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COMMON CONSOLIDATED CORPORATE TAX BASE: GROUPING AND CONSOLIDATION

D. Nerudová

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Abstract

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After the ten years of work and discussion of the proposal the European Commission has published the proposal of CCCTB directive on 16th March, 2011. This proposal can be considered as unique, for the European Commission is suggesting totally new system of corporate taxation. The aim of the paper is to research the rules for consolidation and grouping suggested in the proposal of CCCTB directive, to identify the possible conflict situations and to suggest the possible solution. The focuses on the provisions regarding the conditions for consolidation and grouping, comprised in chapter IX, Art. 54–60. In that area has been identified, that even though the provisions seem to be clear, their practical application can in some situations lead to double interpretation, mainly with respect to the fact that individual member states are responsible for the implementation of the directive and also national tax administrators and national courts are going to interpret the provisions of the directive. Therefore even though the fact that suggested system is unique and addresses a lot of problems which are facing companies running business on the internal market, the provisions regarding the consolidation rules and rules for group formatting may still lead not to unified interpretation. In that respect, some of the rules should be more specific in order to ensure unified interpretation.

common consolidated corporate tax base, consolidation, group, European Union

Even though the main priority of the European Union was the total harmonization of indirect taxation, the first effort to identify the problems in the area of corporate taxation has brought in 1962 Neumark report[1], which based on the conducted analysis recommended the harmonization of free areas of corporate taxation. Firstly, the study has revealed that in many states there arises economical double taxation in the area of dividend taxation. Therefore it has been suggested to harmonize the taxation of corporate profits and dividends. As the unified model of corporate system, taxation was suggested split-rate system. In 1975 the commission has published the proposal of the directive on introduction of partial imputation credit in corporate taxation systems. This proposal nevertheless has not found the support amongst member states.

Secondly, the study has revealed the need for elimination of juridical double taxation of cross-border transactions and situations. With respect to the main aim of the economic integration and establishment of the European Union – the establishment of the Internal Market – the main priority of the Commission was to harmonize only such corporate income tax provisions, which influence the smooth functioning of the Internal Market, which transactions as cross-border payments of dividends and, interests or royalties obviously fulfills. This effort in connection with the

1 The EEC Reports on tax harmonization: reports of the final and financial committee and the reports of sub groups A, B and C (Neumark Report), Amsterdam: IBFD, 1963.

Internal Market establishment has resulted into the adoption of Parent-Subsidiary Directive[2], Merger Directive[3] and Interest and Royalty Directive[4]. It means that only partial selected provisions were harmonized, not the area of corporate taxation as whole. The last area researched by Neumark Committee was represented by the possibility of the structural harmonization in the area of corporate taxation.

The increase in globalization and the influence of MNEs, who were not able to benefit fully from the advantages connected with the Internal Market due to the existence of different systems of corporate income taxation and connected compliance costs of taxation, has led the European Commission to the establishment of Ruding Committee. The task of the Committee was to answer the question, whether the differences in corporate income taxation systems cerate the obstacles on the Internal market and to suggest the provision for removing of those obstacles. Based on the results, the European Commission has aimed its efforts accordingly.

The end of the last century has brought the important changes in economic environment, which should be reflected in the tax legislation. Those changes were represented mainly by the increase number of international mergers and acquisitions, the development of e-commerce and the increase in the mobility of the production factors. This has led European Commission to make a study aiming at the differences in the effective corporate tax rates and differences in the rules for tax base construction. The study has revealed, that differences in effective corporate tax rates represents very important factor, influencing the decisions about the placement of the investment. Based on the results of the study, for possible models of corporate tax systems harmonization were considered. Based on that, European Commission decided to implement twin-track strategy. The main long-term aim has become the implementation of Common Consolidated Corporate Tax Base (hereinafter as CCCTB), while as the short-term aim was defined the implementation of home state taxation system.

