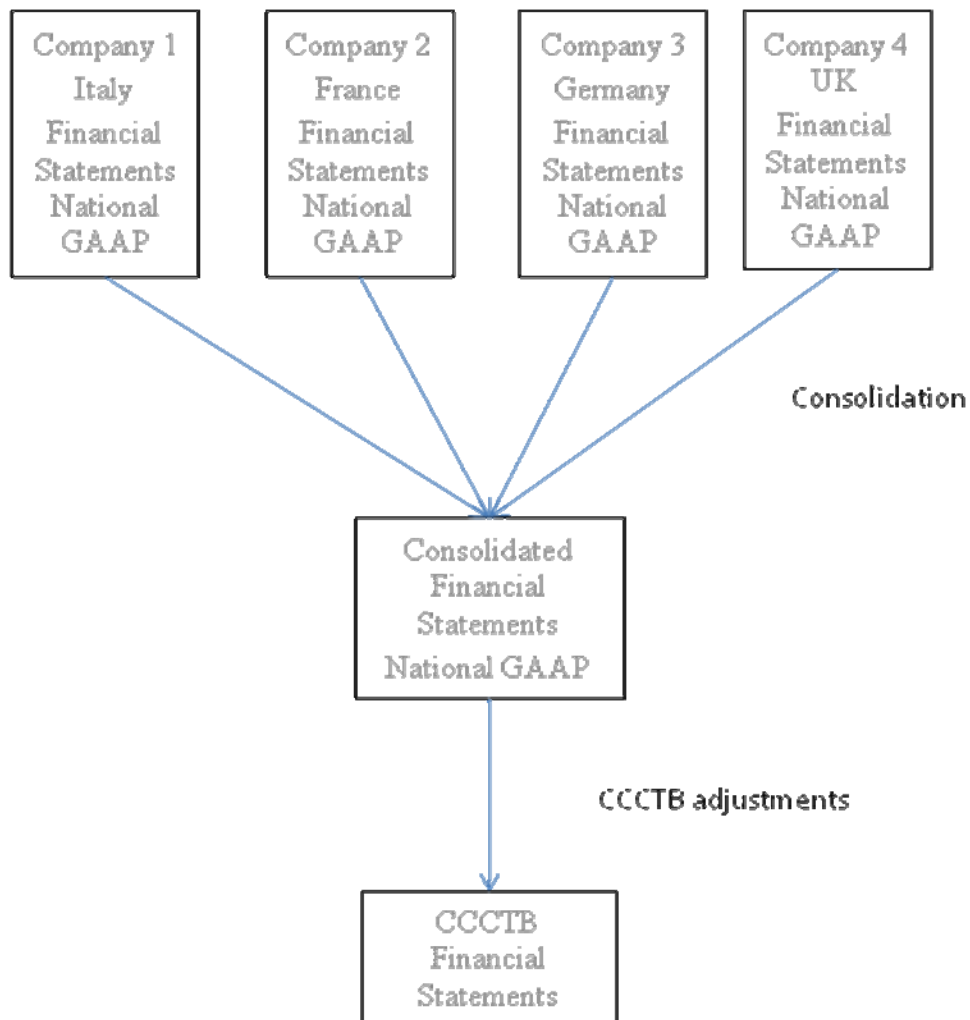
Further clarification of the adjustments is necessary. Differences between accounting and tax value require reconciliation showing the temporary differences that will be used for calculating deferred taxes (see IAS 12).

The practical feasibility of the constant reconciliation of tax and accounting values of all assets and liabilities over a number of tax years should require a sheet of reconciliation.

