EU Direct Tax Newsalert

European Commission proposes Corporate Tax Package

On 25 October 2016, the European Commission (EC) adopted yet another comprehensive tax package which consists of four new draft EU Directives on:

- a Common Corporate Tax Base (CCTB Directive)
- a Common Consolidated Corporate Tax Base (CCCTB Directive)
- hybrid mismatches with third countries
- double taxation dispute resolution mechanisms in the EU (Dispute Resolution Directive)

In 2011, the EC proposed a Directive for a CCCTB, which has been pending in Council, which aimed to provide companies with the option for a single set of corporate tax rules for doing business across the internal market. Discussions in Council have shown that the 2011 CCCTB Proposal would be unlikely to get adopted in its entirety without a staged approach. In the EC's 2015 Communication on an Action Plan for a Fair and Efficient Corporate Tax System in the EU, the EC therefore advocated a step-by-step approach. The first step could be regarded as the adoption of the Anti-Tax Avoidance Directive (ATAD) in July 2016. The adoption of a mandatory set of rules for a CCTB is then the second step. Third is the adoption of rules for consolidation: CCCTB, the EC's ultimate goal in this regard. The difference between CCTB and CCCTB thus is the cross-border *consolidation* of profits and losses which only arises with CCCTB in the final step, as well as the elimination of intra-group transactions. The 2011 CCCTB Proposal is withdrawn with the adoption by the EC of the new proposals for a CCTB and CCCTB. It should be noted that whereas the ATAD is a minimum standards Directive, the current proposals for CCTB and CCCTB are more prescriptive.

Key provisions of the CCTB Directive:

- Scope: different from the 2011 CCCTB Proposal, the CCTB Directive proposes a mandatory common corporate tax base for EU companies (including PEs in EU Member States) belonging to a consolidated group for financial accounting purposes with a total consolidated group revenue exceeding €750m. Companies falling outside the scope of the Directive may opt to apply its rules under certain conditions (voluntary opt in).

- PE definition: different from the 2011 CCCTB Proposal, the revised PE definition refers only to PEs situated in the EU and belonging to a taxpayer resident for tax purposes in the EU. The third-country dimension is thus left to be dealt with in bilateral tax treaties and national law.

- A broadly designed tax base: all revenues will be taxable unless expressly exempted. An example is that dividends and proceeds from the disposal of shares held in a participation of at least 10 percent are exempt under conditions. The CCTB Directive replicates, with some necessary adjustments, the list of non-deductible expenses of the 2011 CCCTB Proposal. There is a super-deduction for R&D costs: on top of the amounts already deductible for R&D costs, a deduction of an extra 50% of R&D costs each tax year will be granted for costs up to €20m. If R&D costs stand at €20m or above, taxpayers will be able to deduct 25% of anything above this threshold. Furthermore, an enhanced 100% super-deduction for R&D costs up to €20m for start-up companies is granted under certain conditions.

- Interest limitation rule: this rule was not included in the 2011 CCCTB Proposal and is similar, but not the same as the rule adopted in the ATAD, in principle restricting net borrowing costs to the higher of EUR 3m or 30% of the taxpayer's EBITDA.

- Allowance for Growth and Investment (AGI): to neutralize the current asymmetry between debt and equity financing, the CCTB Directive provides for an AGI defined as the difference between the equity of a taxpayer and the tax value of its participation in the capital of associated enterprises. An amount equal to the notional yield on the AGI equity base increase will be deductible from the taxpayer's taxable base under certain conditions. In case of an AGI equity base decrease, an amount equal to the notional yield of the AGI equity decrease shall become taxable.

- Depreciation rules: fixed assets shall be depreciable for tax purposes, subject to certain exceptions. The Directive provides for individually depreciable assets (incl. medium-life fixed tangible assets), asset pool depreciation and non-depreciable assets.

- Losses: as under the 2011 CCCTB Proposal, losses can be carried forward indefinitely from one year to the next, without an option for carry-back. The rules are accompanied with a) a change of control provision to discourage trade in loss-making companies and, b) a temporary form of consolidation for cross-border losses applicable until the adoption of the CCCTB Directive.

- Anti-tax avoidance provisions: a General Anti-Abuse Rule (GAAR) is included, allowing tax authorities to ignore arrangements where the essential purpose is to obtain a tax advantage

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For more detailed information, please do not hesitate to contact:

Vassilios Vizas
Tax Partner
PwC Greece
+ 302106874019
vassilios.vizas@gr.pwc.com

Jonathan Hare –
Chair, PwC CCCTB Working Group,
PwC UK
+44 (0)20 7804 6772
jonathan.hare@uk.pwc.com

Bob van der Made –
EU Public Affairs-Brussels,
PwC Netherlands
+31 6 130 96 296
bob.van.der.made@nl.pwc.com

that defeats the object or purpose of the tax provision and where the arrangements are not regarded as genuine. The GAAR is supplemented by: a) a switch-over clause, and b) CFC rules similar to (but not the same as) the ATAD CFC rules.

