Use of the Common and Consolidated Corporate Tax Base at European Union Level. Implications for Romania

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Abstract. *In recent years, the European Union is taking more and more decisive tax harmonization measures for the Member States and for combating aggressive tax planning. The measures are supported by the European Commission and some Member States on the grounds that the single rules will simplify the calculation and reporting of corporate income tax, increase national budgetary receipts and decrease administrative costs. The evolution of the economy in the digital sphere has also been taken into account, which requires new approaches regarding taxation and the definition or redefinition of certain terms currently used. Opponents of the amendments invoke the principle of subsidiarity in Community law, as well as the application of provisions different from those issued by the OECD in terms of transfer prices – the BEPS project (Base Erosion and Profit Shifting). Also, the harmonization of the accounting provisions can be a significant obstacle, the criteria for recognizing the income and expenses can be substantially different in the new context.*

Keywords: tax harmonization, aggressive tax planning, digital economy, turnover tax, common corporate tax base.

JEL Classification: H68, K34.

1. Introduction

On 15 September 2018, the European Parliament approved two proposals for Directives on the Common Corporate Tax Base - **CCTB** and on the Common Consolidated Corporate Tax Base - **CCCTB**.

The first proposal in this regard has been drafted since 2011, but it was blocked due to objections from countries such as Ireland and the United Kingdom. In 2016, the European Commission resumed discussions on this topic and proposed a mandatory modified version (as opposed to the first option which was optional).

Important steps were taken in December 2018, when ECOFIN (Economic and Financial Affairs Council) of the EU presented a proposal from France, Germany and Austria regarding the application of a single tax on turnover of 3% for digital services starting with the year 2021.

France has not waited for the year 2021 and has already passed, since April 2019, to the enactment of a law providing for the establishment of a 3% tax, which will be applied retroactively from 01 January 2019, on the turnover of companies that make a figure business from digital activities of 750 million euros worldwide and over 25 million euros on the French territory.

The tax is also known as the GAFA tax, because it targets in particular the four major US giants: Google, Amazon, Facebook and Apple. Of course, the tax does not exempt the companies concerned from paying the corporate tax, which is most often declared in low-tax countries such as Ireland, Luxembourg, Malta, Cyprus and Belgium.

In fact, France has stated that it will apply this tax only until the OECD adopts an international agreement on the universal imposition of digital activities, but this agreement is expected just because of the jams established by the US.

2. Directive on the Common Corporate Tax Base - CCTB

This Directive adopted by the European Parliament will be mandatory, like the CCCTB, for the groups of companies with an annual consolidated turnover of at least 750 million euros, and this threshold will be reduced at zero to a maximum of 7 years.

According to the approval given by the European Parliament, the tax base will be consolidated at the level of the group of companies, and each tax jurisdiction will apply its own tax rate on a part of the tax base, depending on the volume of the group activity in each country according to the **turnover, assets** and **labour costs** of companies in that country. As a result, each Member State will benefit, by taxing, from a part of the consolidated profit of a transnational company, with the help of a distribution key accepted throughout the European Union. This means that we will have to deal with a proportional breakdown of the tax base, not the tax, because each Member State will set its tax rate as it wishes, according to its own interests.

The Common Corporate Tax Base Directive (CCTB) contains a set of mandatory rules for determining the basis for applying the corporate tax. In short:

a) introduces the concept of digital permanent establishment, - defined as a significant digital presence of a taxpayer providing digital services to natural or legal persons in a Member State (MS), other than the state in which it is resident. Criteria:

- the annual income of the taxpayer or of the associated enterprises from digital transactions remotely rendered in a MS is more than 5 million euros;
- at least 1,000 registered users of a MS visited the taxpayer's digital platform in one month, or
- at least 1,000 digital contracts have been concluded with users from a MS, or
- the volume of digital content collected in a fiscal year exceeds 10% of the stored digital content of the group;

b) modifies the tax facilities for R&D costs, limiting the tax credit to 10% of the costs with the personnel engaged in R&D activities and imposing a maximum ceiling of the eligible costs of 20 million euros;

c) introduces the non-deductibility of the expenses incurred in favour of beneficiaries who are based in a jurisdiction considered tax haven (according to the **List of the European Union** of non-cooperative jurisdictions);

