The Common Consolidated Corporate Tax Base (CCCTB):

Should Malta adopt it?

By

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DECLARATION OF AUTHENTICITY

I, the undersigned, declare that this dissertation is an original work done by myself as a result of my own research, and any conclusions or statements contained are mine, unless otherwise stated.

ABIGAIL SCERRI

APRIL 2009
To my Family and Ronnie

for their patience, encouragement and support

throughout the years at university
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ABSTRACT

Tax harmonisation is critical to the operation of the Single Market so that goods, services, people and capital can move freely around the EU. Full realization of the single European market is impeded because businesses operating across borders deal with many different company tax regimes. To help remove this obstacle, the European Commission wants to introduce a Common Consolidated Corporate Tax Base (CCCTB).

The diversity of company taxation in the EU causes several distortions and obstacles with respect to cross-border business activities. As László Kovács, the Commissioner for Taxation and Customs Union commented:

“...the CCCTB is the solution to eliminate existing fiscal obstacles throughout the European Union, help companies to improve their competitiveness and make Europe a more attractive place to do business.” (László Kovács, 2007) ¹

However, there has been considerable debate and discussion by the Member States who are not very optimistic about this ambitious project.

Member States currently benefiting from lower corporation taxes in relation to their EU neighbours are opposing the CCCTB. Similarly, this research shows that CCCTB may negatively impact Malta. The main reasons being that currently Malta has a taxable system that attracts many investments, while being also relatively simple. Furthermore, CCCTB may shift taxable profits out of Malta and create more administrative costs and complications for both Inland Revenue and businesses alike.

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Chapter 1: Introduction

1.1 Tax harmonisation in the EU

Issues concerning harmonisation of taxation can be justifiably described as a never ending story in the history of European integration. Unlike indirect taxation, which over time, has achieved a comprehensive harmonisation of Value Added Tax, harmonisation of corporate direct taxation still has a long way to go. The European Commission has launched several platforms for comprehensive harmonisation solutions from as early as 1962, with the Neumark Report (Commission European Economic Community, 1962). Studies like the mentioned Neumark report and the Tempel Report (Commission of the European Communities, 1970) were followed by a number of initiatives designed to achieve a limited degree of harmonisation of the corporate tax system. Up to 1990, moves towards harmonisation always sought to standardize corporate income tax almost entirely. However, following the Guidelines on Company Taxation (European Commission, 1990) and the Runding Report (European Commission, 1992), the focus shifted onto individual structural elements. One outcome of this approach was the triple package – two directives and a
convention – consisting of the Merger Directive\textsuperscript{2}, the Parent-Subsidiary Directive\textsuperscript{3} and the Arbitration Convention\textsuperscript{4}.

In 2001 the Bolkestein Report (European Commission, 2001) was drawn up giving priority to a comprehensive solution to remove obstacles to EU-wide economic activity. Four models were discussed in the Bolkestein Report: Home State Taxation, an optional Common Consolidated Tax Base, a mandatory Harmonized Tax Base and the model of a European Union Company Income Tax.


1. Updating the list of companies that the Directive covers from the Council directive 90/435/EEC;
2. Relaxing the conditions for exempting dividends from withholding tax; and
3. Eliminating double taxation for subsidiaries of subsidiary companies.

Since the Bolkestein report, the European Commission has pursued the Common Consolidated Corporate Tax Base (hereafter referred to as CCCTB) model which is, by far, the largest project sponsored by the Commission currently in the direct tax field.

1.2 Common Consolidated Corporate Tax Base

The tax burden is a crucial factor in a company’s decision on where to set up base, and one that Member States can influence directly. However, presently if a company is active in all EU Member States, it is obliged to cope with 27 different tax regimes. This gives rise to a host of difficulties for companies engaged in EU-wide trade and commerce, reflected in high compliance costs. The expense this involves has a particularly pronounced impact on smaller companies and may possibly even prevent them from engaging in EU-wide activities at all.

The CCCTB is a proposal to provide companies with establishments in at least two Member States with the option to compute their group taxable income according to one set of rules. The European Commission (Directorate – General Taxation and Customs Union) says that the Common Consolidated Corporate Tax Base (CCCTB) constitutes a comprehensive solution to tackle, at one go, all the company tax obstacles arising when companies carry out cross border activities within the Internal Market. In addition to reducing compliance costs for companies operating across the Internal Market, the CCCTB will eliminate many of the existing intra-community
transfer price difficulties, allow cross-border loss offsetting, simplify many international restructuring operations, and avoid many situations of double taxation. It will contribute to greater simplicity and transparency in the 27 existing company tax systems, thereby, promoting fair and open tax competition within the European Union.

In principle, the concept for a CCCTB is a good idea, however, a lot of debate has been surrounding this issue, with a number of Member States not being very optimistic about this initiative.

1.3 Need for Study

The European Commission is investing many resources in the CCCTB initiative and a formal proposal is expected in the near future. European Member States will have to evaluate whether it is beneficial to implement the CCCTB alongside the national tax regime.

Malta, together with other 26 EU Member States will have to evaluate the CCCTB proposal. In view of this, this study aims to research and point out all impacts of the CCCTB on the Maltese jurisdiction, should this proposal be implemented.
1.4 Objectives

The objective of this study is to examine, analyze and evaluate in detail the proposed measures of the CCCTB and its relevance to Malta.

It will also establish benefits which may accrue, if any, should Malta decide to implement the CCCTB. Any valid reasons outlining why it would not be favourable for Malta to implement the CCCTB will be pointed out.

Given that so far, the Commission has advised various implementation options, the study, above all, will conclude and recommend Malta's level of implementation of the CCCTB.

1.5 Chapter Overview

Chapter 1 gives a brief introduction on tax harmonization within the Single Market and the proposed CCCTB. This chapter also gives an overview of the dissertation, the need of the study and the objectives for the research.

Chapter 2 is a very important chapter for this type of dissertation, where information is very dynamic. The literature review consists of an overview of the literature available regarding the subject. A vast amount of material issued by the CCCTB working group,
ministries of Member countries, tax journals and tax related websites were reviewed in order to be able to cover the literature available. This chapter includes a synopsis of the developments in tax harmonization in the EU leading to the CCCTB, and an overview of the CCCTB and its objectives, and also the arguments and debates surrounding this EU initiative.

Chapter 3 purports to describe the methods by which the data required for the purpose of this dissertation was obtained i.e. through a series of semi-structured interviews.

Chapter 4 describes the main issues that were raised during the interview and the important points are pointed out.

Chapter 5 analyses the findings obtained in the literature review and interviews. In this chapter, the impact of CCCTB on Malta was examined in relation to the effective tax rates and compliance costs.

The final chapter, chapter 6, consists of the conclusions reached in view of the research carried out.
1.6 Limitations

The information obtained for the dissertation leads up to February 2009. Since it is a very topical issue, information in this field is being continuously updated.

During the course of the research, the CCCTB proposal was delayed from the original date of September 2008 when the legislative proposal was to be issued. Nevertheless, a considerable amount is still being invested in the CCCTB and a formal proposal is expected in the near future. Since the formal proposal has not yet been issued, there might be some future changes. However, no major changes are expected from the already issued working papers.
Chapter 2: Literature Review

This chapter aims to discuss published information in relation to CCCTB. Being a vast subject and having a word limit, parts of the literature review are discussed in more depth in the Appendices. This section starts with an overview of the CCCTB. The second section describes the objectives of the CCCTB, of which a more detailed analysis is discussed in Appendix 3. Consequently, a discussion of the current arguments and Member States feedback follows.

2.1 CCCTB Overview

The extensive Commission Working Paper 57 – CCCTB: Possible elements of a technical outline\(^5\), is probably close to the working group final version, which was to be issued in September 2008 but was delayed. The purpose of the paper was to start discussion on key issues in order to assist the Commission Services in taking the work forward and to highlight a number of areas on which further guidance from the Working Group would be helpful.

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In general the CCCTB proposes to do two things:

1. Introduce a common base for the calculation of taxable corporate profits across the EU, so that taxable income would be computed in the same way in all EU Member States.

2. Aggregate the profits of each group of companies operating in the EU and then to reallocate those taxable profits across EU Member States.

### 2.1.1 Calculating the Common Tax Base

The working group stated that neither domestic accounting rules nor International Accounting Standards (IAS/IFRS) are a suitable starting point for calculating the common tax base; rather, the rules in the directive defined the tax base. The Directive would apply to EU companies which are subject to corporate income tax in one or more Member States. It would also apply to third country companies which have a similar form to EU companies and which are also subject to corporate income taxes in the European Union. Both EU and third country companies would be subject to an EU corporation tax through their incorporation, residency or via the establishment of a permanent establishment (PE) in the EU.

The CCCTB objective is to have a uniform tax base. Member States will then individually decide on their respective tax rates. The general rule to calculate the tax base, as stated in Working Paper 57, is the difference between:
• Income subject to tax, less exempt income;
• Deductible expenses and other deductible items.

Deductible expenses would include all those expenses incurred by the taxpayer for business purposes in the production, maintenance and securing of income, including cost of research and development; or, in the raising of equity or dept for business purposes. 6

With respect to single company losses, the working group decided that losses should be eligible to carry forward indefinitely; however, there should be no carry back of previous year losses. The paper envisages also consolidation of group losses. Consolidation would be mandatory for all companies opting for CCCTB which have a qualifying subsidiary7 or a Permanent Establishment in the EU i.e. the all in/all out principle. See Appendix 1 for definition and examples of groups opting for CCCTB.

6 A list of non-deductible expenses includes:
• Profit distribution, repayments of equity or debt or any payment to or expenditure uncured for the benefit of shareholders or persons related thereto
• Expenses related to assets treated as non business (including bribes, 50% of entertainment costs, fines and penalties, monetary gifts and donations).

7 For a subsidiary to be a qualifying subsidiary its voting rights would have to be owned directly or indirectly as to 75% or more. When a holding is more than 75% it would count as 100% and when a direct holding is 50% or less it would count as zero. For the purpose of calculating the parent company’s level of indirect ownership each respective holding % would be multiplied.
When the consolidation results in an overall group loss, this loss would be carried forward at a group level and set off against future consolidated profits, before the net profits are shared out. Losses incurred by the group before entering CCCTB would not be taken into account.

2.1.2 Sharing the consolidated tax base

The crucial element of the CCCTB proposals relates to the allocation of the common corporate tax base to each Member State. The aggregated profits of a group of companies operating in the EU will be apportioned to each Member State, based on a set of rules, known as formulary apportionment. With the choice of the appropriate formula, the Commission aimed that the sharing mechanism should have the following objectives:

- Be as simple as possible to apply
- Difficult to manipulate by taxpayers
- Distribute the tax base among the various entities in a fair and equitable way
- Not lead to tax competition.

The Commission has suggested a three-factor formula. It was argued that such three-factor formula should be more robust than a single-sector formula and should tackle aspects of both supply and demand on the generation of companies’ income. The supply part of profits’ generation should be represented by the production factors (i)
labour and (ii) capital (measured by means of assets). The demand shall be represented by a (iii) sales by destination micro-factor. A detailed description of the three factors is found in the *Appendix 2*.

