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GROUP TAXATION UNDER THE SYSTEM OF COMMON CONSOLIDATED CORPORATE TAX BASE

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Abstract

The aim of the paper is to make a comparative analysis of the group taxation regimes, consolidation rules and loss-compensation rules in EU Member States and to discuss the regulation suggested in that area by European Commission in Common Consolidated Corporate Tax Base (hereinafter as CCCTB) draft directive. At the end, there should be also suggested solutions to questionable regulations. Theoretical background of the paper presents the reasons of the efforts of the European Commission to harmonize the area of corporate taxation. Second part of the paper presents the research of the rules which are used in individual EU member states for group taxation, consolidation and transfer of losses. Third part of the paper shows the rules comprised in CCCTB draft directive and discusses mainly the problems connected with setting of dual thresholds and rules for entering and leaving the group. All the aspects are analyzed with the use of concrete examples and schemes.
Keywords: CCCTB, group, loss compensation.

Introduction

The idea of harmonization corporate taxation across the European Union has started in 1960s. The Segré Committee Report, which was published in 1966 stated, that the fiscal systems in Europe should not obstruct the creation of conditions similar to those on internal market. Based on that study, several harmonization efforts in the area of corporate taxation in the European Union took place. In 1975 the commission published “Proposal for a Directive on the Harmonisation of Systems of Company Taxation and of Withholding Taxes on Dividends”, further was published document COM (80) 139 final “Scope for the Convergence of Tax Systems in the Community” in 1980, document COM (84) 404 final “Proposal for a Council Directive on the Harmonisation of the Laws of the Member States relating to Tax Arrangements for the Carry-Over of Losses of Undertakings” in 1980, followed by the document COM (90) 595 final “Proposal for a Council Directive Concerning Arrangements for Taking into Account by Enterprises of the Losses of their Permanent Establishments and Subsidiaries Situated in Other Member States” in 1990. None of these above mentioned initiatives was successful. The break came in 1990s in connection with the establishment of the internal market and the abolition of the fiscal frontiers. In that time the positive integration in the area of corporate taxation – i.e. by the EC directives and not by ECJ case law – started to be successful.

Successful legislative initiatives can be divided into two phases. Firstly, the measurements regarding the taxation of groups were adopted – Parent-Subsidiary Directive, Merger Directive and Arbitration Convention. Second phase is represented by the adoption of Tax Package, which comprised Interest and Royalties Directive and the Code of Conduct for Business Taxation.

The indivisible part of the harmonization efforts in the area of corporate taxation represents also the effort for corporate tax rate approximation. The first proposal was put forward in 1975, and suggested for the tax rate the range between 45-55%. Another suggestion was done in Ruding Report, published in 1992, which comprised a suggestion for the range between 30-40%. Since 1993, the effort for harmonization of the corporate tax base can be identified in the EU.

In 2001 the European Commission has identified the areas, in which the lack of harmonization crated obstacles to the functioning of the internal market and started to tackle them one-by-one. In that process four harmonization models were suggested. Firstly, the Commission has suggested Home State Taxation system, under which the companies with European activities should use for the purpose of taxation the rules valid in their home country (i.e. they would be subject just to one taxation system).

Second model was represented by European Union Corporate Income Tax, under which the multinational enterprises would be subjected to unified European taxation system which would be administrated on the European level.

European Commission has also suggested Compulsory Harmonized Tax Base under which the harmonized corporate tax base would be introduced in the EU and would be compulsory for all business.

The last suggested model was CCCTB which would introduce common consolidated tax base with national tax rate.

In respect to the present situation in the area of direct taxation and mainly to the great unwillingness of the EU member states to any kind of harmonization, European Commission has excluded the model of European Union Corporate Income Tax and Compulsory Harmonized Tax Base; for their introduction would not be possible form the political reasons. The European Union Corporate Income Tax would be perceived by EU member states as the infringement of their national sovereignty and Common Compulsory Harmonized Tax Base would not be possible to introduce due to the reason of obligation.

Therefore the attention of the European Commission has been aimed just on two projects – Commission decided to practice so called “twin-track strategy”. Home State Taxation has been selected as the short-term aim. It is focused on SMEs. That model should started as the pilot project in 2007. At present, all work on that project is stopped, for the European Commission has not been successful in negotiations about the practical start of the project.

