

BDI – The Voice of German Industry

The Federation of German Industries

A Common (Consolidated) Corporate Tax Base for the EU

Ralph Brügelmann, Tax and Financial Policy

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Background

The CCCTB - Background

A second attempt

- On October 3rd 2011 the EU-Commission published its first proposal for a Common Consolidated Corporate Tax Base (CCCTB) in the EU (COM(2011) 121 final/2)
- The proposal was not approved by the EU-Member States (EU-MS)
 - In particular the EU-MS could not agree on the consolidation provisions and the subsequent apportionment formula
- The new proposal dated October 25th 2016 consists of two steps
 - First a Common Corporate Tax Base (CCTB), proposal (COM(2016) 685 final) shall be implemented
 - Then the consolidation and the distribution of the tax base among EU-MS shall follow, proposal COM(2016) 683 final

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The ATAD in the CCTB

The ATAD in the CCTB

Timeline of proceedings

- ATAD 1 is part of the CCTB
 - But not identical
- Together with the CCTB the proposal for ATAD 2 was published
 - Provisions for hybrid mismatches related to third countries
 - Additional provisions against various other hybrid mismatches
- Highly ambitious timeline: ATAD 1 and CCTB shall be implemented in the national tax code until December 31st 2018 and applied from January 1st 2019
- For ATAD 2 the same timeline was designated but the agreement of February 20th 2017 the EU ministers concluded on an implementation until December 31st 2019 and application from January 1st 2020
 - With exemption for Art. 9a (reversed hybrids: Implementation until December 31st 2021 and application from January 1st 2022
- The new design of ATAD 2 still needs to be transferred in the CCTB

Components of ATAD in the CCTB

Transfer of the provisions

- All components of ATAD 1 are part of the CCTB proposal
 - Art. 4 ATAD 1 limitation of interest deduction → Art. 13 GKB
 - Art. 5 ATAD 1 exit taxation → Art. 29 GKB
 - Art. 6 ATAD 1 general anti-abuse clause → Art. 58 GKB
 - Art. 7 & 8 ATAD 1 CFC Rules → Art. 59 und 60 GKB
- Art. 9 ATAD 1 & ATAD 2 hybrid mismatches → Art. 61 und 61a GKB plus new definitions in Art. 4 CCTB → to be amended

Components of ATAD 1 in the CCTB

Art. 13 CCTB – Limitation of interest deduction

- Art. 4 paragraph 5(a) ATAD I equity-escape clause is withdrawn
- Art. 4 paragraph 5(b) ATAD I group ratio rule is withdrawn
- Art. 4 paragraph 6(c) ATAD I carryforward of unused interest capacity is withdrawn
- According to Art. 13 paragraph 6 (Art. 4 Abs. 6 a ATAD I) only an unlimited carryforward of undeducted interest is allowed
- No transitional period until end of 2023 as in Art. 11 paragraph 6 ATAD I for MS which have national targeted rules which are equally effective to the interest limitation rule in place and which communicate to the Commission before 1 July 2017 all information necessary for evaluating the effectiveness of these rules
- OECD best practise recommendations in final report on AP 4:
 - De minimis threshold ✓
 - Fixed ratio rule ✓
 - Group ratio rule / equity-escape ✗
 - Carry forward of disallowed interest/unused interest capacity and/or carry back of disallowed interest (optional) ✗

Components of ATAD 1 in the CCTB

Art. 29 CCTB – Exit taxation

- Art. 5 paragraphs 2 and 3 are withdrawn
 - EU-MS are treated like third countries
- No payment in instalments possible

Art. 53 CCTB – Switch-over clause

- As Art. 6 part of the ATAD proposal dated January 28th 2016 but not approved
 - No exemption of dividends received as a profit distribution from an entity in a third country
 - Shall not apply where a convention for the avoidance of double taxation does not allow switching over
 - Tax paid in the third country shall be deducted from its tax liability
 - Shall apply if CIT rate in the other country is less than half of the national CIT rate

