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COMMISSION STAFF WORKING PAPER
SUMMARY OF THE IMPACT ASSESSMENT

Accompanying document to the

Proposal for a

COUNCIL DIRECTIVE

on a Common Consolidated Corporate Tax Base (CCCTB)

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1. PROBLEM DEFINITION

Globalisation has reshaped the economic landscape. Not only the geography of production, but also the internal organization of firms operating in international markets has dramatically changed. The framework of steadily progressing market integration changes radically when it comes to corporate taxation. With 27 different tax systems that co-exist and often clash, the EU market remains indeed highly fragmented. This situation places the EU at a significant disadvantage *vis-à-vis* its major trading partners, the United States and Japan, each being perceived as one single market by businesses.

Firms currently operate through schemes structured to accommodate increased mobility of capital and frequent cross-border transactions between associated companies. Consequently, concepts defined for tax purposes, such as source and residence, traditionally used to address the needs of relatively closed economies, often prove inappropriate to tackle the challenges of commercial activity within an integrated market. Specifically, the coexistence of heterogeneous, frequently changing tax rules represents an obstacle for businesses competing in international markets. Further, national tax systems become increasingly vulnerable to tax avoidance schemes. In fact, income shifting and treaty shopping are naturally facilitated in a context of high mobility of productive factors.

Against this background, a number of tax obstacles remain for companies with cross-border operations in the EU, namely:

- I. *Additional compliance costs*, which arise from compliance with different national tax systems and with transfer pricing rules. According to evidence reported in the Company Tax Study published by the Commission in 2001, tax related compliance costs are in the range of 2-4% of the corporate income tax revenues. In the context of the EU27, this could be translated into an average figure of more than €10 billion for 2008.
- II. *Double taxation*, which takes place when comparable taxes are imposed on the same income in two or more states.
- III. *Over-taxation*, which occurs when cross-border activities create tax liabilities that would not occur in a purely domestic context (e.g. associated companies of different Member States or their permanent establishments are not entitled to share losses, whereas loss consolidation for companies established only in one Member State reduces their taxable profits and tax burden).

2. ANALYSIS OF SUBSIDIARITY

The current framework with 27 different national corporate tax systems impedes the proper functioning of the Internal market. Member States cannot provide a comprehensive solution to this problem. Non-coordinated action – planned and implemented by each Member State individually – would replicate the current situation, as taxpayers would still need to deal with as many administrations as the number of jurisdictions in which they are liable to tax. Community action is necessary in view of establishing a juridical framework with common rules. The Commission has taken the initiative having in mind that, under the principle of

subsidiarity, Member States retain sovereignty in setting their corporate tax rates. Therefore, they are free to determine the desired size and the composition of their tax revenues.

3. OBJECTIVES OF EU INITIATIVE

The specific policy objectives of the EU initiative are to eliminate the remaining tax obstacles in the Internal market outlined above, that is additional compliance costs related to international activity, as well as instances of double taxation and over-taxation. As a result, a general objective of improving economic efficiency in the allocation of productive capital in the EU could be attained by means of reduced tax distortions to investment decisions and increased opportunities for cross-border investments. As such, the envisaged improvement in the simplicity and efficiency of the corporate income tax system in the EU can significantly contribute to achieving the objectives of the EU2020 strategy, and to strengthening the Internal market, in line with the initiatives advocated in the Single Market Act.

The operational objective is to establish a common set of rules to calculate the taxable base for the relevant companies in the EU.

It should be stressed that the effects on the size and the distribution of corporate taxable bases across the EU are not an intended aim of the policy initiative *per se*. No objectives are therefore defined in terms of revenue distribution or revenue neutrality for MS.

4. POLICY OPTIONS

The report considers four main policy scenarios, which are compared with the "no action" or status-quo scenario (option 1):

- The adoption of an *optional Common Corporate Tax Base (CCTB)*, i.e. the replacement, for the relevant companies, of the 27 different company tax codes by a common tax base, calculated using a single set of rules (option 2).
- The *compulsory* introduction of a *Common Corporate Tax Base (CCTB)* for all EU-based-companies (option 3).
- Under an *optional Common Consolidated Corporate Tax Base (CCCTB)* companies could opt for a common (eg, calculated using a single set of tax rules) EU-wide consolidated tax base that would replace the current 27 different company tax codes and the separate accounting mechanism (option 4).
- The same rules would be obligatory for all EU-based companies under a *compulsory Common Consolidated Tax Base (CCCTB)* (option 5).

Under all possible options, common rules would be established only for the calculation of the tax bases, whereas Member States would be left with fiscal sovereignty in deciding the applicable tax rates.

5. ASSESSMENT OF IMPACTS

5.1. Impact on the size and on the distribution of the tax base

The policy options entail changes in the size and the cross-country distribution of the corporate tax bases that is worth quantifying, although such effects are not objectives *per se* of the tax reforms under analysis. Importantly, no general conclusions should be drawn on the final effect on revenues or on the budgetary position of the different MS, as these will ultimately depend on national policy choices with regard to possible adaptations of the mix of different tax instruments or applied tax rates.