From the reasons mentioned above, the European Commission aims its efforts on the CCCTB project, which was chosen as the long-term aim. The creation of CCCTB model should bring the rules for common consolidated tax base of the companies with European activities. The introduction of that model should bring number of advantages to the corporations.

The objective of the paper is to make a comparative analysis of the group taxation regimes, consolidation rules and loss-compensation rules in EU Member States and to discuss the regulation suggested in that area by European Commission in Common Consolidated Corporate Tax Base (hereinafter as CCCTB) draft directive. At the end, there should be also suggested solutions to questionable regulations.

The paper uses standard methods of scientific work. Firstly, the method of description is used, to describe the present situation in the area of profit consolidation in the EU member states. Then, the comparative analysis is used to discuss the differences in individual EU member states and also the possible implication for the rules under CCCTB system. At the end the method of synthesis, deduction and induction is used, when presenting the consolidation rules under CCCTB and drawing the attention to the problematic provisions of the draft, their consequences and impacts on companies during consolidation itself. Possible solutions are suggested at the end as well.

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Situation in EU member states

Concept of the group for the tax purposes significantly differs from the IAS/IFRS. They cover the consolidation of financial statements, but do not comprise any provision on group taxation. Generally, based on IAS 27, the companies are going to consolidate in case those are controlled by the parent (i.e. the parent owns the majority of voting rights either directly or indirectly).

Most of the EU Member states enable to compute the tax liability on the consolidated basis. However, there are seven Member States, where the taxation regime for the groups is not available, as shows the following table. This was also proved by (Gammie, 2005).

Table 1. Availability of group taxation scheme

Group taxation scheme available	Austria, Cyprus, Denmark, Finland, France, Germany, Ireland, Latvia, Luxembourg, Malta, Netherlands, Poland, Portugal, Slovenia, Spain, Sweden, United Kingdom
Group taxation scheme not available	Belgium, Czech Republic, Estonia, Greece, Hungary, Lithuania, Slovak Republic

Source: Amos, J. (2007). Global Corporate Tax Handbook 2007, Amsterdam: IBFD, European Tax Database and own research.

The characteristic which qualifies the group for consolidated taxation is the amount of voting rights. The threshold varies in the Member States between 50% and 100%. The situation describes the following table.

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Table 2. Voting Rights Thresholds for Qualification for Consolidation

Threshold	Country
More than 50%	Austria, Denmark, France, Germany, Italy, Malta
More than 75%	Cyprus, Ireland, Spain, United Kingdom
More than 90%	Finland, Latvia, Portugal, Sweden
More than 95%	France, Luxembourg, Netherlands, Poland
100%	Slovenia

Source: Amos, J. (2007). Global Corporate Tax Handbook 2007, Amsterdam: IBFD, European Tax Database and own research

Majority of the Member States allows the shareholding to be direct or indirect. Only three states – Latvia, Poland and Slovenia do not allow the shareholding to be indirect.

To avoid the speculations and arbitrations connected with the possibility of either group tax base or single tax base, some Member States declare, that group taxation regime is binding for a minimum period of time. Nearly half of the Member States do not regulate the minimum period of group taxation at all. The situation is shown on the following table.

Table 3. Minimum periods of group taxation

Period	Country
3 years	Austria, Italy, Poland
5 years	France, Germany, Italy, Luxembourg, Portugal
10 years	Denmark
None	Cyprus, Finland, Ireland, Latvia, Malta, Netherlands, Slovenia, Spain, Sweden, United Kingdom

Source: Amos, J. (2007). Global Corporate Tax Handbook 2007, Amsterdam: IBFD, European Tax Database and own research

There can be found different consolidation techniques among the Member States. With respect to the calculation and combination of individual results of the group members, there can be identified three basic techniques.

Table 4. Techniques of consolidation

Consolidation technique	Country
Full Tax Consolidation	Netherlands
Pooling of the results on to parent company	Austria, Denmark, France, Germany, Italy, Luxembourg, Poland, Portugal, Slovenia, Spain
Intra-group loss transfer	Cyprus, Finland, Ireland, Latvia, Malta, Sweden, United Kingdom

Source: Amos, J. (2007). Global Corporate Tax Handbook 2007, Amsterdam: IBFD, European Tax Database and own research

Full tax consolidation is applied only in Netherlands. Under Dutch consolidation regimes, all individual pre-tax results of the group members are aggregated. The intra-group transactions are eliminated. Then, the tax base is created by the overall net result of the group. As mentions (Mitroyanni, 2008), liability to pay taxes clerly rests with the head company of the group.