3.1.1.3 Groups

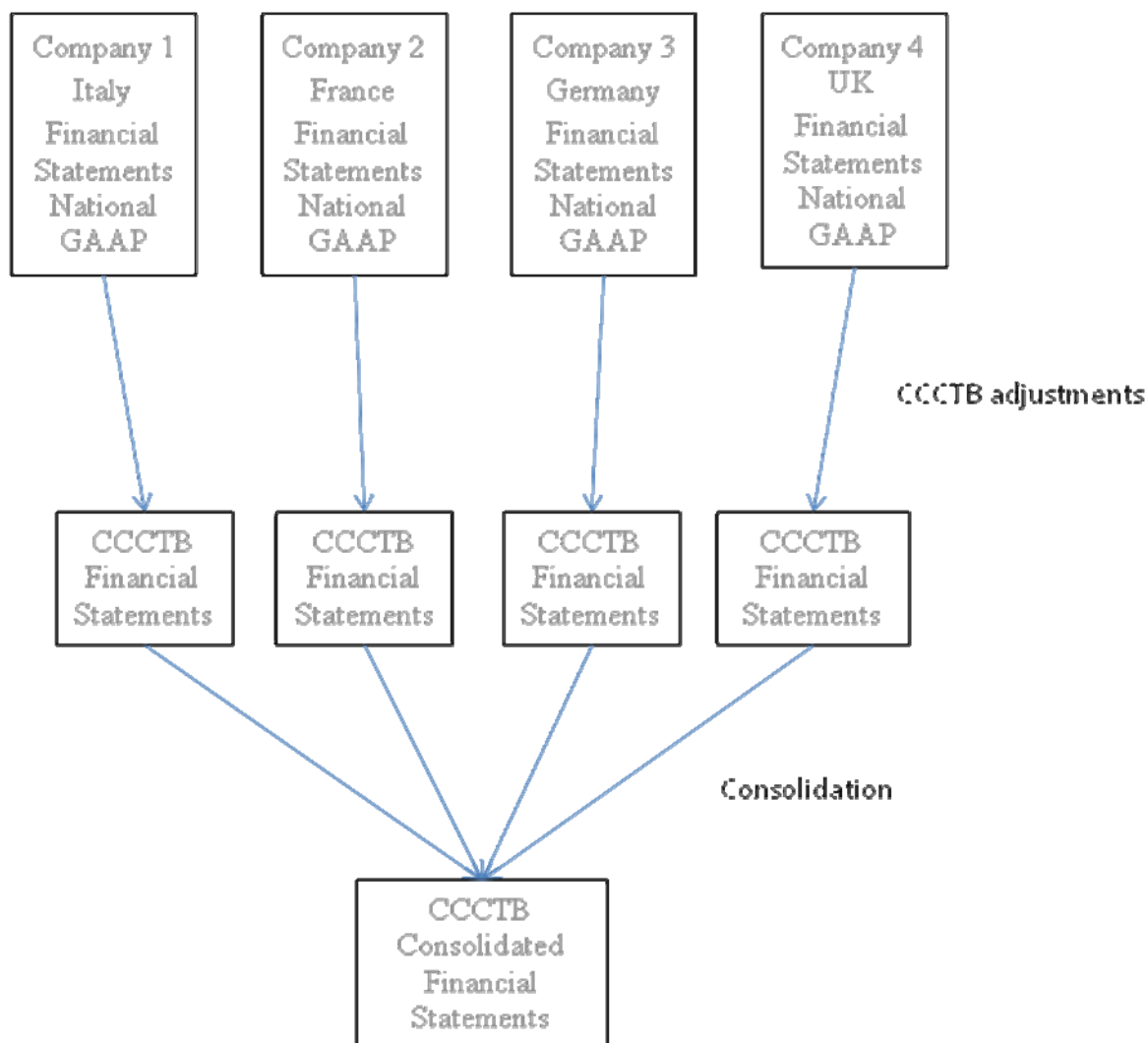
There are two possibilities for groups with companies located in different Member States to prepare consolidated financial statements including adjustments to CCCTB:

3.1.1.3.1 Consolidation before CCCTB adjustments



This possibility implies however that the group is obliged to prepare consolidated financial statements. It is not applicable in case of a small group that is not obliged to prepare consolidated financial statements.

3.1.1.3.2 Consolidation after CCCTB adjustments



This possibility assures that non deductible expenses can be tracked and it is also more transparent for tax audit purposes. However, each deviation has to be dealt with in the appropriate way, for CCCTB purposes.

