autonomous set of tax accounting rules without any formal reference to domestic law. Up until now, the CCCTB Working Group has been following this approach.

(4) The precise rules for the determination of an EU-wide common tax base – accepted IFRS as well as their modifications and separate tax accounting rules – should be laid down in an Accounting Directive (Art. 94 EC Treaty).

(5) An Accounting Directive as proposed here introduces a comprehensive tax base. But without an EU-wide standardization of tax accounting rules, the advantages of a common tax base cannot be realized.

CCCTB – Optionality

Johanna Hey

I. Introduction

The question of whether the Common Consolidated Corporate Tax Base (CCCTB) should be mandatory or optional will become one of the key issues of the harmonization project since the interests of the Member States and the interests of the business community naturally diverge on this issue. The business community – seeking to maximize the possible added value of the CCCTB – has strongly argued for optionality. Member States, in contrast, are not interested in increasing tax planning opportunities by promoting optionality, at least if they have suffered from tax evasion in the past. To date, the Commission has sympathized with the business community in order not to jeopardize its support. In Communication COM(2006) 157 dated 5 April 2006, in accordance with the European Parliament, the Commission decided to propose the CCCTB as an optional system.[1]

In the following, the pros and cons of optionality will be scrutinized by considering the extent to which an optional CCCTB system would meet the expectations associated with the harmonization initiative. In doing so, first, the goals and the legal framework of the CCCTB have to be set out insofar as these affect the decision between a mandatory or optional system (II.). In a second step, different designs of optionality are discussed (III.), but then the focus is shifted to the evaluation of the option as sketched to date by the Commission (IV.). Before coming to a conclusion, a comparison is drawn among experiences with sub-national profit tax systems in other jurisdictions and optional or mandatory consolidation (V.).

II. Goals of the CCCTB and the Institutional Framework

2.1 The Aim of the CCCTB Project

To answer the question of whether the CCCTB should be optional or mandatory, precise disclosure of the aims that the project is intended to achieve is necessary.[2] The CCCTB project has a twofold nature:[3] Simplification and ease of cross-border investments, on the one hand, limitation of profit-shifting opportunities, on the other hand. Hence, the business community's and Member States' interests in harmonization only align with one another in part. The ambivalent character of the project – not only granting a privilege, but at the same time restricting the possibilities to escape taxation – explains why the decision between a mandatory and optional CCCTB is not as easy as it appears at first glance.

1 See Implementing the Community Lisbon Programme: Progress to date and next steps towards a Common Consolidated Corporate Tax Base (CCCTB) of 5/4/2006, COM(2006) 157 final, pp. 8 et seq.

2 Schön, Perspektiven der Konzernbesteuerung, Zeitschrift für das gesamte Handelsrecht und Wirtschaftsrecht (ZHR) 2007, p. 409 (pp. 428 et seq.).

3 See Towards an Internal Market without Tax Obstacles: A Strategy for Providing Companies with a Consolidated Corporate Tax Base for their EU-wide Activities of 23/10/2001, COM(2001) 582 final, e.g. p. 5.

From the viewpoint of taxpayers, the most important issues are[4] (1.) the reduction of compliance costs and an increase in transparency, (2.) the elimination of international double taxation due to divergent qualifications, (3.) cross-border loss offsetting, and (4.) the simplification of cross-border restructuring.

The most significant simplification will be achieved by the adoption of a common set of rules for the determination of the tax base. However, simplification would not only be derived from the harmonization of the tax base, but also from attribution of profits by formula apportionment. Abandoning the troublesome determination of transfer prices and the extensive documentation obligations required by the application of the arm's length standard would save businesses money. Furthermore, the arm's length standard of uncontrolled prices is questioned to be viable in a highly-integrated economic area.[5]

However, it is not clear if the business community is honestly willing to give up opportunities to exploit the differences between national systems to reduce tax liabilities through tax planning devices in exchange for the benefit of simplification and cross-border loss utilization. Optionality would serve the taxpayers' interests in an optimal way to the extent that taxpayers can cherry-pick between tax planning opportunities, on the one hand, and can benefit from simplification and cross-border loss offsetting, on the other hand.

The perspective of the Member States naturally is quite different, although Member States can be divided into two groups, depending on their view of tax competition. Increasing the attractiveness of the European business environment by removing tax obstacles to cross-border activities and administrative difficulties could already be attractive enough on its own to convince Member States to surrender some of their sovereignty in tax matters. However, compared with the harmonization achieved to date in the field of direct taxation, the adoption of the CCCTB is a huge step. Prior directives only modified features of international tax law (Parent-Subsidiary Directive) or forced Member States to apply their domestic tax law equally to cross-border cases (Merger Directive). The CCCTB project is qualitatively different, since it would change applicable domestic tax law itself. Furthermore, harmonization of the tax base could run counter to the Member States' aims if an ease in comparing tax bases leads to pressure on tax rates. Transparency of markets in general increases the pressure on prices. Considering the

4 See BusinessEurope (formerly UNICE), Andersson, An Optional Common Consolidated Corporate Tax Base for the European Union, in Andersson/Eberhartinger/Oxelheim (ed.), National Tax Policy in Europe. To Be or Not to Be?, 2007, p. 85 (98).

5 Spengel, EU-Recht und Harmonisierung der Konzernbesteuerung in Europa, *Steuer und Wirtschaft* 2006, p. 34 (pp. 48); Spengel/Wendt, A Common Consolidated Corporate Tax Base for Multinationals in the European Union. Some Issues and Options, Working paper 07/17, Oxford University Centre for Business Taxation, June 2007, p. 14; Kleinbard, Throw Territorial Taxation From the Train, *Tax Notes International*, April 2, 2007, p. 63 (p. 69–72); Clausing/Avi-Yonah, Reforming Corporate Taxation in a Global Economy: A Proposal to Adopt Formulary Apportionment, The Hamilton Project, Discussion Paper 2007–08, p. 8.

Member States budget concerns and the usually short-sighted political decision-making process, it seems unlikely that long-term economic welfare gains will convince the Member States to give up sovereignty.