A numerical example makes the context clearer. The following examines a German corporate group, with subsidiaries in Italy and Spain. Assuming that these business units together earn 100 monetary units, these then have to be divided among three countries. For each country using the sharing mechanism formula, as proposed by the Commission, will obtain the following results:

\[
\text{Tax Base}^A = (1 \text{ Sales}^A + 1(1 \text{ Payroll}^A + 1 \text{ Number of Employees}^A) + 1 \text{ Assets}^A) \\
\quad (m \text{ Sales}^{\text{Group}} + n(2 \text{ Payroll}^{\text{Group}} + 2 \text{ Number of Employees}^{\text{Group}}) + 1 \text{ Assets}^{\text{Group}})
\]

where \(1 + 1 + 1 = 1\)

\[m + n + 0\]

<table>
<thead>
<tr>
<th></th>
<th>Capital</th>
<th>Labour</th>
<th>Sales</th>
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<tr>
<td></td>
<td>EUR</td>
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<tr>
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<td>100</td>
<td>50</td>
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<tr>
<td>Italy</td>
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<td>20</td>
<td>80</td>
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<tr>
<td>Spain</td>
<td>100</td>
<td>30</td>
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</tr>
<tr>
<td>Total</td>
<td>300</td>
<td>100</td>
<td>250</td>
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</tbody>
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*Table 2.1: Sharing mechanism with numerical examples*
The case in point, thus, produces the following results (given equal weighting to the factors):

Germany = \( \frac{1}{3} \times 100 + \frac{1}{3} \times 50 + \frac{1}{3} \times 150 = 48 \)

\[ \begin{array}{cccc}
3 & 300 & 3 & 100 \end{array} \ 3 & 250 \]

Italy = \( \frac{1}{3} \times 100 + \frac{1}{3} \times 20 + \frac{1}{3} \times 80 = 28 \)

\[ \begin{array}{cccc}
3 & 300 & 3 & 100 \end{array} \ 3 & 250 \]

Spain = \( \frac{1}{3} \times 100 + \frac{1}{3} \times 30 + \frac{1}{3} \times 20 = 24 \)

\[ \begin{array}{cccc}
3 & 300 & 3 & 100 \end{array} \ 3 & 250 \]

2.1.3 Foreign income and participation exemption

Finally, the report also deals with foreign income and the elimination of economic double taxation. Four types of foreign incomes are considered:

- Income from Permanent Establishments
- Income from major shareholdings
- Income from portfolio shareholdings
- Royalties, Patent income, Interest ('passive income')
Working paper 57 makes a distinction between income from third countries and EU income. As regards third country income, dividends received from major shareholdings and Permanent Establishments would be exempt subject to a switch over to the credit method where the corporate tax rate in the source country was a low rate of tax. Portfolio dividends and other passive income would be taxed with a credit for withholding tax paid.

With regards to EU income which is attributable to a permanent establishment situated in one of the Member States, such income should always be consolidated with the group or single company tax base. Dividend income from major shareholdings would be consolidated if the ownership requirements for consolidation (75%) are met; otherwise, this should follow the same treatment as for third country income. Portfolio dividend income would follow the same treatment for third country income, as would other passive income unless the requirements for consolidation were met. EU income would include domestic income.
### 2.2 CCCTB Objectives

The EU Commission has recognized that taxation and customs policies have a significant role to play in the attainment of the Lisbon objective i.e. for the European Union to become the most competitive economy in the world by 2010.\(^8\) Full realization of the Single European Market is currently impeded because businesses operating across borders have to deal with many different company tax regimes. The European

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Commission introduced the CCCTB with the aim to help remove these obstacles and to improve efficiency and competitiveness in the Internal Market. The Commission believes that the introduction of CCCTB will contribute to the international competitiveness of EU businesses (European Commission, 2008). The goals that the European Commission is targeting to achieve with the CCCTB project are to:

- Avoid unnecessary or high compliance costs in cross border economic activity
- Allow cross border offsetting of profits and losses
- Resolve existing transfer pricing problems
- Tackle harmful or economically undesirable forms of tax competition
- Increase transparency in tax rate competition
- Create level-playing field for all EU companies
- Ensure tax considerations distort as little as possible economic decisions

Some of the benefits highlighted above are also clear to business professionals. Eugen Bogenschutz, head of German tax at law firm Allen & Overy argued that:

> “It would reduce compliance costs that currently result from reporting under 27 national tax systems. It would also reduce the risk of double taxation and the impetus to shift income or expenses from one EU jurisdiction to another would be reduced.” (Bogenschutz, 2008)

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The results of International Tax Review’s 2007 EMEA poll\(^\text{10}\) showed that the majority of the directors that took part, support the CCCTB idea of harmonization. 55% of the respondents answered that they would like to see CCCTB introduced across the EU. Out of these respondents, 59% answered that they do not have any reservations about the introduction of CCCTB; and 94% answered that they would like to see harmonization of transfer pricing rules.

Due to word limit, a more in-depth discussion of CCCTB objectives is included in Appendix 3.

### 2.3 Current Arguments and Debates

Ever since the European Commission announced its plans to create a common tax base, the matter has been surrounded by debate and discussion. Large amounts of literature have been written and endless discussions have taken place among Member States, tax authorities, tax practitioners and the business community.

\(^{10}\) The poll was carried out by International Tax Review magazine. 92% of the survey respondents were based in Europe, Middle East and Africa (EMEA), the majority of which resided in Europe. Large companies (turnover greater than $500 million), were the best represented, with 34% of respondents working in this group. 28% came from mid-tier firms (turnover between $499 million and $50 million). 27% of respondents came from small companies (turnover of $49 million or less). The poll went online in early May and closed on May 21 2007. The poll was split into three sections, which asked about topical issues in the region, respondents’ tax teams, and their advisers. 49 responses from heads of tax, tax directors, finance directors, CFOs, and CEOs who did tax work in the region were received.
2.3.1 Enhanced Cooperation

The CCCTB should become a reality only if all 27 Member States unanimously agree with the commission’s proposal on a common tax base, including the sharing mechanism. Given the different interests of the various Member States and consistent opposition of some Member States, this seems to be a very challenging task. The European Commission has clarified that, in the event of persisting opposition by some Member States, CCCTB may be introduced by way of the untried and untested route to law known as enhanced cooperation.\textsuperscript{11}

The introduction of CCCTB by way of enhanced cooperation would have to meet certain requirements, which include:

- Participation of at least eight Member States
- Opening to all Member States
- Intention to further the objectives of the European Union

\textsuperscript{11} This position was made clear by the EC Commissioner for Taxation and Customs Union, László Kovács, when the Commission set out actions to encourage EU competitiveness. See European Commission Press Release IP/05/1352, 26 October 2005.

Enhanced cooperation allows those EU Member States that wish to work more closely together to do so, as long as the initiative they wish to cooperate on is in line with the objectives of the EU’s treaties. It was first introduced for judicial and criminal matters under the Treaty of Amsterdam. The Treaty of Nice consequently introduced major changes aimed at simplifying the mechanism. In principle, at least eight States must be involved in enhanced cooperation. However the co-operation may not constitute discrimination between the participating Member States and the other non-participating Member States. Enhanced cooperation must also further the Treaty objectives and respects the whole of the \textit{acquis communautaire}. Although it can apply to all the three pillars of the European Union (the European Community, the Common Foreign and Social Policy and Justice and Home Affairs) - except defence matters, enhance coopeartion may not be applied to an area that falls within the exclusive competence of the community. See Europa (2008), Glossary [online]. Available from URL: \url{http://europa.eu/scadplus/glossary/index_en.htm}.  

- 18 -
• Respect to the competence, rights and obligation of non participating Member States.

EU commissioner Kovács publicly mentioned Austria, Belgium, France, Germany, Italy, Luxembourg, The Netherlands and Spain as the minimum eight supporting countries required under the Enhanced Cooperation procedure. This would be a number large enough to enact the CCCTB with enhanced cooperation. Even though a sufficiently large group expressed its interest in the CCCTB project, the likelihood of adoption by means of enhanced cooperation depends upon the question of whether an initiative by a smaller group will be viable to achieve the ultimate expectations which Member States attach to harmonisation.

CCCTB rules could be either more or less favourable than those of each of the non participating Member States. The hypothesis of CCCTB, introduced by way of enhanced cooperation and more favourable than those rules regarding the tax base of all the non-participating Member States could, however, be subject to objections. One objection is that enhanced cooperation could strengthen the attractiveness, as business locations, of the participating Member States at the expense of the non participating Member States.
Such a scenario would give rise to important issues regarding the Member States inside CCCTB and those outside CCCTB. James Somerville, a partner at A&L Goodbody, an Irish law firm stated:

"If the aim of the CCCTB is to make Europe more efficient, will this really happen under enhanced cooperation? Yes, it might benefit, say German companies with French subsidiaries, assuming both countries opt for the system, but what if one subsidiary is not in the enhanced cooperation block? It could get very messy." (Somerville, 2008)  

Paul Morton, head of group tax for Reed Elsevier, an international publishing company agreed with the above and added that problems and complications could arise for areas such as joint ventures and acquisitions. John Hume, managing partner of Hume Brophy Communications in Ireland, stated that irrespective of how the CCCTB is implemented, CCCTB would not be advantageous but bad news for Irish business and Irish competitiveness. On the other hand, Johan Van den Driessche of KPMG in Belgium stated that if successful, enhanced cooperation could attract more countries to join CCCTB.

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13 John Hume - Hume Brophy Communications (2008), *CCCTB – A Serious Threat to Irish Business and Ireland’s Competitiveness.*

John Hume is a Partner in Hume Brophy Communications, a communications, lobbying and public relations agency. Hume Brophy is a pan European consultancy specialising in public affairs, corporate communications, market development and financial communications. It has operations in Brussels, London and Dublin and serves clients in the transport, financial services, energy, consumer goods, and security technology sectors.
A discussion paper on problematic issues arising under enhanced cooperation by Luca Cerioni (2006) highlighted the fact that participating Member States would become more attractive as business locations. This may be even more possible if CCCTB allowed cross border loss compensation without the limitations set out in the Marks & Spencer case.