Art. 58 CCTB – General anti abuse clause

- Art. 6 ATAD was taken over the CCTB as Art. 58

Components of ATAD 1 in the CCTB

Art. 59 and 60 CCTB – CFC Rules

- Art. 7 Abs. 2 ATAD: “Point (a) **shall not apply** where the controlled foreign company carries on a substantive economic activity supported by staff, equipment, assets and premises, as evidenced by relevant facts and circumstances.
Where the controlled foreign company is resident or situated in a third country that is not party to the EEA Agreement, Member States may decide to refrain from applying the second subparagraph of point (a).”
- Art. 59 Abs. 2b CCTB: “The first subparagraph **shall not apply** to a controlled foreign company that is resident or situated in a **Member State or in a third country that is party to the EEA Agreement** where the controlled foreign company has been set up for valid commercial reasons that reflect economic reality.”
 - Substance carve out applies only for EU-MS and EEA countries, no more substance carve out for third countries possible
- Art. 7 Abs. 2b ATAD (application of CFC-rules in case of non-genuine arrangements) was withdrawn in Art. 59 CCTB

Components of ATAD 2 in the CCTB

Art. 61 CCTB und 61a – Hybrid Mismatches

- Current CCTB version must be regarded as preliminary
- Tackled mismatches according to ATAD 2:
 - Art. 9 paragraph 1: Double deduction
 - Art. 9 paragraph 2: Deduction without inclusion
 - Art. 9 paragraph 3: Imported Hybrid Mismatches
 - Art. 9 paragraph 4: Possible exemptions
 - Art. 9 paragraph 5: Permanent establishment mismatches; no untaxed income due to the non-existence of a PE (avoidance of the McDonalds-case, country where parent company is established recognizes a PE abroad but country where subsidiary is operating does not)
 - Art. 9 paragraph 6: Hybrid Transfer Mismatches; limitation of the refund of withholding taxes in proportion to the net taxable income regarding such payment
 - Art. 9a: Reversed Hybrid Mismatches

Components of ATAD 2 in the CCTB

A general scheme to identify a hybrid mismatch

- Associated enterprises according to Art. 2 point (4) ATAD 2
- Cross border payment
- Double deduction or deduction without inclusion
- Which must be based on a different characterization of the instrument/entity in both countries

Components of ATAD 2 in the CCTB

Interim Conclusion

- Some elements of the ATAD 1 are significantly stricter in the CCTB
 - Limitation of interest deductibility
 - Exit taxation
 - CFC-rules
 - Switch-over clause is back
- Art. 9 paragraph 3 of ATAD 2 will cause administrative problems and may give rise to double taxation and political conflicts

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Innovative Elements of the CCTB

Innovative Elements of the CCTB

Art. 1 Abs. 2 Subject matter

- “A company that applies the rules of this Directive shall cease to be subject to the national corporate tax law in respect of all matters regulated by this Directive, unless otherwise stated.”
 - No patent-box regime possible under the CCTB
 - The (national) special treatment of income is no longer possible
 - Instead super deduction for R & D according to Art. 9 paragraph 3

Innovative Elements of the CCTB

Art. 2 Scope

- Art. 2 paragraph 1; application of CCTB is mandatory if all of the following criteria is met:
 - a) Company form (incorporated)
 - b) Subject to corporate income tax
 - c) The firm belongs to a consolidated group with total consolidated group revenue exceeding 750 Mio Euro
 - d) It qualifies as a parent company or qualifying subsidiary (voting rights or ownership)
- Art. 2 paragraph 3; companies which meet only a) and b) but not c) and d) may opt for the CCTB

Innovative Elements of the CCTB

Art. 9 paragraph 3 R & D incentives

- All incurred expenses for R & D are deductible
- Additionally part of the incurred expenses may be deducted exceeding the normal 100 percent deduction
 - Exemption: Movable tangible fixed assets
 - Up to an amount of 20 Mio. € (incurred expenses in a fiscal year): 50 percent
 - Exceeding expenses: 25 percent
 - Expl.: 80 Mio. € R & D expenses:

| | |
|-----------------------|--|
| | 10,0 Mio. € (which is 50 percent of 20 Mio. Euro) |
| | <u>15,0 Mio. €</u> (which is 25 percent of 60 Mio. Euro) |
| Additional deduction: | 25,0 Mio. € |
- Special provision for SMEs:
 - Additional deduction of 100 percent of incurred expenses possible if the company is:
unlisted, less than 50 employees, turnover and/or balance sheet are less than 10 Mio. €, not been registered for longer than five years, not been formed through a merger, any associated enterprises