Thus, the main reason why Member States could be willing to impose self-restraint upon their sovereignty is the hope of stopping or slowing down tax rate competition[6] and of safeguarding the corporate tax base by application of formula apportionment instead of separate entity accounting. Stabilization of the tax base due to mandatory consolidation and formula apportionment is particularly crucial for all Member States with high tax rates; these presumably suffered most in the past from profit-shifting.[7] From their standpoint, severe forfeits in tax revenue caused by cross-border loss offsetting could at least be partly mitigated by regaining tax base, presently shifted to low tax European jurisdictions. This aim, however, will be jeopardized if application of the CCCTB is subject to the choice of the taxpayers. For this reason, the question of optionality marks the culmination of the tension between taxpayers' and Member States' interests. At the same time, it divides Member States into two groups – the ones that benefited from tax competition and those that lost revenue.

2.2 Normative Framework

2.2.1 Compatibility with the Fundamental Provisions of the Treaty

As secondary European law, the CCCTB Directive must be compatible with primary European law.[8] EC Directives must be interpreted in compliance with the fundamental provisions of the EC Treaty.[9] To avoid infringements of the Treaty, Directives must leave to the Member States a sufficiently wide margin of appreciation to enable them to transpose the content of the directive into national law in

6 The extent to which formula apportionment will limit the tax competition depends very much on the characteristic of the chosen formula: Wellisch, Taxation under formula apportionment – tax competition, tax incidence, and the choice of apportionment factors, 60 *Finanzarchiv* (2004), p. 24 (p. 37); Pethig/Wagner, Profit tax competition and formula apportionment, *International Tax and Public Finance* 2007, 631.

7 Questioned by Mintz, Corporate Tax Harmonization in Europe: It's all about Compliance, 11 *International Tax and Public Finance* (2004), p. 221, who considers neither consolidation nor apportionment to offer a way out of tax competition. Instead, he sees the most important reason as simplification; see also Spengel, *Steuer und Wirtschaft* 2006, p. 49, who even assumes an intensification of tax competition under a formulary profit allocation.

8 With regard to the relationship between EC secondary and EC primary law, see Bleckmann/Pieper in Dauses (ed.), Handbuch des EU Wirtschaftsrechts, loose leaf (2007), B. I para. 3; Ruffert, in Calliess/Ruffert, Kommentar zum EUV/EGV, 3rd edition (2007), Art. 249 EGV para. 14.

9 See ECJ 18 September 2003, C-168/01 Bosal [2003] ECR I-9409, para. 26. In my view, the greater leeway in regard of the application oft he proportionality principle mentioned by Dennis Weber and Antonio Russo, in this book, see p. 751 et seq., does not change the requirements set out by the fundamental freedoms as such.

a manner that remains consistent with the requirements of the Treaty.[10] A directive obliging Member States to treat cross-border cases less favourably than domestic cases would not comply with these requirements. Hence, the CCCTB Directive may not require the imposition of any higher burden on EU multinationals than on domestic companies or groups. Otherwise, taxpayers could claim that a violation of the market freedoms has occurred, in particular, the freedom of establishment or the free movement of capital.

Further restrictions on the design of the CCCTB Directive could result from the state aid provisions of Art. 87 of the EC Treaty. In general, harmonization of domestic laws does not exclude the application of the state aid provisions. According to the prevailing scholarly opinion, only domestic laws which transform coercive provisions of a directive without any scope of discretion do not fall within the scope of Art. 87 of the EC Treaty, since the state aid provisions are directed only at the Member States, and not at the Community itself.[11] If, in contrast, the Directive leaves discretional leeway to the Member States, state aid provisions have to be complied with in the transformation.

2.2.2 Compatibility with Member State Constitutional Law

Furthermore, the content of the directive that Member States are required to transform into domestic law may not conflict with Member States' constitutional law,[12] namely with equal treatment provisions as the constitutional basis for the ability-to-pay principle. This could be the case if the directive coerces Member States to treat differently groups of taxpayers with equal ability to pay. Optionality would avoid such conflicts, in particular, if purely domestic companies were also entitled to opt for taxation under the CCCTB regime. In light of this, the general criticism that taxation subject to choice is not compatible with equal taxation according to the ability-to-pay principle fades into the background.[13] Furthermore, optionality

[10] ECJ 17 June 1999, C-166/98 Société Critouridienne de Distribution (Socridis) [1999] ECR I-3791, para. 19; ECJ 13 July 1989, C-5/88 Wachauf v Bundesamt für Ernährung und Forstwirtschaft [1989] ECR 2609, para. 22.

[11] See Grube, Der Einfluss des EU-Beihilfenrechts auf das deutsche Steuerrecht, *Deutsche Steuerzeitung (DStZ)* 2007, p. 371 (p. 374); Koenig/Kühling, Reform des EG-Beihilfenrechts aus der Perspektive des mitgliedstaatlichen Systemwettbewerbs, *Europäische Zeitschrift für Wirtschaftsrecht (EuZW)* 1999, p. 517 (p. 519); Mederer/Triantafyllou, in von der Groeben/Schwarze (ed.), Kommentar zum EUV und EGV, 6th edition (2003), Art. 87 para. 1 EGV para. 29; critical Harings, Subventionen im Marktordnungsrecht, *Zeitschrift für Zölle und Verbrauchsteuern (ZfZ)* 2007, p. 141 (p. 147).

[12] With regard to the question of the applicability of domestic constitutional law, see EJC 15 July 1964, C-6/64, *Costa* [1964], ECR 1252 (p. 1269); at length Zorn/Twardosz, Gemeinschaftsgrundrechte und Verfassungsgrundrechte im Steuerrecht, *Deutsches Steuerrecht* (DStR) 2007, pp. 2185 et seq.

[13] Especially if the CCCTB option is mainly considered as a tax benefit, see Tipke, Die Steuerrechtsordnung, Vol. I, 2nd edition, 2000, p. 517.

would not conflict with the rule of law if the conditions under which the option may be exercised are precisely defined.

III. Possible Delineations of the Option and the Commission's Outline

3.1 Elements of Optionality

The assessment on the pros and cons of optionality depends on the design of the option. In judging this, one must distinguish between the question of optionality by itself and the definite delineation of the option.