Ten Member States apply as the consolidation technique pooling system. Under that system, the individual tax results of group members are aggregated, but without the elimination of intra-group transactions. The total is then pooled (accumulated) by the parent. Accroding to (Borrat; Bassiere, 2004), liability to pay tax on behalf of the entire group is exclusively borne by the parent company.

Consolidation technique based on the intra-group loss transfer has been identified in two variants. As mentions (Enders, 2003), integration is limited to surrendering or considering losses on an entity-by-entity basis.

Table 5. Intra-group loss transfer

Type	Country
Group relief	Cyprus, Ireland, Latvia, Malta, United Kingdom
Subvention payments	Finland, Sweden

Source: Amos, J. (2007). Global Corporate Tax Handbook 2007, Amsterdam: IBFD, European Tax Database and own research

Under group relief, individual members of the group can transfer their losses to a member of the group, which is profitable. Those losses can be immediately offset.

In Finland and Sweden, the transfer of loss is done through subvention payments. Those payments are

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taxable income for the recipient and tax deductible for the payer.

In case of the domestic loss transfer, all the above mentioned methods enable full vertical (i.e. between parent and subsidiary) and horizontal (i.e. between subsidiaries) loss compensation within the group. Vertical loss compensation within the group can be done either upward or downward.

EU Member States usually restrict the possibility of offsetting losses incurred prior to the start of the group. Some of the Member States strictly forbid offsetting those losses.

All the above mentioned possibilities of loss compensation (transfer) were considered in domestic dimension, for cross-border loss relief is available only in four Member States. The situation is described in the following table.

Table 6. Loss relief in EU member states

	Domestic relief of losses	**Cross-border relief of losses**
Within one company ("permanent establishment")	Available in all 25 Member States	Austria, Belgium, Czech Republic, Cyprus, Finland, Ireland, Italy, Latvia, Lithuania, Malta, Netherlands, Portugal, Slovak Republic, Slovenia, Sweden, United Kingdom
Within a group of companies ("parent and subsidiary")	Austria, Cyprus, Denmark, Finland, France, Germany, Ireland, Italy, Latvia, Luxembourg, Malta, Netherlands, Poland, Portugal, Spain, Sweden, United Kingdom	Austria, Denmark, France, Italy

Source: Amos, J. (2007). Global Corporate Tax Handbook 2007, Amsterdam: IBFD, European Tax Database and own research

The Member States which enable cross-border loss relief apply different methods than in case of domestic loss relief. In domestic relief Austria, Denmark, France and Italy apply the system of pooling. It would not be possible to apply the rules for domestic loss relief on cross-border situations, for they are not able to cover the needs of the cross-border situation. The methods used for cross-border loss relief by Denmark, Italy, France and Austria are shown in following table.

Table 7. Methods of cross-border relief

Country	**Method of cross-border loss relief**
Austria	Deduction/Reintegration
Denmark	System of consolidated profits – comprehensive scheme
France	System of consolidated profits – comprehensive scheme
Italy	System of consolidated profits – comprehensive scheme

Source: Amos, J. (2007). Global Corporate Tax Handbook 2007, Amsterdam: IBFD, European Tax Database and own research

The system of consolidated profit means, that profits and losses in a given tax year of selected or all group members are taken into account over a certain period of time at the level of the parent company. The system of consolidated profits is designed in the Member States to include all subsidiaries of the group. This is called a comprehensive scheme. The economic result of the group is taxed in the country, where the parent company is resident. That is very often connected with the compliance costs of taxation, for all incomes of the group members has to be recalculated according to the rules valid in the state, where the parent company is resident.

Austria is applying different method – deduction (reintegration). It means that losses incurred by the subsidiary situated in another EU member state, which were deducted from the result of the parent company, are subsequently recaptured when the subsidiary starts to be profitable.