Innovative Elements of the CCTB

Art. 42 CCTB cross border loss offset

- Art. 42 paragraph 1: A profitable taxpayer is allowed to deduct losses of qualified subsidiaries in other EU-MS
- Art. 42 paragraph 2: Deductible losses are calculated according to the degree of ownership
- Art. 42 paragraph 3: As soon as the subsidiary/PE is profitable again the parent's deducted losses are added back to its profit
 - Subsidiary/PE makes use of its own loss carryforward → reduced tax liability
 - No definite cross border shift of tax revenues
- Art. 42 paragraph 4: Losses deducted at the parent's level are automatically added reincorporated if
 - a) after 5 years there are no compensation profits of the subsidiary/PE
 - b) The subsidiary /PE is sold, wound up or transformed
 - c) The parent company no longer satisfies the association requirements

Innovative Elements of the CCTB

Art. 11 CCTB Allowance for growth and investment (AGI)

- Art. 11 allows for a notional interest deduction on equity
- Art. 11 paragraph 1: Equity is the difference between the equity of the taxpayer and the tax value of the associated enterprises as referred to in Article 56 (deduction of direct and indirect participations that are not part of the group)
- Art. 11 paragraph 2: Definition of equity according to the accounting directive
- Art. 11 paragraph 3 sentence 1: A defined yield on an equity increase is allowed to be deducted
 - But: According to Art. 4 paragraph 12 the notional deduction is subject to the limitation of interest deduction according to Art. 13 CCTB
- Art. 11 paragraph 3 sentence 2: A defined yield on an equity decrease has to be added (reduction of loss carryforward)
- General formula: $x \% * \Delta \text{AGI-equity} = \Delta \text{taxable profits}$
- Art. 11 paragraph 5: Defined yield = “yield of the euro area 10-year government benchmark bond ..., increased by a risk premium of two percentage points. A floor of two per cent shall apply where the curve of the annual yield is negative.”
- Art. 11 Abs. 4 $\Delta \text{AGI-equity} = 10 \text{ year difference}$

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Conventional Elements of the CCTB

Conventional elements of the CCTB

Art. 24 pension provisions

- „Member States may provide for the deduction of pension provisions.”
 - No clearly defined provision due to national discrepancies in EU-MS
 - Germany: § 6a income tax code: Deductions are calculated with a constant discount rate of 6 percent
- Old version in the 2011 proposal (Art. 26, sentence 2):

„The pension provision shall be discounted by reference to Euribor for obligations with a maturity of 12 months, as published by the European Central Bank. The calculations shall be based on the yearly average of that rate in the calendar year in the course of which the tax year ends.”
- The treatment of pension schemes is associated with an extremely high amount of tax revenues in some EU-MS. Thus it seems to be highly unlikely that an agreement on a common treatment among EU-MS can be found.
- If no agreement on the treatment of pension schemes can be found this would make the introduction of a common consolidated corporate tax base in the EU impossible!

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Conclusion

Conclusion

There are still many problems to solve

- The further tightening of the anti-BEPS-measures are difficult to understand from a business perspective
 - These tightenings go way beyond the OECD-BEPS proposals
- Some innovative elements are favorable
 - E.g. cross border loss offset
- Some innovative elements are not acceptable
 - E.g. notional interest addition in case of equity decrease (losses) according to AGI
- But before we discuss innovative elements, the EU-MS will have to find solutions for some old fashioned problems
 - E.g. the treatment of pension provisions
- Even without discussing the consolidation provisions and the apportionment formula in the CCCTB proposal a consolidation of corporate profits of MNEs in EU-MS seems to be very difficult/unlikely
- Would a CCTB without consolidation be a sufficient improvement for business?

Thank you!

Ralph Brügelmann

Senior Manager

Tax and Financial Policy

Rue Marie de Bourgogne 58, 1000 Brussels

Tel.: +32 2 792-1012

E-Mail: r.bruegelmann@bdi.eu