Without considering a great variety in the details, two basic models are in the cards:

1. The Commission thus far considers making the application of the CCCTB itself optional, but then requiring compulsory consolidation if a corporate group opted for determination of its profits under the common tax base and a certain ownership threshold is met. Hence, the taxpayer cannot solely take advantage of the alignment of the tax accounting provisions. Invariably, this taxpayer is subject not only to consolidation, but also to formula apportionment of the group's profits. The working paper CCCTB/WP/057 suggests two different ownership requirements – one for opting and one for consolidation. Companies commonly owned by > 50% of the voting rights are considered to be a group for the purposes of opting, but only companies commonly owned by at least 75% are consolidated.
2. Alternatively, consolidation (and as a consequence formula apportionment) could be made subject to choice irrespective of the rules for the application of the harmonized tax base (mandatory or optional).

In the technical outline CCCTB/WP/057/doc/en of 26 July 2007 and the subsequent working paper on administration issues CCCTB/WP/061/doc/en of 13 November 2007, details of the option under model 1 were set out as follows:

1. Single companies may opt for the CCCTB if they are EU companies subject to corporate income tax in a Member State or companies incorporated in third countries resembling EU companies. The option is not limited to companies with activities in more than one Member State. Apparently, the directive will oblige the Member States to grant the option also for pure domestically acting companies. In any case, Member States themselves can decide whether they will make the CCCTB available (optional or mandatory) for purely domestic companies/groups as well.
2. The option of a group of companies is based on an "all in/all out" approach. If a controlling company exercises the option, the CCCTB applies to all affiliated companies that are more than 50%-owned (based on voting rights). Exercise

of the option would be invalid if it does not cover all of the companies of the group where the common ownership threshold of 50% is exceeded. An affiliated group company cannot opt out of the CCCTB on its own. Newly-acquired companies must be included in the CCCTB application if the common ownership requirement of more than 50% is met.

3. The option would be valid for five years and automatically renewed for successive periods of three years unless the controlling company ("principal taxpayer") does not formally opt out.[14] In the event of reorganizations, the CCCTB continues to apply for the remainder of the respective period, so that reorganization does not provide an "escape mechanism" from the CCCTB.
4. Tax consolidation would be mandatory for all companies opting for CCCTB which have a qualifying subsidiary (direct or indirect ownership of 75% or more) in another EU Member State.

Limitation of the option to a choice which only includes the "full package" (harmonized tax base, consolidation and formula apportionment) and allowing only uniform options for the whole group is designed to prevent cherry-picking.[15] However, this approach burdens the taxpayer with complex considerations of possible advantages of the CCCTB accounting provisions in comparison with domestic GAAP, as well as the comparison between profit allocation under formula apportionment in opposite-to-separate entity accounting. These considerations are juxtaposed against simplification and a possible cross-border loss-offset offered by the CCCTB.

3.2 Related Questions: Personal Scope of CCCTB and Consolidation Requirements

The decision between optional versus mandatory application and the design of the option is closely related to the personal scope of the CCCTB and the requirements for consolidation (definition of the taxable unit). These topics are not discussed here in detail, since they are covered by the papers of *Claus Staringer*, *Daniela Hohenwarter* and *Mario Tenore*; only significant interdependences are highlighted.

Since the CCCTB – as its name already indicates – is generally limited to entities that are subject to EU Member States' corporate tax law, partnerships (as flow-through entities) would not fall within its scope – either under an optional or a mandatory system. Hence, the CCCTB project is not neutral in relation to legal form. In a mandatory system, application of the CCCTB would present a strong argument for the choice between legal forms. If the CCCTB were compulsory, the only way for companies to escape its application would be by reorganization into

[14] Critical regarding the consequences of the expiration of the additional three-year period if the option is not explicitly prolonged, see Daniela Hohenwarter, in this book, p. 165 et seq.

[15] Andersson (footnote 4), p. 109.

a partnership. Optionality would therefore reduce the distortion of the choice between different legal or organizational forms. Even though partnership would still be excluded, companies would not find it necessary to change their legal form if these do not wish to be taxed under the CCCTB regime. In addition, intricate issues of separation into categories under mandatory application could be narrowed down to the question of the entitlement to opt.

Secondly, the evaluation of whether the application of CCCTB as such or consolidation should be optional or mandatory is closely related to the definition of the consolidated group and the question of whether permanent establishments are included. In general, the definition of the consolidated group can either be based on legal criteria (formal determinants like a specific percentage of ownership measured by capital or voting rights), or economic criteria (substance-over-form approach) or a combination of both.[16] The definition of a consolidated group based on legal form with a certain threshold of ownership or control measured by voting rights has the advantage of administrative simplicity.[17] However, group determination by way of legal form criteria entails opportunities to circumvent the application of the CCCTB by division/reorganization of the entities. If the application of the CCCTB depends on such criteria, taxes – rather than business considerations – would become a driving force in the design of a group's structure.[18] In the case of compulsory application of the CCCTB, the design of the enterprise's legal structure could serve as device to "opt" out of CCCTB. The higher the threshold for consolidation (e.g. > 75%), the higher becomes the potential for tax planning without significant detriments to economic substance. In contrast, eligibility by legal structure would be more difficult if either the threshold for consolidation were set lower (> 50%) or if the definition of a CCCTB group were based – solely or in addition – on a case-by-case test of the functional integration and the centralization of management decisions ("facts and circumstances" approach). However, the latter concept of a definition on economic criteria has the disadvantage of legal uncertainty, even though it is considered to be more consistent with the underlying rationale of the CCCTB.[19] So far, the Commission has voted for a formal threshold, proposing the (quite high) percentage of 75% of directly- or indirectly-owned voting rights.[20]

[16] See Spengel/Wendt, A Common Consolidated Corporate Tax Base for Multinationals in the European Union. Some Issues and Options, Working paper 07/17, Oxford University Centre for Business Taxation, June 2007, p. 19.

[17] Andersson (footnote 4), p. 109.

[18] Weiner, The European Union and Formula Apportionment: Caveat Emptor, *European Taxation* 2001, 380.

