Updating the Common Consolidated Corporate Tax Base

Tax competition between EU Member States has led to lower prices for consumers, higher employment and salaries, and better public administration than would otherwise be the case.

The proposal for a Common Consolidated Corporate Tax Base (CCCTB) would undermine tax competition in the EU, failing to take into account intangible assets and artificially raising tax rates applicable to multinational enterprises. It would also make the tax system more arbitrary and open the door to eventual full harmonisation.

Recommendation: The Commission should work to preserve the highest degree of tax competition between Member States. The CCCTB poses the danger of fundamentally hindering this vital feature of the internal market, and should therefore be reconsidered. If the CCCTB is retained, it is imperative to include intangible assets in the calculation of Member-State shares and to remove arbitrary thresholds on profit distribution. The Commission should also ensure that the CCCTB remains optional and pre-empts future moves to damaging harmonisation.

The Common Consolidated Corporate Tax Base (CCCTB) refers to a proposal by the European Commission for an optional EU-wide tax code aimed at companies operating in more than one Member State. The CCCTB would compute an enterprise's annual EU taxable income and apportion shares of it to the different Member States where that enterprise operated, according to a set formula taking into account revenue, employee numbers and wages, as well as most assets.[i] The code would apply to multinational enterprises resident in the EU and to EU-located branches of international MNEs.

Originally developed in 2011, the proposal has since remained stalled at EU Council stage. However, in the context of public resentment at the perceived low rates of tax paid by some MNEs relative to the volume of their activity in many jurisdictions, Competition Commissioner Margrethe Vestager has signalled her intention to revive the proposal.[ii] Renewed talk of the CCCTB comes amid allegations that the government of Luxembourg facilitated tax avoidance by a number of MNEs,[iii] and the announcement by UK Chancellor George Osborne of a 25 per cent "Google Tax" aimed at profits "artificially shift[ed] out of the country,"[iv] to be levied from mid-2015.

Corporation tax: aims, incentives and problems

The basic goal of any tax system is to raise an adequate amount of revenue to cover government expenditure.[v] An efficient tax system would also minimise deadweight losses, i.e. the reductions in welfare as a result of the tax "driving a wedge" between pre- and post-tax prices. While all taxes in practice have deadweight costs, these vary widely depending on the type of levy and are particularly high in the case of corporation taxes.[vi]

Their relative inefficiency has only been exacerbated by improvements in the international mobility of capital and by the rise of technology multinationals in recent years. The latter, much less reliant on raw materials and physical capital than traditional manufacturing industries, are better able to take advantage of competitive tax jurisdictions and to react to policy changes. Greater capital mobility has thus increased the deadweight losses of high rates of tax, prompting governments across the world to reduce them: between 1981 and 2013, weighted average statutory rates in the OECD went down from over 49 per cent to 32.5 per cent.[vii]

The combination of large cross-country variation in tax rates with high capital mobility has had the results that economic theory would predict: Studies into the effect of corporate income taxation on MNEs' decisions regarding subsidiary location, capital expenditure and allocation, and profit allocation find significant relationships between corporation tax policy and business decisions by multinationals.[viii] Anecdotal evidence from the EU points in the same direction, with low-tax Ireland as a preferred location for the European headquarters of technology giants like Yahoo!, Facebook and Google.[ix]

Higher corporation taxes lead to reduced capital investment, employment and wages.

While reduced tax revenue in high-tax countries is the most visible consequence of this, it is hardly the only one: higher corporation tax rates lead to lower levels of capital investment, which in turn reduce worker productivity, leading to lower wages and lower overall employment.[x] A 2009 paper by World Bank economists found "a consistent and large adverse effect of corporate taxes on both investment and entrepreneurship," with a 2 percentage point decrease in investment-to-GDP ratios and a 1.4 percentage point reduction in entry rates for every 10 percentage point increase in corporation taxes.[xi]

