Mandatory CCTB Implementation in EU28: The Impact of the First Implementation Stage on the Tax Bases in the Czech Republic

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Abstract
By June 2016 the Commission would like to implement a mandatory Common Corporate Tax Base (hereinafter as CCTB) for EU 28, with the exemption of small and medium sized enterprises or enterprises with no cross-border activities. During the interim period between mandatory CCTB implementation and full CCCTB implementation, the missing consolidation regime should be replaced by temporary cross-border loss offset regime. The aim of the paper is to quantify the differences in the division of the MNEs group tax bases between the individual Member States in current situation – i.e. when applying separate entity approach and situation when in the second implementation stage the temporary cross-border loss offsetting regime would be introduced. The results show, that in comparison with current situation, the introduction of temporary possibility for cross-border loss offsetting for Czech parent companies in case that their EU subsidiary is running loss would result into the decrease of total corporate revenues in the Czech Republic by 0.7843% i.e. by EUR 13 896 ths.

Key words: CCCTB, CCTB, loss offsetting, cross-border, EU
JEL codes: H25, K22

1. Introduction

European Commission published the directive proposal on the introduction of Common Consolidated Corporate Tax Base on 16th March, 2011. It represents the most ambitious project in the area of corporate taxation so far, for the suggested system allows for "one-stop-shop" for filling the tax return and consolidating profits and losses within the EU while retaining the right of EU Member States to set their own corporate tax rate. The aim of the Commission was to reduce compliance costs of taxation, to eliminate transfer pricing within the group of companies and to introduce the possibility of cross-border loss offsetting. This all should according to the Commission lead to the fair tax competition and higher economic growth.

However, CCCTB introduction could also be an instrument to combat tax avoidance the Member States are currently facing. Mismatches between two or more national tax systems are very often used by companies for tax planning in order to reduce tax liability. As shows the study by Ferret et al. (2015), at present, the revenue losses for the European Union due to the tax avoidance from the corporate taxation are estimated at around EUR 50-70 billion. The lack of coordinated action in this area forces Member States to adopt unilateral measures, which seems to be ineffective, as mentioned above. The problems connected with the lack of coordination are also presented by David and Nerudova (2008).

Due to these facts, European Commission decided to re-launch the CCCTB, but slightly in different shape than intended in 2011. Firstly, by June 2016 the Commission would like to implement a mandatory Common Corporate Tax Base (hereinafter as CCTB) for EU 28, with the exemption of small and medium sized enterprises or enterprises with no cross-border activities. Based on that, companies acting on the Internal Market should face just one set of rules for tax base construction.

Consequently, during the interim period between mandatory CCTB implementation and full CCCTB implementation, to replace the missing consolidation regime, temporary cross-border loss offset regime should be introduced. During that period the Commission plans to introduce a set of measures for reducing profit shifting (mainly through transfer pricing).

The aim of the paper is to quantify the differences in the division of the MNEs group tax bases between the individual Member States in current situation – i.e. when applying separate entity approach and situation when in the second implementation stage the temporary cross-border loss offsetting regime would be introduced. The empirical analysis is based on the data available from the Amadeus database.

2. Theoretical Background and Methodology

In theory of loss relieves, there can be identified two basic models. The main characteristic of the first model is that the loss is offset within one company (i.e. losses incurred by a branch or permanent establishment). The second model represents the situation when the loss is offset in the group of the companies (parent and subsidiary). Both of the above mentioned models are allowing loss-offsetting either within one state (domestic relief of loss) or cross-border. While the domestic relief of loss within one company and even within the group is commonly implemented in majority of the EU member states, cross-border loss relief in case of the group of companies is very rare and causes the main obstacles in cross-border business on the internal market.

As Nerudova and Solilova (2015) mention, in case of the domestic loss relief within a group of companies, there can be identified three models applied within the European Union. Firstly, the model of intra-group relief of loss enables to one group member to transfer its loss to a profitable group member. Under an intra-group contribution system the profits from one group member can be transferred to a loss-making group member. In fact, intra-group contribution system is used to eliminate losses; therefore it has the same economic effect as system of intra-group loss transfer.

The second applied model represents pooling system. It allows aggregating all individual tax results (profit and losses) from the members of the group at the level of the parent company.

The last model applied within the European Union is represented by full tax consolidation. This system goes far beyond the pooling system, since for tax purposes, the legal personality of the group members and any intra-group transactions are disregarded. The result of the group is determined on the basis of single profit and loss account.