2.3.2 Optionality
Another important issue is whether the CCCTB regime should be optional or mandatory for qualifying companies. It has been suggested that the regime would be optional at least during the first years of implementation. This means that it will be left

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The decision of the European Court of Justice (ECJ) of the Marks & Spencer case on December 2005 identified the urgent need for multinational groups to be able to offset tax losses on an EU-wide basis. In this specific case the ECJ decided that the UK’s restricting group relief to losses incurred by UK resident subsidiaries infringed the EC Treaty of freedom of establishment if such losses couldn’t be used either by:
- carry back of losses,
- current year relief against local profit or
- carried forward by either the EU (non UK) subsidiary or another legal person.
This judgment was however specific to this case and couldn’t be used generally to offset losses on an EU-wide basis. Without CCCTB, parent companies could deduct losses subject to the rigorous conditions set out in the Marks & Spencer case. CCCTB introduced by the way of enhanced cooperation could result in a situation in which a parent company based in a participating Member State could unconditionally deduct losses incurred by subsidiaries in a another participating Member State and also losses incurred by subsidiaries in a non-participating Member State subject to the conditions set in the Marks & Spencer case.
up to the individual Member States to decide whether the application of CCCTB should be mandatory or optional. In a communication to the European Council of Finance Ministers Council in 2004, the European Commission stated that:

“An optional system leaving companies the choice between the existing national base and the common EU tax base presents a number of practical advantages. Applying the new system as an option in parallel to existing national bases would avoid a potentially risky big bang changeover, leaving more control with Member States.” (European Commission, 2004)\(^{16}\)

The Commission allows for optionality, however, there would be two limitations:

1) The taxpayers may only choose the full package of CCCTB;

2) The CCCTB applies to all affiliates which meet a certain threshold (all in/all out approach).

In connection with the above, Kiekebeld and Smit (2007)\(^{17}\), however, argued that optionality would add a further layer of complexity. It would mean that all existing tax laws and systems will need to be maintained, along with an entire new system. Member States have also expressed their concern as to the possibility of cherry picking practices by companies. Due to this, Member States may be inclined to make the regime compulsory. On the other hand, the business community expressed its intention to have the right to choose whether to apply the CCCTB or not.

\(^{16}\) European Commission (2004), *A Common Consolidated EU Corporate Tax Base*.

2.3.3 Sharing mechanism

One of the most difficult and controversial issues in the CCCTB proposal is the sharing mechanism and allocation of profits between Member States. It is likely that the introduction of the CCCTB will result in taxable profits being shifted out of some countries onto others. The current suggestion is a three-factor approach, based on labour (payroll and number of employees), tangible assets and sales. One of the reasons for the application of this method is that, this method has been applied for many years in the USA and Canada and both countries appear satisfied by the outcome of the mechanism (Hey Johanna, 2008).18

According to Fennell19, Director of Tax Knowledge Services at Ernst & Young, the allocation factors are more suitable for traditional types of industry and reflect a line of thinking which is not consistent with the Lisbon Strategy. They are also inappropriate for certain types of industries, such as where intangibles assets play a very important role, e.g. high tech, where intangibles are critical.

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In this paper, Hey assessed whether a less uniform approach was a viable option for CCCTB. Hey carried out this assessment by making a comparison to the non uniform corporation tax system of the U.S.

(i) Payroll factor

With regards the payroll factor in the sharing mechanism there are some issues which still need to be discussed (European Commission, 2007). Firstly, the definition of payroll factors has disclosed difficulties of defining the factors, such as the distinction between employees and self-employed persons. Fennell has argued that another problem that needs to be addressed is the significant differences in the wage level throughout the community which would affect the payroll factor. Some of the new Member States argued that the payroll factor should be adjusted to take account of convergence in hourly labour costs. On the other hand, the European Commission has stated several times that factors should be kept as simple as possible.

Furthermore, Fennel argued that if a number of employees factor will be used, this may favour those Member States in which a large number of employees are based, irrespective of their efficiency (Fennell D, 2008). Problems were also identified in relation to outsourced labour with the Commission favouring the exclusion of any labour component of outsourced services.

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21 European Commission (2008), Working paper 60 - *CCCTB: possible elements of the sharing mechanism*. In this aspect the Commission has specifically stated: “The sharing mechanism is aimed to be as simple as possible to apply for taxpayers and tax administrations and easy to audit for tax administrations”, “The Commission Services would not suggest including such an adjustment (relating to differential wage levels)”, and “…the objective of a factor that is simple to calculate and easy to administer.”
(ii) Assets factor

As to what to include in the asset factor, the Commission excluded inventory, financial and intangible assets, due to the difficulties of their valuation, location and potential manipulation. However, it is to be noted that for certain industries such as banks and high-tech industries, stock, intangible and financial assets are an important asset. Obviously any assets factor which does not incorporate intangible assets has material implications for those industries that derive significant revenue from the value of their intangible assets such as patents and trademarks. Businesses in Intangible Property Intensive Industries, such as pharmaceuticals and software, might be particularly affected by such an artificial approach. The focus of fixed tangible assets, once again, favours Member States with high industrial manufacturing complexes.

The Commission has also suggested that the location of the asset would be where it is effectively used; this means that, in the case of intra-group leasing, the asset will be deemed to be where it is located, rather than at the legal owner.
(iii) Sales Factor

The sales factor has proved to be the most controversial issue in the sharing mechanism formula. The Commission appears to have favoured the measurement of sales at destination rather than at origin. However some Member States, in particular Ireland, argued that this will favour large states with greater consumption over smaller states with small markets and small GDPs. The Commission reacted by stating that ‘sales by origin’ is impracticable, since it could result in duplication of payroll and property factors and complicated transfer pricing.

In connection with the ‘sales by destination’ approach, the Commission also indicated that the mere production of a product does not generate profits, unless it is sold. Fennell (2008) opposed to this on the basis that it was an atypical factor in the context of corporation tax. This is due to the fact that corporation tax is aimed at taxing production and not consumption, the latter being subject to VAT. This approach, Fennell argues, also ignores the true value drivers in a business.

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As regards the sales by origin, the Commission sees that this approach has a weak conceptual basis as an income generating and apportioning factor. The reasons given are that “If intra-group transactions were eliminated from the factor, sales by origin would not attribute the tax base to the ‘right’ locations, in the sense that the effects of the contribution of intermediate inputs to the generation of income or the differences in productivity of the other factors across a chain of companies of a given group would not be ‘picked up” and that the location of the ‘sales by origin factor’ could be easily manipulated.

23 Hume Brophy Communications (2007), CCCTB – A Serious Threat to Irish Business and Ireland’s Competitiveness, October 2007 Update.
As regards inter-group sales, the Commission included only third party sales, as otherwise this would lead to transfer pricing issues. However, this would also lead to some controversies, since group members producing goods for intra-group deals would receive no tax base on the account of this factor, even if they actually produce a large value added to the group.

### 2.3.4 Uniformity

From a technical perspective, uniformity appeared to be the first best solution. However, as Hey\(^24\) (2008) argued, part of the opposition of Member States may be due to a general averseness towards any kind of harmonisation.

> “There might be other Member States which agree with CCCTB in general, but find single features objectionable. This would lead in the end of not approving the directive. To some extent, the permission to deviate from uniformity can help facilitate adoption of the agreement.” (Hey, 2008)

This is not a new approach. In fact, the adoption of the VAT directive was made by introducing numerous opening clauses. Another important advantage to an approach containing binding standards, but without demanding full uniformity, is that Member States remain flexible to some extent to smooth away faults and to adjust the CCCTB system to their individual needs. This may be especially important in the period immediately after the introduction of CCCTB.

2.3.5 Compliance cost increase

One of the objectives of the CCCTB is the simplification of tax obligations, as previously mentioned. However, new complexities could arise with issues, such as:

- Definition of groups for tax purposes
- Dealing with companies leaving a CCCTB group
- Handling of corporate tax
- VAT offsets which can currently be done in certain countries,
- Treatment of trade taxes.

Consequently given such complexities, it was questionable whether the CCCTB will actually deliver any simplification of tax compliance administration and reduction in compliance costs. Furthermore, as Van den Driessche, stated:

“ It’s been agreed that IFRS would not be the basis of the CCCTB, so a new set of accounting rules would have to determine the taxable basis. This could be quite complex as some companies may need to use three sets of valuation rules: local accounting rules, IFRS and the new system.” (Van den Driessche, 2008)

In view of these current arguments and debates, Appendix 4 gives an overview of Member States’ reaction to the introduction of CCCTB. Finally, the present stage of the CCCTB proposal is discussed in Appendix 5.

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Johan F. Van den Driessche, is a Tax Partner at KPMG Belgium. Partner
Chapter 3: Research Methodology

This chapter purports to describe the methods by which the data required for the purpose of this dissertation was obtained. The nature of this area of study necessitated qualitative data collection techniques based upon literature search and interviews.

3.1 Literature Research

The literature review has been consolidated by using several resources, including secondary data available at the University of Malta library, the laws of Malta, journals and dissertations and the World Wide Web.

3.2 Interviews

Information obtained for the literature-based study has been complemented by a sequence of interviews, based on direct open-ended questions. As published documentation on local perspective is limited, interviews helped to explore further the feedback regarding CCCTB in the local scenario.

The interviews conducted were semi-structured interviews. While structured interviews have a formalized and limited set questions, semi-structured interviews are flexible, allowing for new questions to be brought up during the interview. This type of
interview was preferred to structured interviews because information obtained from semi-structured interviews does not just provide answers, but also valid reasons for such answers.

The objective of the interviews was to understand the respondent’s point of view rather than make generalizations. The interviews allowed the researcher to discuss in depth and detail and to clarify complex questions on the issue. The questions prepared for the interviews are found in Appendix 6.

The interviewees were carefully selected among tax experts working within various audit firms, Inland Revenue Department and International Tax Unit. Vince Callus, Aldo Farrugia and Mario Borg have attended the meetings and working groups regarding the CCCTB. Dr. Neville Gatt, Dr C. Cassar Torregiani and Marvin Gaerty were very knowledgeable about the CCCTB and its relevance to Malta. Interviews were carried out during the months of December 2008 and January 2009.
Below is a list of interviewees together with their designation in the respective organisation or audit firm.

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<thead>
<tr>
<th>Name:</th>
<th>Designation:</th>
<th>Firm:</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dr. Neville Gatt</td>
<td>Tax Partner</td>
<td>Pricewaterhouse Coopers</td>
</tr>
<tr>
<td>Dr. C. Cassar Torregiani</td>
<td>Tax Partner</td>
<td>Deloitte Touche Tohmatsu</td>
</tr>
<tr>
<td>Mr. Marvin Gaerty</td>
<td>Tax Enforcement Manager</td>
<td>Inland Revenue Dept.</td>
</tr>
<tr>
<td>Mr. Mario Borg</td>
<td>Operations Director</td>
<td>Inland Revenue Dept.</td>
</tr>
<tr>
<td>Mr. Vince Callus</td>
<td>Director</td>
<td>International Tax Unit</td>
</tr>
<tr>
<td>Mr. Aldo Farrugia</td>
<td>N/A</td>
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</tr>
</tbody>
</table>

3.3 **Time Frame**

Research, both through published information as well as through interviewees, extends up to March 2009.
Chapter 4: Interviews

This chapter describes the main issues that were raised during the interviews, which were carried out between December 2008 and January 2009. It was clear that all interviewees agreed that CCCTB is a good initiative to increase harmonisation within the European Union. On the other hand, all agreed, as well, that it is very difficult to implement and that it is not a viable option for Malta.