d) introduces the limitation of the deduction for the excess costs of the indebtedness to the maximum between the value of 1 million euros and 10% of the financial indicator EBITDA of the taxpayer;

e) the period of carry-over of losses is reduced to a maximum of five years (in the proposed version in 2016, seven years were foreseen);

f) it brings changes regarding the classification of a company as a foreign controlled company;

g) it provides for the European Commission to submit a proposal for a commonly harmonized European tax identification number, with the aim of streamlining the automatic exchange of tax information within the European Union;

h) it introduces measures against the misuse of tax treaties, in the sense that it recommends amending the bilateral tax conventions, so that they contain the following:

- a clause which guarantees that both signatory parties to the convention undertake to introduce measures whereby the tax will be paid at the place where the economic activity takes place and the value is created;

- an addendum that clarifies that the objective of bilateral agreements, in addition to avoiding double taxation, is to combat tax evasion and aggressive tax planning;
- a clause regarding a general rule to combat tax evasion based on the main purpose test.

3. Directive on the Common Consolidated Corporate Tax Base (CCCTB)

The Directive on the common consolidated corporate tax base (CCCTB) contains principles of tax consolidation, as well as the formula for allocating the tax base of a multinational company between the Member States. In short:

a) the tax base of a consolidated group is established as if it were a single entity: the profits or losses between two or more entities within the group are consolidated; if the consolidated base is negative, the losses can be carried forward for a maximum period of five years;

b) for the formula of allocating the consolidated tax base, four factors are considered: labour force, assets, sales, and data collected and exploited by digital content users, each of these factors having an equal weight;

c) it provides that the EC will adopt acts that will lay down the rules for the electronic filing of the consolidated tax return and other forms;

d) it provides that the EC will establish a specific compensation mechanism, financed from the budgetary surplus of the Member States that earn tax revenues as a result of the implementation of this regime (initially established for a period of seven years).

The deadline for transposition of the two proposals of Directives, provided in their texts, is 31 December 2019, with effect from 01 January 2020.

The tax harmonization measures undertaken by the European Union although in theory are beneficial, in practice will certainly have negative effects for some States; in practice it is possible that Member States with less developed economies will be adversely affected. **Further are identified** the advantages and disadvantages of the new tax system:

Benefits:

- all companies in the European Union will be subject to the same set of rules regarding corporate income tax with respect to the tax base (the tax rate remains a national prerogative);
- the possibility to consolidate the result at group level and implicitly to compensate the losses registered by the subsidiaries in other Member States;
- the decrease of the administrative costs related to the application of the tax rules of each State where a group operates;
- the decrease of administrative costs caused by the loss of the importance of the documentation of the transfer prices in the case of the operations carried out in the territory of the European Union, but the occurrence of other problems related to the allocation of the tax base;
- extending the possibility of appealing to the Community court for misinterpretations of Community law in the field of corporate tax.

Additionally in the case of Romania:

- the increase of the stability and clarity of the legal provisions regarding the tax on profit (changing the rules will not be possible frequently).

Disadvantages:

- the proportional allocation formula of the taxable base starts from four factors whose values are not comparable between the Member States, therefore it can be seen that the more developed Member States that export capital (Germany, France, Holland, etc) and import manufactured goods will benefit from a mathematical

advantage from the formula for allocating the taxable base at the expense of the smaller and less developed Member States (the developed states will retain a larger part of the taxable base) E.g.: labour cost, value of assets, selling price, the degree of digitization of the market of the respective Member State;

- the allocation formula will determine the emergence of new tax planning mechanisms, perhaps even more aggressive, so that the tax burden will be reduced;
- it cancels the effects of the BEPS project at European Union level;
- the only element of tax competition between the Member States remains the percentage of profit tax.

Additionally in the case of Romania:

- The high dependence of the Romanian economy on foreign capital, the companies with foreign capital are targeted and will be the first affected;
- The granting of tax facilities will no longer be a tax leverage at national level, (exemption for reinvested profit, additional deduction for research and research and development expenses, accelerated depreciation);
- The uncertainty of the alternative tax regimes, the tax regime on the income of micro-enterprises or the specific tax may become history;
- The deductibility of the excess costs with the debt will be more restrictive than at present.