The aim of the paper is to research the rules for consolidation and grouping suggested in the proposal of CCCTB directive, to identify the possible conflict situations and to suggest the possible solution. The paper uses standard methods of scientific work. Firstly the method of description is used, in order to describe the suggested rules, then the method of modelling is applied to identify the possible conflict situations and finally the method of analysis and synthesis is used to suggest the possible solution.

RESULTS AND DISCUSSION

After the ten years of work and discussion of the proposal the European Commission has published the proposal of CCCTB directive[5] on 16th March, 2011. This proposal should be considered as unique for the European Commission is suggesting totally new system of corporate taxation and at the same time the Commission mentions, that it represents the unified rules for construction of corporate tax base, not the suggestion of unified corporate tax base.

As mentions (Erasmus-Koen, 2011), the Commission estimates that CCCTB can save to European business EUR 700 million every year in the form of reduced compliance costs of taxation, and EUR 1.3 billion due to the possibility of consolidation[6]. Moreover, remarkable amount could be saved by business looking to expand cross-border. Therefore, the Commission hopes, that the proposed directive will be enacted for entry into force in 2013.

In the proposal, there can be identified five main principles on which the system is based – optionability, common tax base, possibility of consolidation, formulary apportionment of consolidated tax bases among member states and the principle of one tax administrator.

Under the proposal of the directive a company eligible to become a taxpayer under CCCTB must be the company, established under the laws of a Member state and has to take a form listed in Annex I to the proposal and has to be subjected to a corporate income tax or similar tax listed in Annex II. Further, eligible company can also become a third country company, which would fulfil the conditions for consolidation if it were resident in the EU and would have similar form to the companies listed in Annex I and would be subjected to the corporate income tax or similar tax listed in Annex II as they would maintained a permanent establishment. As mentions (Staringer, 2008), the Commission follows the technique that is ready to use for other important instruments of European Law as Merger Directive[7] or Parent-Subsidiary Directive[8].

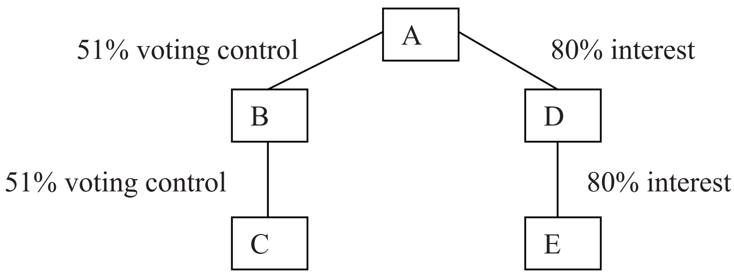
Consolidation under CCCTB is defined as adding up all individual tax bases of group companies with the elimination of all intra group transactions. I.e. the company has to ignore all profits and losses from

2 Directive No. 90/434/EEC
3 Directive No. 90/435/EEC
4 Directive No. 2003/49/EC
5 Proposal for a Council Directive on a Common Consolidated Corporate Tax Base SEC(2011) 315, SEC(2011) 316.
6 Due to the possibility of cross-border loss compensation.
7 Council Directive No. 90/434/EEC
8 Council Directive No. 90/435/EEC

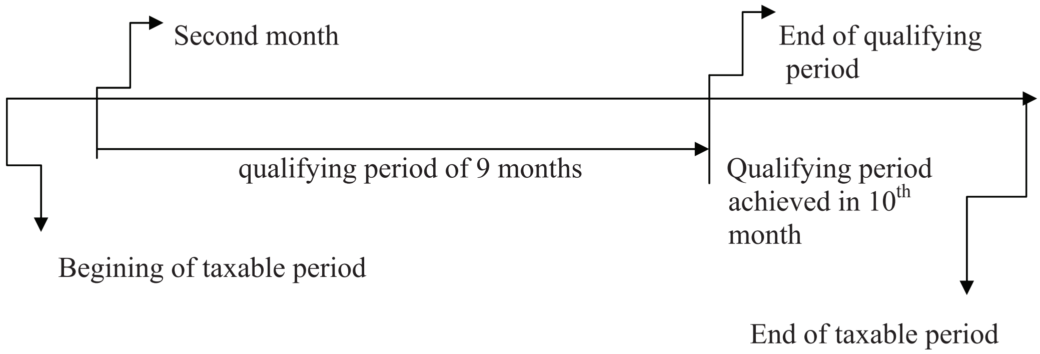
transactions directly carried out between members of a group. As mentions (Tenore, 2008) this principle is align with IAS 27, which also requires that intra-group transactions, as well as incomes and expenses related therewith will be eliminated in full.