Group taxation under CCCTB

As suggests the European Commission in the document CCCTB/WP057 – CCCTN: Possible elemnts of a technical outline, companies acting on the Internal Market can opt for CCCTB. If the company is not EU resident, it can opt through the permanent establishment, which is resident in the EU. Unless the companies are joining an existing group they may only opt for CCCTB with the effect from the beginning of the taxable year. Once the company opts, it has to remain in the system for 5 years and after this period the option can be automatically renewed for successive periods of 3 years. The threshold for the companies to qualify as a group is determined by more than 50% of voting rights. Companies within the group must either all opt for

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the CCCTB system or all remain outside the system.

From one point of view, the period of five years may seem to be long time, for as was shown in table 4, ten EU Member States do not restrict the period for group taxation anyhow. The purpose of the regulation of the period under CCCTB system is to avoid the speculations. The existence of the two corporation tax systems (CCCTB and national tax system) opens the space for speculations and arbitrations. The company could by the purchase (or sell) of small percentage of voting rights speculate on being or not being in the system in dependence on the accounting results and the difference of tax advantages in CCCTB system and national tax system.

The threshold for companies to consolidate within the group of companies is set on 75% of voting rights in CCCTB system. Different thresholds for consolidation and for opting for the CCCTB system can also lead to several problems. Companies which are the members of CCCTB group (i.e. they exceed the 50% threshold), but do not have more than 75% of voting rights are defined as the members of the group, but are not included in consolidation and tax base allocation mechanism. So in fact, only the companies meeting the requirements of 75% threshold can benefit from the consolidation.

There is for example company A, which owns 55% of voting rights in company C and 100% voting rihts in company D. Company C is a member of the group, which has opted for CCCTB. The voting rights of A in C are 55%. It means that C can use for tax base determination CCCTB rules, but cannot consolidate, for the voting rights do not exceed the threshold of 75%. In case that C cannot consolidate, all prices of intra-group transaction have to meet arm’s length standards. It means that in that situation the introduction of CCCTB system, due to the dual threshold, would not eliminate one of the main obstacles which are companies facing – transfer pricing rules and transfer pricing documentation. The company, which can fully use the advantages connected with CCCTB system and consolidation, is D. Intra-group transactions are automatically eliminated, and the company can also reach cross-border loss compensation. Due to the above mentioned fact (Lang *at al.*, 2008) adds that there would not be 27 different taxation systems, but 29 different taxation systmes in th EU.

In that connection it can be also clearly seen, that under suggested regulation, there will not be one CCCTB system, but in fact two. One CCCTB system will be used by companies, which are members of the group, but are not allowed to consolidate. Second system – CCCTB system with the possibility of consolidation – will be used by companies exceeding the threshold of 75%. That situation cannot fulfil the primary aim of CCCTB introduction, which was simplicity and efficiency.

The general assumption of the European Commission is that consolidation would be mandatory for all companies opting for CCCTB which have a qualifying subsidiary (i.e. its voting rights would have to be owned directly or indirectly as to 75% or more) or PE in another EU Member State. Consolidation would extent to the entire tax base of all taxpayers of the group – i.e. if a company owns 90% of a subsidiary, it will consolidate 100%.

As was already mentioned above, the consolidation would extent to the entire tax base of all taxpayers of the group. When a direct holding of the company will be more than 75%, it would count as 100%. This should ensure, that all subsidiaries, which are owned directly or indirectly by 75% of voting rights will be included in consolidation. Another very important rule is valid – when a direct holding is 50% or less it would be counted as zero. That rule should ensure the control of any companies in the indirect 75% ownership chain, as shows the following figure given in the draft of the directive.

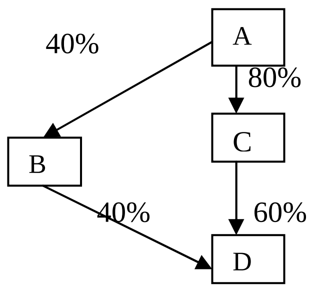

Figure 1. Application of 50% rule

Without the stipulation of 50% rule in the CCCTB draft directive, the holding A in D through C would be calculated as:

$$100\% \times 60\% = 60\% \qquad (1)$$

Plus the holding A in D through B:

$$40\% \times 40\% = 16\% \qquad (2)$$

If we sum up the holding of A in D then we get 76% (60% plus 16%), which is more than 75% and therefore D would be also included in the group. But, the participation of A in B is a minority participation – A cannot control D through 40% in B.