Niemann and Treisch (2005) investigated the impact of the "deduction/reintegration method", which was introduced in Austria in 2005, on MNEs' investment decisions. They found that real investment in the foreign subsidiary is in general favored by loss offsets, unless the parent does not have enough profit to absorb foreign losses.

As European Commission (2006) mention, domestic relief within one company (i.e. with permanent establishment) is available in all EU 25, while cross-border relief only in some member states. The situation is displayed on following Table 1.

Table 1: The Application of Domestic and Cross Border Loss Relief

	Domestic loss relief	Cross-border loss relief
Within one company ("permanent establishment")	Automatically available in all 25 member states	Available in most cases Belgium, Czech Republic, Netherlands, Austria, Portugal, Slovenia, Slovakia, Finland, Sweden, United Kingdom, Spain, Ireland, Italy, Cyprus, Latvia, Lithuania, Malta
Within a group of companies ("parent and subsidiary")	Available under specific rules in most member states Denmark, Germany, Spain, France, Ireland, Italy, Cyprus, Malta, Latvia, Luxembourg, Netherlands, Austria, Poland, Slovenia, Finland, Sweden, United Kingdom	In principle not available, with very few exceptions Denmark, France, Italy, Austria

Source: COM (2006) 824 final

As is obvious from the above stated Table 1, cross-border offset of losses between parent and the subsidiary company is possible only in four EU member states. That is perceived by the companies taking part in cross-border situations as an obstacle of prohibitive character that sometimes discourage the companies from the cross-border business. Basically, the losses are usually incurred by subsidiaries during the first years after the establishment. In contrast to domestic losses, foreign losses cannot be offset against the profit of the parent in 24 EU member states. There is also another aspect, when the subsidiary incurs losses every year and the parent in different EU member state always runs profit, those losses cannot be offset as well. The second stage of CCCTB implementation (i.e. CCTB implementation with indicated temporary cross-border loss offset regime) should address the above stated issue.

European Commission (2006) mentions that the member states which enable cross-border loss relief apply different methods than in case of domestic relief. It would not be possible to apply the rules for domestic loss relief on cross-border situations, for they are not able to cover the needs of the cross-border situation. The methods used by Denmark, Italy, France and Austria for cross-border loss reliefs are stated following table.

Table 2: The Methods of Cross-Border Loss Relief Used by Member States, which Allow Cross-Border Loss Relief

Member state	Method of cross-border relief
Denmark	System of consolidated profits
France	System of consolidated profits
Italy	System of consolidated profits
Austria	Deduction (Reintegration)

Source: COM (2006) 824 final

The system of consolidated profit in tax theory means, that profits and losses in a given tax year of selected or all group members are taken into account over a certain period of time at the level of the parent company. The system is designed as a comprehensive scheme, for it includes all subsidiaries of the group. The economic result of the group is taxed in the country, where the parent company is resident. That is very often connected with the compliance costs of taxation, for all incomes of the group members has to be recalculated according to the rules valid in the state, where the parent company is resident.

As is obvious from the Table 2, only Austria is applying deduction (reintegration) method. Under that system, losses incurred by the subsidiary situated in another EU member state, which were deducted from the result of the parent company, are subsequently recaptured when the subsidiary starts to be profitable. The similar system is suggested by the European Commission as the temporary solution, partially replacing the consolidation regime, missing in newly re-launched CCTB rules.

In the taxation theory, there can be found three possible alternatives of cross-border relief. These alternatives do not differ in taking into account of the losses but they do differ in their treatment of future profits of the subsidiary at the level of the parent company. The situation is described on Table 3.

Table 3: Alternatives for Cross-Border Loss Relief

Tax year of loss	Deduction of loss in the year of loss		
Subsequent tax years	Alternative 1 definitive loss transfer future profits are not taken into account	Alternative 2 temporary loss transfer recapture of deducted loss	Alternative 3 current taxation of the result of subsidiary taking into account of results of loss-making entity for a certain period

Source: COM (2006) 824 final

The empirical analysis is based on the company-level data from the Amadeus database which is provided by Bureau van Dijk. These data were taken from update 227 (August 2013) of the database including standardized financial information of more than 18 million public and private companies in 43 European countries.

In order to quantify the difference between current division of MNEs group tax bases among the individual member states and the situation when CCTB with temporary cross-border loss relief will be implemented in the Czech Republic, there were selected companies resident in the Czech Republic, possessing the subsidiary company in the EU 28. Those groups of companies were further subjected to the two-tier test confirming the eligibility for consolidation (group membership). This test consists of two layers: a) control, which is assumed if the controlling company holds at least 50.01% in the controlled company and b) ownership, which is assumed if the ownership rights amount to more than 75 % of the company's capital. Further, only the companies providing the information on the amount of profit or loss were selected. Based on those selection criteria, we have received the sample of 1,597 parent companies resident in the Czech Republic and 2,476 subsidiary companies in EU 28. In the next step the gained sample of companies was researched in order to identify the structure (the share of each individual Member State) of foreign subsidiary companies.