Corporation tax arbitrage in the EU

Corporation tax rates vary widely across Member States, from Ireland's comparably low flat rate of 12.5 per cent to higher rates of 29.58, 30 and 33.33 per cent (excluding temporary surtaxes and social contributions) in the cases of Germany, Spain and France, respectively.[xii] The EU average stands at 21.34 per cent in 2014, down from 24.83 per cent in 2006. To avoid excessive taxation and promote cross-border investment, the internal market is governed by a number of tax treaties which still give Member States considerable leeway in determining tax rules and allocating taxation powers.[xiii]

In the EU, as elsewhere in the world, MNEs have used tax competition between Member States, coupled with the free movement of capital, to reduce their EU-wide tax bill. It is important to recognise that such tax arbitrage is a natural consequence of the variance in tax rates, and that the incentive to avoid taxation also applies to individuals as well as corporations: Travelling smokers routinely use the opportunity to acquire duty-free cigarettes at airports, while analysis of a so-called 'fat tax' introduced in Denmark in 2011 almost immediately found a significant increase in cross-border trade with Sweden and Germany, widely blamed on the new levy (which was promptly abolished in 2012).[xiv]

Tax competition is a fundamentally positive phenomenon, creating an incentive for governments to reduce the tax burden on their citizens and spend tax revenue as efficiently as possible. Economists at the OECD, which has pioneered work on Base Erosion and Profit Shifting (BEPS),[xv] have at the same time praised "the ability to choose the location of economic activity [as] offset[ting] shortcomings in government budgeting processes."[xvi] Corporation tax is a cost of doing business, just as income tax is a cost for employees and employers. Thus to the extent that companies can minimise their tax burden, they will be able to offer consumers higher-quality services at lower prices than would otherwise be the case. They will also retain additional resources for investment, innovation and to expand the workforce. In sum, tax competition benefits EU consumers, workers and investors (notably the pensioners whose savings are managed by funds investing in MNEs), while also improving the quality of public administration.

Tax competition encourages better public administration, lowering prices and freeing up resources for investment.

Finally, it must be stressed that corporation tax is only one of the direct and indirect levies applied to companies in the EU. Company profits are taxed once more at the individual level through dividend taxes, while enterprises are required to pay VAT at the Member State rate on their EU sales. This comes on top of other company-related levies such as payroll taxes, income taxes on employees, and capital gains taxes on investors. While some of the potential tax revenue may be lost to governments due to corporation tax competition, a wide array of sources remains there for the taking.

The CCCTB: Is it fit for purpose?

The Commission has presented the CCCTB as a way to "ensure consistency in the national tax systems" without full harmonisation, highlighting its potential to avoid over-taxation and to reduce "heavy administrative burdens and high tax compliance costs."[xvii] However, the 2011 proposal included a number of clauses that would treat certain types of MNEs unfairly, while the recent rhetorical shift by the Commission from its traditional goal of avoiding double taxation to clamping down on "harmful tax competition" could lead to damaging changes as the proposal is revisited next year.

There is little justification for excluding intangible assets from the CCCTB other than to increase payable taxes.

The current Commission proposal would exclude intangible assets, including patents and copyrights, from its calculation to apportion shares of the CCCTB between relevant Member States.[xviii] It would also remove tax exemptions on profit distributions and revenue-sharing between MNE branches when corporation tax in the destination country was "less than 40 percent of the average statutory corporate tax rate applicable in Member States."[xix] The proposal states that "artificial transactions […] shall be ignored [when] calculating the tax base," treating income from intellectual property as distinct and arbitrarily determining its location for tax purposes.[xx]

The above provisions clearly seek to artificially raise the tax burden applicable to MNEs, yet there is little economic or legal justification for excluding intangible property from the CCCTB formula or limiting the extent to which businesses can take advantage of favourable tax environments. If included in the final directive, these clauses would severely undermine tax competition between Member States and across the world, with negative effects on all the benefits that such competition brings without raising enough revenue to compensate for the costs of the new tax regime to the wider European economy. Furthermore, the wisdom of excluding intellectual property from the proposed EU-wide tax code at a time when such assets constitute a growing share of companies' capital should be questioned.