With the application of 50% rule, which comprises CCCTB draft directive, the holding A in D through C would be calculated as:

$$100\% \times 60\% = 60\% \qquad (3)$$

Plus the holding A in D through B:

$$0\% \times 40\% = 0\% \qquad (4)$$

If we sum up the holding of A in D then we get 60% (60% plus 0%), which is less than 75% and therefore D would not be included in the group.

This situation would change in case, that we would pose between A and B the company X, which would be owned by A by 100% of voting rights. The situation is described on the following figure.

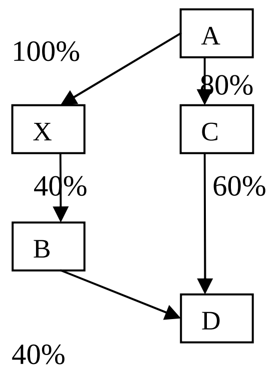

Figure 2. Application of 50% rule with holding company X

In that situation the holding of A in D is calculated as follows:

$$100\% \times 60\% = 60\% \qquad (5)$$

Plus the holding A in D through B:

$$100\% \times 40\% \times 40\% = 16\% \qquad (6)$$

If we sum up the holding of A in D then we get 76% (60% plus 16%), which is more than 75% threshold, therefore D is the member of the group.

As was shown above, the threshold of 50% can avoid overlapping groups, but on the other side under that system the tax planning can occur.

It is suggested in the CCCTB draft directive that a taxpayer would be deemed to be 75% owned and therefore included in a consolidated group in case that 75% threshold is met at the beginning and at the end of the taxable year and the ownership never drops below 50% during the taxable year. The taxpayer would become the member of the group at the date when the threshold of 75% is reached. However, the taxpayer would not be included in a group unless the ownership conditions are met for 6 month at least.

The above mentioned rules can cause, that the company will have to divide its taxable year on more periods in dependence on the rules mentioned in CCCTB draft directive. It can be the complication for the company during the accession into the CCCTB group and can represent compliance costs for the company, which differs with the primary idea of the CCCTB – to decrease the compliance costs of taxation.

Conclusion

CCCTB project belongs at present, to the highest priority of the European Commission in long-term period. The aim of this project is to define rules for CCCTB construction for companies with European activities. European Commission defines as the aim of the project to remove the obstacles to the cross-border operations, to reduce compliance costs of taxation for European companies (by simplification and efficiency) and to increase the competitiveness. The implementation of CCCTB system should bring a number of advantages. It is possible to look at project CCCTB from two sides – from the view of taxpayers and from the view of tax administrations of EU Member States. Each from this group defines its aims in the different way. Simplification of cross-border investments is considered to be the aim in case of the taxpayers, whereas reduction of profit transfers is considered to be the aim in case of tax administration. Decrease in compliance costs of taxation, possibility of cross-border losses offsetting and elimination of transfer pricing problems are the most important effects of CCCTB projects for taxpayers, as is also mentioned by (Lang *at al.*,2008; Mitroyanni, 2008). At present, EU Member States apply different group taxation schemes, but there are also states with no group taxation rules or methods of consolidation. From this reason it is very important to define exact rules for access and exit from the group and consolidation methods. CCCTB draft directive includes unified accounting rules which should be used under the CCCTB system and furthermore also the rules for consolidation and allocation of consolidated tax base.

The draft sets dual thresholds - one for moving in to the group and second for the possibility of consolidation. As was shown in the paper, that situation can cause serious problems. Firstly, it can avoid overlapping groups, but on the other side under that system the tax planning can occur.

Secondly, under suggested dual threshold regulation, there will not be one CCCTB system, but in fact two. One CCCTB system will be used by companies, which are members of the group, but are not allowed to consolidate. Second system – CCCTB system with the possibility of consolidation – will be used by companies exceeding the threshold of 75%. That situation cannot fulfil the primary aim of CCCTB introduction, which was simplicity and efficiency.

Third fact, which can be caused, is that the company will have to divide its taxable year on more periods in dependence on the rules mentioned in CCCTB draft directive. It can be the complication for the company during the accession into the CCCTB group and can represent compliance costs for the company, which is differs significantly with the primary idea of the CCCTB – to decrease the compliance costs of taxation.

The situations which were described in the paper show, that certain suggested rules mainly the dual threshold, the rules for consolidation and moving out an into a group should be defined even more precisely, to avoid the situations described in the paper.

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