3.1.2 Scope (WP 57a no. 11, 12, 16, 17)

CCCTB should be optional for the companies, at least for an initial period.

In case a CCCTB system will be agreed by a limited number of countries according to the enhanced cooperation procedure, the tax treatment of the transactions between CCCTB companies and non-CCCTB companies and Permanent Establishments (located however in the EU) has to be carefully examined. The enhanced cooperation should neither lead to any discrimination nor create obstacles for the internal market.

Option for CCCTB should be possible for all companies, provided they are legal entities, and for permanent establishments. A positive list of legal entities, according to the same method as the one used in the parent-subsidiary directive and in the merger directive, would be useful. The existence of a permanent establishment should be determined according to national tax law and the applicable double taxation treaty.

Option should be binding for 5 years and be automatically renewed for successive periods of another 5 years in order to promote stability. It should be possible for companies to opt out in certain specific and defined circumstances.

The entry into the CCCTB system should be tax neutral and not generate taxable gains or losses. The national tax value of assets and liabilities of a company entering into the CCCTB system should be automatically recognised as CCCTB tax value. The rules of CCCTB should only apply to new assets and liabilities.

The exit from the CCCTB system should also be tax neutral. Insofar, the national tax legislation would have to be amended because the national tax value would have to be the latest value within the CCCTB system. In case of termination of a CCCTB system for a group, the consolidated losses will have to be allocated to any single company using a system similar to the formula apportionment used to allocate taxable profits to Member States.

During the CCCTB, neutrality should be assured for company reorganisations, like mergers, acquisitions and spin-off.

Payments within a CCCTB group should not be subject to any withholding tax. Furthermore, the elimination of withholding tax for payments made between separate CCCTB groups within the EU could contribute to simplification.

3.2 Tax base of individual companies

3.2.1 General (WP 57a no. 21, 24, 25, 26)

All companies belonging to a CCCTB group should have the same tax year. A tax year of 12 month seems to be appropriate and should be the same for all group companies. Aligning the tax year with the calendar year could be a useful simplification measure. Where a CCCTB group takes over a company or group, the latter should automatically be included in the CCCTB group, retroactively from the beginning of the tax year of a group. For domestic tax purposes a shorter tax year for the acquired company or group should be established, in case the tax year is different from calendar year.

Example: group tax year = calendar year 2008, tax year of acquired company ending March 2008, acquisition takes place in June 2008

Solution:

The acquired company has to end its tax year December 31, 2007 (nine month tax year) and the new tax year starts January 2008 in order to consolidate for 2008.

Variation of the example: group tax year = calendar year 2008, tax year of acquired company ending December 2008, acquisition takes place in November 2008

Solution:

The complete tax year 2008 falls within CCCTB.

The suggestion that deductible expenses would mean all expenses incurred by the taxpayer for business purposes would require further definition. As far as the evidence of the business purpose is concerned, the European Commission should collect best practices and recommend them, also for simplification purposes.

Furthermore, the following simplification measures regarding deductible expenses seem to be appropriate:

- Expenses for asset acquisition up to EUR 1.500 should be immediately deductible.
- Certain assumptions should be included, for example entertainment expenses in the amount between 1 % and 2 % of the revenues could generally be deductible, unless the taxpayer proves higher expenses incurred.

3.2.2 Recognition and Timing (WP 57a no. 31, 32, 40, 41)

The general principle, that income and expenses would be recognised on an accrual basis in the tax year to which they relate should be implemented. Further clarification might be helpful in order to identify the matching principle where the pure accrual basis principle is not consistent. For these reasons a two-steps approach should be followed: in a first step the tax year in which the revenue accrued has to be recognised should be identified and – in a second step – the expenses related to this revenue have to be allocated to the same tax year.

Example: For manufacturing activities that require the cleaning of pollution at the end of the business activity, a provision for the expenses that the company will have at the end of its living period should be deductible.

A list of possible provisions could improve legal certainty. Furthermore, the possibility to allow a general provision under certain conditions as tax deductible could be considered.

