

The Effect of Harmonisation of the Corporate Tax Base in the EU

The European Commission has re-launched the Common Consolidated Corporate Tax Base (CCCTB) initiative. CCCTB refers to a proposal by the European Commission for an EU-wide tax code aimed at companies operating in more than one member state. Under a CCCTB, businesses would compute their annual EU taxable income and apportion shares of it to the different member states where they operated, according to a pre-defined formula taking into account revenue, employee numbers and wages, as well as most assets. Under a CCCTB, each member state would tax the profits of the companies in its state at their own national tax rate. The renewed proposal for a CCCTB introduces a two-step approach: efforts will first concentrate on agreeing the rules for a Common Corporate Tax Base (CCTB), and consolidation will be left to be adopted at a later stage (CCCTB).

Proponents of corporate tax harmonisation claim that the proposal is designed to:

- create the common market and secure free trade by removing tax obstacles;
- simplify compliance with the EU tax system;
- alleviate the burden of tax administration (both for taxpayers and tax administrators);
- guarantee even competition conditions;
- safeguard national tax revenues;
- improve tax transparency; and
- reduce tax avoidance (profit shifting and double non-taxation) and aggressive tax planning.

There are reasons to claim that CCCTB is not the best tool to achieve these objectives.

Tax harmonization would destroy tax competition between countries, and this will have negative consequences.

Unified tax rules can hardly contribute to trade liberalisation. The diversity of tax systems is not a roadblock for free trade. Quite the opposite, differences of tax systems might serve as a stimulus to trade. Taxes constitute a significant share of costs and a large share of the price of factors of production, labour in particular. It is tax diversity (which is usually determined by the necessity to accommodate to local conditions and traditions) that provides serious incentives to produce cheaper goods and services and to offer them on the international market. Non-existence of centralised tax harmonisation promotes beneficial trade rather than undermining it.

Countries have always competed using their exogenous factors (e.g. the amount of land, population, proximity to waterways, etc.) as well as endogenous one (e.g. the level of corruption, political stability, low bureaucracy, as well as the level of taxation). Competition by endogenous factors (e.g. taxation) should not be perceived as “unfair” or “unnatural.” Tax competition is no different than competing for investment by cutting red tape, speedy bureaucracy and other factors that depend on the national governments.

CCCTB confuses value-added with inputs.

The current proposal of CC(C)TB for a harmonized tax base and sharing of the profit tax is based on a calculation formula which takes into account revenue, employee numbers and wages, as well as most assets. By trying to reduce tax avoidance CCCTB might directly interfere with modern production and distribution practices. By attempting to determine the “true” location of economic activity (and the country that the tax is due to), CCCTB incorrectly equates value added to inputs (labor, wages or real estate). CCCTB does not account for modern practices where the value of a product is composed of branding, brand names and other subjective factors too.

CCCTB will deprive market agents of the opportunity to select better taxation options.

Companies will not be able to exploit the advantages of different tariffs in different member states. Tax harmonisation must not justify a deterioration of the tax environment because business activity requires favourable business conditions, not uniform taxes. This is confirmed by the fact that the introduction of a CCTB would have a considerable impact on the values of the tax base in the EU member states. Except for Cyprus and Ireland, the values of the tax base would increase in all countries. On average, the effective tax burden would increase by 5.15% [1] and the common tax base would be extended by 7.9%.[2] In particular, the business environment would deteriorate dramatically in Estonia which charges the corporate income tax only on dividends.

If imposed on all companies, CCCTB would make tax compliance harder.

If unified tax rules were imposed on EU companies operating only in the domestic (national) market, corporate tax harmonisation would bring no tangible effects that are expected from the common market and free trade. At the same time businesses (especially SMEs) would also incur costs of conforming to the new rules. For example, a Lithuanian company selling goods only in Lithuania would have to bear compliance costs if CCCTB were to replace the current corporate tax base applicable in Lithuania.

CCCTB might not reduce companies' and tax administrators' costs and could even increase them.

Although CCCTB may be advantageous for businesses in terms of saving their time that is needed to scrutinise different rules of computing the corporate tax base, there is a high probability that a reduction of the administrative burden will be offset by an increase in other burdens and costs. Also, differences between tax bases in various member states may still remain as they are usually given some leeway even in the case of the strictest harmonisation.

