Jens Wittendorff*

Common Consolidated Corporate Tax Base

1. Introduction

The EU Commission has published a draft directive for a common consolidated corporate tax base (CCCTB) (the Draft Directive or the Proposal).[1] The Draft Directive would, if enacted, fundamentally change European corporate taxation by replacing the arm's length principle with formulary apportionment for transactions between group entities in the European Union. The purpose of the CCCTB is to relieve taxpayer compliance burdens.

This article will provide comments on the CCCTB from a Danish perspective. The scope is confined to the specific issues raised in a questionnaire prepared by IBFD, and does not purport to be a comprehensive analysis of the merits of the CCCTB.

2. Danish Tax Law

Group companies are recognized as separate entities for Danish tax purposes, and controlled transactions are normally recognized. The arm's length principle is the sole allocation norm applicable to controlled transactions under Sec. 2 of the Danish Tax Assessment Act. Thus, there is no legal basis in Danish tax law to subject group companies to corporate income tax on a consolidated basis,[2] nor to attribute the corporate tax base between group companies on the basis of formulary apportionment or other non-arm's length methods.

Prior to 2010, non-resident insurance companies with a permanent establishment in Denmark were required to calculate their Danish taxable income on the basis of formulary apportionment under Sec. 12 of the Danish Corporate Tax Act. The worldwide taxable income of non-resident insurance companies was apportioned between Denmark and the rest of the world using insurance premiums from Danish and foreign sources as the allocation key. Sec. 12 had little practical importance, among other things, because taxpayers were entitled to invoke the arm's length principle where an applicable tax treaty did not contain a provision similar to Art. 7(4) of the 2008 OECD Model Income Tax Convention (OECD Model). Sec. 12 was repealed in 2007,[3] presumably due to the introduction of the authorized OECD approach in 2008 (which is now underlying the interpretation of Art. 7 of the OECD Model).

3. Opinions on the CCCTB in Denmark

3.1. Government

The Danish government has not made any general policy statement regarding the choice between the arm's length principle and formulary apportionment. However, thus far Denmark has always endorsed the arm's length principle.

The government has announced that Denmark will participate actively in the negotiations regarding the proposal for a common consolidated corporate tax base.[4] Denmark will emphasize the following issues during the negotiations: (1) the design of the common corporate tax base must be able to withstand tax avoidance, (2) the tax administration must be effective and suitable for both Member States and taxpayers (for example the rules on the election of the principal tax authorities must be designed to prevent taxpayers from engaging in forum shopping), and (3) the administrative burdens of taxpayers must be reduced. In the opinion of the tax authorities, the directive conforms with the subsidiarity principle of Art. 5 of the Treaty on European Union.[5] There has been no discussion in Denmark regarding whether a common corporate tax base would be preferable over a common consolidated corporate tax base.

3.2. Parliament

The Tax Committee of the Danish parliament has adopted a statement on the CCCTB[6] which has been submitted to the EU Commission.[7] According to the majority of the Committee, it is impossible to determine whether the proposed directive adheres to the subsidiarity principle because the Proposal is held not to be sufficiently detailed. Among other things, the following issues need to be clarified before a final evaluation under the subsidiarity principle can be made:

- whether a minimum corporate tax rate will be adopted;
- which remedies will be available for other Member States if the principal tax authorities are not auditing a group effectively;
- whether the Proposal prevents Member States from changing depreciation rules as part of their economic policy;
- an evaluation of whether the competencies and quality of the tax authorities of each of the Member States are sufficient to ensure effective tax audits; and
- the revenue effects of the Proposal. This requirement should be seen in light of the fact that Denmark

* **Partner, Deloitte Copenhagen; Aarhus School of Business and Social Sciences, Aarhus University. The author may be contacted at jwittendorff@deloitte.dk.**