The criteria for a deduction of losses for bad debts should be further clarified. Possible criteria could be the start of a bankruptcy or similar procedure regarding the client's legal position, a commercial register entry confirming the deletion of the client's company, a lawyer's statement advising that the debt collection has no prospect of success.

In addition, a general provision for bad debt should be allowed at a fixed rate based on the total of the accounts receivables at year-end. In case a loss is incurred, first the existing accumulated provision will have to be used and any loss exceeding the amount of such accumulated provision will be deductible for tax purposes.

Furthermore, general depreciation of bad debts up to EUR 1.000 could be allowed for simplification purposes after a period of 6 month without payment despite three reminders.

3.2.3 Measurement (WP 57a no. 43, 44, 45, 48, 49, 53)

The arm's length price in case of transactions between related parties should be determined following OECD Transfer Pricing Guidelines and should only apply to transactions between CCCTB-, and non-CCCTB-companies.

The costs for non-monetary gifts should be deductible provided that there is a business purpose. For simplification purposes and in order to minimise the difficulties in applying a business purpose test, a general allowance for the deduction of non-monetary gifts should be fixed as a certain percentage of the total revenues, e.g. 1 per cent (see above 3.2.1). For the cost exceeding such a percentage, the taxpayer will have to provide evidence of a business purpose.

Gains and losses incurred on conversion of foreign currency would be included in the tax base in the tax year when they are incurred. In this regard, the meaning of "incurred" should however be defined and refer to the payment made or received.

The cost of inventories could be determined by using the method of first in first out (FIFO) or weighted average cost or last in first out (LIFO). For this purpose, the group opting for CCCTB will have to opt for the method of evaluation as well and it will not be allowed to change this method during the period of option. Companies entering into the system that used a method of evaluation of stock different from the method chosen by the CCCTB group will have to evaluate their stock at the end of the tax year before the entering tax year according to the method chosen by the group.

3.2.4 Depreciation (WP 57a no. 56, 60, 61)

Long-term assets such as buildings would be depreciated on an individual basis whereas short to medium term assets would be pooled for depreciation purposes. Regarding the pooling method, further clarification is required in particular in case of division and transfer of business. Provided that the individual method is maintained for accounting purposes, the accounting value could serve as a basis to calculate a proportionate amount in such cases.

In case of financial leasing, the different treatment within the Member States has to be taken into account, in particular for cross-border transactions in order to assure that not more than one taxpayer would depreciate a business asset at the same time. In case a leasing company enters the CCCTB system, it will have to restate for tax purposes the tax value of the assets for depreciation according to the total amount of costs that have already been deducted for tax purposes.

3.2.5 Related Parties (WP 57a no. 78)

The definition of related parties for transfer pricing purposes should be derived from the OECD model convention to avoid double taxation on income and capital (see article 9 OECD model convention and related commentary). We refer to the comments below regarding consolidation and groups.

For transactions with non-CCCTB Member States (in case of an enhanced cooperation) and all third countries, reference should also be made to the works of the EU Transfer Pricing Forum for the procedural aspects.

3.2.6 Third country income and EU income other than PE income (WP 57a no. 79 and 117 to 139)

In order to avoid possible distortion in the tax base, there is the need of a common approach of CCCTB Member States with regard to third country income.

At present, the tax treatment of third country income is influenced by the coexistence of domestic rules of the state of residence of the taxpayer, of those of the source state and of the applicable provisions of Double Tax Treaties. These rules determine the qualification, the measurement and the taxation of income having a non-EU source.

The CCCTB cannot interfere with the single Double Tax Treaty provisions that can vary from country to country depending on a number of facts. The Double Tax Treaties are the result of negotiation between the countries and the rules of taxation are the effect of a balanced approach of fiscal sovereignty of such countries.

Therefore, third country income should be excluded from the tax base and added to the share of taxable profit allocated to the Member State of residence of the taxpayer to whom the foreign income is imputed.

