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Coordination of the Common Tax Base on the Corporate Level of the EU

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Abstract

Coordination of tax policy is one of the basic elements that can contribute to greater economic integration in the European Union. Treaty of Rome establishing the European Economic Community (EEC, the EU and the Community) in Article 2 lays down that the EEC should have as its primary task to establish a common market by gradually approximating the economic policies of the Member States, as well as to promote the harmonious economic development, constantly balanced economic growth, increased stability, accelerated raising of the standard of living and closer relations between the countries to which they belong. The Member States must remove all obstacles to the free movement of goods, services, people and capital (four freedoms). One of the elements of a stronger economic integration is the harmonization of the tax systems (e.g. the corporate tax regimes) of the 28 Member States. The European Commission proposed a common mechanism for the calculation of the corporate tax base, the consolidation of the tax bases incurred in the different Member States and the subsequent allocation of the consolidated tax base between the Member States (formulary apportionment). The system envisaged by the European Commission is already introduced by the world highly integrated economies, like the United States of America and Canada on a domestic level, where the corporate tax base shall be also allocated between the states and the provinces based on the formulary apportionment method.

Keywords: Tax Policy, Treaty of Rome, EU Common Market, Harmonization of Taxes, CCCTB

1. INTRODUCTION

In the Member States, large differences in tax structure and tax rates were found in relation to sales taxation, excise duties, corporate taxation and personal taxation [20]. In the field of direct taxation, a general turnover tax in the form of value added tax was introduced. Excise duties were even more diverse, since fiscal charges of all types were included in this category of duty. Turnover of excise duties was often carried out with the help of state monopolies on production and sale [18]. In the field of corporate taxation, there was also a similar diversity, since three taxation systems were developed, a classical system, a system of shared rates, and an input system. In the system of personal taxation, there were also large differences, in particular with regard to exemptions and financing methods [10]. The Competitiveness Pact proposed six measures aimed at creating the competitiveness of the internal market in the European Union [3]. Initially, the Competitiveness Pact was designed for the territory of the euro area Member States, but non-EU Member States were also invited to join together [10].

Creating a common corporate tax base is a very important but extremely controversial part of the Competitiveness Pact. Although the Competitiveness Pact was renamed the "Pact for the Euro", the original objective of strengthening economic integration with the Member States remained unchanged. The euro pact is intended to strengthen the coordination of economic policies between Member States with the aim of improving competitiveness and facilitating a greater degree of convergence between Member States . The euro pact also includes the coordination of Member States' fiscal policies . Direct taxation issues remain within the competence of the Member States, but in developing the company's overall tax base, fiscal neutrality must be pursued to ensure consistency between national tax systems while respecting national tax strategies, thereby indirectly contributing to the sustainability of public finances and the competitiveness of European companies. Within the framework of the EU Pact, the harmonization of tax policies includes [10]:

- exchange of best tax practices,
- avoiding harmful practices and making proposals to combat tax fraud and evasion,
- the development of a common corporate tax base.

The main objective of the Euro Pact is to promote convergence between Member States in order to reduce the economic imbalances that have contributed to the economic crisis. However, the Pact for the Euro can also have a profound political influence in terms of creating a union in the Union and contributing to the creation of a two-speed Europe. The development of a common corporate tax base was included in the Commission's proposal for a Council Directive on the Common Consolidated Corporate Tax Base (CCCTB). The European Commission has proposed a common mechanism for calculating the corporate tax base, the consolidation of tax bases from different Member States and the subsequent distribution of the consolidated tax base between the Member States in accordance with the distribution mechanism. The system proposed by the European Commission is similar to that used in other market economies, such as the United States of America and Canada, where the consolidated tax base is allocated between countries on the basis of a distribution mechanism [13].

