

## CONSOLIDATION UNDER CCCTB SYSTEM

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**Received: June 9, 2008**

### Abstract

NERUDOVÁ, D.: *Consolidation under CCCTB system*. Acta univ. agric. et silvic. Mendel. Brun., 2008, LVI, No. 6, pp. 181–188

In 2007, when the pilot project of Home State Taxation System should started, but none of the EU Member States applied for, the European Commission has turned its attention to different project in the area of corporate income taxation. The paper presents the problems of consolidation under the system of Common Consolidated Corporate Tax Base, which is at present the aim of the European Commission in the area of corporate tax harmonization. Firstly, the paper presents the results of comparative analysis, which have been done throughout the EU Member States. The research was aimed at the area of group taxation schemes availability. Secondly, the paper presents the draft of CCCTB directive in the field of creation of the group for taxation purposes, the rules for access and exit from the group and the rules for calculation of thresholds for voting rights. The different possibilities of group creation are presented on the schemes. The paper also discuss the rules, suggested by the draft directive, which could create legal uncertainty for the companies and could cause the situation in which the companies would not know whether they can consolidate their accounting results or not, or whether they are the member of the group or not. The paper suggests the possible solutions in that area. At the end, there are also mentioned and discussed the methods, which could be used for consolidation under CCCTB system in the EU.

consolidation, harmonization, CCCTB, tax base, European Union

In 2000 there was elaborated a study for European Commission in the field of corporate taxation. The aim of this study was to research whether the differences in corporate tax rates influence the decisions of companies on allocation of investments. The study found out that in the current environment, when the capital is fully mobile, the investments are very sensitive to differences in corporate tax rates. Considering the given fact the European Commission proposed four possible models of corporate taxation in the European Union (hereinafter as "EU"). Home State Taxation represents the first model. This model would be based on optional system, when companies with European activities would apply rules which are valid in their home state – if the companies would choose this system, they would be liable only to one tax system. Common Consolidated Corporate Tax Base (hereinafter as "CCCTB") is the second proposed system. In frame of this system there would be set common consolidated tax base which would be liable to national tax rates. It would be optional system again. European Union Corporation Income Tax represents the third

proposed system. This system would introduce common consolidated tax base for the big multinational companies. In this case European corporate tax would be administered at the level of European Union and also common tax rate would be set in its framework. Common Compulsory Harmonized Tax Base, which would compulsory establish common tax base for all companies in the EU, is the last proposed system.

European Commission eliminated European Union Corporate Income Tax and Compulsory Harmonized Tax Base considering current situation in the field of taxes and mainly large reluctance of the member states against any harmonization in the field of direct taxation. Their establishment would be politically not possible. The member states would consider European Union Corporate Income Tax as interventions to national sovereignty and it would not be real to enforce Compulsory Harmonized Tax Base for the reasons of obligation.

European Commission was focused on first two projects and set taxation system in home state as a short-term aim. Home state taxation system should

be designed mainly for small and medium sized enterprises because nowadays these companies are the key elements of economic growth and employment in the EU<sup>1</sup>. There was worked out a pilot project and it should be started in 2007. Selected states and companies should have taken place in this project and it should last 5 years. Currently, all works are stopped on this project because European Commission failed in negotiating of practical initiation of the project – no Member State has applied for the project.

From the above introduced reasons whole effort of European Commission is aimed at the project of CCCTB which was chosen as a long-term aim. The aim of this project is to define rules for common consolidated corporate tax base construction for companies with European activities. Implementation of this system would bring a number of advantages to the corporations. All presumptions for establishment of fair tax competition should be fulfilled because the nominal tax rates become more transparent, for it will reflect their real tax burden (they will be mutually comparable, if there is existence of common rules for creation of tax base). Furthermore, the implementation should help to eliminate barriers in the international merges and acquisitions resulting mainly from the insufficient coordination during capital profit taxation. Implementation of CCCTB would eliminate transfer pricing problems, which causes reducing in compliance costs of taxation for companies but also decline in administrative costs for tax authorities. Implementation will significantly reduce compliance costs of taxation for companies because companies will not meet 27 different taxation systems anymore. The last advantage of this system is that it enables cross-border compensation of loss.