The proposal of the directive sets two cumulative requirements on companies to be eligible for the consolidation. It is clearly visible, that the Commission while drafting the rules has decided two layer approach. Firstly, qualifying subsidiaries shall be all immediate and lower-tier subsidiaries in which the parent company holds a right to exercise more than 50% of the voting rights. And secondly, an ownership right of the parent company have to amount to more than 75% of the company capital or more than 75% of the rights giving entitlement to profit. With respect to the voting rights, the proposal of the directive provides that once the voting right threshold is reached in respect of immediate and lower tier subsidiaries, parent company is deemed to hold 100% of such right. Entitlement to the profit and ownership of capital should be calculated by multiplying the interests held in intermediate subsidiaries at each tier. Ownership rights lower than 75% held directly or indirectly by the parent company (including rights in companies resident in third countries) should be also taken into account. It means that if a parent company holds 51% of the voting rights of a subsidiary which in turn holds 51% of voting rights of subsidiary, the parent in general will have voting control over that subsidiary. Nevertheless, the situation is less clear in case of voting rights, because the question whether the voting rights higher than 50% really give the control depends on the provisions in the companies articles of association. Moreover, as mentions (Herzig, 2008), if the parent company holds less than 100% of the shares in a subsidiary, conceptually the consolidation of the tax base is more difficult to establish, since the question of minority interests is arising. It is necessary to mention, that there has been remarkable development since the Technical outline[9] has been published in 2007, for the concept of a group was purely based on the ownership of voting rights. This fact would lead according to (Hohenwarter, 2008) to the use of different criteria regarding the concept of the group for EU corporate tax law purposes. As mentions (Bundgaard, Winther-Sorensen, 2008), the consolidation will be mandatory for all qualifying companies, which is called "all-in all-out" principle. This means that companies belonging to a group cannot opt for the CCCTB separately, but only jointly with other members of the group (Temme, Sporken, Okten, 2011).

The example of application of two layer approach is shown on following Fig. 1.



1: *Two layer approach - lower tier subsidiaries*



2: *Qualifying period covers one taxable period*

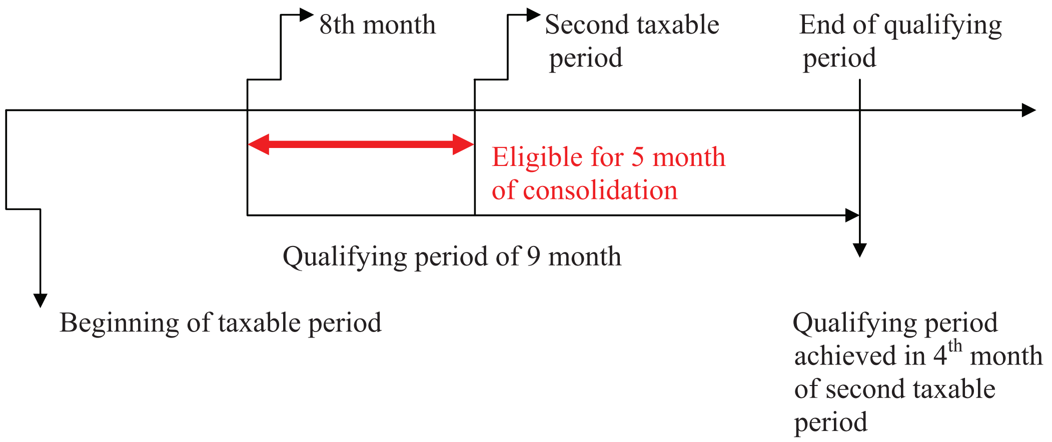
9 CCCTB: possible elements of a technical outline, Working Document CCCTB/WP057

51% voting control is deemed to by 100%, therefore A has 51% voting control of C. Regarding the capital test a pro rata approach is applied. According to it A holds 64% of capital in E (80% x 80%), therefore A does not pass 75% capital (profit) test. Even though the application of two layer approach may seem clear, there can arise questions, mainly in situations, where there is a risk of dual consolidation[10].