[19] Agúndez-García, Taxation Papers – The Delineation and Apportionment of an EU Consolidated Tax Base for Multi-jurisdictional Corporate Income Taxation: a Review of Issues and Options, ed. by The European Commission, Working paper No. 9/2006, Luxembourg 2006, p. 13.

[20] See CCCTB/WP059\doc\en, No. 6 with footnote 6 and No. 89.

IV. Pros and Cons of Optionality

4.1 Arguments in Favour of Optionality

From a tax planning point of view, more options are – at least for those taxpayers who can explore all the opportunities – always favourable. In addition to this argument, however, several other arguments in favour of optionality have been raised; these will be discussed in the following.

4.1.1 Minimizing the Risk of a Non-Competitive System

The most important argument seems to stem from the traditional view that competition of systems has salutary effects and is a value in itself. Harmonization causes regulatory monopolies and precludes the development of better rules by means of legislative competition. Making the CCCTB optional would permit the continuation of competition between the national systems and would introduce sound competition between CCCTB and national systems.[21] Hence, the EU legislator would be compelled to align its own tax system with the CCCTB in order to continually improve the provisions in force. This seems important – especially in the period after the introduction of the new law – in order to keep incentives in place for the Member States to agree unanimously on alterations of the Directive to resolve occurring problems.

However, first of all, the extent to which tax competition between the national GAAPs and the CCCTB would in fact take place is not assured, since the playing field available to Member States to compete with the CCCTB would be restricted by Art. 87 of the EC Treaty and the fundamental freedoms. A favourable ruling that would apply only to taxpayers determining their profits under the domestic GAAP, but not under CCCTB, could be considered "selective" under Art. 87 of the EC Treaty. In addition, the fundamental freedoms would prevent Member States from making their national tax bases more favourable than the CCCTB. Although every company could decide not to opt for CCCTB and to take advantage of a beneficial tax provision of the domestic GAAP, companies having already opted in the past would be excluded until they are able to leave the CCCTB regime. EU multinationals could therefore accuse the Member State of discrimination, even though their joining the CCCTB, instead of remaining within domestic GAAP, took place according to free choice. This applies at least to cases where the tax incentive has been introduced into the domestic tax system after the relevant company has exercised its option.

Furthermore, the benefits of the outcome of tax competition are – in reality – less striking than those resulting in theory. Even though the broadening of the base that has occurred in the last decades through the abolishment of tax privileges can be viewed as a positive result of tax competition (and the application of the state

21 See Andersson (footnote 4), p. 99.

aid provisions of Art. 87 of the EC Treaty), recent reforms in quite a few Member States indicate that tax competition leads to base broadening beyond the abolition of tax incentives.

4.1.2 Optionality Prevents the Drifting Apart of the domestic tax base and the CCCTB

A related argument is that optionality prevents the tax laws for multinationals from becoming totally decoupled from the tax laws applicable to domestic enterprises. Optionality would encourage domestic tax legislators to keep both tax bases aligned closely together. A tight link between national GAAP and the CCCTB would also diminish distortions between legal forms, since partnerships will generally not be eligible for CCCTB.

The CCCTB could even serve as a model for the domestic legislator. The CCCTB has the advantage of being created in one step; it therefore has the potential to be more consistent than the domestic tax bases,[22] which have mushroomed over decades. Such growth has often been very unsystematic, since provisions determining the domestic tax base are driven by changing revenue needs and specific lobby interests. If the CCCTB and domestic GAAP operate as eligible alternatives, companies have the potential to exert pressure on the national legislator to deter it from tightening the domestic rules of the determination of the tax base, e.g. by disregarding business expenses to a greater extent than disregarded in the CCCTB or to adopt restrictions on loss utilization. A good example set by the CCCTB could give national legislators an incentive to clean up the domestic tax bases.

The opposite development – namely, that domestic legislators seek to utilize the domestic tax base as an instrument to prevent taxpayers from exercising the CCCTB option by making the domestic provisions of the determination of the tax base favourable, thereby moving it away from the CCCTB on purpose – seems less likely, considering the restrictions of the state aid provisions and the fundamental freedoms mentioned above.

However, as long as the determination of profits starts from accounts prepared in accordance with national GAAP, which, in a second step, are adjusted to CCCTB standards, an increasing disconnection of both tax bases would at least remain visible. This would therefore be subject to political discussion, even if the CCCTB would be designed as compulsory.

4.1.3 Change Is Less Fundamental

The fact that the CCCTB will be made as an "armchair decision" contains advantages, but also bears the risk that rules will not work as predicted. A complete and exclusive new tax system will probably contain quite a few initial mistakes, of the

22 Similar Barenfeld, A Common Consolidated Corporate Tax Base in the European Union – A Beauty or a Beast in the Quest for Tax Simplicity?, Bulletin of International Taxation 2007, p. 258 (p. 260).

type that have only been eliminated in the domestic tax systems over time. No experience with the application and interpretation of the new rules has yet been gained. Furthermore, mandatory adoption of the new system in one blow would cause tremendous transitional costs, which, in the first years, can outweigh the value added. Since Member States – if they do not decide to also apply the CCCTB exclusively on a national basis – still have to apply CCCTB and GAAP in tandem, it would be easier to limit the need for tax officers trained in the new system to the smaller group of companies that opt for the CCCTB right after implementation. Admittedly, this argument would lose its relevance over time and depends on the assumption that not all eligible taxpayers would opt right away.

4.1.4 Less Severe Restriction of National Sovereignty

Making the CCCTB optional is viewed as a less severe restriction of the Member States' sovereignty. Indeed, for all non-opting companies, the domestic tax base would stay in place. However, since Member States cannot prevent companies from opting for the CCCTB, other than by offering tax privileges (which might conflict with the state aid provisions), the extent to which the sovereignty advantage exists is debatable.

4.1.5 Avoiding Complications, Especially for SMEs

To date, the Commission has not discussed special CCCTB rules for SMEs.[23] The CCCTB would apply no matter what the size (profit or turnover) a company is, provided that the company operates in two different Member States. For small and mid-size entities, the application of the CCCTB could impose higher compliance costs compared to the domestic systems, especially if these entities are eligible for simplified accounting or the application of the cash method under domestic law.[24]

However, whether the CCCTB imposes higher compliance costs than the application of domestic GAAP depends on the definitive design of the rules. It is true that the step from GAAP to CCCTB will be more difficult for small and mid-size companies. But this militates even more for a mandatory system in which transition becomes a one-off event, while an option system results in ongoing high tax planning expenses.