It is necessary to mention, that except wide range of advantages, the CCCTB system brings also disadvantages. Fundamental disadvantage is that companies without European activities will not be able to reach this system that will result in discrimination of small and medium sized companies (for which the Home State Taxation System was originally designed). As the second disadvantage, is considered to be the fact, that existence of two taxation systems (national tax and CCCTB) opens the space for speculations, tax arbitrations and tax evasions. It is the reason why it will be necessary to treat the possibility of access and exit from CCCTB system very carefully.

European Commission set working group whose aim is to define common consolidated tax base, essential tax principles, essential accounting (tax) operations (depreciation, valuation, etc.) and also to define the mechanism, according to which the CCCTB

system will be allocated between the Member States.

## METHODOLOGY

The paper use standard methods of scientific work. Firstly, the method of comparative analysis is used. The paper tries to present and compare the different methods of consolidation, which are use in EU Member States. Secondly, the method of description and analysis is used, while presenting the rules suggested by European Commission. At the end the method of induction, deduction and synthesis is used when discussing the possible implications of suggested rules.

The aim of the paper is the comparative analysis of current situation in the field of consolidation systems throughout the EU Member States and to discuss the methods and rules for group suggested by CCCTB Working Group.

## RESULTS AND DISCUSSION

The main effort of the whole project CCCTB is to increase competitiveness of European territory and companies in the global market. As mentions (Martens-Weiner, 2005) the strategy of the European Commission is a break from tradition in company taxation in the European Union. The traditional method of separate accounting with arm's length pricing requires enterprises to calculate separate tax base in each Member State. Separate accounting should be replaced by formulary apportionment, which uses a formula for the distribution of the multinational enterprise's profit across jurisdictions.

It is possible to look at project CCCTB from two sides – from view of taxpayers and from 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. The compliance cost of taxation seems to be the main obstacle for the business on the internal market, for they are regressive to the size of the enterprise. As has shown (Cressy, 2000) and (Chittenden, Michaleas and Pouziouris, 2000) small and medium sized enterprises are facing compliance costs of taxation which are hundred times higher than in case of large sized enterprises. There is nowadays following situation in the field of possibility of group loss offsetting in the EU:

1 For details see Nerudová, D., 2006: Tax aspects of small and medium sized business in the European Union. Tax and Law in Practice, Vol. 11(4), 38–43.

## I: Consolidation methods used across EU

Type	State	Note
Full consolidation	<ul style="list-style-type: none"> <li>● Netherlands</li> </ul>	With accounting profits of subsidiaries is disposed in tax way as they would be executed by parent company – full consolidation of incomes takes place.
Pooling of the result on the parent company	<ul style="list-style-type: none"> <li>● Denmark</li> <li>● Germany</li> <li>● Spain</li> <li>● France</li> <li>● Italy</li> <li>● Luxembourg</li> <li>● Austria</li> <li>● Poland</li> <li>● Portugal</li> <li>● Slovenia</li> </ul>	Every member of the group finds out the accounting profit separately, afterwards they are offset at the level of the parent company.
Intra-group loss transfer	<ul style="list-style-type: none"> <li>● Ireland</li> <li>● Cyprus</li> <li>● Malta</li> <li>● Latvia</li> <li>● Sweden</li> <li>● Finland</li> <li>● Great Britain</li> </ul>	Every member of the group is taxed separately – losses can be transferred and offset between members of the group
Group taxation scheme not available	<ul style="list-style-type: none"> <li>● Belgium</li> <li>● Czech Republic</li> <li>● Greece</li> <li>● Lithuania</li> <li>● Hungary</li> <li>● Slovakia</li> <li>● Estonia<sup>(1)</sup></li> </ul>	It is not possible to compensate losses because the scheme of group taxation is not available under the taxation systems.