The CCCTB system should provide more favorable conditions for investment in the single market, while reducing management costs. Enterprises would gain competitive advantages in the internal market, mainly due to the elimination of transfer prices, the transfer of losses through national systems in the group as well as the reorganization of the system. The positive effects of the introduction of the CCCTB model, on the other hand, outweigh the introduction of certain additional financial and administrative costs that should be taken into account by the national tax authorities in case of system implementation at first instance. The introduction of the CCCTB would increase the transparency of taxation across EU Member States, thereby helping to reduce fiscal uncertainty, as international companies could reasonably calculate in advance how much the real tax burden would be at the level of the whole company. This system would discourage companies from certain types of behavior for purely fiscal reasons, which would reduce the distortion of investment decisions and increase economic efficiency.

2. HARMONIZATION OF THE TAX BASE OF CORPORATE INCOME TAX

Companies wishing to make activities across the EU face high barriers and distortions of the market due to 28 different corporate tax systems. Tax obstacles to cross-border business are particularly large for small and medium-sized enterprises, which usually do not have the means to eliminate market inefficiencies. The network of conventions on the avoidance of double taxation between Member States does not provide a suitable solution. The current Union legislation on taxation of legal persons deals with only a small number of specific problems.

A system that would allow companies to treat EU corporations as a single market in relation to EU corporate income tax would facilitate the cross-border activity of resident companies in the EU and promote the objective of making the EU more competitive for international investment. Such a system could best be achieved by allowing groups of taxable companies in more than one Member State to regulate their tax matters in the EU on the basis of a single set of rules for calculating the tax base and cooperating with one tax administration. These rules should also be available to entities that are liable to pay corporate income tax in the EU and are not part of the group. Thus, under the aegis of the Commission of the EU and its working bodies, the idea of creating a system of a common consolidated corporate tax base (hereinafter CCCTB) was formed [13].

The CCCTB is used to tackle some of the major tax barriers that restrict growth in the single market. In the absence of common tax regulations, the interaction of national tax systems often leads to excessive taxation and the occurrence of double taxation. Companies are faced with major administrative and coordination costs. Such a situation creates barriers to investment in the EU and results in non-compliance with the priorities set out in the Europe 2020 Strategy - A strategy for smart, sustainable and inclusive growth [4]. The CCCTB is an important initiative which contributes to eliminating the barriers to the completion of the single market [5].

The proposed system of corporate taxation would be technically in three stages. All taxable profits and losses of each group of companies would be consolidated, irrespective of the location of individual companies in the group. The established tax base of a group of companies would be attributed to the individual group companies using the distribution formula. The tax base attributed to an individual group company would be taxed at the national tax rate of the country in which the company is located.

2.1. Implementation of the system

A common approach would ensure the coherence of national tax systems on the basis of a common tax base, but would not interfere with the rights of countries to form a tax rate. Each Member State will apply its own tax rates to its share of the taxable tax base. Differences in the determination of the tax rates of individual Member States provide for a degree of tax competition which is supposed to be maintained on the internal market. It allows Member States to take into account both their competitiveness in the EU internal market and the regulation and balancing of the budgetary needs of each Member State in tax planning [2].

In particular, the CCCTB contributes to reducing tax obstacles and administrative burdens, making it simpler and cheaper for small and medium-sized enterprises (SME), as they can expand their activities across the EU. The approach of SMEs to the CCCTB means that operating across borders use the CCCTB rules to calculate their tax base. In the event of accession to the CCCTB [16], SMEs would have less coordination costs, which would have a positive impact on the decision to commercial extension to another Member State.

The CCCTB introduces a uniform set of tax regulations in the EU Member States and uses only one tax administration model. An undertaking opting for the CCCTB ceases to be subject to a national tax arrangement in respect of all tax matters governed by the common rules of the CCCTB. A company that does not meet the conditions or does not opt for a CCCTB system is still subject to the rules applicable in national tax legislation.

With the introduction of the CCCTB, problems arising from jurisdiction contracts and the taxation of revenues generated by European companies outside the EU or outside the CCCTB area. If a practice of separate profits would remain in use in relation to non-EU countries, this would probably lead to the parallel use of different systems. This would entail an administrative burden for businesses, which would reduce the benefits of taxation through the CCCTB. The question arises, to what extent high capital mobility globally, diminishes the benefits of fiscal coordination within the EU [12].