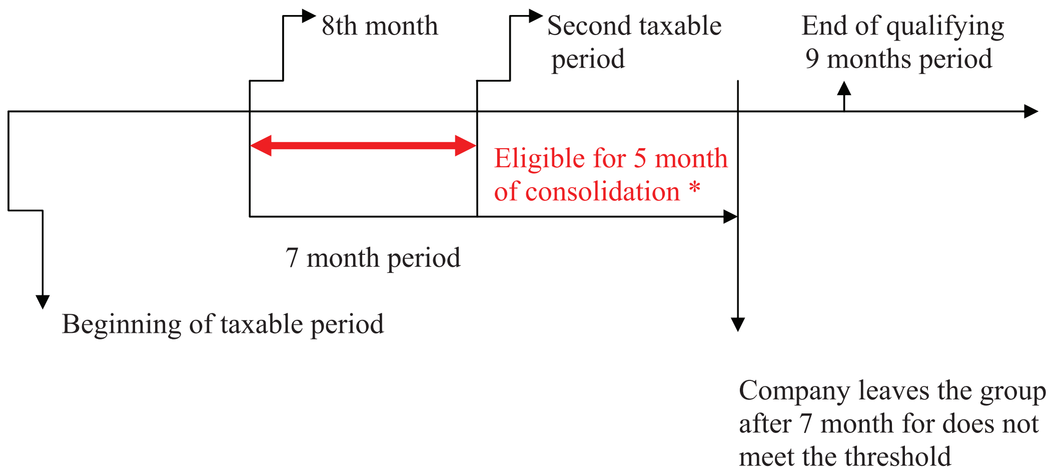
The taxpayer is becoming a member of a group on the date when the above described two cumulative conditions are met. These thresholds have to be met for nine consecutive months; otherwise the taxpayer is treated as if it had never having become a member of the group. Therefore all three thresholds have to be maintained throughout the tax year. In practice there can arise 3 following situations. Fig. 2 presents the situation, when the qualifying period of nine month is met during one taxable period.

The company meets the threshold in second month of taxable year therefore in that month enters into group. In accordance with Art 58 the threshold has to be met for nine following consecutive month – the qualifying period ends in tenth month, i.e. it covers just one taxable year. And further, in case that the company would meet the threshold also at the end of taxable year one, it would be eligible for 9 months of consolidation in that taxable year.

As is shown on Fig. 3, the company meets threshold in eighth month of taxable year, therefore in that month enters into a group. According to Art 58(1) the threshold is met at the end of taxable year one – i.e. the company is eligible for consolidation in five month in taxable year one. Even though the



3: *Qualifying period covers two taxable periods*

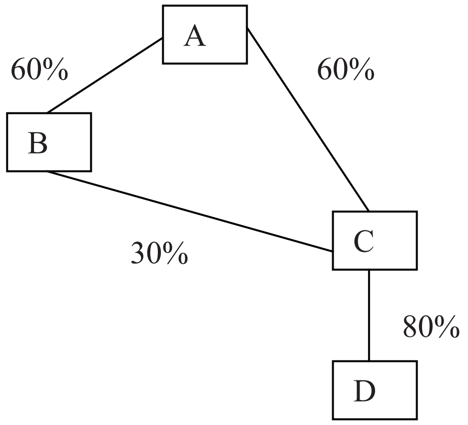


4: *The company stops to meet threshold during the qualifying period*
* The company is treated as if it had never having become a member of the group, since it is ineligible company 5 months in one taxable year will be withdrawn retrospectively

10 For details see Fig. 5.

qualifying period ends in fourth month of second taxable year, the fact whether the company will be also eligible to consolidate depends on the fact whether it will meet the threshold also at the end of second taxable year.

