EFB position paper on the Common Consolidated Corporate Tax Base

November 2017

The CCCTB is ambitious, but will it work?

Main Messages

I. European Family Businesses (EFB) welcomes the proposal by the European Commission. The rational for this proposal is clear; creating a tax environment which is transparent, efficient and fair is in the interest of all family businesses that operate within the single market.

II. To support family businesses, it is important to consider the different levels of taxation which incur at the business level but also crucially at the owner/household level. Therefore, when trying to mitigate the adverse effects of the debt-equity-bias, one must look at the Total Efficient Tax Rate (TETR).

III. The Allowance for Growth and Investment is a step in the right direction by putting equity on par with debt financing. But, the debt-equity-bias cannot be solved merely by means of corporate taxation but as a combination of taxation on both the company and owner level.

IV. EFB is concerned that the introduction of the C(C)CTB will increase the complexity of the corporate tax laws among the Member States. The C(C)CTB rules themselves presuppose the existence of a domestic corporate tax system. By nature, the implemented C(C)CTB will have a hybrid character that partly relies on domestic rules and infrastructure, and is partly based on EU law.

V. EFB is worried that a deviation between the calculation of profits for commercial purposes and for tax purposes would introduce an additional compliance burden for European businesses. In addition, whereas the profit allocation within the EU would be based on a new methodology of formula apportionment, the existing methodology of transfer pricing would remain in place vis-à-vis non-EU Member States. This implies that two different sets for profit allocation would have to be applied.

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EFB position paper on the Common (Consolidated) Corporate Tax Base

With interest, European Family Businesses has read the proposal of the European Commission for a Common Consolidate Corporate Tax Base (CCCTB). The rational for this proposal is clear; creating a tax environment which is transparent, efficient and fair is in the interest of all family businesses that operate within the single market. We hope this proposal acts as the catalyst to start the long overdue debate about the future of business taxation. *European Family Businesses* is particularly encouraged to see that a real focus has been placed on enhancing investment and growth, both of which can be supported by intelligent designs and incentives.

But, EFB is concerned that major complications or certain unforeseen externalities that are likely to arise from the proposal in its current form.

Firstly, about the political implications, the C(C)CTB constitutes a major shift in the way corporate tax is currently levied in the European Union. Understandably, taxation policy is guarded by Member States as it is one of the major leavers of government. Although it is very important that the C(C)CTB does not propose harmonisation of tax rates, it would certainly remove a significant degree of control that a government has to steer its respective economy.

In the current political climate, much like the original 2011 directive, *European Family Businesses fears that* the proposal will not have the unanimous support of all EU Member States. However, *European Family Businesses* believes the proposals certainly should lead to, at least, better fiscal coordination between Member States.

The C(C)CTB undoubtedly constitutes a shift towards 'more Europe', whether this is desirable or politically achievable is a broader question that must addressed in a more holistic way. A decision of this magnitude - which the implementation of the C(C)CTB would undoubtedly constitute - must be backed by an unambiguous democratic mandate.

European Family Businesses welcomes a lot of the ideas that are presented in the proposal, which we will expand upon below, but we believe that many issues must be addressed for the CCCTB to bring about the desired change.

Below ***European Family Businesses*** **underlines its main concerns of the CCTB, with an underlying assumption that the CCCTB would also be introduced.**

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Understanding how corporate taxation affects family businesses

Within the C(C)CTB proposal, *European Family Businesses* welcomes the provisions in favour of equity financing. For many years, we have been advocating for a level playing field between debt and equity. However, European family businesses has consistently advocated for a system that takes both the corporate and owner level into consideration.

For family businesses, it is important to consider the different levels of taxation which incur at the business level but also crucially at the owner/household level. Therefore, when trying to mitigate the adverse effects of the debt-equity-bias, one must look at the **Total Efficient Tax Rate (TETR).** When households/private persons consider whether to invest their funds in the equity of businesses generating growth and employment, or in instruments of a more passive nature such as bonds or bank deposits, they consider the total tax burden facing the profit from their investment. As equity is inferior to debt in this comparison, it diverts the flow of capital away from businesses.