4.1 Main Objections

The tax partners and officials of Inland Revenue Department and International Tax Unit interviewed had several objections to the introduction of CCCTB in Malta. The main objections emphasized in the interviews were:

- *Fiscal Sovereignty* - One of the major drawbacks mentioned in the interviews was that the sovereignty of each Member State would be lost. Malta can presently regulate the economy through fiscal policy. However, the CCCTB would eliminate such right to regulate the economy with fiscal policy. This is so because even though tax rates will not be harmonized with the CCCTB, once the tax base is harmonized, the country will nevertheless be very limited in applying fiscal policy. This is because harmonizing the base is a more significant step to tax harmonisation than rate harmonisation.
All interviewees agreed that the tax base can be separated from tax rates. However, it was also pointed out that a common tax base might eventually lead to tax rate harmonisation in the future.

- **Tax Competition** – One of the objectives of CCCTB is to tackle harmful or economically undesirable forms of tax competition. Tax competition is beneficial to some counties like Malta and detrimental to other high taxed jurisdictions like France and Germany.

It was emphasized during the interviews that the main drawback to Malta in introducing a common tax base, is that the tax advantage currently granted, that attracts many businesses to set their operations in Malta, will become restricted.

Tax competition is very valuable for businesses. Tax implications are an important factor taken into consideration by businesses when deciding where to set up operations. A limitation on competition would lead to a situation similar to CARTEL\(^2^6\) – which is ultimately detrimental to consumers, businesses

\(^{26}\text{A cartel is a formal (explicit) agreement among firms which usually occurs in an oligopolistic industry. Cartel members may agree on such matters as price fixing, total industry output, market shares, allocation of customers, allocation of territories, bid rigging, establishment of}\)
in this case. This is because Member States may ultimately try to set a rate which suits all the Member States at the detriment of businesses.

- **Subsidiarity Principle** – It has also been argued that the CCCTB goes against the subsidiarity principle. Specifically, this is a principle whereby the EU does not take action (except in the areas which fall within its exclusive competence) unless it is more effective than action taken at national, regional or local level. According to the subsidiarity principle, EU Member States have independence in creating policy and legislation in areas where finding a European solution would be very long. Moreover, the tax sovereignty gives countries direct control over the tax rules and the tax revenues. Although the reform of corporate tax systems in the European Union is necessary in order to comply with the requirements of the internal market, harmonisation of direct taxes would be incompatible with the subsidiarity principle.

Members of the International Tax Unit represent the Maltese Government during meetings held in connection with the CCCTB. Following such meetings, it was stated that there were two types of reactions by Member States – Member States who are in common sales agencies, and the division of profits or combination of these. The aim of such collusion is to increase individual member’s profits by reducing competition.
favour of CCCTB and Member States who are skeptic. Malta falls within the latter group.

The major reasons mentioned for this skepticism, are the following:

- **Impact Assessment** - The European Commission is currently carrying out an impact assessment of the CCCTB for each Member State. The International Tax Unit is waiting for the results of the impact assessment to take a formal position. This is due to the fact that the International Tax Unit is not yet knowledgeable of how certain issues will affect Malta. However, up to this date and with the information currently available, the International Tax Unit is opposing the introduction of CCCTB in Malta.

- **Optionality** - Another drawback is the optionality factor. The introduction of another taxation system, will lead to more administrative complications from a tax administration point of view. Administrative costs will also increase for businesses, since businesses will have to make an assessment and choose from two different tax systems.
• *Comitology*

   The directive is not yet very detailed. Thus, a comitology process might be needed for the preparation of more detailed working papers. Tax matters usually require unanimous voting. However, comitology requires only qualified majority. It has been argued during an interview that qualified majority can prove to be negative for Malta. This is due to the fact that if larger Member States agree on an issue, it may not necessarily be the case that it will be beneficial for Malta. Yet, if qualified majority is reached, Malta will nevertheless have to comply with the requirements agreed on.

• *Sharing Mechanism* – It has also been mentioned the sharing mechanism formula, which at present does not favour small countries at all. It has been mentioned during an interview that, the current formula of the sharing mechanism may lead revenue to be apportioned to larger Member States.

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27The European Commission, has the task of implementing European legislation passed by the European Parliament and the Council of the European Union. In implementing the legislation within its scope, the Commission is assisted by committees in a process known as Comitology. The committees are discussion forums chaired by the Commission and composed of representatives of the European Union Member States. This allows the Commission to discuss its proposals with national administrations before they are implemented, in order for the measures to be best adapted to national situations.
4.2 Tax Burden

It has been argued during an interview that the CCCTB is a scheme that is approved by high-taxed countries like France and Germany. Another interviewee also agreed with this point, commenting that Member States with many multinationals will also back the project - mentioning Germany and France, as well as, Italy and the Scandinavian countries (except for Sweden whose position is not yet certain). High taxed economies currently have a problem because businesses are moving to low taxed jurisdictions. However, if all Member States have the same taxation system, this would not be the case.

An important point that came out during the interviews is that although corporation tax in Malta is high at 35%, the effective tax burden is relatively low. On the other hand, other Member States may have a lower corporation tax but a higher tax burden than Malta. For example, the Netherlands have a corporation tax rate of 25.5%, leaving a profit after tax of 74.5. However, another 25% withholding tax is then imposed on the distribution of a dividend which has already been taxed at 25.5% (assuming there is no double taxation treaties and other directives).

Accordingly, shareholders are taxed again on the dividends received. That is if a shareholder received a dividend of 75, net of tax, that 75 will be taxed again by way of
withholding tax. Malta this is not the case since dividends are subject to tax in the hands of the shareholder however; shareholders receive a full imputation credit for the tax paid by the company. Conclusively, Malta’s full imputation system of taxation and the tax refund provisions contained in the Maltese legislation, result in one of the lowest effective tax burden in Europe.

Another point that was mentioned during the interviews related to the tax incentives currently provided in Malta. With the possible introduction of the CCCTB, incentives provided after computing the tax base will not be lost. However, incentives provided prior to the calculation of the tax base would not be possible to apply. This is because the calculation of the tax base has to be common for all the Member States applying the CCCTB.

4.3 Difficulty of Harmonisation

All of the interviewees agreed that direct tax harmonisation is very difficult. This is due to the fact that corporate taxation is a system that has been implemented for quite a long time and it is consequently difficult to change. Furthermore, before harmonizing the tax base, the same accounting standards have to be applicable to all Member States, such that the profit figure would be arrived at using the same set of rules.
It has been argued by one of the interviewees that each time the European Commission proposed projects which were too aggressive, such projects did not succeed. On the other hand, when the European Commission harmonized specific areas like the parent-subsidiary directive, these succeeded. So, it has been argued that the CCCTB has not had a good start from the perspective that wide harmonisation plans never succeeded. However, representatives of the Inland Revenue Department who participated in initial meetings of the working groups added that the initial idea was to discuss the project by tackling only small areas and harmonize each area. However, harmonizing specific areas was becoming too complicated.

4.3.1 One Model Fits All

It has been pointed out during an interview that the CCCTB project, does not recognize that each country has its own individuality and that each country’s fiscal policy is ultimately based on its economy. A common taxation system will not solve Member States’ individual problems and this is a case of ‘one model fits all’. Some interviewees added on that in their opinion, the CCCTB will lead to less flexibility and sovereignty.

Malta, in fact, has many individual factors. Firstly, many problems are derived from the fact that Malta is in the peripheral of Europe, and secondly, because Malta has no natural resources. So, with CCCTB the competitive advantage created in Malta from fiscal policy would also be eliminated.
4.4 Transfer Pricing

The CCCTB project originated to lessen transfer prices complications. Reducing Transfer pricing problems is a big incentive for big businesses. However, in Malta there are not many transfer pricing issues. This is because of two factors:

- Firstly, because Malta does not have any restrictive transfer pricing rules. This ensures flexibility with regards to the rate of interest charged on intra-group financing;
- Secondly, because there is not really the need of transfer pricing issues due to the advantageous tax rates in Malta.

4.5 Increases in Costs

Another point that came out during the interviews is that Malta presently has a relatively simple tax system. Thus, with the introduction of CCCTB, our tax system will become more complicated. Furthermore, these complications in the tax system will lead to administration costs in the civil service. Both the civil service and businesses would have to fund the new system.

Another increase in costs would relate to professionals. Once there is a consolidated tax base, there would be a much higher mobility of professionals. This is because the tax system applicable in Malta would be applicable to any other Member State. This
could possibly increase fees charged by professionals, since professionals would have more opportunities in Europe, resulting in higher opportunity costs.

### 4.6 Maltese Businesses

One of the interviewees commented that the possible advantages to Maltese companies with the possible introduction of the CCCTB would be:

- More certainty regarding tax rates;
- Businesses would be impartial as to where to locate their operations;

However, it has been commented that most advantages arising from CCCTB are for multinational companies.

In terms of simplification, for the SMEs willing to operate in other EU states, the CCCTB will be a positive project, since SMEs will have easier tax compliance. However, it was further maintained by some interviewees that there are other obstacles for SMEs wanting to operate in foreign countries and not just tax complications.

Tax partners mentioned that businesses in Malta are not really aware of this project. Firstly, it is because the Maltese Government was not enthusiastic about the project from the beginning. Secondly, it is because in Malta, there is currently a competitive tax environment. Moreover, there are presently many other issues both locally and
internationally that may be more relevant for businesses in Malta like the VAT amendments and EU court judgments.

4.7 Comparison with Indirect Taxation Harmonisation

Harmonisation of indirect taxes (Value Added Tax) within the European Union has been successful. However, VAT is a different story since the treaty constituting the European Union expressly provides for harmonisation of indirect tax. This is due to the fact that VAT is intrinsic to the success of the single market, since there is the cross border element. Therefore, without a harmonized indirect tax, a single market could not be achieved.

On the other hand, it has been argued that harmonisation of direct taxes is not necessary for the function of the single market. In fact, there are no provisions related to direct taxation since Member States want to maintain their sovereignty.

4.8 Concluding Note

As a concluding note, all interviewees agreed that it may take a few years for CCCTB to be implemented, if it will be implemented, due to the difficulties in harmonisation. Furthermore, it has also been pointed out that, tax systems will eventually even out within a number of years different tax systems following EU court judgements.
The objective of this chapter is to analyse the findings obtained in the literature review and the interviews carried out in the previous chapters. Throughout the research, it appeared that there are several aspects of the CCCTB that would not favour Malta in comparison to other Member States. Similar to several other Member States which include: Ireland, Latvia, Cyprus, Poland, Lithuania and Slovakia; it is recognized in Malta that there are a number of factors which could result in loss of revenue and increase in costs. The impact of CCCTB is explained throughout the chapter.

Malta, being on the periphery of Europe and having no natural resources, competes with attractive tax incentives to attract foreign investments to set their operations here in Malta. It appears that tax harmonisation within Europe would lead to investment flowing to more established economies at the centre of Europe, which may have better infrastructure and economies of scale competitive advantages.

This chapter aims to explore the main reasons why Malta may not be in favour of adopting the European CCCCTB initiative.
5.1 Fiscal Sovereignty

One of the main arguments against CCCTB is that Member States would lose an important level of control over their economies. Taxation is an important tool in addressing efficiently the economic needs of Malta, especially in times of economic crises. As at today, the Maltese Government continues to determine (subject to its obligations under Malta’s double taxation agreements and EU directives):

- The national corporate tax rate (which is currently set at 35%);
- The nature and types of allowances and deductions that can be deducted from revenues in establishing the tax base;
- The income which is subject to tax in Malta;
- The treatment of income from foreign sources.