2.2. Profits and losses

A more important advantage of the CCCTB is the ability to identify profits and losses at the level of an international company, which would enable the loss of businesses at EU level to be covered. Profits and losses of a group of companies should not be distinguished by countries in which individual subsidiaries of the group are located, all taxable profits and losses, irrespective of the location of individual companies in the group, would be consolidated. Thus, the spillover of profits between the companies of the group would lose sense, as the introduction of such a system would also eliminate the need to determine the transfer prices for transactions between individual companies of the CCCTB system [19].

The taxpayer's income must be taxable, unless explicitly exempted. The CCCTB system exempts income in the form of dividends, proceeds from the disposal of shares of a company that is not part of the group and the profit of permanent establishments abroad. In granting double taxation, most Member States exempt dividends and proceeds from disposal of shares, in order to avoid the calculation of the deduction of tax paid abroad, to which taxpayers are entitled. Taxable income should be reduced by operating expenses and some other items. Deductible operating expenses should normally include all the costs associated with the sale and expenses associated with the creation, maintenance and insurance of income. R & D costs and costs arising from the collection of equity or debt for business purposes should be deducted. A list of non-deductible expenditure should also be prepared [15]. Tangible and intangible long-term assets should be depreciated separately, while remaining required to be included in the group of assets. Depreciation in the group means simplification for tax authorities and taxpayers, since it eliminates the need to prepare and maintain the list for each type of fixed asset and its useful life [11].

When transferring the losses, taxpayers are allowed to transfer the losses to a future period for an indefinite period of time. The transfer of losses to the previous period may not be allowed. Since the loss is transferred in the future to the taxpayer to pay tax on his real income, there is no reason to limit the deadline for the transfer to the future period. The transfer of losses to the previous period is relatively rare in the practice of the Member States and entails the excessive complexity of the procedures [14].

2.3. Consolidation and distribution formula

Consolidation is an essential element of the CCCTB, as the main tax barriers faced by companies in the EU can only be addressed in this context. Consolidation eliminates formalities relating to transfer pricing and double taxation within the groups. In addition, the loss incurred by taxpayers is automatically offset by the profits generated by other members of the same group. Consolidation must include rules for the distribution of the result among the Member States in which the members of the group own their business units [17]

The distribution formula of the consolidated tax base contains three equally weighted factors (work, assets and sales). The labor factor is calculated on the basis of remuneration for work and number of employees (each item represents half). The asset factor consists of all tangible fixed assets. Intangible and financial assets should be excluded from the formula because of their mobile nature and the risks of avoiding the system. Finally, sales must be taken into account in order to ensure the fair participation of the state of destination. These factors must ensure that profits are taxed where they are earned. As an exception to the general principle, where the result of a distribution does not represent a fair amount of business activity, a substitution method is defined with a safeguard clause [8].

Example

Table 1: Calculation of the tax base on the basis of the partition mechanism - the loss shown in the Companies A; B and D in the CCCTB group

company	***sales***	***wages***	***employees***	***fixed assets***
A	*15.000*	*1.500*	*3*	*30.000*
B	*60.000*	*6.000*	*7*	*150.000*
C	*150.000*	*15.000*	*8*	*300.000*
D	*200.000*	*20.000*	*10*	*380.000*
E	*5.000*	*500*	*2*	*10.000*
sum	*430.000*	*43.000*	*30*	*870.000*
company	***sales***	***wages***	***employees***	***fixed assets***
C	*150.000*	*15.000*	*8*	*300.000*
E	*5.000*	*500*	*2*	*10.000*
sum	*155.000*	*15.500*	*10*	*310.000*

A.) We calculate the shares through a distribution mechanism, where we take into account both sales revenues, fixed assets and employment