Based on the indicated CCTB implementation with temporary measure for cross-border loss off-setting, we determined the amount of the tax bases which would be subjected to the taxation in the Czech Republic. Firstly, we identified EU subsidiaries of Czech parent companies running losses and we off-set those losses with the tax bases of the Czech parent companies. Secondly, we added to this calculation also the tax bases of Czech subsidiaries of Czech parent companies. In the calculation we did not consider the group of EU parent subsidiaries resident in the Czech Republic, for even in current situation and after the CCTB implementation, if they are running loss, their recorder tax base equals zero in the Czech Republic.

Finally, the comparative analysis of the current distribution of tax bases and the distribution of group tax bases after the implementation of the CCTB with temporary cross-border loss-offsetting was performed. Based on the results of the comparative analysis, the differences were identified and quantified.

It is necessary to mention, that the performed research is based on the similar assumption as Devereux and Loretz (2007) that corporations do not change their behavior in response to the tax reform, which provides a useful benchmark for the analysis. Moreover, the paper also follows the approach of Devereux and Loretz (2008), Fuest et al. (2006), Szarowská (2010) or Clien et al. (2010).

3. Results

As was already shown above in Table 3, there exist three possibilities of treatment of cross-border loss relief in subsequent taxable years in the taxation theory. First method, definitive loss transfer, is sometimes also called "intra-group loss transfer" leads to the definitive transfer of profit (within an intra-group contribution scheme) or loss (within a group relief scheme) without recapture, unless counterbalancing measures are introduced. The way, how to neutralize the effect on the revenue in the member state in which a loss-absorbing company is resident, would be the introduction of a clearing system, under which the member state of the company surrendering the loss would compensate the member state of the company absorbing the loss. Nevertheless, the system would need to take into account any significant differences between applicable tax rates and tax accounting rules. Under second method, the scheme of temporary loss transfer (deduction/reintegration), a loss incurred by a subsidiary situated in another Member State, which was deducted from the results of the parent company, is subsequently recaptured once the subsidiary returns to profitability. That system is relatively easy to operate. The losses are deducted at first and later, when the subsidiary returns to the profit, the previous deducted loss is recaptured through a corresponding additional tax burden on the level of the parent company. Under third method, usually called current taxation of the result of the subsidiary (system of consolidated profit), the profits and losses for a given tax year of selected or all group members are taken into account over a certain time period at the level of the parent company. Consolidated subsidiaries are treated in the same way as permanent establishment. That system can have two designs. Firstly, it can be designed as selective scheme, comprising one or more subsidiaries selected at the taxpayer's discretion. Or alternatively, it can be designed as comprehensive scheme, comprising all subsidiaries of a group.

As European Commission indicated that the possible off-set losses might be recaptured on the level of the parent company once the subsidiary starts to run profit, we expected in our research the application of the system of temporary loss transfer and comparing it with current situation.

Bellow stated Table 4 presents the calculation of the sum of total tax bases of all the companies meeting CCCTB criteria in the Czech Republic. Under the current conditions – i.e. the situation when CCCTB rules are not applied and companies are taxing their tax bases according to their domestic taxation rules – the total sum of tax bases allocated in the Czech Republic represent EUR 1 771 876 ths.

Table 4: Current Situation

NACE	No. of Parents	No. of Subs	Sum of TB		Subs in the EU and their TB according to NACE of Czech Parent in ths. EUR – CZ Parents and EU Subs								
			%	ths. EUR	BE	CZ	DE	EE	ES	HU	PL	SI	SK
A	39	42	0.12	1 663		1 663							
B	5	6	0.59	7 836		7 836							
C	232	307	9.81	131 190		110 250	11 481	16		12	712	220	8 500
D	19	33	18.34	245 378		245 368							11
E	16	29	0.97	13 006		12 955					51		
F	131	171	0.64	8 565		8 565							0
G	407	550	29.38	393 012		341 386	4 114		103		649		46 761
H	36	51	1.58	21 084		21 084					0		
I	30	55	0.14	1 813		1 813							
J	53	66	3.33	44 575		44 540							35
K[1]	25	170	37.52	664 744	4 292	621 782	25 406					12 669	595
L	224	359	4.03	53 965		53 897	7						61
M	283	495	7.02	93 968		93 671					3		294
N	41	51	0.30	4 005		3 996							9
O	2	8	5.51	73 767		73 767							
P	22	35	0.04	557		557							
Q	16	22	0.18	2 376		2 376							
R	11	19	0.77	10 347		10 347							
S	5	7	0.00	25		25							
Sum ths. EUR	1 597	2 476	100	1 771 876	4 292	1 655 877	41 008	16	103	12	1 414	12 889	56 265
				100%	0.24	93.45	2.31	0.0009	0.0058	0.0007	0.079	0.73	3.17