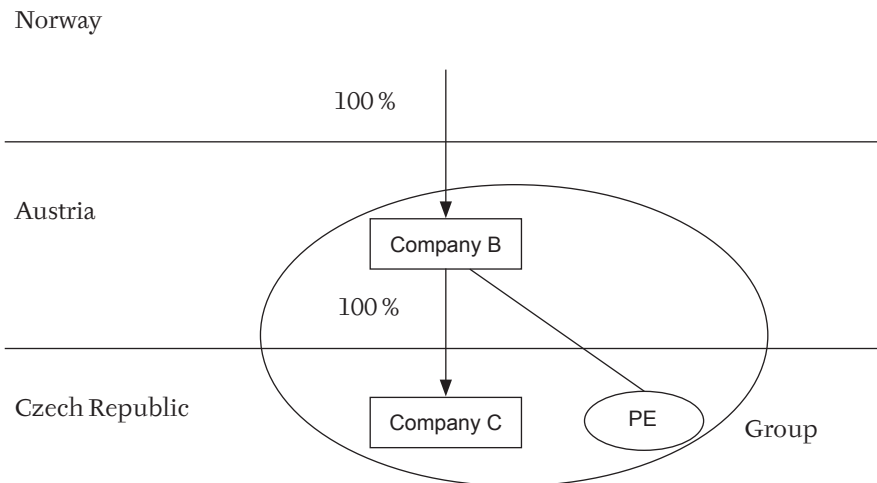
Source: Amos, J. et al. (eds.) Global Corporate Tax Handbook 2007, Amsterdam, IBFD, 2007

It is obvious from the above mentioned table, that 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 for consolidation methods. CCCTB draft directive will include common accounting rules which should be used<sup>2</sup> under the CCCTB system and furthermore also the rules for consolidation and allocation of consolidated tax base.

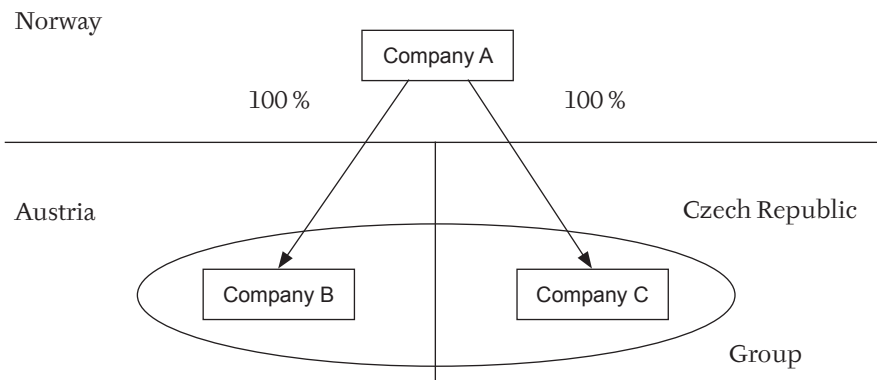
### Groups

Fundamental presumption is that consolidation will be compulsory for all companies choosing CCCTB system and having qualified subsidiary or permanent establishment (hereinafter as “PE”) in other EU Member State. Consolidation should be related to whole tax base of every group member with no respect to the ownership share (it means that if company will own 90% of subsidiary then 100% will be consolidated). In practice the consolidation of group should be applicable also on the following examples:

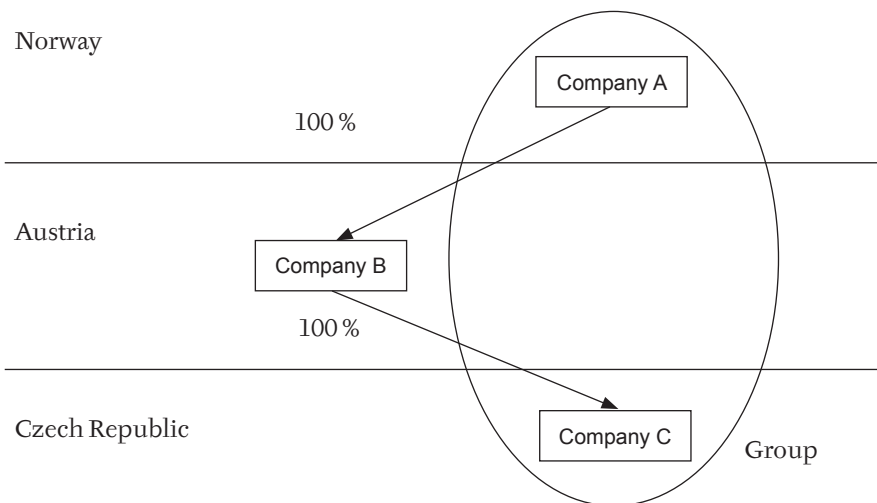
<sup>2</sup> For details see Nerudová, D., 2008: Corporate taxation in the EU 1st part – CCCTB draft directive, Tax and Law in Practice, Vol. 13 (2), 43–49.