DO = 0,33 x (sales / total sales + (0,5 x (wages / total wages) + (employees / total employees)) + axis / total axis)
DOC = 0,33 x (150,000 / 155,000 + (0,5 x (15,000 / 15,500) + (8/10)) + 300,000 / 310,000) = 0,33 x (0,968 + (0,5 x (0,968 + 0 , 8)) + 0.968) = 0.931
DOE = 0.33 x (0.032 + (0.5 x (0.032 + 0.2)) + 0.032) = 0.059

B.) We calculate shares through a distribution mechanism, where we take into account turnover and fixed assets without employment

DO = 0.5 x (sales / total sales + axis / total axis)
DOC = 0.5 x (150.000 / 155.000 + 300.000 / 310.000) = 0.5 x (0.968+ 0.968) = 0.968
DOE = 0.5 x (0.032 + 0.032) = 0.032

C.) We calculate the shares through a distribution mechanism, where we take into account the elements of employment without sales and fixed assets

DO = 0.5 x (wages / total wages + employees / total staff)
DOC = 0.5 x (15.000 / 15.500) + (8/10) = 0.5 x (0.968 + 0.8) = 0.884
DOE = 0.5 x (0.032 + 0.2) = 0.12

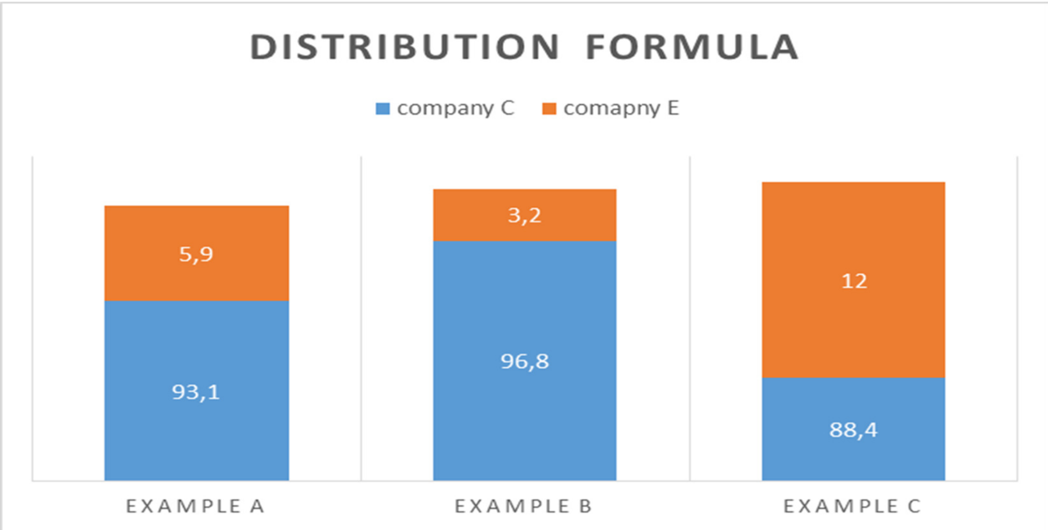

Figure 1: Distribution formula

With regard to the distribution of the tax base through the CCCTB system in companies certain discrepancies are observed. The example A shows the distribution of the tax base through all three elements of the distribution formula (sales, work and fixed assets). In the example B, we excluded the work (salaries and employees) from the distribution formula. The analysis shows that the distribution of the tax base increases with those companies that have a higher percentage of sales and consequently a higher percentage of the value of fixed assets, while the share of the distribution of the tax base in those companies with a lower percentage of sales and the value of fixed assets consequently decreases. From this point of view, such a distribution formula would be fairly fair, since companies that achieve higher sales values would possibly also be heavier taxed through a higher tax base (possibly because taxation also depends on the tax rate, which is determined by individual countries in accordance with its national law). Through the example C, we excluded from the distribution formula revenues from sales and value of fixed assets, so that only fixed costs remain - wages and the number of employees, which indirectly affects the value of fixed costs. Due to the rigid system of value of these items, there is a visible deviation in the case of companies that have low values of revenues from sales and fixed assets.