4.1.6 Avoiding the Necessity of an Opening Clause to the Formula Apportionment Procedure

Optionality avoids the necessity to provide the formula apportionment procedure with an opening clause for cases where the application of the common formula

23 On the initial idea of an experimental application of Home State Taxation to SME, see TAXUD/C/1 DOC 2110.

24 However, simplified accounting usually does not apply to corporations, see *Dieter Endres et al. (ed.)*, The Determination of Corporate Taxable Income in the EU Member. States, 2007, p. 25–26, without specification to which extent these simplifications also apply to incorporated businesses.

leads to an unreasonable allocation of the group's profits. A group that considers the results of the application of the formula as not sound simply will not opt for the CCCTB. Under a mandatory system, an opening clause would be inevitable. However, as the experiences in the US show, such opening clause would offer quite a bit of cause for conflict.[25]

4.1.7 Avoiding the Reproach of Discrimination

Even though not discussed as yet, the most important argument in favour of optionality could arise from the fundamental freedoms of the EC Treaty. Whenever a provision of a compulsory CCCTB is less favourable than the domestic GAAPs that apply to purely domestic business activities, EU multinationals could claim a violation of the freedom of establishment or the free movement of capital.[26]

First, application of the CCCTB would not put these companies in a wholly different position, excluding them from comparison to companies with only domestic branches or subsidiaries. Thus, both taxpayers are in a comparable situation. Second, the argument that as a whole the CCCTB results in an advantage would not be able to offset the higher tax burden stemming from the application of single provisions. According to this general practice, the ECJ would presumably take only the single disadvantageous provision into consideration, and would not take an overall view balancing the advantages and disadvantages of the CCCTB regime as a whole.[27] The taxpayer's possible advantage through cross-border loss-offsetting under CCCTB is likely to be disregarded. Other offsetting

25 Section 18 of the UDITPA (Uniform Division for Income Tax Purposes Act) contains an opening clause stating that either the taxpayer or the tax administrator may claim application of separate accounting, a change in the factors the apportionment was based on, or application of any other method that will result in an equitable allocation and apportionment of the taxpayer's income (see on this John C. Healy & Michael S. Schadewald, 2007 Multistate Corporate Tax Guide, Chicago 2007, Vol. I, p. I-469). It is incumbent on the taxpayer to demonstrate by clear and convincing evidence that the applied apportionment formula grossly misrepresents the amount of income actually earned in that state, an effort in which corporations in the past usually failed (Hans Rees' Sons, Inc. v. North Carolina, 283 U.S. 123 (1991); Moorman MFG Co. v. Bair, 437 U.S. 267, 279 et seq. (1978); Container Corporation of America v. Franchise Tax Board, 463 U.S. 159 (1983); Unisys Corp. v. Pa Bd. of Fin. and Rev., 812 A2d 448 (Pa. Sup. Ct. 2002); Colgate-Palmolive Company, Inc. v. Bower (No. 01 L 50195, Ill. Cir. Ct., Cook Cty., Oct. 15, 2002).

26 Of the same opinion Ceroni, The Possible Introduction of Common Consolidated Base Taxation via Enhanced Cooperation: Some Open Issues, *European Taxation* 2006, p. 187 (p. 189); adumbrated also in Gutachten des Wissenschaftlichen Beirats beim Bundesministerium der Finanzen, Einheitliche Bemessungsgrundlage der Körperschaftsteuer in der Europäischen Union, No. 81, 2007, p. 48.

27 See ECJ 28 January 1986, C-270/83 *Avoir fiscal* [1986] ECR 285, para. 2; ECJ 27 June 1996, C-107/94 *Asscher* [1996] ECR I-3113, 3127 paras. 51 et seq.; ECJ 21 September 1999, C-307/97 *Saint Gobain* [1999] ECR I-6181 para. 54; ECJ 26. October 1999, C-294/97 *Eurowings* [1999] ECR I-7463 para. 44.

tax advantages under the CCCTB would not be relevant to the determination of a discriminatory effect.[28]

Optionality would avoid these conflicts with the EC Treaty. If the application of the less favourable rule is on an optional basis only, the taxpayer cannot claim to have been violated by an action of the Member State – at least with respect to the provisions in force at time of the exercise of the option.

4.2 Arguments against Optionality[29]

4.2.1 High Compliance Costs of Exercising the Option

An optional CCCTB regime would add a 28th accounting system to the already existing 27 different sets of Member States' accounting rules. This would result in higher – instead of lower – tax planning costs. If the claim for simplification is meant seriously, optionality should be rejected – not only from the tax authorities' point of view but also on behalf of the taxpayers.

Due to the fact that the option for CCCTB includes not only a whole new set of rules for the determination of taxable income, but also cross-border consolidation and formula apportionment, taxpayers face a highly complex decision. To opt for CCCTB or not must be considered from a long-term planning perspective, since the option is binding for a period of at least five years. Large multinationals are endowed with sufficient human resources to calculate the consequences of different tax scenarios. Small and mid-sized companies/groups, however, would have to seek external advice, which can only be afforded to a limited extent. They will not be able to take full advantage of optionality and will therefore suffer competitive disadvantages.

4.2.2 Administrative Burden

4.2.2.1 Control of the option requirements and changes between the systems

From the standpoint of the tax administration, options always cause additional costs. First, the exercise of the option requires monitoring. Second, changes between the CCCTB and the domestic GAAP would require multiple adjustments.

However, the administrative burden in controlling the exercise of the option itself depends very much on its final design. In the technical outline, the Commission sought to ease administration by including several features: (1.) all in/all out principle; (2.) five-year mandatory period (3.) automatic renewal after expiration of the initial period; and (4.) automatic cancellation of the option if corporate group status is terminated. Restricting the options available and requiring a minimum duration not only prevents permanent arbitrary in- and out-options,[30] but also reduces the costs of control.