Fiscal sovereignty could be further reduced by the harmonization of tax rates. Even though Commissioner Kovács had explicitly mentioned that there is no intention of harmonizing the tax rates, this seems to be the next logical step of harmonisation. One of the fears of CCCTB is the imposition of the minimum standard tax rate requirement just like the 6th VAT Directive. Large Member States like France and Germany support the idea of a minimum tax rate to restrict smaller countries from attracting companies and to set up in their jurisdiction mainly on the basis of levying a lower corporate tax rate which results in a lower tax cost.
Another disadvantage which CCCTB may create is the reduction of flexibility in fiscal policy. Firstly, the use of the tax base as a policy tool is diminished with the application of the EU-wide common set of rules to calculate the consolidated base. Moreover, the system will be rather inflexible as any change to the previously agreed base will require unanimity. In these times of economic uncertainty, governments would not be able to make changes to boost industries in trouble. A consultation with 27 Member States would have to take place and by the time each Member State would have responded, the industry might have already gone bust. This will render the taxation system in Malta less flexible and much slower if Malta joins the CCCTB.

5.2 Effective Tax rates

Member States opposing the CCCTB appear to be nearly all new Member States which are competing within the EU through a low corporation tax. For instance, the corporate tax rates of Lithuania, Cyprus, Slovakia, Latvia and Poland range between 10% and 19%. All the mentioned countries are relative ‘new’ Member States, having joined the EU in the same year as Malta.

Ireland, on the other hand, is one of the ‘old’ Member States which has also one of the lowest corporation taxes in EU. Ireland levies a corporate tax rate of just 12.5% on trading income. Ireland also gives significant tax incentives for Research and Development to complement the setting up of business in this jurisdiction. Ireland
argues that the CCCTB will favour larger Member States, while Ireland will lose on the three fronts of the sharing mechanism. The reasons mentioned were that:

- The ‘labour’ factor would benefit countries with large working populations;
- The ‘asset’ factor would favour countries with large manufacturing bases;
- The ‘sales’ factor would be to the advantage of Member States with large consumer markets.

Ireland’s low corporation tax is a key policy instrument in attracting foreign direct investment. Although the CCCTB will not directly change Ireland’s corporate tax rate, the Irish government still argues that the proposal has serious implication on Irish businesses and competitiveness. It has been argued that Ireland will lose substantial tax revenues and undermine the rationale for locating operations in Ireland.

Malta, similarly to Ireland, has given significant importance in giving incentives to foreigners establishing their business here, even more after Malta’s accession to the EU. In an international tax planning scenario, Malta may well prove to be efficient in reducing the overall tax burden of international groups. In fact, Malta again like Ireland, has a significant large financial service industry which is fuelled by the low tax rate levied in Malta.
Malta’s taxation system is presently attracting many foreigners to set up their operations in Malta. Apart from the fiscal advantages, foreigners also benefit from a beneficial rate of tax which is considered to be one of the lowest in the EU. A detailed explanation of the refund mechanism is found in Appendix 7. It appears that the eventual implementation of CCCTB would disadvantage foreigners as they will no longer benefit from the low effective tax rate.

5.2.1 Practical examples using the Sharing Mechanism Formula

A considerable amount of companies shift their profits to Malta in order to benefit from the refund mechanism. These types of companies include:

- Trading Companies

- Intellectual Property (IP) Companies

- Financing Companies

- Treasury Companies

- Holding Companies

---

28 Intellectual property may take various forms such as trade-marks, trade-names, software copyrights, brand-names, patents, designs and technical know-how.

29 Financing companies ensure funds are transferred in the most efficient manner and that income from financing and treasury operations arise in a jurisdiction characterised with a stable and tax efficient system. Companies forming part of an international group may enter into intra-group financing agreement so as to ensure that the benefits of a favourable tax system are enjoyed by the whole group.

30 A holding company is used to hold assets and participations in other companies. Typically, the holding company itself does not trade, but it is used to hold the assets or shares in the
A number of companies set up their administrative and back-up office in Malta which enables them to invoice their clients from Malta. This means that no real activity actually takes place in Malta. The main objective of opening an administrative office in Malta is to transfer part of the group profit to Malta in order to benefit from the low effective tax rate and consequently reduce the overall tax rate of the group.

To explain better the impact of CCCTB on these type of companies which shift their profits to Malta, several scenarios are illustrated. Scenario A and B highlight the difference of including a trading company in Malta on the group effective tax burden in the present taxation system. Scenarios C, D and E on the other hand illustrate the inclusion of a trading company with different versions of the proposed CCCTB sharing mechanism formula.

Instead of owning the asset, a company may decide to transfer ownership and lease back the asset. A company may also opt to acquire and finance an asset through a tax-efficient vehicle. Cross-border asset leasing may create various advantages in the light of different tax regimes.
• **Scenario A**

![Diagram](image)

**Figure 5.1:** German Company sells goods to a French Client

A German company sells goods to a client in France costing €1,000,000 for €2,000,000, making €1,000,000 profits. The profits are taxable in Germany at a rate of 29.51%.

Thus, the following would take place:

- **Profit before tax** = €1,000,000
- **Tax at 29.51%** = €295,000
- **Profit distributed as Dividends** = €705,000
Scenario B involves the same situation of Scenario A but it also includes a trading company in Malta. German goods are invoiced to Malta at €1,100,000 and Malta Co. sells these goods to the client in France for €2,000,000. Thus, €900,000 profits arise in Malta. Where the Malta Company’s income arises from trading activities, as in the above example, its shareholders, following receipt of the dividend, may claim a refund of 6/7ths of the Malta tax suffered at the company level. The effective tax rate in this

*Figure 5.2: Use of a Trading Company in Malta*
case would result to be only 5%, as shown in Appendix 7 Table 7.1: Tax Refund Mechanism.

**Company Level:**
- Profit before tax = € 900,000
- Malta tax of 35% = € 315,000
- Profit distributed as dividends = € 585,000

**Shareholder Level:**
- Gross dividend receivable = € 900,000
- Malta tax suffered at company level = € 315,000
- Refund of 6/7ths of the Malta tax suffered = € (270,000)

i.e. an effective Malta tax of € 45,000 i.e. 5%

Scenario A and B shows the benefit of shifting profits to Malta in the present taxation system. In Scenario A, the company would incur a 29.51% tax in Germany on the €1,000,000 profit, while in Scenario B, due to the Trading company in Malta and the refund mechanism available in the Maltese tax system, a 5% effective tax would be incurred on the €900,000 taxable in Malta.
With the introduction of CCCTB, profits would be attributed to Member States according to Sharing Mechanism Formula. This may eventually shift profits to other Member States other than Malta, as explained in the next scenarios.

- **Scenario C**

The formula used in this scenario is the formula that is most favourable by the Commission. In this formula, the taxable profits are attributable to Member States according to the proportion of labour (payroll and employees), asset and sales of the group in that Member State. In this Scenario, sales are attributed according to their destination i.e. sales are deemed to take place in the Member State where the goods are ultimately delivered. Thus, in this example, sales would be attributed to France, assuming that the group has also a physical presence (subsidiary or permanent establishment) in France.

**Sharing Mechanism Formula**

\[
\text{Tax Base}_{\text{Malta}} = \frac{1}{(3 \text{ Sales}_{\text{Group}} + 3 \text{ Payroll}_{\text{Group}} + 3 \text{ Assets}_{\text{Group}})} \times \text{CCCTB} \\
\text{Malta}\text{ } = \frac{1}{(1 \text{ Sales}_{\text{Malta}} + 1 \text{ Payroll}_{\text{Malta}} + 1 \text{ Assets}_{\text{Malta}})} \times \text{CCCTB}
\]
In this example, since Malta is only an administrative centre (trading company), a relative small amount of labour and assets would be located here. Furthermore, sales would not be allocated to Malta or even Germany, but to the French subsidiary since a ‘sales by destination’ approach is used.

Using the formula above and inputting the amounts using in the example would mean that the profit will be shared 5.6%, 46.9% and 47.5% between Malta, Germany and France respectively. Therefore, under this method Malta would only be allowed to tax €56,160 instead of €900,000.

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32 The Payroll factor is equally divided into the number of employees and labour cost in the Sharing mechanism formula. However, in this example for simplicity sake, only one figure is included.
• **Scenario D**

This example uses the same figures in scenario C, but it is assumed that the group has no physical presence in the France. In the case where the group has no physical presence in the Member State where the client is located, and also in the case of sales to third countries, Working Paper 60: *CCCTB - possible elements of the sharing mechanism*, suggests that the sales portion would be taken into account by the other entities of the group proportionately to the other factors.\(^{33}\)

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**Table 5.2.:** 3 Factor Formula – Sales by destination. (Having no subsidiary in France)

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\(^{33}\) The Commission suggests that for the apportionment of the tax base a physical presence in the Member State should be necessary. Because taxing profits in Member States in which the group has no physical presence would be a new method for taxing companies’ profits and which is also not in line with OECD principles. In cases where the sales occur in a Member States where the group does not have a taxable presence or in a third country the sales would be taken into account by the other entities of the group proportionally to the other factors.
In this case the taxable profits would be apportioned 11% and 89% to Malta and Germany respectively. Accordingly, Malta would only be eligible to tax €109,650 of the profit instead of €900,000.

- **Scenario E**

In this example, the same figures are used once again; however, sales are now determined by the country of origin. Since intra-group transactions are eliminated so as to avoid transfer pricing complications, the sales are to be deemed to originate from Germany.

<table>
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<td>0</td>
<td>1,000,000</td>
<td>0</td>
<td>1,000,000</td>
</tr>
<tr>
<td>3-Factor Case</td>
<td>0.069</td>
<td>0.792</td>
<td>0.139</td>
<td>1.000</td>
</tr>
<tr>
<td>Taxable Profits</td>
<td>69,440</td>
<td>791,670</td>
<td>138,890</td>
<td>1,000,000</td>
</tr>
</tbody>
</table>

*Table 5.3: 3 Factor Formula – Sales by origin (Having a subsidiary in France)*
In this case, the majority of profits are taxable in Germany since sales are deemed to occur in Germany. Profits would be allocated 6.9%, 79.2% and 13.9% to Malta, Germany and France respectively.