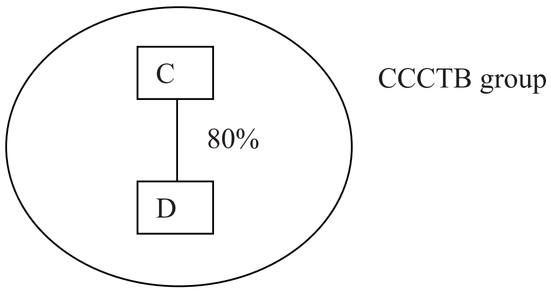
On Fig. 4, the company meets threshold in eighth month of taxable year one, therefore in that month enters into a group. At the end of taxable year one, the company still meets the threshold, therefore it is eligible for consolidation in five moth of taxable year one. However, the company stops to meet the threshold in seventh month of qualifying period (i.e. in second month of second taxable year). Since the condition set in Art 58(1) is not met, the company has to be treated as it would had never been a member of the group and 5 months of consolidation in taxable year one have to be withdrawn retrospectively.



5: *Dual consolidation*
Source: Modified from Webber, D. Proposal for a Common Consolidated Corporate Tax Base (CCCTB). Highlights and Insights on European Taxation. Kluwer: Deventer. Vol. 4, No. 6, ISSN 1876-0665.

Even the Art 54–58 clearly set the rules for qualifying subsidiaries and rules for consolidation, there might arise difficulties in situations, in which the company can form a part of two groups. The situation is described on Figure 5.

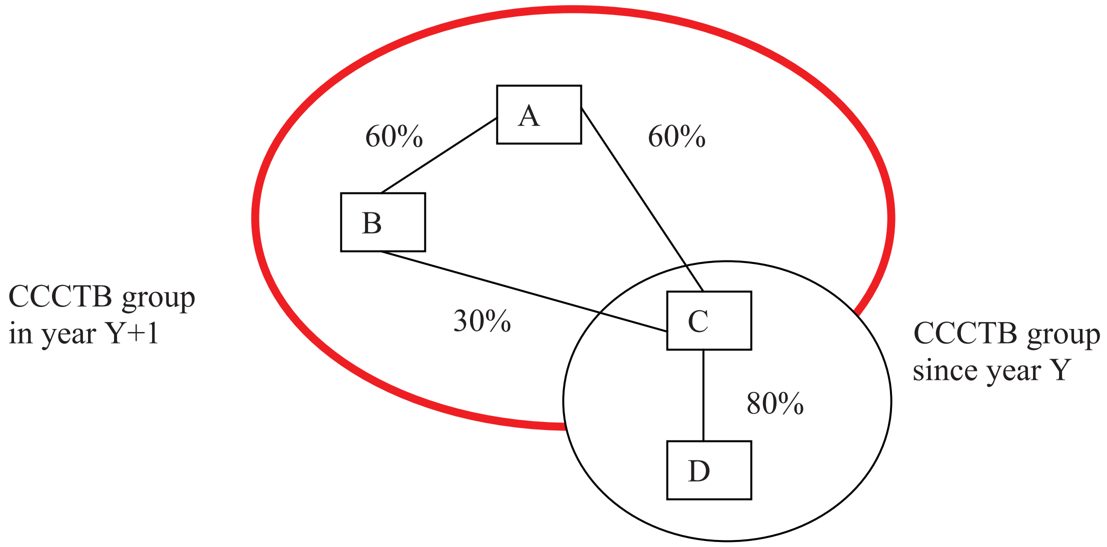
In application of two cumulative conditions in eligibility test, company A meets voting rights test in B, C and D, but does not meet capital test. Therefore try to fulfil profit right test, which says that company can be part of a group if it has more than 75% of rights giving entitlement to profit. Assume that C also meets voting rights test in connection with D. C is the company, which would like to opt for CCCTB, therefore as majority shareholder in D will ask D to opt as well. Companies C and D will opt for the system in year Y and create a group. The situation is shown on Fig. 6.