Rules on the reorganization of undertakings are also laid down to safeguard the rights of Member States in relation to taxation. In the event that a company joins the group, the market loss before the consolidation should be carried over to the future period to be deducted from the distributed share of the taxable person. If the company leaves the group, it is not allocated to the loss incurred during the consolidation period. Transactions between a taxable person and an affiliated company that is not a member of the same group is a co-subject of a price adjustment in accordance with an independent market principle, which is a generally valid criterion.

2.4. Administrative view

In the administrative area, groups of companies have the possibility of cooperating with only one tax administration (the main tax authority), which is the tax administration of the Member State in which the parent company of the group (principal taxpayer) is resident for tax purposes [1]. A general anti-abuse rule is also included, complemented by measures to limit certain types of abuse. These measures include restrictions on the deductibility of interest paid to affiliated undertakings which for tax purposes are residents of a low-tax country outside the EU that does not exchange information with the Member State of the payer on the basis of an agreement comparable to Council Directive 2011/16 / EU on mutual assistance the competent authorities of the Member States in the field of direct taxation and taxation of insurance premiums and regulations on foreign subsidiaries.

2.5 Recent changes in harmonization of the tax base of corporate income tax

The Council is considering a newly launched legislative initiative to introduce a common consolidated corporate tax base in the EU. The initiative consists of two legislative proposals:

- a proposal for a directive establishing a common tax base for corporation tax (CCTB) [7];
- a proposal for a directive establishing a common consolidated corporate tax base (CCCTB) [6] .

The previous proposal for the establishment of a common consolidated corporate tax base published in 2011 was not approved in the Council. However, technical work on the aspects of tax avoidance in 2016 led to the adoption of the anti-avoidance directive. In July 2013, EU ministers agreed that the common base for corporation tax should first be introduced, but then consolidated. Therefore, the European Commission has redrafted the proposal and divided it into two directives: the Directive on the introduction of a common corporate tax base (CCTB) and the CCCTB. The proposal included the Council's proposals for the previous (2011) proposal on the introduction of the CCCTB, in particular the compromise proposal of the Presidency of the EU Council of November 2014 and the Council's work on anti-avoidance measures. Both draft directives concern taxation, so they will need to be adopted in accordance with a special legislative procedure that requires consensus in the Council of the EU after consulting the European Parliament.

The objective of the CCTB Directive is to introduce a single set of rules for the calculation of the corporate tax base in the EU internal market. This would reduce administrative costs and improve legal certainty for businesses, as the calculation of their taxable profit would be the same in all EU countries. In addition, the new rules would help Member States to combat aggressive tax planning.

The draft CCCTB Directive lays down technical rules for profit consolidation and the distribution of the consolidated base to the eligible Member States. However, the aim of the CCCTB initiative is not to harmonize tax rates or possible tax incentives in the EU - these issues do not fall within the scope of the proposals. The setting of corporate income tax rates is a sovereign right of the Member States.

The proposed rules would be mandatory for groups of companies whose consolidated turnover exceeds EUR 750 million in the financial year and which have a permanent seat under the law of an EU Member State and belong to a taxable person who is resident for tax purposes in the EU. Small and start-up companies, whose turnover is lower than this threshold, could also be part of this system.

A very broadly defined tax base is proposed in the draft CCTB Directive. In accordance with the proposed rules, any revenue will be taxable unless explicitly exempted. The draft contains exempt revenue, which includes profits from the permanent establishment of a company in the country in which the head office of that company is located, and income from dividends or sales of shares of a company that is not part of the group. In addition, the draft rules propose a reduction in taxable income through operating expenses and other items. The proposal also contains a list of non-deductible expenditure.