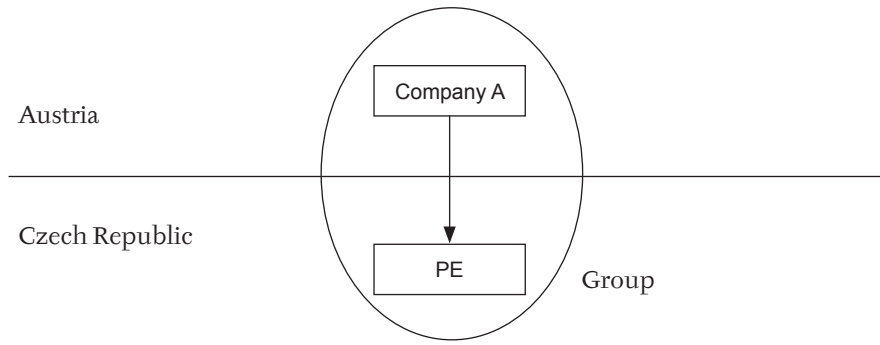
1: EU resident subsidiaries owned by EU non-resident parent company



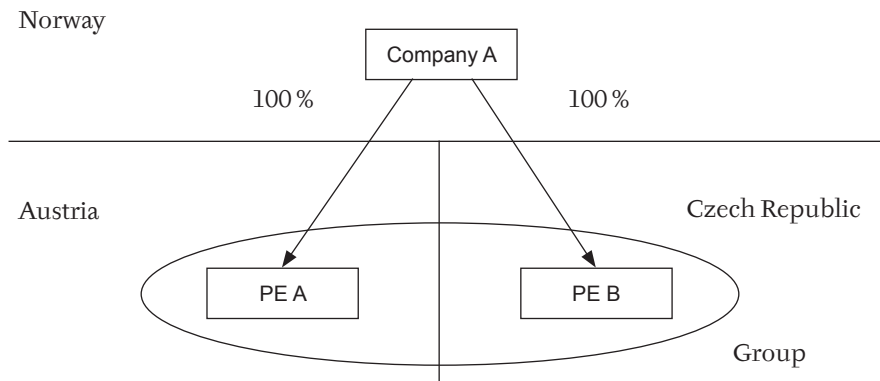
2: EU resident subsidiary controlled by EU non-resident parent company



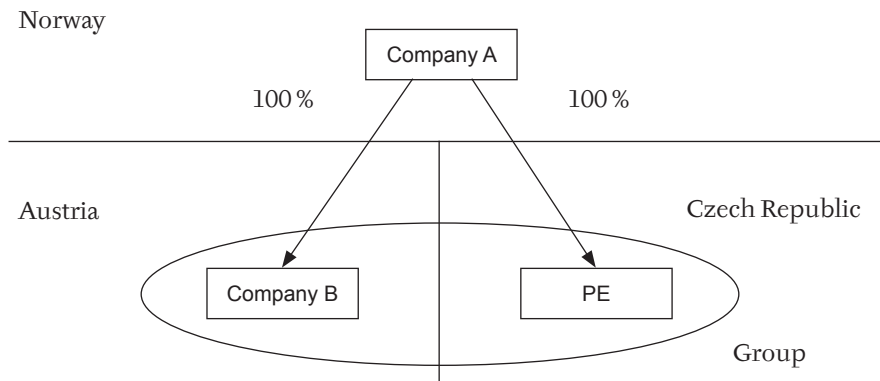
3: The chain of EU resident group of companies covers the company which is EU non-resident (sandwich situation)



4: EU resident company with permanent establishment (PE) in other EU Member State



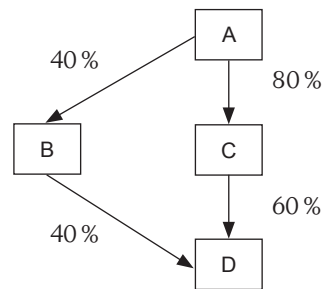
5: EU resident PEs owned by EU non-resident company