Additionally, the interaction of Member State and EU-wide tax rules cannot be ignored. It is justifiable and even beneficial to provide MNEs with an EU alternative to complying with the individual national tax code of each country where they operate, but such an option should not be used by Member State governments as a lever to cajole companies into paying ever mounting corporation taxes. The combination of an EU-wide tax code that weakened tax competition, as the current CCCTB would do, with a national "Google Tax" of the sort announced by UK Chancellor Osborne would place MNEs in a tax straitjacket that would harm consumers and quite possibly reduce capital investment and employment in the EU.

As the Commission's Expert Group on Taxation of the Digital Economy acknowledged in its report earlier this year, "corporation tax is a difficult trade-off between collecting […] revenues, international […] cooperation and establishing a tax environment that fosters investment and growth."[xxi] Tax competition in the EU's internal market has delivered enormous amounts of cross-border investment and growth, benefiting European citizens. At a time of economic frailty, it should not be jeopardised for the comparably meagre reward of additional corporation tax revenues in the short run.

As the Commission revisits the CCCTB proposal, it should work to maintain tax competition and promote investment, growth and competitiveness across Member States.

[i] "Proposal for a Council Directive on a Common Consolidated Corporate Tax Base," European Commission (2011). http://ec.europa.eu/taxation_customs/resources/documents/taxation/company_tax/common_tax_base/com_2011_121_en.pdf
[ii] http://www.euractiv.com/sections/eu-priorities-2020/vestager-says-will-use-luxleaks-documents-eu-tax-probe-310189
[iii] http://www.icij.org/project/luxembourg-leaks
[iv] Oral statement to Parliament: Chancellor George Osborne's Autumn Statement 2014 speech. https://www.gov.uk/government/speeches/chancellor-george-osbornes-autumn-statement-2014-speech
[v] While some levies, such as so-called 'sin taxes' on products like tobacco and alcohol, seek to change behaviour in addition to raising money, this is the exception rather than the rule.
[vi] Cf. Tim Worstall, "UK Uncut Unravelled," IEA Current Controversies 32 (London: Institute of Economic Affairs, 2011).
[vii] http://taxfoundation.org/article/oecd-corporate-income-tax-rates-1981-2013
[viii] Cf. Michael P. Devereux and Giorgia Maffini, "The Impact of Taxation on the Location of Capital, Firms and Profit: A Survey of Empirical Evidence," prepared for the European Tax Policy Forum conference "The Impact of Corporation Taxes across Borders," April 2006. Cf. also Salvador Barrios, et al., "International Taxation and Multinational Firm Location Decisions," Economic Papers 356, European Commission (January 2009).
[ix] Finbarr Flynn and Cormac Mullen, "Tech Companies Love Dublin's Tax Rates," BloombergBusinessweek, 4 April 2013.
[x] Worstall, "UK Uncut Unravelled," 12.
[xi] Simeon Djankov, et al. "The Effect of Corporate Taxes on Investment and Entrepreneurship," American Economic Journal: Macroeconomics 2 (July 2010), 33.
[xii] KPMG Corporate Tax Table, http://www.kpmg.com/global/en/services/tax/tax-tools-and-resources/pages/corporate-tax-rates-table.aspx
[xiii] "EC Law and Tax Treaties," Directorate-General for Taxation and Customs Union, European Commission, 2005.
[xiv] Christopher Snowdon, "The Proof of the Pudding," Current Controversies 42 (London: Institute of Economic Affairs, 2013), 25-27.
[xv]Action Plan on Base Erosion and Profit Shifting, Organisation for Economic Cooperation and Development (Paris: OECD Publishing, 2013), http://dx.doi.org/10.1787/9789264202719-en
[xvi] OECD, Economic Outlook No.63 (June 1998), quoted in Daniel J. Mitchell, "The Economics of Tax Competition: Harmonization vs. Liberalization" (London: Adam Smith Institute, 2009).
[xvii] "Proposal for a Council Directive on a CCCTB," 4.
[xviii] Ibid., 14.
[xix] Ibid., 43.
[xx] Ibid., 46-47.
[xxi] "Report by the Commission Expert Group on Taxation of the Digital Economy," European Commission (May 2014), 44.

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