The following table compares the taxable profits under the five mentioned scenarios. As is very clearly illustrated, the most favourable scenario in Malta is that of having a trading company in the current system, which would result in the €900,000 to be taxable in Malta. With the introduction of CCCTB, in the instances where no real activity takes place in Malta, more profits would be shifted in the other Member States. This would reduce the motivation for companies in opening a subsidiary in Malta.
### Table 5.4: Comparing Taxable Profits

<table>
<thead>
<tr>
<th>Scenario</th>
<th>Malta</th>
<th>Germany</th>
<th>France</th>
</tr>
</thead>
<tbody>
<tr>
<td>A  German Company sells to a</td>
<td>0</td>
<td>1,000,000</td>
<td>0</td>
</tr>
<tr>
<td>French Client</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>B  Use of a Trading Company in</td>
<td>900,000</td>
<td>100,000</td>
<td>0</td>
</tr>
<tr>
<td>Malta</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>C  3 Factor Formula – Sales by</td>
<td>56,000</td>
<td>469,000</td>
<td>475,000</td>
</tr>
<tr>
<td>Destination (Having a subsidiary in France) – CCCTB</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>D  3 Factor Formula – Sales by</td>
<td>110,000</td>
<td>890,000</td>
<td>0</td>
</tr>
<tr>
<td>destination. (Having no French subsidiary) – CCCTB</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>E  3 Factor Formula – Sales by</td>
<td>69,000</td>
<td>792,000</td>
<td>139,000</td>
</tr>
<tr>
<td>origin (Having a subsidiary in France) – CCCTB</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
5.3 Other aspects of the Sharing Mechanism

The Sharing Mechanism would not only be unfavorable to Malta in the case where the Maltese subsidiary acts as an administrative centre, but it would also be detrimental and would shift profits away from Malta, even when activity takes place in Malta.

5.3.1 Labour Factor
Malta attracts enterprises to set operations here also by way of competitive wage rates. In fact, Malta’s labour cost per hour is one of the lowest within the EU\(^3\). However, this advantage could turn to have a negative impact with the proposed sharing mechanism. If the payroll factor is included without any kind of adjustment for differences in labour costs between the jurisdictions, the result may be unacceptable. This is because a corporation may have operations in low cost jurisdictions to save on labour costs but the profits would be attributed to high wage jurisdictions disproportionately.

The payroll element would not only disadvantage Member States with competitive wages, but it would also ignore efficiency. Other Member States in the same situation of Malta proposed that the payroll factor should be adjusted to take account of convergences in hourly labour costs. Such proposal has not been well received by the Commission, since it will increase calculations to determine the labour factor.

\(^3\) See Lindsay, D (2008), Malta’s labour costs the EU’s second lowest, *The Malta Independent Online*. 
Therefore, having lower wage rates in comparison to other Member States, Malta would receive a smaller part of tax revenues.

Furthermore, any allocation that uses labour factor will favour those Member States in which large numbers of employees are based - another point that will ultimately be detrimental to Malta. The efficiency of the employees will, once again, not be taken into consideration. Thus, a large loss-making manufacturing plant could attract a higher share of the tax base than a more efficient newer operation.

5.3.2 Asset Factor

In the asset factor computation, the Commission favours the exclusion of intangible assets. The focus on fixed assets and the exclusion of intangible assets would once again favour those Member States with large and immovable industrial manufacturing estates. This is, yet, another drawback of the sharing mechanism to Malta.

Malta is shifting from a manufacturing industry into a service based industry. IT intensive companies are becoming increasingly important for the Maltese economy. Intangible assets are being excluded in the asset factor due to the difficulties in their valuation and location. However, Intangible assets have a significant role in the economy, and thus, cannot be disregarded. The end result would be that more revenue would be attributed to Member States with manufacturing bases at the
expense of Member States, such as Malta, which are becoming more reliant on financial services, pharmaceuticals and information technology.

5.3.3 Sales Factor

The proposed mechanism for the sales factor is to apply tax where the business transaction takes place and not where the business is headquartered. For multinationals based in Malta, this would mean that companies exporting to other European Member States would pay tax in the Member State to which the goods will be sold. Being a small exporting country, Malta may also in this case lose a part of tax revenue.

5.3.4 Other sharing mechanism formulae

Other approaches of the sharing mechanism would also put Malta at a disadvantage. The ‘value added’ approach would benefit Member States with large markets and big GDPs at the expense of Member States with small markets and small GDPs. This would put at disadvantage smaller states like Malta which have a low base, small domestic markets and relatively low GDPs.

However, these findings have to be interpreted very carefully since the impact on Member States of the sharing mechanism is not yet know for certain. One thing is
certain though: the choice of apportionment factor has a hugely important impact on tax revenues.

5.4 The Conflict between CCCTB and OECD proposals already adopted by EU Member States

The arm's length principle\(^{35}\) is the international standard that OECD Member countries have agreed in terms of determining transfer prices for tax purposes. This principle has achieved widespread acceptance across the globe as the basis on which transactions between associated enterprises should be priced in order to achieve a fair division of tax revenues between national governments. The guidelines describe and reject the Global Formulary Apportionment (hereafter referred to as GFA).

The GFA would allocate the consolidated profits of a multinational enterprise among the various affiliates of the group by applying a particular formula. Examples of such formulas are usually based on a combination of turnover, costs, assets and payroll. However, this apportionment is periodically rejected by the OECD due to the following reasons:

\(^{35}\) Article 9 of the OECD Model Tax Convention defines the arm’s length principle as follows: where “conditions are made or imposed between the two enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly”. (OECD, *Transfer Pricing Guidelines*)
• Difficulty in achieving co-ordination and consensus on the predetermined formula by OECD member and non-member countries. A common accounting system would have to be used apart from common factors and weighting of the formula. This would be very time consuming and difficult to achieve;

• Agreement on factor formulas would be also very difficult since each country may want to emphasize different factors that predominate in its jurisdiction;

• It would present political and administrative complexity and required international co-operation;

• If all major countries fail to adopt GFA, countries may have to comply with two different taxation systems. This could result in double taxation problems and increase administrative burden and compliance costs;

• Potential artificial shifting of production factors used in the formula to low tax countries;

• Difficulties in determining the sales and valuation of assets, especially intangibles;

• Such a consolidated formula would fail to take into account geographically differences and specific factors of an individual company in a group.
5.4.1 Comparing the GFA and CCCTB Sharing Mechanism

The OECD Transfer Pricing Guidelines define the GFA as:

A method to allocate the global profits of an MNE group on a consolidated basis among the associated enterprises in different countries on the basis of a predetermined formula. (OECD, Transfer Pricing Guidelines)

On the other hand, the Commission explains the CCCTB sharing mechanism in the following paragraph:

The Commission Services’ view is that the sharing mechanism should attribute the shares of the consolidated tax base to the various entities of the consolidated group on the basis of micro based apportioning factors that contributed to the generation of the taxable base (profits) of each individual tax players. (EU Commission, CCCTB: possible elements of the sharing mechanism / Working paper 60 par 11.)

The definitions of both methods show that the concept of the GFA and the sharing mechanism are very similar. Consequently the disadvantages highlighted for the GFA are also disadvantages of the sharing mechanism. In fact, the main disadvantages of the OECD GFA method are also disadvantages of the CCCTB Sharing Mechanism. A considerable number of Member States are skeptic of the CCCTB, while there is no consensus on the apportionment formula, as argued in section 2.4. Furthermore, it appears that administrative complexities would also increase and geographical differences would not be taken into consideration.
It is regular practice that the EU applies OECD Principles. In fact, the European Committee participates in the work of the Organisation for Economic Co-operation and Development (hereafter referred to as OECD).

However, in this case, the EU is proposing a sharing mechanism that was explicitly rejected from the OECD by the following comment:

*OECD Member countries reiterate their support for the consensus on the use of the arm's length principle that has emerged over the years among Member and non-Member countries and agree that the theoretical alternative to the arm's length principle represented by global formulary apportionment should be rejected.* (OECD, Transfer Pricing Guidelines).

Nineteen out of the twenty seven EU Members States are also OECD Members. The fact that the EU Commission is proposing a sharing mechanism that was explicitly rejected by the OECD is, therefore, very contradictory, considering also that EU regularly applies OECD principles and definitions.
5.5 Increase in Tax Compliance Costs

The corporate taxation system in Malta is presently a relative simple one. Corporate tax is regulated by the Income Tax Act and administered by the Income Tax Management Act, subsidiary legislation in the form of Legal Notices and case law delivered by the Board of Special Commissioners and the Court of Appeal. Furthermore, given Malta’s EU membership, compliance with the Fundamental Freedoms of the EC Treaty and EC Treaty rules on State Aid are also required.

Maltese companies are required to prepare financial statements using International Financial Reporting Standards (IFRS) as adopted by the EU. Under the proposed CCCTB system, the Commission would have to create a new set of accounting rules such that companies arrive at the same profit, since it has been agreed that IFRS would not be the base for CCCTB. The introduction of CCCTB would create the need to prepare yet another set of accounts for CCCTB purposes. This would render corporate tax base more complicated and even more distinct form the IFRS. Furthermore, implementing and adhering to new standards would increase costs. The CCCTB would also rob the Member States of the possibility of structuring the tax base themselves. This places the model in a rather negative light from a subsidiarity aspect, as pointed out in the interviews.
5.5.1 Optionality

Furthermore, if CCCTB is introduced with the possibility of optionality, it would mean that apart from the existing laws and systems, Member States would need to maintain along an entirely new system. Optionality would also mean more administrative costs for the Inland Revenue Department. In addition, while businesses would have another option to choose from, the CCCTB would increase tax-compliance costs to business, especially to small and medium-sized enterprises.

As far as big, international operative companies are concerned, which are few in Malta, one more option is always better. However, small businesses do not have sufficient resources to determine which system suites them better. Even though presently SMEs have a higher proportion of administrative and compliance costs than those for larger enterprises, this still does not evidence the necessity of CCCTB since most enterprises in Malta operate within national borders only.

Thus, a new tax system (whether optional or mandatory), would increase tax compliance costs for both the Inland Revenue and SMEs. It would also increase administrative burdens since close communication between tax authorities would be needed.
In my opinion, from the research concluded, it appears that CCCTB will not favour Malta, neither in mandatory form nor in optional form. The interviews conducted showed that the interviewees were skeptic about the advantages in introducing CCCTB. The discussion in Chapter 5 also showed that revenues may decrease while costs may increase.

The findings from the interviews and the analysis of Chapter 5 explain the main reasons why the CCCTB could put Malta at a disadvantage. The research showed that in several aspects, Malta would be better off in the current tax regime, without harmonisation. The main motives that led to this conclusion are the limits that would be imposed on fiscal sovereignty and tax competition and the possible increase in compliance costs.

This study did not result in any perceived advantages which could accrue to Malta as a result of implementing CCCTB.
6.1 Fiscal Sovereignty

One of the main arguments against CCCTB is that Member States would lose an important level of control over their economies by harmonizing the tax base. Taxation is an important tool in addressing efficiently the economic needs of Malta, especially in times of economic crisis. Furthermore, the characteristics of Malta would lead to different needs, and therefore, different taxation system. Fiscal sovereignty could be further reduced by the harmonization of tax rates.

Additionally, the system would be rather inflexible as any changes would require unanimity from all Member States.