6: EU resident company and PE owned by EU non-resident company

Qualified subsidiary is defined as a company whose voting rights are owned directly or indirectly at least from 75% by parent company. Every percentage of ownership will be multiplied for the purposes of calculation of the size of indirect ownership of voting rights of parent company. In the case that direct ownership will amount more than 75% it will be calculated as 100%. This method ensures that all subsidiaries in which parent company controls (directly or indirectly) more than 75% of voting rights will be included into consolidation. In case that direct ownership amount less than 50% it is calculated as a zero. Above introduced rule ensures the control

of group of any companies in chain of indirect ownership of voting rights in the amount of 75%.



7: Application of 50% rule

**Without the rule of 50% the company D would belong to the group:**

A owns through C the company D  $80\% \times 60\%$  – it is calculated as  $100\% \times 60\% = 60\%$

Plus A owns through B the company D  $40\% \times 40\%$  – it is calculated as  $40\% \times 40\% = 16\%$

Total share of company A in voting rights of company D amounts 76% ( $60\% + 16\%$ ), that is more than 75% and that is the reason why the company D would be included into the group.

However, company A has in the company B only minority participation and can not control it (it owns only 40%) and in addition, company B can be member of other CCCTB group.

**With the application of rule of 50% the company D does not belong to the group:**

A owns through C the company D  $80\% \times 60\%$  – it is calculated as  $100\% \times 60\% = 60\%$

Plus A owns through B the company D  $40\% \times 40\%$  – it is calculated as  $0\% \times 40\% = 0\%$

**Total share of company A in voting rights of company D amounts to 60% ( $60\% + 0\%$ ), that is less than 75% and that is the reason why the company D is not included into the group.**

All members of CCCTB group would compulsory have the same taxable period. In case that any company would become member of CCCTB group and would have different taxable period, it will have to change its taxable period.

**Changes in the level of voting rights**

It is proposed that taxpayer will be considered as owned from 75% and consequently as a member of consolidated group in case that he fulfills the test of 75% at the beginning and at the end of the taxable period and the ownership must not fall below 50% during the taxable period. Taxpayer becomes member of the group on the day when he reaches the limit of 75%. However, the taxpayer will not be included into the group if he will not fulfill the above introduced rules at least for the period of 6 months (it is similar for subsidiaries of the taxpayer if they reach above introduce limit). The situation is described by following example A.

**A: Changes in the level of voting rights**

Already existing CCCTB group gains from the 1<sup>st</sup> August 80% of the voting rights in the company A. Company becomes, on the basis of above introduced rule, a member of the group from 1<sup>st</sup> August. Losses and profits of the company A can not be consolidated before the period of 6 months. Consolidation can start as far as 1<sup>st</sup> February of the following taxable period. It means in practice, that despite the fact that company A becomes a member of the group from 1<sup>st</sup> August (of regular taxable period) and will have to set its accounting profit not on the basis of national rules but on the basis of CCCTB rules, it will not be allowed to consolidate. Company A will have to divide its taxable period into two parts. In the period from 1<sup>st</sup> January till 31<sup>st</sup> July it will set the accounting profit on the basis of national accounting and tax rules. Consequently, from 1<sup>st</sup> August till 31<sup>st</sup> December, company will set its accounting

profit on the basis of CCCTB rules but it will not be able to consolidate. If the possibility of consolidation arises as far as from 1<sup>st</sup> February of the following taxable period, the company will have to again divide its taxable period into two parts. January will be the first part when the company will not be able to consolidate and the rest of the period will be the second part when the company already has the competence to consolidate.

Taxpayer will leave the group on the day, when the ownership of the voting rights will:

- fall below 50% at any time,
- fall below 75%, in the case that it happens at the end of the taxable period (it is similar for subsidiaries of taxpayer) – situation shows the following example B.