6: *Grouping in year Y*

In year Y+1 also company A decides to opt for the system. A can form a group with company C. A has 78% (60% * 30% + 60%) of profit rights in C, but only 62% (78% * 80%) of profit rights in D. The situation is shown on Fig. 7.

It is not clear from the CCCTB proposal, how to solve the following situation. A can form a group with C but not D (for there A has just 62% of profit

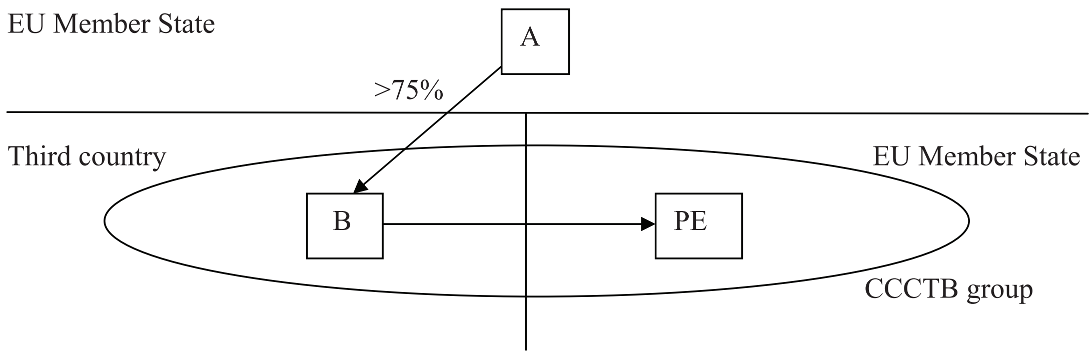


7: *Grouping in year Y+1*

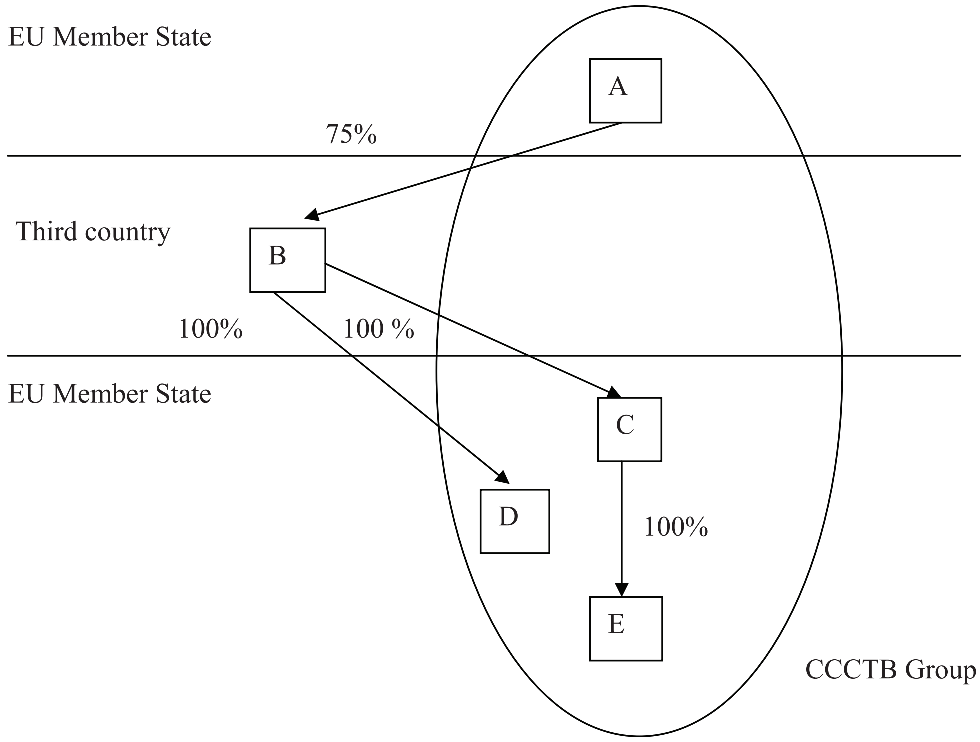
rights), but D is already in group with C. Will the opting of A into the system automatically lead to the degrouping of C and D? If A opts for the system C becomes the part of the group automatically, with no possibility to step out. It means that under present state of the proposal of CCCTB directive once the company opts for the system does not have any control over the fact whether it will be included in the group. Therefore, the directive proposal should explicitly mention, whether the above described situations will lead to degrouping.