To exemplify, we will present at microeconomic level the effects of CCCTB application in our country:

4. Implications for Romania

Most of the foreign capital companies operating in Romania carry out more or less a “lohn” type activity for the group. This is perhaps the most relevant and most frequently encountered model of foreign capital companies in the Romanian economy. Also, according to PIAROM (Romanian Employers’), in 2018, only 50 companies from the largest 500 exporters in Romania were companies with Romanian private capital, which shows how dependent the Romanian economy is on the foreign capital.

The Romanian companies that carry out activities for the group provide services/deliver goods mainly to affiliated persons outside Romania, from the European Union. They have a low degree of independence or are significantly controlled. The companies do not have significant assets, they do not have production know-how, and the raw materials and all the elements necessary to carry out the activity are imposed by the group.

The market for the sale of products/services is generally represented by the market of the European Union (less Romania).

The treatment, currently, according to the OECD guidelines and the practice of transfer pricing documentation, for these situations implies the need for a profit margin (at a low level) regardless of the results recorded by the group as a whole.

According to the new regulations, in the present situation, where the Romanian company that provides services/delivers goods mainly to affiliated persons, rents the assets that they use from the group and has mainly personnel costs, the Romanian tax authority can issue claims only on maximum proportion of the tax base allocated to the staff (in the ideal hypothesis, in which all employees are from Romania).

The criterion in the formula for distributing the taxable base with respect to personnel takes into account the value of wages and the number of employees. Thus the results can be influenced by the two factors: the number of employees and the level of wages. In practice, if the group has employees also in other Member States (where the wage level is high), a larger portion will be allocated in those States as well. The allocation is not favourable to the States of the East and South-East of Europe

where the wage level of the subsidiaries in these States is much lower than that of the more developed States of Western Europe.

The discrepancy is obvious because the costs with salaries in Romania reached only 36% of GDP, unlike the Member States of the European Union where the average is 47.3% of GDP, according to Eurostat. Costs with salaries (salary mass) include all net salaries, duties, taxes and social contributions related to salaries paid by employers for work performed by employees.

Table no. 1. The evolution of the wage mass in the states of the European Union (as a share in GDP and in absolute value) between 2008 and 2017

Country	Wage mass (% of GDP)		Wage mass (billion euros)		Country	Wage mass (% of GDP)		Wage mass (billion euros)	
	2008	2017	2008	2017		2008	2017	2008	2017
France	50.7	52.2	1010.2	1196.0	Portugal	46.8	44,4	83.6	85.6
Denmark	52.7	51.8	127.4	149.8	Lithuania	43.9	44.1	14.4	18.4
Germany	48.5	50.9	1241.3	1667.6	Cyprus	44.1	43.7	8.4	8.4
Luxembourg	48,9	50.2	18.6	27.8	Hungary	45.4	43.5	49.1	53.8
Belgium	50.4	49.4	178.4	216.1	Bulgaria	33.6	43.1	12.5	21.7
Slovenia	49.9	49.3	19.0	21.2	Czech Republic	40.2	41.4	64.8	79.3
United Kingdom	50	49.1	992.3	1143.9	Malta	43.5	41.1	2.7	4.6
Estonia	49.9	48.2	8.2	11.4	Slovakia	35.4	40.1	23.4	34.1
Netherlands	47.5	47.9	307.6	353.3	Italy	39.2	39.8	639.2	683.7
Austria	45.9	47.6	134.9	175 1.	Poland	38,7	38.2	141.7	167 9.
Spain	50.1	46.9	559.8	547.3	ROMANIA	36.5	36	53.3	67.7
Sweden	45.8	46.9	161.4	224.0	Greece	34.3	33.6	82.9	59.7
Finland	47.5	46.9	92.0	104.9	Ireland	43.3	29.4	81.4	86.4
Latvia	48.2	46.6	11.7	12.5	EU average (28 countries)	46.9	47.3	6143.1	7258.9
Croatia	47.6	46	22.9	22 5.					