The draft provides for pan-European tax relief for companies investing in research and development. R & D companies will be entitled to an additional 50% annual allowance for R & D and up to a further 25% relief for amounts exceeding EUR 20 million. Small startup companies could deduct 100% of their R & D costs, insofar as these expenditures do not exceed EUR 20 million and if these small enterprises do not have any related companies. By doing so, we would like to encourage innovation in the EU and help smaller companies to develop. Provisions against corporate tax avoidance (profit reorientation). The draft CCTB Directive contains several anti-tax avoidance provisions that include:

- the rule on the limitation of interest
- the rule of controlled foreign companies
- rules on hybrid discrepancies
- general rule on the prevention of abuse

Example
The company spends € 30 million on research and development in a given year. It will be allowed:
To deduct the total costs from your taxable income = EUR 30 million
An additional 50% for the first EUR 20 million = EUR 10 million
An additional 25% for the remaining € 10 million = € 2.5 million
In total, a R & D company can deduct 42.5 million euros from its tax base.

These rules reflect the rules already agreed by the Council under the VAT Aid Directive (ATAD Directive). Compared to the latter directive following the de minimis approach, the CCTB proposal is a step further, as it proposes that these rules be fully harmonized.

The directive contains a new tax advantage aimed at encouraging companies to use equity capital to finance growth rather than debt. For companies that, for the purpose of financing their activities, decide to increase equity, instead of borrowing, a special tax deduction will be available. These rules should help small companies to use capital markets and generally reduce the dependence of the private sector on borrowing.

Example
The company begins to use a common base in January of year X.
In the same year, it issued new shares worth EUR 10 million for investments in new premises.
The AGI rate for year X is 3% (the rate will change from year to year).
This year, the company may deduct AGI from its tax base of EUR 300 000 = EUR 10 million, multiplied by 3%.
The company will also receive additional fees for the next 9 years after the issue of this equity. The exact amounts of this allowance will depend on how the equity value develops.

The Council will only consider the directive establishing a Common Consolidated Corporate Tax Base (CCCTB) only after sufficient progress has been achieved in the consideration of the directive establishing a common tax base for corporation tax, which will lead to a period in which taxpayers are temporarily they will not be able to benefit from fiscal consolidation. To resolve this problem, the proposal contains a provision for a relief mechanism to cover cross-border losses with subsequent reintegration. This rule would apply until the introduction of a common consolidated corporate tax base, when the facilitation to cover cross-border losses should become automatic. The CCCTB Directive basically suggests that the consolidated taxable profit of a multinational enterprise group be divided between those Member States in which the group operates. This would be achieved using a specially designed distribution formula. Under the proposed mechanism, each Member State will then be able to tax its distributed share of profits at its own national tax rate.

Given today's international economic environment, characterized by increasingly globalized, mobile and digital business models and the complex structures of multinational companies, governments are increasingly difficult to secure the taxation of operating income in countries where value is created. Differences between national corporate tax systems across the EU create favorable conditions in which transnational corporations can implement tax planning schemes, which most often involve redirection of profits into lower-tax jurisdictions (in so-called 'preferential tax regimes'). This activity, known as 'profit reorientation', is detrimental to the state budget and contributes to the erosion of its tax base. The practices of aggressive tax planning, most commonly used by large multinational companies, have a particularly negative effect on the competitiveness of small and medium-sized enterprises that can not afford high consultancy fees associated with such tax solutions.

3. CONCLUSION

The main advantage of fiscal harmonization at EU level (tax harmonization) is to reduce costs at the level of national tax systems, given the fact that, due to different tax systems, countries have higher costs in collecting taxes, and the mobility of tax factors is further facilitated by tax evasion, since the taxation of income from other countries are much more difficult. The advantages of fiscal harmonization are also in the elimination of disruptions in the internal market, as the free movement of goods, services, persons and capital is applicable. Due to high tax burdens in one and low in another Member State, taxpayers are motivated to transfer activities to countries with a lower tax burden. Due to differences in the amount of the tax burden, production factors are moved to countries with a lower tax burden. In the case of corporate income tax, we note that companies do not move their production to countries with lower production costs, but to countries with lower taxes, as they can outweigh the higher production costs. It may happen that in the long run, a company that is less efficient will survive in the common market, but it is also less taxed.

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