Commission company tax strategy - frequently asked questions

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(See also IP/03/1593)

What exactly is the Commission proposing in terms of a single EU-wide tax base (taxable profits)?

The Commission is proposing that companies with cross-border activities within the EU should be allowed to calculate the taxable income of the entire group according to one set of rules, and establish consolidated accounts for tax purposes (thus eliminating the potential tax implications of purely internal transactions within the group).

Currently a group of companies is forced to calculate a separate tax base (taxable profits) in each Member State in which it operates, according to the tax rules in that Member State.

Allowing companies to apply one set of rules would significantly reduce the compliance costs resulting from the need to deal with 15 and soon 25 tax systems within the Internal Market; do away with transfer pricing problems within the EU; allow for the offsetting and comprehensive consolidation of profits and losses on an EU basis; simplify many international restructuring operations; avoid many situations of double taxation; and remove many discriminatory situations and restrictions.

Is the European Commission advocating full EU company tax harmonisation?

No. The Commission is only advocating that companies should be given the opportunity to use a single company tax base (taxable profits) for all their EU-wide activities. The business community is very supportive of this idea. The level of the tax rates would remain a matter for the individual Member States. The idea would be that Member States would apply their national tax rate to their specific share of the overall tax base (taxable profits) as computed according to a commonly agreed allocation mechanism. The Commission proposal to allow a company to use a single tax base (taxable profits) would in fact make the differences between the tax rates of the Member States more visible, thus promoting fair tax competition.

Why does the Commission not propose any co-ordinated action on rates?

The Commission considers that the level of taxation is a matter for Member States to decide, in accordance with the principle of subsidiarity. There is no convincing evidence at present which leads the Commission to believe it is necessary to recommend specific actions on the approximation of the national corporate tax rates or the fixing of a minimum corporate tax rate.

Why is the Commission advocating a "twin track" strategy instead of concentrating its resources on a single strategy?

The Commission's approach does represent a 'single' strategy. The Commission has identified a number of specific tax obstacles. If all these were resolved the underlying problem for companies of compliance costs and complexities from having to deal with up to fifteen or even twenty five different tax systems would still remain and the full benefits of the Internal Market would not be realised. This has led the Commission to conclude that in the longer term a common company tax
system in the form of a consolidated corporate tax base (taxable profits) is the most promising way forward.

However, the introduction of such a tax base (taxable profits) is a longer term objective and therefore it makes sense to begin work on targeted solutions at the same time as examining the more comprehensive approach. Work on the specific obstacles will support the work on the comprehensive approach, and may lead to early results and thus tangible benefits for the EU. The ideal comprehensive approach has not yet been identified so it makes sense to ensure that whilst a project of this magnitude is debated and discussed we also make progress on the separate individual issues where this is possible.

How would International Accounting Standards (IAS/IFRS) be useful as a starting point for a common EU-wide tax base (taxable profits)?

A 2002 Regulation adopted by the Council and the European Parliament requires listed companies from 2005 onwards to prepare their consolidated accounts in accordance with International Financial Reporting Standards (IFRS), formerly known as International Accounting Standards (IAS) (see IP/03/1297). The Commission suggests that if companies will be reporting profits according to a common standard then this common measure of profitability could be used as a starting point for a common EU tax base (i.e. a common definition of taxable profits). The Commission launched a public consultation on this idea in March this year (see IP/03/307). The issues that have been raised and that require further consideration include the relationship between the principles of materiality and substance over form in IFRS as compared to existing tax principles, the need to ensure that where assets are re-valued for accounting purposes this does not lead to taxation of unrealised gains, and the need to re-assess the dependency that currently exists between a company's statutory accounts and its tax accounts. The Commission envisages establishing a series of meetings with accounting and financial experts from the Member States to discuss the links ("dependency") between financial accounts and tax accounts, the tax implications of the introduction of IFRS. The Commission also envisages launching discussions with interested parties on individual aspects of the tax base (taxable profits), such as depreciation.

What would be the issues involved in allocating the tax base (taxable profits) between Member States?

The mechanism agreed would have to be equitable and transparent and be as administratively straightforward as possible. It would both have to satisfy sound economic principles and meet the approval of Member States. The choice of the formula to be used is subject to current Commission research.

The sharing could be carried out at a macro level (i.e. the level of Member States) or at the micro (i.e. company) level. Some consideration has been given to a formula apportionment approach used in some countries such as the US. The traditional three factors used in a formulaic method of apportioning tax are sales, capital and labour.

What is the pilot scheme that the Commission is planning to launch for Small and Medium Enterprises (SMEs)?

The Commission is proposing that SMEs should be allowed, if they so choose, to use the tax rules of their home state for calculating their EU-wide taxable profits. There are many technical and legal reasons for piloting this "Home State Taxation" approach on an experimental basis with SMEs. In particular, SMEs are hampered by tax problems more than larger companies when they engage in cross-border activities. Compliance costs resulting from tax formalities appear to be regressive to company size and are thus disproportionately high for SMEs. Similarly, the general difficulty with
the cross-border offsetting of losses hits SMEs particularly hard, especially as regards start-up losses that occur almost by definition in the first years of an international investment. Business associations, federations and academics have emphasised the efficiency and simplification gains for SMEs from a pilot scheme.

What company tax changes does the Commission propose following the recent adoption of the European Company Statute?

Following the agreement on the European Company Statute (Societas Europeae - SE) on 8 October, the Commission believes the tax situation of companies choosing the European Company Statute must be reviewed. It will be possible for companies to adopt this new legal form as from 2004. In the Commission’s view, it is imperative that by this date the whole body of EU company tax legislation, such as the Parent/Subsidiary, Merger Directives and Interest and Royalties Directives, is available to companies created under the Statute. It has made proposals for the extension of the first two Directives to SEs (see IP/03/1214 and IP/03/1418) which are currently under discussion in the EU’s Council and it intends to make a similar proposal to bring the SE within the scope of the Interest and Royalties Directive shortly. Comparable measures are also being taken for the recently adopted State of a European Co-operative Society (see IP/03/1071).

Last but not least the concept of the European Company Statute is closely linked to that of a common comprehensive approach to company taxation in the EU. The work on the technicalities that are necessary for providing companies with a consolidated corporate tax base (taxable profits) for their EU-wide activities will therefore be particularly relevant to future SEs.