Such a solution would also leave the decision to the Member States to choose the best technique to avoid Double Taxation (exemption method or foreign tax credit method).

The principle suggested for the non-EU income should be applied also for EU income deriving from non-CCCTB companies (other than PE income) taking into account that the issues of the different Double Tax Treaty provisions are the same also in EU context.

In this respect, any protective measure implying a switch over mechanism like CFC rules in Europe would not be acceptable, except where an anti-abuse mechanism could take place in order to counteract purely artificial arrangements – as FEE has stated in many occasions.

As far as taxation of EU dividend is concerned (provided that they are not consolidated) the exemption method should be the simplest.

3.2.7 EU PE income (WP 57a no. 80)

EU PE income should be included in the tax base and the sharing mechanism should be applied on the “consolidated” income.

As far as non-EU PE income is concerned, the remarks made on third country income still remain valid.

3.2.8 Transparent entities and hybrids (WP 57a no. 81 to 83)

Transparent entities should be treated according to the principles suggested for the non-EU foreign income. In other words the share of profit or loss of a transparent entity should be attributed to the single share of profit allocated to a Member State.

A positive list of transparent entities in the EU could help to avoid different qualifications, for example that an entity is treated as transparent in a Member State and as not transparent in the Member State of its participants. Such list should also exclude the existence of hybrid entities because the classification should be either as transparent or as opaque entity. This would avoid double taxation as well as double non-taxation.

3.2.9 Losses for single company (WP 57a no. 84)

CCCTB losses should be eligible for carry forward indefinitely.

However, the possibility for a carry back of losses within the CCCTB system should not be excluded in particular for cases where a carry forward is not possible, e.g. the group is declared bankrupt.

A form of compensation of minority shareholders for losses that has been transferred to the CCCTB should be identified and regulated.

3.3 Consolidation

3.3.1 Groups (WP 57a no 85 to 91)

As many companies as possible should qualify as intra-group companies, in particular a threshold of 50 % plus one share should be established both for being considered part of a group and for consolidation.

A distinction between controlled companies not consolidated (from 50 % plus one share to 75 %) and controlled companies to be consolidated (from 75 % plus one share to 100 %) would maintain the issue of transfer price in Europe, jeopardising one of the major benefit of CCCTB, taking into account the huge number of controlled companies in Europe belonging to a group with a shareholding of less than 75 %.

3.3.2 Changes in the level of ownership (WP 57a no. 92 to 105)

For entry rules we refer to our comments above under 3.1.2 and 3.2.1.

In case of a partial or total sale of shares of companies belonging to the CCCTB group during the tax year and where such a sale would reduce the participation below the threshold for consolidation, then the consolidation mechanism should end with effect from the next fiscal year. This system will prevent that groups avoid the tax base by buying or selling shares during a tax year in order to modify the consolidated taxable profit of this tax year.

3.3.3 Sale of assets or shares (WP 57 a no. 106 to 109)

In case of sale of assets this would be taxed according to the normal CCCTB rules.

In case of sale of shares in a group company, participation exemption should apply.

It does not seem to be necessary to identify a mechanism for taxing unrealised gains on the assets of the departing company. Such gains will be taxed when realised. Therefore, a normal exemption in full should be applied in all cases.

A look-through approach would represent an obstacle for the circulation of shares and in some cases also for the free movement of capital. It could also lead to double taxation and is the opposite of the simplification philosophy that should inspire the CCCTB.

3.3.4 Intra-group transactions (WP 57a no. 110)

The rules for consolidation will have to be drafted according to the provisions of the 7th Directive on consolidated accounts and to the IFRS related to consolidation (see IAS 27).

3.3.5 Consolidation methods (WP 57a no. 111 to 115)

Intra-group income and expenditure other than that related to depreciable assets should be included by each group company and netted off when the consolidation is carried out, following the IFRS related to consolidation (see IAS 27).

3.4 The sharing mechanism (WP 57a no. 116)

This issue will be addressed in due course.

3.5 Foreign income and participation exemption (WP 57a no. 117 to 139)

We refer to our comments above under 3.2.6.