On the other hand, the technical outline renders the control of the application of the CCCTB unnecessarily complicated by providing two different thresholds for eligibility and consolidation. If the controlling company opts for the CCCTB, all affiliated companies that are owned by more than 50% are included in the CCCTB, but only companies commonly owned by at least 75% are consolidated. In the subsequent working paper on possible elements of the administrative framework, the application of two different thresholds – one for opting and one for consolidation – was already justifiably criticized as causing complexity,[31] namely because it will lead to situations in which the controlling company that opted for CCCTB is not part of the consolidated group (i.e. ownership is between > 50% and 75%).

4.2.2.2 Parallel application of two sets of rules for the determination of business profits

Beyond the control of the exercise of the option itself, optionality cannot be made responsible for the extra burden of the application of two different systems. Provided that national GAAP is not entirely replaced by the CCCTB, domestic companies as well as unincorporated businesses (i.e. sole proprietorships) must still be taxed under the national systems. Member States would be free to avoid the administrative burden of the application of two sets of rules, where they decide to entirely supersede their domestic GAAP by making CCCTB the only method of determining business profits, regardless of whether the taxpayer only carries out its activities domestically and irrespective of legal form.

Optionality, however, would reduce the expected alleviation in the field of transfer pricing, because groups not opting in would still compute their profits according to separate entity accounting at arm's length. Even though transfer pricing will in no way be dispensable, since it will still be used in relation to related parties in third countries, the number of transfer pricing cases in the European Union would decrease to a lesser extent than under a mandatory system.

4.2.3 Opportunities of Shopping between the Two Systems

Optionality of the CCCTB would not only fail to decrease the present tax planning opportunities, but could even introduce new ones, since companies could shop between both systems.

The five-year mandatory minimum period makes constant opting in and out impossible, thereby limiting the risk of base shopping. However, if losses do not occur permanently, but e.g. stem from a new investment abroad, a group could

[28] E. g. ECJ 21 September 1999, C-307/97 *Saint Gobain* [1999] ECR I-6161, para. 54.

[29] Addressing some of these arguments, see Herzig, Harmonisierung der steuerlichen Gewinnermittlung in der Europäischen Union, *Steuer und Wirtschaft* 2006, p. 159 (p. 162); Mintz, European company tax reform: prospects for the future, CESifo-Forum 2002, Heft 1, S. 3 ff.; Mintz/Weiner, Exploring Formula Allocation for the European Union, 10 International Tax and Public Finance (2003), p. 695 (p. 700).

[30] See W. Schön, *ZHR* 2007, p. 429.

[31] CCCTB/WP061\doc\en, No. 11.

decide to opt out after all losses are utilized, if the allocation of profits under formula apportionment is less favourable than under separate entity accounting.

Another tax planning opportunity arises through the application of the two different thresholds for opting and consolidation. Even though the option is designed as an all in/all out option for the "full package" of the harmonized tax base (consolidation and formula apportionment), the double threshold for opting and consolidation opens the door to opt the group into CCCTB, but to avoid consolidation and formula apportionment by deliberately failing the consolidation threshold. To prevent rule shopping, as well as to avoid administrative difficulties, the ownership threshold for the option for CCCTB and for consolidation must be the same.

4.2.4 Perpetuating Profit-shifting Opportunities

The most important drawback to optionality is that the CCCTB project would no longer serve as a means to prevent tax avoidance and profit-shifting. Multinationals that have been engaged in profit-shifting in the past most likely would not opt for the CCCTB, of course, depending on the incentive posed by uniform rules for the determination of the tax base and the chance of cross-border loss-offsetting.

However, if CCCTB application were mandatory, taxpayers still could avoid application of formula apportionment by the structural design of the company group. If the threshold remains as high as the 75% discussed to date, such designs could be achieved without sacrificing much in the way of economic substance.[32] It becomes more difficult to achieve such structuring if the threshold for consolidation is reduced to simply more than 50% because the means to reduce engagement to 50% or less – and to still preserve *de facto* control – seems rather unlikely.

4.2.5 Increasing the Budget Risks of Cross-Border Consolidation

Due to the arbitrariness of an optional CCCTB, the costs of cross-border consolidation would become higher. *Devereux* and *Loretz*[33] show the impact of optionality versus non-optionality on the revenue consequences of the new system. The distribution of tax revenues differs significantly between the two constellations of optionality and a mandatory system. Generally speaking, high-tax countries gain revenue or lose less revenue from cross-border loss-offsetting where the new system is mandatory. The underlying assumption is that companies with high losses and profits in different countries will exercise the option, while companies that have reduced their tax liability by shifting profits to low-tax jurisdictions will remain in the separate entity accounting system.

[32] Pomp, Issues of the Design of Formulary Apportionment in the Context of NAFTA, 49 *Tax Law Review* (1995), p. 795 (p. 808).

[33] Devereux/Loretz, The Effect of EU Formula Apportionment on Corporate Tax Revenues, Oxford University Centre für Business Taxation, WP 07/06, p. 22.

V. Experiences with Optionality in Other Tax Systems with Sub-national Profit Taxation

5.1 Link between National and Sub-national Level

It might be interesting to compare how the issue of optionality is handled in other jurisdictions with sub-national profit taxation. Most countries in which sub-national authorities are entitled to tax business profits attribute profits by formula apportionment, rather than by application of transfer pricing rules. However, the extent to which profits are apportioned by the formula method depends on the group taxation systems of these countries. Here, a brief summary of the situation in Germany, Canada and the United States is helpful.

In all of the systems considered, there is no choice between different tax bases, but groups can indirectly make a choice between the application of either formula apportionment or separate entity accounting to the extent that consolidation is not compulsory.

At first, this issue is related to the federal level. In none of the countries mentioned is consolidation compulsory for federal tax purposes. In contrast, Canada does not allow consolidation at the federal level, nor do its provinces. For that reason, the Canadian formula apportionment system is limited to branch profits, while separate entity accounting applies among related companies. In Germany and the US, where consolidation at federal level is provided for, one can distinguish between whether the option to consolidate for federal tax purposes is made binding for sub-national tax purposes as well.