According to a study performed by PricewaterhouseCoopers based on a survey of business companies, an introduction of CCTB in Lithuania would increase internal costs of a company by 14%, external costs, by 6 %, while one-off costs associated with the introduction of CCTB would be approximately 19.000 EUR. The projected growth of costs has generally been associated with more complex tax rules than the current regulations, as anticipated by the surveyed companies.

An introduction of CCCTB would increase internal costs by 5% and reduce external costs by 22 %, while one-off costs associated with introduction of CCCTB would be the same as in CCTB scenario (approximately 19.000 EUR).

The introduction of both CCTB and CCCTB is likely to increase the administrative burden for the State Tax Inspectorate (STI). If CCTB were compulsory, the administrative burden would increase by 23% or 1.4 mln. EUR *per annum* (assessing a 5-year period). If the CCTB were optional, the administrative burden would increase by 45% or 2.7 mln. EUR *per annum* (assessing a 5-year period). In case of a compulsory CCCTB, the administrative burden would increase by 25% or 1.5 mln. EUR *per annum* (assessing a 5-year period). If CCCTB were optional, the administrative burden would increase by 47% or 2.9 mln. EUR *per annum* (assessing a 5-year period). This increase is associated with the complexity of the CC(C)TB tax administration process, taking into account existing expertise of STI and the need to administer two systems (national and CC(C)TB).[3]

In three scenarios (optional CC(C)TB and compulsory CCCTB) an increase in the administrative burden of STI would outweigh the expected corporate tax revenues.

Requirements to disclose sensitive information would put EU businesses at a competitive disadvantage.

Requirements to disclose more information about a company's tax affairs and the nature of other corporate activities which are necessary for the operation of CCCTB would also increase the likelihood of disclosure of trade secrets and confidential business information (like information about tax management, revenues, revenue split between related and unrelated parties, profit or loss before tax, income tax paid and accrued, stated capital, accumulated earnings, tangible assets, public subsidies received, etc.). This policy would be harmful for EU companies as businesses established in the EU would be placed at a competitive disadvantage vis-à-vis non-EU multinational companies operating in the EU.

Conclusions

Harmonisation of the corporate tax base would not only fail to attain the targeted goals but would also entail a number of negative consequences such as:

- Corporate tax harmonisation will spawn considerable compliance costs in the transition period, especially for SMEs operating within the market of only one member state.
- Fiscal centralisation would undermine competitiveness of the entire region. The region's competitiveness would decline as the centralised tax system erected inside the region would force companies to take opportunity of the competitive advantage outside the region's territory.
- In certain cases harmonisation of the corporate tax base may be advantageous to individual tax payers or tax payers in certain countries (due to the removal of double taxation, reduction of administrative costs of MNEs in a long term, etc.). However, this would not occur as a systematic reduction of the tax burden but rather as a side effect of tax harmonisation on individual tax payers.

Recommendations

- The Commission should work to preserve the highest degree of tax competition between member states. CC(C)TB poses a danger of fundamentally hindering this vital feature of the internal market and should therefore be reconsidered.
- If CC(C)TB is retained, the Commission should also ensure that CC(C)TB remains optional and pre-empts future moves to damaging harmonisation.
- High-tax EU member states that are advocating tax harmonisation should undertake practical steps towards harmonisation by bringing their tax systems closer to more competitive tax regimes that stimulate economic growth.

[1] Christoph Spengel, Andreas Oestreicher et al., Centre for European Economic Research (ZEW), *Study on the impact of reforms of corporate income taxation systems at the EU level on the size of the tax bases of the EU companies, using the model "European Tax Analyzer"*, 2008, 150.

<http://ec.europa.eu/taxation_customs/resources/documents/common/publications/studies/ccctb/eta.pdf>

[2] European Commission, *CCCTB: Questions and answers*, 2011, 7. <www.europa.eu/rapid/press-release_MEMO-11-171_it.doc>

[3] PwC, *Bendros konsoliduotos pelno mokesčio bazės įtakos Lietuvai vertinimas*, 2013.