6.2 Tax Competition

Malta’s taxation system is presently attracting many foreigners to set-up their operations in Malta. Apart from the fiscal advantages, foreigners also benefit from a beneficial rate of tax which is considered to be one of the lowest in the EU. Member States opposing the CCCTB appear to be nearly all new Member States which are competing within the EU through a low corporation tax. The main problem with CCCTB is that it will reduce the possibility for Member States to engage in tax competition.
Malta currently attracts many companies with the favourable low effective tax burden which provides refunds mechanism to residents and non-residents alike. The examples given in Chapter 5 also show that CCCTB would reduce the incentive of setting up companies in Malta, since less taxable profits would be attributed here. This is due to the fact the multinational profits would be attributed according to the asset, labour and asset factor. In the discussion, it was noted also that the sharing mechanism is very similar to the Global Formulary Approach which was explicitly rejected by the OECD.

6.3 Compliance Costs

The corporate taxation system in Malta is presently a relative simple one. The introduction of CCCTB would create the need to prepare yet another set of accounts for CCCTB purposes. This would render corporate tax base more complicated and even more distinct form the IFRS. Furthermore, implementing and adhering to new standards would increase costs.

The CCCTB would have no effect on companies operating nation wide other than an increase in compliance cost. It would also increase compliance cost and administrative burden or the tax authorities.
6.4 Limitations

The CCCTB is very wide and includes many details. However, in this dissertation the researcher tried to highlight the main factors that would be affecting Malta.

A thorough analysis of the impact that the CCCTB would bring about in Malta is still difficult to make. This is due to the fact that no formal proposal has yet been issued and there are still some issues undecided. Furthermore, as noted in the interviews, harmonization of direct tax is more complicated than indirect tax harmonization and it is difficult to say whether the proposal will ever be implemented.
Appendices

Appendix 1 - Examples of Group Consolidation

Working Paper 57 – CCCTB: Possible elements of a technical outline sets out several examples of what constitute a Group for CCCTB purposes. The following are three explanations of a Group found in the mentioned Working Paper.

Figure 1.1: Ultimate parent Non-EU resident

A group, as in Figure 1.1 above, would compromise an EU resident parent company and its subsidiaries and Permanent Establishment in another Member State, even if the ultimate parent is a non-EU resident company.
Another example of a group would consist of EU resident subsidiaries under the common control of a non-EU resident parent, and PE’s in two member states of a non EU-resident company, as shown in Figure 1.2 above.

A PE and subsidiary in two Member states of a non-EU resident company or group would be also be defined as a group, as shown in Figure 1.3 above.
Appendix 2 - Sharing Mechanism

Working Paper 60 – CCCTB: Possible elements of the Sharing Mechanism gives an in depth description of each of the sharing factors. This section deals with the basic rules found in the mentioned Working Paper for (i) defining the scope, (ii) valuing and (iii) locating each of the factors used in the formula.

2.1 Labour Factor

Scope: All personnel employed by a given entity should be covered, including managers and directors and temporary workers but excluding outsourced services to third parties. The labour factor includes two weights: the payroll of the workforce and the number of employees.

Value: Remuneration that is taken as a deductible expense for the calculation of the tax base, including fringe benefits, social contributions, stock options etc.

Location: The place where employees provide their service. Where employees provide their service for different entities during a tax year, their cost should be shared based on number of months.

2.2 Asset Factor

Scope: Only fixed tangible assets should be taken into account assets (land and buildings, plant and machinery, other fixture and fittings, tools and equipment) including idle assets. Stocks, intangibles, financial and current assets (including inventory) are to be excluded; the reasons being that, stocks and financial assets are rather mobile, and therefore, prone to manipulation and profit shifting. Furthermore, it is sometimes very difficult to value intangible assets, especially self-generated intangible assets.
Value: Assets would be valued at the tax written down value (historical costs minus tax depreciation). Among the various arguments in favour of making use of the tax written down value, it is mentioned that the tax written down value reflects most closely the market value of the asset. To calculate the asset factor, the year end's tax written down values of the assets could be used. Alternatively, an average value of the tax written down value of the assets could be taken into account.

Location: The location of assets is to be attributed to the entity which is effectively using the assets. In the vast majority of cases that location would coincide with the location of the economic owner of the assets, i.e. who has the right to depreciate the assets; however there could be situations where the assets are depreciated by an entity but effectively used by another entity: this rule would assign it to the latter.

2.3 Sales Factor (by destination)

Scope: The proceeds from the sale of goods and provision of services only should be covered (Core Business). Revenues from exempt income and extraordinary income should not be counted for in the factor. Revenues from passive income such as interest, dividends, deemed dividends and royalty should not be included, either - unless it represents the revenues accrued in the ordinary course of trade or business (the core business).

Value: The sales value to be taken into account should be the same value used for the purpose of calculating the tax base.

Location: In general, sales should be attributed to the entity which is located in the Member State where the sales to third parties occur, i.e. the final place of physical delivery. Intra-group sales would not be taken into account, and therefore, transfer pricing issues will not arise.
Appendix 3 - CCCTB Objectives

3.1 Compliance Costs

The CCCTB concept is based largely on the premise that it will simplify tax compliance obligations, thus reducing compliance costs for cross border activities within the EU. The European Commission, in a report published on May 4 2007, stated that the CCCTB should have a "fair impact on the Member States' public finances" and could raise revenue because of the boost that the reduction in compliance would give the common market (European Commission, 2007).

In terms of both nominal tax rates and the tax base, tax rules differ very substantially in Member States. This gives rise to a host of difficulties for companies engaged in EU-wide trade and commerce, reflected mainly in high compliance costs. To make matters worse, tax rules often contain regulations on the calculation of profits under both commercial and tax law. The expense this involves has a great impact particularly on smaller companies and may possibly prevent small companies from engaging in EU-wide activities at all.

[36] Implementing the Community Programme for improved growth and employment and the enhanced competitiveness of EU business: Further Progress during 2006 and next steps towards a proposal on the Common Consolidated Corporate Tax Base (CCCTB) – Communication from the Commission to the Council, The European Parliament and the European Economic and Social Committee (2007). This Communication outlined the progress on the CCCTB under the outline Work Programme established in 2004. It concentrated on the work done during 2006, and highlighted issues which required further discussions. The Commission stated that more attention was needed in the following areas:
- the consolidation component and the necessary fair and equitable sharing mechanism
- the optional nature of the CCCTB
- the treatment of the financial sector
- the administrative and judicial framework for the CCCTB.
The European Commission carried out a survey, based on a questionnaire concerning company taxation and VAT in 2004, where 700 companies from 15 countries took part. The main findings of the survey showed that:

- A parent company with subsidiaries in other EU Member States appears to have significantly (about five times) higher compliance costs than companies without subsidiaries;
- Annual compliance costs are about €202,000 for the average SME compared with €1,470,000 for a large company, corresponding to an estimated cost-sales ratio of 2.6% for SMEs compared to 0.02% for large companies;
- The principal company tax compliance problems relate to transfer pricing, with an estimated 81.9% of companies indicating difficulties linked to documentation requirements.

KPMG International also carried out a study in September 2007, where finance directors, tax directors and tax managers from over 400 companies from all 27 EU countries and Switzerland were asked their view for the CCCTB. It was concluded that

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37 See European Commission (2004). European Tax Survey. Taxation papers. Working Paper No. 3/2004. Company responses included quantitative estimates of their compliance costs and opinions on a number of issues related to tax systems. The countries that took part in the survey were: Austria, Belgium, Germany, Denmark, Spain, Finland, France, Greece, Ireland, Iceland, Italy, Luxembourg, The Netherlands, Norway, Portugal, Sweden and United Kingdom. In order to correct for under- or over-representation of some countries the responses of companies were weighted in order to reflect the number of companies of the same size in their country. The main conclusions highlighted from this survey were:

- Compliance costs relative to sales are larger for SMEs than for large companies
- Cross-border activity leads to higher compliance costs for companies
- Transfer pricing requirements are a major difficulty in the company tax area
- Repayment and refund requirements are a major difficulty in the VAT area
- Taxation is a factor for investment location decisions
- Taxation affects company structure decisions.
businesses were attracted by the prospect of more straightforward tax compliance and better business planning, which further supported the objective to reduce compliance costs.\textsuperscript{38}

### 3.2 Consolidation and Transfer Pricing

A central feature of the CCCTB, and perhaps its core attraction is consolidation i.e. the profits and losses of the various members of the CCCTB group would be consolidated. This implies that losses incurred by one CCCTB member company could be offset against profits of another CCCTB member company since their tax bases would be pooled.

Another important benefit arising from consolidation is the elimination of intra group transactions for companies participating in the CCCTB group. This would help remove the transfer pricing issues arising from separate accounting. Transfer pricing refers to the contributions transferred between associated enterprises. The transfer pricing regulations attempt to inhibit tax motivated profit-shifting practices by ensuring that internal transactions are properly priced.

However, certain transactions between associated enterprises cannot be easily priced, and this may result in a complex set of procedures that are costly to comply with and hard to enforce. Transfer pricing problems would be resolved by pooling EU-wide profits and once consolidated allocate such profits among Member States according to the sharing mechanism.\textsuperscript{39}


\textsuperscript{39} Emrah Arbak (2008), \textit{Will the CCCTB be stillborn?} [online]. Available from URL: www.ceps.eu
3.3 **Tax Competition**

Another reason for which the European Commission is launching CCCTB is to render profit shifting within Member States less attractive. Currently, countries operating in Europe can enjoy the infrastructure of whatever country they wish and then transfer their profits to a lower jurisdiction. This has led to tax competition within the EU, which has put tax rates on income from capital and business profits under pressure. In view of this, national budgets are therefore relying more on tax revenues from less mobile sources. In addition, with the application of the State Aid provisions, other privileges such as tax holidays for foreign investors cannot take place any more. Accordingly, it can be argued that competition evolved from tax base to tax rate competition.

Given that harmonisation of the tax base would increase the pressure on corporate tax rates, the proposal also includes a profit sharing mechanism. This implies that the consolidated tax base of multinationals is shared among the Member States, in which the business activities are conducted, aiming to nullify profit shifting devices. (Hey Johanna, 2008)\(^40\).

So far, the general approach of the European Court of Justice’s has been the following:
- Tax competition is the natural consequence of the remaining sovereignty of the Member States;

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\(^40\) See Hey Johanna (2008), EU Common Consolidated Corporate Tax Base: Guided Variety versus Strict Uniformity - Lessons from the “U. S. States’ Tax Chaos”. This paper reviewed the U.S. corporation income tax system and analysed whether a change in the uniformity of CCCTB and a change to the apportionment formula were advisable. Hey Johanna is a professor and director of the Institute of Tax Law at the University of Cologne, Germany.
- Tax payers have the right to take advantage of rate differences and any preferential tax features.
Appendix 4 - Member States’ Overview

There are mixed feelings by Member States regarding the CCCTB. The Irish government opposes the CCCTB proposal most strongly. However, the proposal is backed by other countries, especially larger Member States, such as France and Germany.