- Hybrid and tax residency mismatches: these rules apply to mismatches between Member States and mismatches involving a third country attributable to differences in legal characterization of financial instruments or entities, tax residency, and the treatment of a commercial presence as a PE. In brief, the provisions lay down rules whereby one of the two jurisdictions party to a mismatch shall deny the deduction of a payment or ensure that the corresponding income is included in the corporate tax base.

If adopted, Member States need to transpose the CCTB Directive by 31 December 2018 into domestic law, with the provisions becoming applicable as per 1 January 2019.

CCCTB Directive

Temporary cross-border consolidation of losses is included in the CCTB. Permanent and full consolidation is addressed by the CCCTB Directive as the third step of the EC's staged approach. The CCCTB Directive builds to a large extent on the consolidation part of the 2011 CCCTB Proposal through a formula apportionment.

Key provisions of the CCCTB Directive:

- Scope: the same as the scope of the CCTB Directive.

- Definition of the group: a two-part test based on (i) control (more than 50% of voting rights) and (ii) ownership (more than 75% of equity) or rights to profits (more than 75% of rights giving entitlement to profit) determines the eligibility for the consolidated tax group. These thresholds need to be met throughout the tax year, otherwise, the failing company will have to leave the group immediately. Furthermore, these thresholds should be met for at least nine consecutive months as minimum requirement, failing which a taxpayer shall be treated as if it has never been a group member, in order to tackle manipulations of the tax results by the taxpayer.

- Business reorganisations and taxation of losses and unrealised capital gains: when a company enters the group, pre-consolidation trading losses will be carried forward to be set off against its apportioned share. When a company leaves the group, no losses incurred during the period of consolidation will be allocated to it. Contrary to the 2011 CCCTB proposal, in cases of more extensive reorganizations where more than one company has to leave a loss-making group, a fixed threshold is introduced, to determine under which conditions companies will no longer be leaving a group without losses but there will instead be a loss allocation across the consolidated group.

- Withholding taxes: the proceeds of withholding taxes charged on interest and royalty payments will be shared according to the formula apportionment of that tax year. Withholding taxes charged on dividends will not be shared since, contrary to interest and royalties, dividends are distributed after-tax and do not lead to any previous deduction borne by all group companies. Furthermore, no withholding taxes or other source taxation will be imposed on intra-group transactions.

- Formulary apportionment: it will comprise of three equally weighted factors (i.e. labour, assets and sales by destination). According to the EC, this combination reflects a balanced approach to distributing taxable profits amongst eligible Member States and ensure that profits are taxed where they are actually earned.

- Administrative procedures: different from the 2011 CCCTB proposal, the common administrative rules are limited to the consolidated group. Under these rules, groups will deal with a single tax administration (principal tax authority) in the EU (one-stop-shop). The principal tax authority will be based in the Member State where the parent company of the group (principal taxpayer) is resident for tax purposes. Single taxpayers, who opt to apply the rules of the CCTB Directive continue to fall within their national administrative provisions.

If adopted, Member States need to transpose the CCCTB Directive by 31 December 2020 into domestic law, with the provisions becoming applicable as from 1 January 2021.

The EC also issued a proposed **Directive on hybrid mismatches with third countries.** This Directive amends the ATAD, and incorporates minimum standards provisions with respect to hybrid mismatches with third countries. The proposed provisions are consistent with the relevant provisions regarding hybrid mismatches in the more prescriptive CCTB Directive. Member States would need to adopt the provisions of the Directive by 31 December 2018, with the provisions becoming applicable from 1 January 2019.

Furthermore, the proposed **Dispute Resolution Directive** introduces a beefed-up mandatory dispute resolution procedure for double taxation disputes concerning income from business in the EU, including arbitration with stricter deadlines. If adopted, Member States need to transpose the Directive by 31 December 2017 into domestic law.

Finally, the EC has also published a Communication on the Corporate Tax Reform Package, a Q&A on the package of corporate tax reforms, a CCCTB factsheet, an Impact Assessment of the CCTB and CCCTB Directives and an EC Staff Working Document accompanying the proposed Directive on hybrid mismatches with third countries.

Takeaway

All four Directives as tax measures require the unanimous backing of all EU Member States in the ECOFIN to be adopted. It remains to be seen therefore how discussions progress, whether certain measures will be amended or dropped completely and ultimately whether unanimous agreement on final Directives can be reached. If not then it also remains to be seen whether a group of Member States may seek to take the initiative forward under the enhanced co-operation mechanism.

In the meantime it should be noted that there appear to be differences between ATAD and CCTB on certain provisions, such as exit taxation and CFC rules. It remains to be seen how these differences are resolved as matters progress.