Source: authors´ calculations

The situation, when the CCTB with temporary possibility of cross-border loss off setting would be implemented is shown in Table 5. Under that situation, Czech subsidiaries would be allowed to off-set the losses of their EU subsidiaries. As is obvious from the table, it would lead to the decrease in the total corporate tax revenues from EUR 1 771 876 ths. on EUR 1 757 980 ths. i.e. by 0.7843%.

Table 5: Situation after CCTB Implementation with Temporary Possibility of Cross-border Loss Off-setting

NACE	No. of Parents	No. of Subs	Sum of TB		Subs in EU and their TB categorized according to NACE of Czech Parent in ths. EUR – CZ parents and EU Subs										
			%	ths. EUR	BE	CZ	DE	EE	ES	HU	IT	NL	PL	SI	SK
A	39	42	0.09	1 663		1 663									
B	5	6	0.43	7 505		7 836						-330.771			
C	232	307	7.41	130 206		110 250	11 481	16		12	-1.943		471.5987	220	7 758
D	19	33	13.92	244 699		245 368									-668.738
E	16	29	0.74	13 006		12 955							51		
F	131	171	0.48	8 484		8 565									-80.661
G	407	550	22.32	392 361		341 386	4 114		103				555.3724		46 203
H	36	51	1.20	21 080		21 084							-3.61846		
I	30	55	0.10	1 813		1 813									
J	53	66	2.54	44 575		44 540									35
K[1]	25	170	37.18	653 576	4 292	621 782	25 406					-7419.78		12 669	-3 153
L	224	359	3.07	53 965		53 897	7								61
M	283	495	5.35	93 968		93 671							3		294
N	41	51	0.23	4 005		3 996									9
O	2	8	4.20	73 767		73 767									
P	22	35	0.03	557		557									
Q	16	22	0.14	2 376		2 376									
R	11	19	0.59	10 347		10 347									
S	5	7	0.00	25		25									
Sum in ths. EUR	1 597	2 476	100 %	1 757 980	4 292	1 655 877	41 008	16	103	12	-2	-7 751	1 077	12 889	50 457
%				100%	0.2441	94.1920	2.3327	0.0009	0.0059	0.0007	-0.0001	-0.4409	0.0613	0.7332	2.8702

Source: authors´ calculations

4. Conclusion

Current corporate tax systems applied within the European Union were conceived mostly in 1930´s, when cross-border transactions were limited and business structures were not so complex and complicated. Nowadays those systems are showing to be inefficient for they are not able to react on the sophisticated tax planning of the companies and lack of harmonization is leaving the space for companies to escape from taxation.

Based on those facts, European Commission came on 17th June 2015 with the Action Plan to improve corporate taxation in the European Union. The aim is to establish new approach towards corporate taxation. This means that companies should pay taxes, where they generate profits; taxation should be more growth-friendly and should not be compromised by tax competition in the area of mobile tax bases. The introduction of preferential tax regime in one country should not lead to losses of revenues in another country and there should not be the space to shift the profit outside the EU.

One of the main elements of the introduced Action Plan represents re-launching of the Common Consolidated Corporate Tax Base through step-by-step approach. This means that the intention of the Commission is to implement CCCTB in two steps. Firstly, as CCTB – i.e. just as unified rules for corporate taxation together with temporary possibility of cross-border loss offsetting in order to replace missing consolidation element in the first step. Only then the Commission plans to proceed to second step and to implement full CCCTB – i.e. including consolidation regime and tax sharing mechanism.

The aim of the research was to calculate the impact of the CCTB implementation with temporary tool for cross-border loss offsetting on the total corporate tax revenues in the Czech Republic. The results show, that in comparison with current situation, the introduction of temporary possibility for cross-border loss offsetting for Czech parent companies in case that their EU subsidiary is running loss would result into the decrease of total corporate revenues in the Czech Republic by 0.7843 % i.e. by EUR 13 896 ths.

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