The findings indicate that the introduction of the common tax base provisions unrelated to cross-border loss consolidation (CCTB) could lead on average and for most EU-based companies to broader tax bases than the current ones. However, the magnitude of this increase seems to depend essentially on the depreciation rules applied. In any case, the common tax base would reduce the current substantial variation in tax bases across European countries.

The CCCTB provisions would allow for cross-border consolidation of profits and losses. Calculations on a sample of EU multinational groups based on the Amadeus and ORBIS databases show that, on average every year approximately 50% of non-financial and 17% of financial multinational groups in the respective samples could benefit from immediate cross-border loss compensation. Weighting the separate results for the different sectors indicates that on average for the groups involved the taxable base under the CCCTB scenario would be around 3% lower than in the status-quo scenario¹.

Under the CCCTB, the question arises on how the overall tax base should be divided among the Member States in which the multinational group operates, and thus requires the definition of ad hoc apportionment mechanisms. Using data from financial accounts to proxy for taxable profits of multinational groups shows that the formula with employee costs, assets and sales by destination equally weighted would lead to increases in the bases mostly in the MS in Central and Eastern Europe, as well as in Germany, Spain, France, Greece and Italy. Survey results indicate that changing the weighting of the apportionment factors has little effect on the relative distribution of the tax base between countries.

5.2. Impact on compliance costs

According to survey evidence, the main corporate compliance cost drivers for multinational enterprises are directly or indirectly related to transfer pricing tasks (transfer pricing documentation, clearances and rulings and mutual agreement procedures). Moreover, the compliance burden due to transfer pricing has been increasing over time, mainly as a result of two factors: (i) more demanding documentation requirements from tax authorities accompanied by tax authority reviews; (ii) adjustments and changes of the type and scope of business operations around the world².

¹ Overall, in the sample used, the combined effect of the new tax base provisions unrelated to consolidation (which tend to broaden the tax base) and the introduction of immediate cross-border loss consolidation (which tend to shrink it) realised in the CCCTB scenarios tends to keep the aggregate tax bases roughly constant compared to the current ones (for the companies concerned).

² Ernst & Young *Transfer Pricing Survey*.

According to a study commissioned to Deloitte, the CCCTB is expected to translate into substantial savings in compliance time and outlays in the case of a multinational setting up a new subsidiary in a different Member State. On average, the tax experts participating in the study estimated that a large enterprise spends over €140,000 (0.23% of turnover) in tax related expenditure to open a new subsidiary in another MS. The CCCTB will reduce these costs by €87,000 or 62%. The savings for a medium sized enterprise are even more significant, as costs are expected to drop from €28,000 (0.55% of turnover) to €42,000 or a decrease of 67%. Additional evidence gathered from a sample of existing European multinationals (PWC study) points to more moderate but still significant reduction in the compliance burden for recurring tax related tasks. The savings expected from the introduction of the CCCTB would amount to 8 percentage points of the compliance time.

5.3. Economy wide impacts

The CGE model CORTAX is used to assess the economy-wide impacts of the different reforms. The model, conceived to simulate tax policy changes for the EU Member States, has been extended and refined for the purpose of this impact assessment³. However, like any general equilibrium model, CORTAX includes simplifying assumptions and specifications that are not undisputed, and cannot take away the uncertainty about the strength of certain behavioural effects of tax policies. More importantly, CORTAX does not capture the long run dynamic gains from further integration in the Internal Market, e.g. in terms of an increase in the number of internationally active firms. The removal of cross-border tax barriers is expected to translate into reduced distortions in the allocation of capital, as it will increase the substitutability between domestic and cross-border investment, on the one hand, and enhance the attractiveness of the EU as whole for multinational investors, on the other. The increased allocative efficiency is expected to translate into productivity and employment gains, stemming also from the economies of scale that can be exploited in the larger market.

The four different policy options – optional CCTB, compulsory CCTB, optional CCCTB and compulsory CCCTB – are compared to the status quo scenario. In the *optional* scenarios it is assumed that all multinationals, but no domestic companies, opt for the alternative tax systems, whereas in the compulsory scenario also domestic companies need to apply the new tax provisions. This assumption might lead to an underestimation of the welfare gains in the optional scenarios as it can be expected that in practice multinational firms would opt in the new system only if that would not lead to lower net profits than dealing with the different national tax systems. In all scenarios it is assumed that corporate tax revenues are kept constant ex-ante adapting the tax rate, so that the government budget is balanced before companies react to the new policy environment.