The debt-equity-bias cannot be solved merely by means of corporate taxation but as a combination of taxation on both the company and owner level.

The C(C)CTB would affect taxation at corporate level. However, taxation at owner level would remain at the discretion of the Member States. This could be problematic from the family business perspective, as there would be no legislative party - the EU or the Member States - that would have the possibility to ensure that the TETR on income from equity is on a level that decreases the debt-equity-bias in taxation within the EU. There is a severe risk that even though the corporate taxation would be harmonized by C(C)CTB, the taxation of family businesses and their owners would become even less uniform in the EU.

For example, in Germany, corporations are subject to two main types of company taxation: Corporate Income Tax and Trade Tax. The overall tax burden is somewhere around 30% depending on the municipality, with both taxes approximating to about 15% each. However, only the German corporate income tax is mentioned in Annex II of the CCTB proposal. The local trade tax is not. This would result in almost half of the company's tax burden in Germany not being considered for CCTB purposes. In other words, the tax burden in Germany would be distorted from a European perspective and Germany would still be able to levy a special tax on businesses.

Another example, in Finland, the above-mentioned mechanism has been applied for the past five years: the owners' taxes have been raised every time corporate tax has been lowered. Whereas corporate tax was cut from 26 to 20 % in the course of a few years, the capital income tax has been raised from 28 to 34 %. In addition, dividend tax and inheritance and gift tax have been raised notably in the same period.

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In Finland, **the tax bill has been paid by family business owners**, not by the (institutional and foreign) owners of MNE's. The dividend taxation of such owners cannot be unilaterally raised by a member state due to the EU regulations and tax treaties setting maximum withholding tax levels on dividends. Such a development does not attribute to the growth of family businesses or ensure a level playing field for equity and debt finance but might have effects to the contrary.

There is a further potential problem in splitting the legislative powers over TETR on income from equity between two parties. Due to the new tax revenue allocation system contained in C(C)CTB, some Member States will lose tax revenue, and some will gain. Those who lose will start looking for new sources of tax revenue. From the family business perspective, the risk is that the source of new tax revenue will be from the owners.

One of the key attributes in the proposed C(C)CTB would be Allowance for Growth and Investment (AGI). In assessing the AGI and its role in tackling the debt-equity-bias, one must consider the TETR on dividends, which consists of corporate taxation and owner's taxation. Hence, the AGI works only at the corporate level, and therefore, it is not possible to say whether it improves the position of equity. In considering this issue, it is of paramount importance to keep in mind that C(C)CTB would only affect corporate taxation, not owners' taxation. Hence, would the AGI as such be beneficial in combating the debt-equity-bias? Its effect might be negated by the possible changes in the owners' taxation that different Member States might introduce in pursuit of tax revenue. Put in other words, the **debt-equity-bias cannot be solved merely by means of corporate taxation but as a combination of taxation on both the corporate and owner level.**

Increased complexity?

European Family Businesses is concerned that the introduction of the C(C)CTB could increase the complexity of corporate tax laws in the Member States. The C(C)CTB rules themselves presuppose the existence of a domestic corporate tax system. By nature, the implemented C(C)CTB will have a hybrid character that partly relies on domestic rules and infrastructure, and is partly based on EU law. *European Family Businesses* expects that this would increase complexity, for example in situations where a company leaves one regime and enters the other. *European Family Businesses* believes that an increase in complexity of the corporate tax laws of Member States would not favour European businesses.

It is understandable that the C(C)CTB rules will only be mandatory for large MNEs (accounting groups with a group consolidated turnover above EUR 750 million). Smaller companies would therefore, generally, continue to fall under the domestic corporate tax rules. Therefore, for a considerable amount of time, two different systems (the C(C)CTB and the domestic corporate tax system) with their own structure, terminology and background would therefore exist alongside each other.