1. COM(2011) 121 final.
2. Group companies are required to file a joint tax return pursuant to Sec. 31 of the Danish Corporate Tax Act. This means that the taxable income of each of the group companies is added together. However, intercompany transactions are not eliminated.
3. Secs. 8(3) and 11(11) Act 1534 of 19 December 2007.
4. SAU 2010-11, Alm. del, exhibit 195 of 20 April 2011.
5. SAU 2010-11, Alm. del, answer to question 496 of 27 April 2011.
6. SAU 2010-11, Alm. del, exhibit 215 of 12 May 2011.
7. SAU 2010-11, Alm. del, exhibit 221 of 18 May 2011.

is one of the Member States that would lose tax revenues under the CCCTB according to the impact assessment prepared by the EU Commission.[8]

3.3. Taxpayers

The Danish business community has generally been positive towards the Proposal because it is considered that it would reduce compliance burdens of taxpayers. However, it has been stressed that the scheme should remain optional as proposed by the Commission.

4. Intangibles

The apportionment formula of the CCCTB does not pertain to intangibles.[9] This will arguably cause a distortion of the inter-nation distribution of the tax base vis-à-vis market transactions where intangibles are a key profit driver. The exclusion of intangibles is likely to lead to a loss of tax revenue for Denmark, which has a small home market and where manufacturing activities are often outsourced to other countries. Among other things, the exclusion of intangibles has been justified by the need to curb tax planning. However, this will simply shift the focus of tax planning to the factors of the formula. An example would be to structure export sales through group companies located in low-tax Member States.

That being said, the right of taxpayers to opt out of the CCCTB means that tax planning focusing on intangibles may continue. For example, the Proposal seems not to take into account that a group which has opted for the CCCTB may transfer ownership of an intangible to a group company resident in a low-tax Member State without triggering exit taxation. If the group subsequently opts out of the CCCTB, the Member State of the transferor will have lost the right to impose tax on the intangible. Similarly, an emigration of intangibles to a low-tax Member State may be made under the CCCTB by transferring the place of effective management of a company which holds valuable intangibles. It may also be possible for a group company in a low-tax Member State to engage in an R&D project where losses caused by developments costs will be offset against profits of group companies in high-tax Member States. If the R&D project is successful, the group may opt out of the CCCTB and the profits from the intangible will be taxable in the low-tax Member State.

5. Fixed Assets

Chap.VI of the Proposal deals with the depreciation of fixed assets. Art. 44 provides that all assets and liabilities of a taxpayer must be recognized at their "value" as calculated according to national tax rules immediately prior to the date on which the taxpayer begins to apply the CCCTB, unless otherwise stated in the directive. The Proposal does not explain what is meant by the term "value". Is it the arm's length value, fair value, book value or tax basis for depreciation purposes?[10] The reference to national tax rules does not clarify the issue because domestic tax law may apply multiple valuation standards. In Denmark, fixed assets are normally valued at their market value. The Proposal does not deal with the question of how valuation should be made when a taxpayer opts out of the CCCTB.

6. Exit Taxation

Art. 68 of the Proposal contains an exit tax rule under which intangible development costs incurred for the past five years by a taxpayer leaving the group must be added to the consolidated tax base. This would cause exit taxation of the leaving taxpayer. Under Danish tax law, exit taxation is applied where (1) an intangible is transferred from a Danish permanent establishment to a foreign head office or another foreign part of the enterprise, (2) an intangible is transferred from a Danish head office to a foreign permanent establishment or (3) a resident company transfers its place of effective management to another jurisdiction. Exit taxation is applied on the basis of the arm's length value or fair value of the assets.

7. The Arm's Length Principle vs Formulary Apportionment

The arm's length principle and formulary apportionment generally both aim at ensuring that the taxable income of group companies is not distorted by control over the group exercised by the parent company. A key question is whether the benchmark for the examination is unadjusted market data from comparable uncontrolled transactions or market data adjusted for the impact of economies of integration. The arm's length principle arguably requires economies of integration to be considered.[11] Thus, a discrepancy between the market price and the transfer price of a controlled transaction does not necessarily mean that there is income shifting contrary to the arm's length principle. Under formulary apportionment, the fact that a multinational enterprise normally functions as an economic unit is also taken into account, as income allocation is based on the consolidated profits of the group. The application of the two allocation norms should thus ideally lead to identical results.