Art 55 of CCCTB proposal deals with eligible group structures. A resident taxpayer can form a group with all its permanent establishments located in other member States, also with all permanent establishments located in a Member State of its qualifying subsidiaries resident in a third country, further with all its qualifying subsidiaries resident in one or more Member States and finally with other resident taxpayers which are qualifying subsidiaries of the same company which is resident in a third country. A non resident taxpayer can form a group in respect of all its permanent establishments located in Member States and all its qualifying subsidiaries resident in one or more Member States. Based on the above mentioned rules, bellow are presented the situations under which a company A – EU resident taxpayer can form a group.

As can be seen from Fig. 9, subsidiary of company A located in third country (company B) is eligible to form CCCTB group with the PE of company B located in the EU. The decisive factor in this situation is the fact, that company B would fulfil the condition



8: *EU resident taxpayer and PE of third country subsidiary*



9: *Sandwich situation*

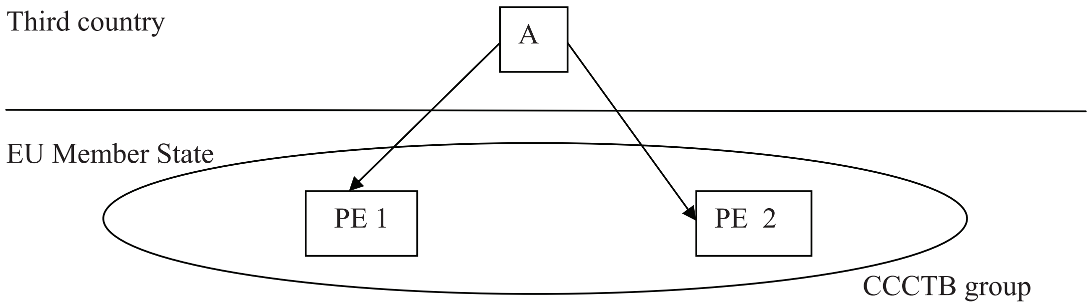
for consolidation in case it would be resident in EU – i.e. company A has more than 75% of voting rights in company B.

Fig. 10 above shows the situation, when an EU resident taxpayer – company A – holds more than 75% of voting rights in company B, which is located in third country. This company wholly owns subsidiaries C, D and E, located in EU member state. Based on the rules for formatting the group in Art 55, company A can create a CCCTB group with company C, D, E. The decisive factor is that company A holds indirectly through company B 100% in company C, D, and E. This situation is sometimes called as "sandwich" situation.

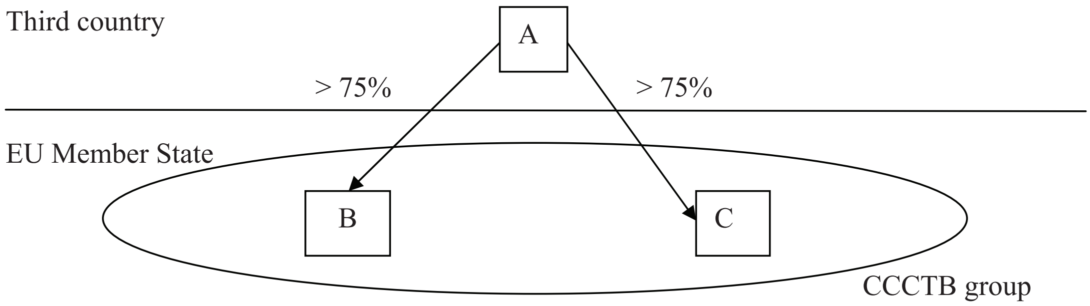
As can be obvious from Fig. 11 a non-resident taxpayer may reach CCCTB system through PE located in EU member states. PE1 and PE2 are according the rules eligible to form a CCCTB group. Similar situation is shown bellow.