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Lack of flexibility and legal uncertainty?

CCTB in Practice? A view from German Family Businesses

In Germany, almost 80 % of all companies are tax transparent entities. Often German family businesses use this legal form. Germany treats partnerships (OHG, KG, GmbH & Co. KG) as transparent for tax purposes. This means that the taxable profits are determined at the level of the partnership, but that this balance is subsequently proportionately attributed to and is taxed at the level of its partners. Per Annex 1 of the CCTB proposal, these partnerships are all not subject to the rules. If the CCTB rules are implemented regardless, Germany would have three sets of rules to tax companies: those for partnerships, those for corporations following the CCTB rules (i.e. over 750 million Euros turnover or opting for the rules) and those applying the German corporate tax rules. This has also resulted in some debate if a national company tax reform is necessary before any further steps are taken. Due to the sheer mass of partnerships used in Germany compared to other countries, it is unclear if it would become less complicated.

European Family Businesses is also concerned that the introduction of the C(C)CTB could decrease the flexibility of the corporate tax laws Each change in the C(C)CTB rules would require unanimity by all Member States. *European Family Businesses* believes that the unanimity requirement in corporate taxation would restrict the responsiveness of Member States to new economic or societal developments. Uncertainty could arise as to what extent Member States remain free to maintain or introduce specific domestic tax facilities, such as domestic group consolidation rules, next to the C(C)CTB rules.

In addition, EFB expects that the specific interests of local business in each Member State would consequently diminish. *European Family Businesses* furthermore is concerned that the introduction of the C(C)CTB could increase legal uncertainty. On the one hand, C(C)CTB does not include a common set of rules for tax audits. These would still be carried out according to national procedures leading to new disputes on the allocation of the tax revenue based on common rules. On the other hand, existing doctrines under domestic law, case law and/or administrative guidelines that have been developed over time would no longer necessarily apply under the C(C)CTB rules. Under the C(C)CTB rules, however, for the moment very little guidance from the legislative process is available and there is a risk that it could take considerable time before newly construed terminology under the C(C)CTB rules are formulated. In this respect, many new interpretation problems are expected to arise which ultimately would need to be solved by the European Court of Justice. *European Family Businesses* believes that in many cases, such a scenario would mean a step back in terms of legal certainty.

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Increase of compliance and transfer pricing

European Family Businesses is concerned that the introduction of the C(C)CTB would increase the compliance burden for European businesses. This is because the C(C)CTB rules determine the taxable base autonomously. The common tax base therefore could deviate from the annual business profits as recorded in the commercial annual accounts, whereas under the domestic corporate tax rules in many Member States, the commercial annual accounts typically form the starting point for calculating the taxable business profits.

European Family Businesses is worried that a deviation between the calculation of profits for commercial purposes and for tax purposes would introduce an additional compliance burden for European businesses. In addition, whereas the profit allocation within the EU would be based on a new methodology of formula apportionment, the existing methodology of transfer pricing would remain in place vis-à-vis non-EU Member States. This implies that two different sets for profit allocation would have to be applied (roughly speaking: one towards the EU parts of a multinational group and one towards the non-EU parts of that group). On top of that, despite the C(C)CTB rules, transfer pricing methodology will still be required from a business management point of view and from the perspective of the recently adopted Country-by-country reporting obligations.

In addition, it is hard to predict how non-EU Member States would apply the existing tax treaties to income that is no longer automatically attributed to the receiving company, but that is attributed under the formula apportionment rules to other companies that are established in other EU Member States. *European Family Businesses* recognizes a risk that non-EU Member States could start discussing tax treaty protection. *European Family Businesses* furthermore emphasizes in this respect that under the proposed formula apportionment, intangible property is ignored when allocating the common tax base among the Member States. *European Family Businesses* believes that this could result in a shift in tax base from knowledge based economies to industrial economies.

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