The important economic mechanisms in the CGE analysis of the CCTB is the trade-off between a low effective marginal tax rate (result of a narrow base and high statutory tax rate), which minimises distortions in investment, and a low statutory corporate tax rate (coupled with a broad base), which reduces multinational profit shifting to outside locations and improves the attractiveness of a location in the case of discrete investment choices. Base-

³ The extensions concern the inclusion of (i) *tax havens*, to capture the opportunity for profit shifting outside the EU, (ii) *loss probabilities*, to precisely quantify the economic effects of loss consolidation, and (iii) *discrete location choices*, to model the infra-marginal choices of firms on *where* to invest, preliminary to the decision on *how much* to invest.

broadening implied by the new definition of the common tax base -, and the consequent rate reduction are found to decrease aggregate welfare in the EU⁴.

On the other hand, the main positive effect of the CCTB reform stems from the assumed reduction in compliance costs. All in all, a compulsory CCTB leaves welfare at a European level nearly constant while the introduction of a CCTB optional for multinationals renders slight welfare gains.

Compared to the CCTB, the welfare effects of the CCCTB options are more favourable under any of the analysed scenarios. The overall final impact is a small net positive welfare gain of around 0.02% of GDP in aggregated terms for the EU, which amount to roughly €2.4 billion (2009 figure). Disentangling the effects of the different elements of the reforms shows that:

- The lion's share of the positive economic impact of consolidation and formula apportionment is due to lower compliance costs.
- The move from separate accounting to formula apportionment exerts a negligible effect on GDP and welfare. It is the result of different offsetting effects: fewer incentives to shift profits and capital from high tax countries, but additional distortions in the allocation of formula factors to low tax economies.
- Loss consolidation tends to shrink the tax bases. Hence, given the model assumptions, certain increase in corporate tax rates may be required to balance the government budget. The combination of a lower tax burden via loss consolidation and a higher tax burden due to higher rates may raise overall the cost of capital. Accordingly, investment slightly falls but employment expands due to lower labour costs. On balance, GDP slightly falls, whereas the net effect on welfare is negligible.

6. COMPARISON OF OPTIONS

The removal of all the three types of identified corporate tax obstacles – possible under the CCCTB policy options – would allow business to make sounder economic choices thus improving overall economic efficiency in the EU. On the basis of the quantified economic impacts, the optional CCCTB and the compulsory CCCTB are preferred to the alternative options given the savings in compliance costs they can generate. However, the macroeconomic evidence points to the optional CCCTB as the overall preferred policy option of the scenarios analysed.

The reforms under analysis are potentially associated with important dynamic effects in the long run. The reduction in uncertainty and in the costs (actual and perceived) that firms operating in multiple jurisdictions incur is the main channel through which these effects are expected to materialize. Ultimately, this will translate into increased cross border investment

⁴ In the model a policy of base-broadening cum rate-reduction results in welfare gains when applied separately by individual countries, and particularly by high-tax countries that suffer from profit shifting. However, a generalized implementation of such policy at the European level reduces the beneficial effects of lower corporate tax rates. In fact, the comparative location advantage of a country does not improve if all other Member States reduce their tax rate too. Only location choices *vis-à-vis* third countries will be affected. On balance, a multilateral policy of base broadening and rate reduction is therefore less likely to be welfare improving than a unilateral policy.

within the EU, stemming both from further expansion of European and foreign multinationals and from de novo investment of purely domestic firms into other Member States. By the same token, to the extent that the current fragmented landscape of corporate tax systems acts as a barrier to entry into international markets, small and medium sized enterprises (SMEs) might be particularly advantaged by the level playing field created by the reforms under analysis. The elimination of additional compliance costs associated with having to deal with different tax rules and the introduction of the 'one-stop shop' principle in tax administration is likely to enhance SMEs' capacity to expand cross-border.

7. MONITORING AND EVALUATION

The proposed policy intervention will exert effects on a number of variables that should be monitored. At the microeconomic level, the effects of the policy options on firms' tax related compliance costs and on their investment behaviour across national borders should be assessed. To overcome the well-known difficulties in obtaining reliable estimates of actual and perceived compliance costs, ad hoc surveys should be designed, and particular attention devoted to the representativeness of the selected samples. Propensity to expand abroad by SMEs might be particularly revealing on the expected long term impacts of the policy options. Such effects can be gauged both by means of surveys among the relevant companies and by analysing observed changes in actual investment choices.

At the macroeconomic level, consistent with the general objectives of improving the allocation of productive capital in the EU, evidence should be gathered on foreign direct investment flows directed to the EU and among EU countries.

The evaluation of the consequences of the application of the legislative measure could take place five years after the entry into force of the legislative measures implementing the Directive. The Commission could then submit to the European Parliament and the Council a report on the technical functioning of the Directive.

The content of such a report would vary according to the scope of the Directive as finally agreed in the Council.

Table 1: Ranking of policy-options (1 = best option)

	Option 1: status-quo	Option 2: Optional CCTB	Option 3: Compulsory CCTB	Option 4: Optional CCCTB	Option 5: Compulsory CCCTB
PWC-study (compliance costs)	2	3		1	
Deloitte-study (compliance costs)	3	2		1	
CORTAX-study (macroeconomic variables)	4	3	5	1(2)	2(1)