Under the arm's length principle, prices of uncontrolled transactions relating to the purchase and sale of goods and services are normally recognized. By contrast, transfer prices of controlled transactions must conform to prices of market transactions. It is impossible to make an allocation of economies of integration based on empirical market data, as such advantages are a distinctive feature of group companies. This poses a challenge for the arm's length principle. In practice, economies of integration are

8. SEC(2011) 315 final of 16 March 2011.
9. However, Art. 92(2) provides that in the five years that follow a taxpayer's entry into the CCCTB, its asset factor will include intangible development costs incurred in previous years.
10. On the difference between the arm's length principle and fair value, see J. Wittendorff, "The Arm's Length Principle and Fair Value: Identical twins or just close relatives?", 62 *Tax Notes International* 3 (18 April 2011), at 223.
11. J. Witttendorff, *Transfer Pricing and The Arm's Length Principle in International Tax Law* (Alphen aan den Rijn: Kluwer Law International, 2010), at 326 and 334.

normally allocated to the companies that own non-routine intangibles.[12]

Under formulary apportionment, consolidated profits are allocated between group companies based on predetermined allocation keys. This means that both uncontrolled and controlled transactions are affected by the norm. Economies of integration are allocated among all group companies.

The main similarities and differences between the two allocation norms are summarized in Table 1.

Table 1

Characteristic	Arm's length principle	Formulary apportionment
Group companies recognized as separate entities	Yes	Yes
Controlled transactions recognized	Yes	No
Scope	Controlled transactions	All transactions
Allocation factor	Concrete market data	Predetermined allocation keys

The arm's length principle is arguably preferable over formulary apportionment in an international context because the income allocation is more likely to be in line with the intended result. Among other things, this may be explained by the fact that (1) the arm's length principle does not affect uncontrolled transactions which are exposed to the market forces whereby the actual business success or failure of the individual group companies is recognized, (2) it is less arbitrary to rely on market evidence than internal data and (3) predetermined allocation keys do not pay attention to the specific facts and circumstances of the individual case.

Moreover, adopting formulary apportionment in an international context is likely to cause the administrative burdens for both taxpayers and tax authorities to increase. Under the arm's length principle, taxpayers are required to produce transfer pricing documentations. By contrast, under formulary apportionment, taxpayers would be required to produce documentation regarding both the components of the allocation formula and the controlled transactions that must be eliminated for purpose of the consolidation. Taxpayers will still be required to prepare separate accounts for financial accounting purposes. Moreover, if formulary apportionment does not cover all group entities, taxpayers may be faced with compliance burdens under both norms, i.e. double burdens.[13] On this basis, there is no reason to believe that formulary apportionment will reduce the overall compliance burden of taxpayers.[14] The tax authorities would be required to operate two distinct corporate tax systems (assuming that formulary apportionment is not mandatory for all companies).

8. Future Outlook for CCCTB and Arm's Length Principle

The destiny of the CCCTB is quite uncertain. The primary purpose of the scheme to reduce compliance costs for taxpayers is thus unlikely to materialize. A reduction of compliance costs could be achieved more easily through enhanced cooperation between the Member States regarding the application of the arm's length principle.[15] The CCCTB is thus in conflict with the principle of subsidiarity. Moreover, several Member States – including Denmark – are expected to lose significant tax revenues under the CCCTB.

12. Id. at 699 and 787.
13. Para. 1.31 OECD Guidelines.
14. Para. 1.27 OECD Guidelines.
15. J. Witttendorff, *Transfer Pricing and The Arm's Length Principle in International Tax Law* (Alphen aan den Rijn: Kluwer Law International, 2010), at 794.