**B: Changes in the level of voting rights**

Member of the group, the company A, holds 80% of voting rights of member of group, the company B. Company A will sell on 1<sup>st</sup> August 20% of voting rights of company B. At the end of the taxable period (31<sup>st</sup> December) company A owns only 60% of voting rights of company B. The company B has to leave the group. Provision of the above introduced period of 6 months for consolidation should be analogically applied on situation when the company will leave the group. In this case company B has to divide its taxable period into two parts. In the period from 1<sup>st</sup> January till 31<sup>st</sup> July company B will set the accounting profit according to the CCCTB rules and will be liable to consolidation. In the period of 1<sup>st</sup> August till 31<sup>st</sup> December the company will still set the accounting profit according to the CCCTB rules but it will not be able to consolidate.

The aim of above introduced rules is to ensure stability of group and to avoid potential manipulation with consolidated companies (which would be able to take place in case that it would be necessary to fulfill the limit of 75% for inclusion into the group during the whole year, so then it would be possible to manipulate with companies for example by sales of low percentage of voting right, etc.). The rule, that company has to leave the group at any time when the ownership of voting rights fall below 50%, was chosen considering the cases when full consolidation aside from minority shareholder takes place.

Companies leaving and accessing the group start to consolidate (deconsolidate) with other companies of group on the date of access or exit from the group (taxable period is divided into two parts). Another possible solution is that leaving and accessing companies will be considered to be members (non-members) of the group as far as from the first day of the following taxable period or on the first day of the current taxable period. However, the working group agreed that the first proposed solution, immediate consolidation (deconsolidation) better reflects the actual situation and in addition it has been already applied with success in some member states.

Weak point of the proposed system is the fact, that the company at the end of the taxable period will not know whether it will be liable to consolidation. Situation is described by example C.

**C: Conditions for consolidations**

If in frame of the group, whose taxable period is considered to be calendar year, it is bought 75 % of voting rights of company X on September and six months later (March), the ownership will fall below 75 %.

During consolidation it is necessary to fulfill two tests:

- 1) the period of ownership of 75 % of voting rights has to be 6 months at least,
- 2) in the case that number of voting rights will fall below 75 %, it has to increase to 75 % at the end of taxable period in order to stay in the group

On 31<sup>st</sup> December company X does not know whether it can consolidate or not. Company has to wait as far as December of the following taxable period to review whether the condition 1 and 2 are fulfilled and whether it can consolidate in both taxable periods.

Another aspect connected with the access and the exit from CCCTB group, which is necessary to consider, is the impact of access (exit) during taxable period on factors serving for CCCTB allocation.

Losses that companies showed before entering CCCTB group will not be considered to be taken into account during consolidation. Losses can be offset against shares of individual companies on future consolidated profit in accordance with national tax rules. If the loss will be the result of consolidation of group, this loss will carry-forward at the level of whole group and be offset against the future consolidated profit of group (before distribution). In consequence, only the net profit will be divided between members of group. No losses will be allocated to the leaving companies in accordance with the idea that group should be treated as single entity. That is the reason, when in the case of sale of the company, all losses carried-forward at the level of group will remain in the group. Alternatively, division of losses to leaving companies would demand that existing losses of company would be divided by the same methodology as the tax base – on the day of the sale. However, in the case of company termination, the group can not be considered as single entity any more, and therefore since that the division of showed losses of individual companies belonging to consolidated group has to take place (on the day of company termination). In that connection, two cases are distinguished:

- 1) company is leaving the group – division of loss does not take place,
- 2) the group terminates – the division of losses between the companies of the group takes place.

The above introduced rules lead to different treatment of profit and loss. Situation is illustrated in the following example D.

**D: Treatment of profits and losses**

Company X and Y create CCCTB group and profits are consolidated in the rate of 1:1 in frame of this group. In the taxable period A company X generates profit in amount of 50 whereas company Y generates loss in the amount of 100.

- 1) In the case that total loss of the group would be divided between members, company X and Y would accordingly received loss in amount 25. Both companies would have possibility of loss carry-forward in amount of 25.
- 2) In the case that total loss remains at the level of the group, only group as such has the possibility of loss carry-forward in amount of 50.

In the following taxable period company X generates profit in amount of 50 whereas accounting profit of company Y amounts 0.

- 1) In the case that profit would be divided to individual member of the group, the share of companies X and Y amounts 25. The tax base of companies X and Y was, because companies X and Y have from the taxable period A possibility of loss carry-forward in the amount of 25.
- 2) In the cases that total loss remains at the level of group and only net profit is divided between members, the profit is the same. The tax base of companies X and Y amounts 0.