5.2 German Gewerbesteuer

With respect to the German trade tax ("Gewerbesteuer"), consolidation at local and federal level has become synchronized. After several – not always consistent – amendments of the statutory regime, the German parliament finally linked consolidation for purposes of federal corporate income tax with consolidation for trade tax purposes.[34] Consolidated subsidiaries are treated like branches (§ 2 (2) Trade Tax Act) with the effect that profits of companies belonging to a tax group are automatically apportioned under the formula apportionment rules on the basis of payroll (known as "*Zerlegung*"). Hence, groups that want to take advantage of differences in local trade tax rates by allocating profits in a manner departing from the formula apportionment contained in § 28 et seq. Trade Tax Act may not consolidate for purposes of federal corporate income tax. Up until now, the opportunities for immediate loss-sharing among the group for federal corporate income tax purposes were usually the driving force for consolidation. However, in the future, the chance to avoid formula apportionment for purposes of the Gewerbe-

[34] Güroff, in Glanegger/Güroff, Gewerbesteuergesetz, 6th edition (2006), § 2 para. 190.

steuer might end up becoming a valid tax planning consideration militating against consolidation, since from 2008, the impact of trade tax rates equals or even exceeds the impact of the federal corporate income tax on the overall tax burden. Already in the past, profit-shifting among non-consolidated affiliated entities became a trade tax issue, whereas in 2004, the Federal parliament introduced a minimum tax rate for the trade tax of 200% (equivalent to 7% compared with the average of around 15%, subject to a multiplier of 428%).

5.3 US State Corporate Income Tax

In the US, there is no automatic link between consolidation for federal corporate income tax purposes and consolidation for state tax purposes. Instead, US states have adopted a great variety of different schemes for optional or mandatory consolidation (in US state tax parlance, usually referred to as "combined returns"). The conditions under which an affiliated entity can be included into a group sometimes relate to the thresholds at the federal level, but diverge from state to state. Four states (Delaware, Maryland, Pennsylvania and Wisconsin) do not allow consolidation at all, but instead mandate separate entity accounting. The rest of the forty-six US states that impose corporate income tax are divided into two groups: The majority allows, but does not require consolidation. States that made consolidation and formula apportionment mandatory have been in the minority for a long time. Until quite recently, only sixteen states made combined reporting mandatory if certain criteria were met, sometimes based on case-by-case discretion by state authorities. However, this number has been growing now that four more states[35] have adopted mandatory combined reporting and several other states are discussing similar legislation.[36]

The intention behind moving to mandatory combined reporting for unitary business groups is to prevent taxpayers from exploiting tax shelters aggressively offered by some US states. The optionality of consolidated returns is considered to facilitate cherry-picking.[37] The trend toward mandatory combined reporting might even increase, since piecemeal add-back provisions employed today to prevent profits from being siphoned out of states are not only not very effective, but also have been – similar to the situation in the European Union – recently challenged as discriminatory with respect to interstate commerce.[38] In contrast,

35 Vermont, West Virginia (effective from 2009); New York and Texas, which moved from compulsory separate entity accounting to mandatory combined reporting.

36 See, for an overview, Mazerov, Growing Number of States Consider Combined Reporting, *State Tax Notes*, April 30, 2007, p. 335 (pp. 336 et seq.)

37 Fox/LeAnn, State Corporate Tax Revenue Trends: Causes and Possible Solutions, 55 *National Tax Journal* (2002), p. 491 (p. 503); Fox/Murray/LeAnn, How should a Subnational Corporate Income Tax on Multistate Business Be Structures, 53 *National Tax Journal* (2000), p. 139 (pp. 146 et seq., 156).

38 See Houser/Grissom/Ely, Alabama Judge Rules for Jeans Manufacturer in Addback Case, *State Tax Notes*, Feb. 5, 2007, p. 288.

mandatory combined reporting has been upheld by the US Supreme Court.[39] Most US authors appreciate this trend, criticizing the optionality of combined reporting as one of the fundamental flaws of the US state tax system for its tacit allowance of cherry-picking. Such authors therefore consistently recommend making combined reporting mandatory.[40]

VI. Conclusion and a Possible Compromise

As shown, optionality is only partly consistent with the aim of simplification, and it contradicts the aim of tackling profit-shifting. If the main goal is the promotion of international activities of multinational firms, the CCCTB should be optional.[41] If, however, the main aim of harmonization is reducing the arbitrariness of the tax base, then it must be obligatory.

The Commission has argued for optionality in order to forestall drainage of support from the business community, which has been the driving force behind this demand. The reasons for this are quite obvious. Even though there are good arguments for optionality, some of them seem to be purported or overstated. The main reason for the demand for optionality seems to be the preservation of a maximum of tax planning opportunities, and even the addition of further tax planning options. To which extent these options will actually be exploited depends on the attractiveness of the CCCTB. The risks of optionality further relate more to the design of the option; these might therefore be controllable. In any event, the threshold for consolidation should be reconsidered and preferably reduced, closing a gaping loophole and avoiding much arbitrariness.

The Commission is not only dependent upon the support of the business community, but also needs the support of the Member States. These are the entities that must adopt the Directive – ideally unanimously. From a Member State perspective, however, where an optional CCCTB is considered, the project loses much of its potential to address profit-shifting. Instead, such a project bears the risk of substantial revenue losses due to optional cross-border loss offsetting. The question of whether intermediate solutions are available is thus raised.

39 *Moorman Manufactoring Co.* v. *Bair*, 437 U.S. 267 (1978); *Container Corporation of America* v. *Franchise Tax Bd.*, 463 U.S. 159 (1983); *Quill Corp.* v. *North Dakota*, 504 U. S. 298 (1992).

40 Fox/LeAnn, 55 *National Tax Journal* (2002), p. 491 (pp. 503 et seq.); Fox/Murray/LeAnn, 53 National Tax Journal (2000), p. 139 (p. 146 et seq., 156); McLure, The Nuttiness of State and Local Taxes – and the Nuttiness of Responses Thereto, State Tax Notes, September 16, 2002, p. 841 (p. 849); also from the Canadian background, where consolidation is prohibited; Mintz, Corporate Tax Harmonization in Europe: It's all about Compliance, 11 *International Tax and Public Finance* 2004, p. 221 (pp. 227 et seq.).

