Looking for further simplification of corporate taxes in Europe

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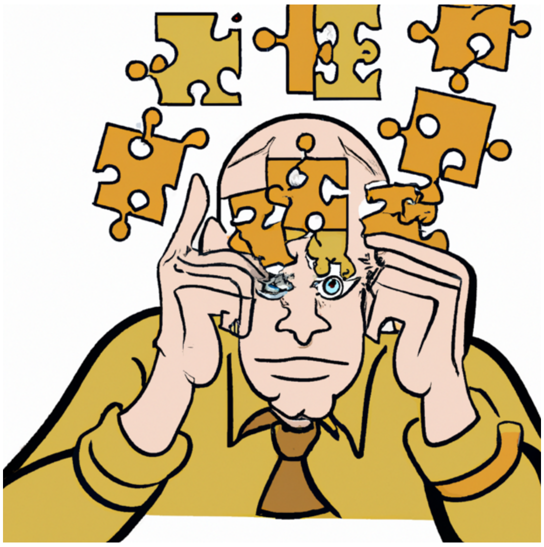
Single European Tax "Market"

Although the European Union promises a so-called Single European Market, the reality is different. If you want to do business in the European Union you should be aware of many and very diverse corporate tax systems. That is why the European Union is already trying for years to simplify the European corporate tax system. The arguments for further simplification are straight forward:

- Reduction in compliance costs for businesses active in more than one Member State if there would be a unified system
- Less distortions in investment and financing decisions (which may also be driven by tax optimization strategies rather than primarily commercial considerations).



Many different EU tax systems create a challenge for multinational enterprises

History

The European Commission already tried to simplify things and launched the Common Corporate Tax Base (CCTB) in 2016. The second step would involve the move towards a consolidation regime for EU group companies, the so-called Common Consolidated Corporate Tax base (or CCCTB), which principle originates from a 2011 proposal from the European Commission.

The consolidated results of the group (i.e. the sum of the tax bases of the constituent members of the group and elimination of intra-group transactions) would be allocated among the Member States by way of an allocation formula based on different (production) factors – so-called formulary apportionment.

Reason for failure – formulary apportionment

The consolidated determination of the taxable income is not so easy as it looks like. You need to perform many eliminations (intra EU transactions between affiliated EU entities/branches). You cannot rely on local commercial statements. Furthermore, if you subsequently divide the taxable income between EU member states using a formula, this generally results in 'winners' and 'losers' amongst the EU member states. The key problem is that between Member States there are enormous differences in how there economies are structured and organized. Using a mathematical formula to determine the 'value contribution' of business activities in each member state is therefore problematic. Since EU wide tax proposals require unanimity, I believe the changes are very low that such a proposal will be accepted. It would be seen by many states as a loss of sovereignty. Setting up a monetary union (single currency like the euro) is already difficult in practice, let alone a form of a budgetary union.

New momentum – Pillar one and two

Despite these practical issues, the European Commission believes there is new momentum to 're-introduce' the EU consolidated tax base. They have now named this new plan: "Business in Europe: Framework for Income Taxation" (BEFIT).

BEFIT will build on some of the fundamental elements of the OECD/G20 global agreement, which introduces a two-pillar solution towards addressing the tax challenges arising from the digitalization of the economy. It will operate in a similar context, as it addresses cross-border issues linked to the taxation of groups of companies, and will be based on a formulary apportionment and a common tax base. It will replace the pending proposal for a CCCTB.

Public consultation BEFIT

There is not yet draft EU directive or proposal. The EU commission has launched a public consultation to ask the public to give their view on the following topics:

- Should the new directive target large multinationals with a turnover exceeding EUR 750 million or also be introduced to smaller companies which would result in less distortions?
- Should we introduce a limited number of very detailed set of tax results to arrive at this EU wide taxable income?
- Would the formula for the formulary apportionment require the inclusion of a remuneration for intangible assets or not?
- How are we going to deal with transfer pricing in relation to entities and branches outside the EU, since they are not covered in this proposal?

Our view

We will need to see how the final BEFIT Directive will look like. Nevertheless, it is very likely that the formulary apportionment will be a key item of it. In my view you need a quite detailed formula to properly reflect the value contribution of business activities in each member states. This will make things very complicated. Furthermore, since economies are evolving over time, a static formula will lose its effectiveness over time. Therefore, I am not so optimistic that a proposal including formulary apportionment will ever be introduced.

Corporate Tax Alliance