Source: Eurostat 2018[1]

As shown in table no.1, the lowest share of costs with wages in GDP were registered in 2017 in Ireland (29.4%), Greece (33.6%), Romania (36%), Poland (38.2%) and Italy (39.8%), and the highest share of the wage mass in GDP was in France (52.2%), Denmark (51.8%), Germany (50.9%) and Luxembourg (50.2%).

[1] Source Eurostat 2018, taken from Ziarul Financiar of 12 September 2018

However, we can say that in Romania the wage mass increased in 10 years by over 14 billion euros (from 53.3 billion euros in 2008 to 67.7 billion euros in 2017), as a result of permanent increases in wages and of economic growth; of course, during this period also the GDP of Romania increased significantly, which determined that the share of the wage mass in the GDP would be reduced further.

Location of the marketplace is also an allocation element that does not favour poorer States and will result in the allocation of a larger share of the tax base in the developed States of the Union.

Another allocation element - **the value of assets** - it has a not so favourable effect because multinational groups are reluctant to invest significantly in other tax circumscriptions, than those of origin.

Following the use of the factors listed above in addition to the effects at the level of the new Member States will also determine at the level of the EU hard core a redistribution between the Member States of the tax base, thus Ireland, Luxembourg, Malta will lose from the tax base (the groups that have their headquarters here they will transfer from the tax base to the States where the sales and employees market is). Germany will gain from the redistribution of the tax base as a result of the three factors: capital, market and employees, but will lose as a result of the structure of the export-based economy (which will diminish the tax base in Germany and increase it in the tax circumscriptions where Germany exports to affiliates). France, Italy, Spain, and other States will gain from redistribution with a significant mass of employees and an important market.

Romania has taken over the ATAD directive (EU Directive 1164/2016 - Anti Tax Avoidance Directive) and imposed a deductible threshold for borrowing costs. The level initially set was EUR 200,000 + 10% fiscally adjusted EBITDA, and as of 2019 the level has been increased to EUR 1 million and 30% of fiscally adjusted EBITDA, (fiscally adjusted EBITDA = the difference between revenues and expenses recorded according to the applicable accounting regulations, during the reference tax period, from which the non-taxable income is deducted and to which are added the expenses with the profit tax, the excess costs of the debt, as well as the deductible amounts representing the tax depreciation).

In the European Union, the Member States have paid particular attention to internal competitiveness. Member States have balanced the investor-friendly framework and implemented a threshold for the deductibility of borrowing costs to achieve the proposed goal - limiting the artificial transfer of profits. The rush with which Romania implemented this Directive in the national legislation (its implementation could be postponed until 2023 under certain conditions, and Romania had limitation instruments provided in the legislation), can be considered as unjustified and harmful in terms of attracting foreign investments interested in a more tax-friendly environment.

We consider that a less drastic implementation of the ATAD Directive regarding borrowing costs, by increasing the limits has already been implemented and an exemption from these limitations of loans granted by banks and financial institutions (enterprises) would be auspicious.

5. Conclusions

In conclusion, an allocation of the taxable base given the proportional allocation keys will have the effect of reducing the base in the small States and its transfer to the larger and more developed States. It is desirable that a study on the impact in each Member State be carried out at EU level. Member States should also consider the effects of implementing the CCCTB and adopt positions that will ensure better tax administration and not a limitation of tax competition and leverage through which less developed countries attract investment.

Of course, for all these decisive tax harmonization measures and combating aggressive tax planning to succeed, it takes time. On the other hand, there is increasing pressure due to the rapid evolution of the digital economy, the diversity of business models and the ingenious solutions found by companies. In addition to this, the lack of political will in some EU member States in the fight against tax evasion, with the criticism of the European Commission against Belgium, Cyprus, Hungary, Ireland, Luxembourg, Malta and the Netherlands, countries whose tax systems are known to facilitate aggressive tax planning.

However, it is unanimously recognized that the longer the implementation of a solution is delayed, the greater the losses suffered by most States. From all the statements of the European officials, the European Commission wants to implement the new system of taxation of profits of all the multinational companies active in the European Union from 2020, which, in our view is very unlikely, especially that the final solution will have to be also integrated globally, in agreement with the countries of the Organization for Economic Cooperation and Development and with the G20.

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