41 American Chamber of Commerce in the European Union, Position Paper on CCCTB, 2005, p. 1; European Business Initiative on Taxation (EBIT), Contribution to the Commission on CCCTB, 2006, para. 8.

As yet, the Commission pursues an approach of full optionality. However, intermediary solutions are possible with either a mandatory or an optional approach. These include making the CCCTB compulsory for only a select category of companies or limiting the option to SMEs. The argument raised by the working group on CCCTB,[42] namely that a partial mandatory system could potentially conflict with state aid rules, seems implausible. Advantageous rules contained in the CCCTB Directive would not have to pass muster under Art. 87 of the EC Treaty if one agrees that these must be considered to constitute Community aids to which state aid provisions do not apply. However, even if Art. 87 of the EC Treaty were to be found applicable, in my view, partial compulsory CCCTB application would not fulfil the tests for state aid under the Treaty. Even if the benefits of simplification and cross-border loss consolidation were considered to constitute economic advantages and hence, to be state aid according to Art. 87 of the EC Treaty, it would not be selective,[43] provided other companies and cross-border groups could opt for the same simplification without discretion on the part of the tax authorities. On the contrary: The application of the domestic tax base for those companies that did not opt could not be viewed as state aid on its own. If the domestic tax base contains tax incentives, then they themselves must be proven to be compatible with Art. 87 of the EC Treaty. This is not a problem unique to a (partial) mandatory application of the CCCTB as limited to a selected category of companies. Finally, it is at least not self-evident that for those companies that are not covered by the mandatory application of the CCCTB regime, the remaining opportunity of profit-shifting can be regarded as a prohibited state aid. However, the main reason against making the CCCTB compulsory for only a group of companies (e.g. large multinationals) is the risk of creating a special regime for an even smaller group. This remains subject to attack by considerations of equal treatment.

Alternatively, the decision of whether to make the CCCTB mandatory could be left to the Member States, thus creating a situation similar to the US corporate state taxation which allows for the coexistence of mandatory and optional consolidation. However, a coexistence of separate entity accounting and formula apportionment within one group could cause severe double taxation problems if the profit share in country A determined by separate entity accounting overlaps with the share in country B determined by formula apportionment.

Another compromise between the interests of the business community and those of Member States is to permit optionality for an evaluation period of – perhaps – 10 years, but with the final aim of a mandatory system. This would appear to be a sound solution if one trusts the business community's argument that the motivation of their claim for eligibility is not to preserve tax planning opportunities, but mainly the lack of experience with the new system and the need for an evaluation of the new system subject to comparison with the national GAAP systems.

Finally, the case for optionality needs to be re-evaluated if the Member States are unable to agree on cross-border consolidation and formula apportionment, but can only set common rules for the determination of the tax base. In this case, optionality makes more sense, since the project would then no longer be designed to serve Member States' interests in addressing profit-shifting. Hence, a need to make the CCCTB mandatory would no longer exist.

[42] See Working paper CCCTB\WP\053\doc\en, No. 6.

[43] Of the same opinion Cerioni, The Possible Introduction of Common Consolidated Base Taxation via Enhanced Cooperation: Some Open Issues, *European Taxation* 2006, p. 187 (p. 193) regarding introduction of the CCCTB via enhanced cooperation.

As one of the leading tax advisory networks in Europe and globally, Ernst & Young[1] has had a strong interest in the development of CCCTB from its very start in 2001. It is our great pleasure and honour to facilitate the publication of the highly qualified presentations from this seminar through financial support. This shows our commitment to further support the analysis of CCCTB and to enable a broad audience, including our clients and friends of Ernst & Young to obtain a more structured and in-depth knowledge about what CCCTB stands for and what it can mean for doing business in Europe.

We at Ernst & Young will closely follow and monitor the further development of the CCCTB regime, and we will give our input to this highly interesting area of Direct Taxation in the EU. Our thanks goes to Professor Lang for his enthusiasm and engagement in organizing this high calibre seminar and editing this publication.

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Preface

Complying with the Lisbon Strategy set forth by the Council of the European Union in 2001, the European Commission identified corporate taxation across the European Union as one major obstacle to the achievement of a common market. With – today – 27 different corporate tax systems, pan-European companies are facing – among other administrative issues – extremely high compliance costs. In order to tackle this problem, the European Commission commenced its work on the "Common Consolidated Corporate Tax Base", an ambitious project to coordinate corporate taxation throughout the European Union. By 2008 the European Commission intends to present to the Council and the European Parliament a legislative proposal on the basis of which corporate taxation in the European Union could be harmonized.

This book provides the first comprehensive in-depth analysis of the preparatory work done by the Commission since 2001. In 43 contributions distinguished academics, practitioners and representatives of several European tax administrations and Institutions discuss the major issues.

Almost 200 experts, including the contributors to this book, convened for a joint conference on the "Common Consolidated Corporate Tax Base – The Possible Content of Community Law Provisions" from February 21 – 23, 2008 in Vienna. This conference was organized by the Institute for Austrian and International Tax Law of the Vienna University of Economics and Business Administration (WU) in co-operation with the European Commission. The knowledge shared at the conference benefited not only the participants themselves, but also manifested itself in the papers included in this volume, which were completed after the conference. Without the support of the European Commission neither the conference nor the entire project would have been feasible.

We are very grateful to all the authors who contributed to this book, albeit on a very strict and tight time schedule. They displayed enormous discipline in completing their contributions and actively participated in the discussions at the conference in Vienna with impressive enthusiasm. After presenting their results at the conference, they finalized their papers immediately.

The Linde publishing house agreed to include this book in its catalogue. We would like to express our sincere thanks for their cooperation and the swift realization of this publication project. Ms Margaret Nettinga contributed greatly to the completion of this book by editing and polishing the texts for the authors, for whom English is – to a great extent – a foreign language. Above all, we would like to thank the members of the secretariat and the research assistants of the Institute for Austrian and International Tax Law, especially Ms Necha Demirova, Ms Reneé Pestuka, Ms Katharina Kubik and Mr Christian Massoner, who were responsible for the organization and preparation of the conference in Vienna and who also worked on the publication of this book. Without their dedication and talent for or-