A non-resident taxpayer – company A can reach CCCTB system also through the subsidiaries owned in EU member states. Company B and C are eligible to form a CCCTB group for third country company A holds a participation higher than 75% in those companies.

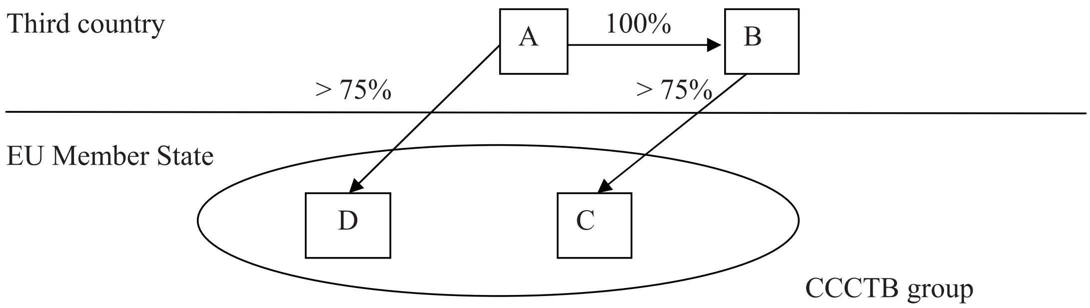
A non-resident taxpayer – company A – has wholly owned subsidiary located in third country – company B – and holds the participation higher than 75% in EU-resident subsidiary – company D. Company B also holds participation higher than 75% in EU-resident subsidiary – company C. Due to the fact that company A holds directly more than 75% in company D and indirectly more than 75% in company C, the rules for consolidation are fulfilled and company D and C can form the CCCTB group.



10: *Permanent establishments of company settled in third country*



11: *Subsidiaries of parent company settled in third country – I*



12: *Subsidiaries of parent company settled in third country – II*

CONCLUSION

Even though the fact that the introduction of the directive proposal on Common Consolidated Corporate Tax Base (CCCTB) represents ten years of work and very intensive discussions, there still can be found provisions, which are not clear enough and might led to not a unified interpretation in different member states. Different interpretation might arise mainly with respect to the fact that individual member states are responsible for the implementation of the directive and also national tax administrators and national courts are going to interpret the provisions of the directive.

The paper has focused on the provisions regarding the conditions for consolidation and grouping, comprised in chapter IX, Art. 54–60. In that area has been identified, that even though the provisions seem to be clear, their practical application can in some situations lead to double interpretation. The first example represents the rule for qualifying subsidiaries in Art. 54. The suggested two layer approach leads to the fact that under present state of the proposal of CCCTB directive once the company opts for the system does not have any control over the fact whether it will be included in the group or not. This situation has been presented on Fig. VI and VII. Moreover, if a parent company holds 51% of the voting rights of subsidiary, which in turns holds 51% of voting rights of sub-subsidiary, the parent company in general will have voting control over sub-subsidiary. However, in that connection is necessary to mention, that whether and to what extent more than 50% of voting rights give control also depends on the provisions in the company's articles of association. In situations, where majority is required for the decision, 51% of voting rights gives just negative control. Similar problem has been identified in the rules for grouping set by Art. 55.

Therefore even though the fact that suggested system is unique and addresses a lot of problems which are facing companies running business on the internal market, the provisions regarding the consolidation rules and rules for group formatting may still lead not to unified interpretation. In that respect, some of the rules should be more specific in order to ensure unified interpretation.

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Address

doc. Ing. Danuše Nerudová, Ph.D., Ústav účetnictví a daní, Mendelova univerzita v Brně, Zemědělská 1, 613 00 Brno, Česká republika, e-mail: d.nerudova@seznam.cz