In case that, companies of the group belonging to CCCTB group own at least 75 % they have to consolidate the tax bases. Above introduced fact carries neutralization of transactions in frame of the group – only transactions between group and third parties and between other not consolidated groups of companies have the tax effect. There are two possible accesses to consolidation. Intra-group profits and costs except that ones that are connected with depreciable assets can:

- 1) be completely ignored,
- 2) be included by every group of companies and adjusted during consolidation.

Intra-group transactions including depreciable assets can not be totally ignored, because they have to be presented in tax written down value. Problem arises in the case of supplies. If the final value of stock includes supplies purchased in intra-group way, then one part of the intra-group profit will be in valuation of stock if all intra-group purchases and sales were not showed in the costs of seller. Above introduced fact should be theoretically eliminated.

**SUMMARY**

Present situation in the area of corporate income taxation in the European Union decreases the competitiveness of the corporations, for it does not enable to use fully the advantages connected with the internal market. Considering the given fact the European Commission proposed four possible models of corporate taxation in the European Union. At present, the effort of the European Commission is aimed at the project of CCCTB which was chosen as a long-term aim. The aim of this project is to define rules for common consolidated corporate tax base construction for companies with European activities. Implementation of this system would bring a number of advantages to the corporations. It is possible to look at project CCCTB from two sides – from view of taxpayers and from

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. 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 for consolidation methods. CCCTB draft directive will include common 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 different thresholds for group creation and consolidation, which can cause the problems. In practice, there can arise the situation, when the company will be the member of the group but will not be allowed to consolidate. It can also happen that the company at the end of the taxable period will not know whether it will be liable to consolidation. The situation which were described in the paper shows, that certain suggested rules should be defined even more precisely, to avoid the situations described in the paper.

## SOUHRN

### Konsolidace v rámci systému společného konsolidovaného základu daně

Současná situace v oblasti korporativního zdaňování v Evropské unii snižuje konkurenceschopnost, protože neumožňuje společností plně využívat výhod spojených s jednotným trhem. Z výše uvedeného důvodu navrhla Evropská komise čtyři možné modely harmonizace korporativního zdaňování v EU. V současné době je snaha Evropské komise zaměřena především na projekt systému společného konsolidovaného základu daně, který byl zvolen za dlouhodobý cíl. Cílem projektu je definovat pravidla pro konstrukci společného konsolidovaného základu daně pro společnosti s celoevropskými aktivitami. Implementace tohoto systému by společností přinesla řadu výhod. Na projekt společného konsolidovaného základu daně je možné se dívat ze dvou stran – z pohledu daňových poplatníků a z pohledu daňových správ členských zemí EU. Obě tyto strany mají odlišné cíle. Cílem daňových poplatníků je zjednodušení přeshraničních investic, zatímco cílem daňových správ je redukovat převody zisků. Pokles vyvolaných nákladů zdanění, možnost přeshraničních zápočtů ztrát, eliminace problémů transfer pricing – to vše jsou nejvýznamnější efekty projektu CCCTB pro daňové poplatníky. V současné době jednotlivé členské státy EU aplikují odlišná schémata skupinového zdanění a metody konsolidace. Z tohoto důvodu je nezbytné velmi přesně definovat pravidla pro vstup a výstup ze skupiny a pro metody konsolidace. Návrh CCCTB směrnice bude zahrnovat společná účetní (daňová) pravidla, která budou v rámci tohoto systému používána, a dále pravidla pro konsolidaci a alokaci konsolidovaného základu daně. Návrh směrnice stanovuje odlišné prahy v případě vzniku skupiny a možnosti konsolidace, což v praxi může způsobovat problémy. Může totiž nastat situace, kdy společnost bude členem skupiny, ale nebude moci konsolidovat. Dále také může dojít k situaci, kdy společnost ani na konci zdaňovacího období nebude vědět, zda bude podléhat konsolidaci. Příklady, které byly v práci popsány, ukazují, že navržená pravidla by měla být definována ještě přesněji, aby zabránila situacím, které byly v práci popsány.

konsolidace, harmonizace, CCCTB, základ daně, Evropská Unie

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