Michel Aujean, Director of Analyses and Tax Policies, DG Taxation and Customs Union commented to the International Tax Review\(^{41}\) on the position of Member States, stating:

“My personal view is that the five Member States who have chaired subgroups on the subject will be in, so Germany, Italy, Spain, France and Denmark. It would then be difficult for the Beneleux countries (Luxembourg, Netherlands and Belgium) to set aside their two main economic partners, Germany and France, so that would be eight countries already. It’s also unlikely that Austria would distance itself from Germany. But there is uncertainty in Sweden where apparently the prime minister is for it and the finance minister against it.” (Aujean, 2008)

It is worthwhile mentioning the Irish reactions to CCCTB since they are opposing the proposal very strongly. On the 12\(^{th}\) of June 2008, the Irish electorate rejected the Treaty of Lisbon. The Irish Business and Employers Confederation\(^{42}\) believe that CCCTB is bad news for the Irish business and Irish competitiveness. It was argued that CCCTB would favour larger Member States, while Ireland would lose out on the three sharing mechanism factors – labour, property and sales factor.


Ireland is joined by a number of the EU’s newer Member States in its hostility to CCCTB. To date, Poland, Latvia, Lithuania, Cyprus, and Slovakia have all declared their opposition to the CCCTB proposal. On the other side, France and Germany actively support CCCTB. Both the French and German governments have both declared harmonisation as their ultimate political aim with CCCTB. Both governments have also been openly hostile to the more competitive corporate tax rates of their EU partners. Other EU Member States with relatively high corporate tax rates, like Italy and Belgium, also support CCCTB, as do larger markets such as Spain, Austria and Greece. In the middle, is a large group of Member States undecided on CCCTB. These include The Netherlands, Sweden and other Member States with low corporate tax rates like Bulgaria and Romania. Table 4.1 below summarizes the feedback by Member States to the CCCTB proposal and their current corporation tax.
<table>
<thead>
<tr>
<th>Member State Against</th>
<th>Tax %</th>
<th>Member State Undecided</th>
<th>Tax %</th>
<th>Member State In Favour</th>
<th>Tax %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cyprus</td>
<td>10</td>
<td>Bulgaria</td>
<td>10</td>
<td>Hungary</td>
<td>16</td>
</tr>
<tr>
<td>Ireland</td>
<td>12.5</td>
<td>Romania</td>
<td>16</td>
<td>Austria</td>
<td>25</td>
</tr>
<tr>
<td>Latvia</td>
<td>15</td>
<td>Czech Republic</td>
<td>21</td>
<td>Greece</td>
<td>25</td>
</tr>
<tr>
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<td>15</td>
<td>Estonia</td>
<td>21</td>
<td>Finland</td>
<td>26</td>
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<tr>
<td>Poland</td>
<td>19</td>
<td>Slovenia</td>
<td>22</td>
<td>Luxembourg</td>
<td>29.63</td>
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<td>Denmark</td>
<td>25</td>
<td>Germany</td>
<td>29.51</td>
</tr>
<tr>
<td>Malta</td>
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<td>Portugal</td>
<td>25</td>
<td>Spain</td>
<td>30</td>
</tr>
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<td></td>
<td></td>
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<td>25.5</td>
<td>Italy</td>
<td>31.4</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Sweden</td>
<td>28</td>
<td>France</td>
<td>33.33</td>
</tr>
<tr>
<td></td>
<td></td>
<td>United Kingdom</td>
<td>28</td>
<td>Belgium</td>
<td>33.99</td>
</tr>
</tbody>
</table>

**Table 4.1**: Member States’ Feedback to CCCTB proposal

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43 See KPMG’s Corporate and indirect tax rate survey 2008. See also John Hume - Hume Brophy Communications (2008), *CCCTB – A Serious Threat to Irish Business and Ireland’s Competitiveness.*
Appendix 5 - Present stage of the CCCTB proposal

The European Commission had originally set September 2008 as the date when the legislative proposal would be issued. However, as this date approached and after the Irish negative response to the Lisbon treaty, the issuance of the legislative proposal on this date is now very much in doubt. In fact, in an address by EU Tax Commissioner Kovács to the International Fiscal Association (IFA) congress on 31st August, Kovács formally confirmed that the draft legislative proposal has been considerably delayed. This was due to the fact that there were still some areas which required very detailed work, as for example areas related to the financial sector. Kovács stated that he:

“...would rather present a perfectly elaborated and well justified product at the appropriate time than present an incomplete one just to meet an artificial deadline”. (Kovács, 2008)

It is also very likely that political reasons may have played a major role in delaying the draft legislative proposal. On June 12th 2008, the Irish rejected the Lisbon Treaty. The Irish remain deeply suspicious of the CCCTB. Secondly, the strong initial political support for the CCCTB from Germany and France has weakened in the last months. Added to these difficulties was also the fact that Commission president Barroso has showed interest in running the office for five more years. The fact that this is the last year of the five year mandate might mean that political sensitive dossiers are being delayed. Furthermore, the economic downturn is being felt more and more in Europe and this is hardly the time for launching such a controversial and experimental project.
Appendix 6 - Interview Questions

1. The majority of Tax Directors who took part in the *Tax Review EMEA 2007* poll backed the CCCTB. However 59% showed reservations about the introduction of CCCTB. What is your general opinion relating to this ambitious project?

2. Some argue that for CCCTB the end has come before it began. On the other hand, the European Commission continues to put more time and resources into this project. What is the general feedback in Malta?

3. There has been debate and controversy all over Europe regarding CCCTB. Many articles and papers have been written, yet in Malta there has been little discussion. Why is it so?

4. Are Maltese businesses aware of CCCTB?

5. What are the most attractive aspects of CCCTB and the aspects that can lead to the rejection of CCCTB in Malta? What are the biggest obstacles?

6. Is CCCTB designed to suit more Continental Europe’s larger economies?

7. Michel Aujean – Tax Partner at a French Law firm stated that “Whether a company would adopt the system depends very much on their size and structure”.

CCCTB is aimed at companies operating in more than one European country. Is it also relevant and beneficial for SMEs operating in Malta?
8. With the introduction of CCCTB, would Maltese companies find it easier to start business in other European States?

9. Ireland fears that with CCCTB the country’s tax regime is threatened. Is this the same case for Malta?

10. Most countries that oppose CCCTB have a very low corporation tax; for example, Ireland has a tax rate of 20%. On the contrary, Malta has a high corporation tax. Isn’t this a contradiction?

11. Malta’s tax system offers a number of attractive features apart from a low effective tax burden. There are tax incentives such as: reduced rates of tax, investment tax credits, and investment allowances. Would an eventual introduction of CCCTB in Malta eliminate such incentives?

12. In a communication from the ITU, it was argued that notwithstanding the Commission’s assurances that the tax base can be separated from the tax rate, changing the tax base would eventually lead to a harmonisation of tax rates. Do you agree?

13. The objectives of CCCTB are:

   - **Avoid** unnecessary or high compliance costs in cross border economic activity
   - Allow **cross border offsetting** of profits and losses
   - Resolve existing **transfer pricing** problems
   - Tackle harmful or economically undesirable forms of **tax competition**
   - Increase transparency in tax rate competition
• Create **level-playing field** for all EU companies
• Ensure tax considerations distort as little as possible **economic decisions**

Are these objectives achievable by this project? And will Malta actually benefit if these objectives are reached?

One of the objectives is to reduce tax competition? Is this an advantage?

14. The Marks & Spencer ruling forced the British Exchequer to repay around £30 million. Will the possible introduction of CCCTB lead to a decrease in tax revenues?

15. Why has harmonisation of indirect taxation VAT succeeded while harmonisation of corporate taxes is so difficult?

16. Is this a case of **ONE MODEL FITS ALL**?

17. With the Neumark Report in the 1960’s and Runding Report in 1990’s, the Commission plans to harmonize taxes failed. On the other hand, the 3 package (parent-subsidiary, merger, arbitration) of the 1990 succeeded. Could there be a way for partial harmonisation instead of the CCCTB?

**ENHANCED COOPERATION**

18. Malta could choose to remain out of CCCTB. However, CCCTB can still be introduced by way of enhanced cooperation. It has been argued that this will nevertheless affect non participating member states; in the sense that enhanced cooperation may strengthen the attractiveness as business location
of the participating Member States at the expense of the non-participating. Will it ultimately affect Malta if introduced by way of enhanced cooperation?

19. Luca Cerioni argues that cooperation between participating and non-participating countries is necessary. For example, problems could arise in the context of a group strategy; subsidiaries created in non-participating Member States of a parent company in participating Member States could transfer their place of central administration and management to a participating Member State so as to permit the group to fully benefit from CCCTB. Would this lead to Malta being a disadvantageous position?

**OPTIONALITY**

20. CCCTB could be optional, at least, initially. Is this a better option for Malta? Or, would introducing another set of law make tax compliance even more complicated?

**SHARING MECHANISM**

21. The U.S. has a factor formula which is not uniform for all the States. There have been discussions regarding this issue i.e. the factor formula should perhaps not be uniform for all EU countries. Could this be a viable option for Malta? And should we then adapt the formula to our needs?
Labour Factor

22. With regards to the labour factor, the European commission wants to keep it as simple as possible. However, wages differ around Europe. Is this yet another disadvantage for Malta, given the relative low wages?

23. The number of employees could also be used in the labour factor. This will without doubt favour Member States having large amounts of employees irrespective of their efficiency. Is this another drawback to the inclusion of Malta in this project?

Asset Factor

24. Malta is increasingly positioning itself in niche industries of funds, captive insurances, information and communication technology, and pharmaceuticals. The assets factor as proposed by the Commission does not incorporate intangible assets. Is this another aspect of the sharing mechanism that will affect Malta adversely?

Sales Factor

25. Sales by destination vs. Sales by origin. The Commission favours the Sale by destination measurement. Which one is more favourable for Malta, taking into consideration that Malta has a small GDP?

26. Multinationals based in Ireland would have to pay part of its tax in the state in which the goods are sold. Irish Business and Employers Confederation argued that this is bad for small exporting states like Ireland. Is this the same case for Malta?
Appendix 7 - Refund Mechanism

Since 1994, Malta has allowed shareholders of certain companies to claim refunds of tax which effectively reduced the corporate tax rate suffered to 4.17%. This was achieved through a series of tax refunds based on dividends a company distributed to its shareholders which was known as the International Trading Company regime. The EU Commission, however, found the system to be incompatible with the principles of the EC Treaty, in view of the fact that the refunds were only granted in respect of profits derived from outside Malta. This implied that the tax system was selective and therefore, constituted state aid in violation of the EC Treaty.

In March 2006, the EU Commission accepted Malta’s proposal to amend the existing income tax regime so that income tax refunds available under the Maltese imputation tax system would be available to all shareholders and in respect of all profits. The new income tax system utilizes different tax accounts for different sources of income namely; the Final Tax Account (FTA), the Immovable Property Account (IPA), the Foreign Income Account (FIA), the Maltese Tax Account (MTA) and the Untaxed Account (UA).

Malta operates a full imputation system for dividends paid from a company’s MTA and the FIA. Dividends are subject to tax in the hands of the shareholder however, shareholders receive a full imputation credit for the tax paid by the company. Since the highest tax rate for individuals is equal to the corporate tax rate in Malta, the full imputation system ensures that the shareholder is not subject to further tax on dividends distributed from the Maltese Taxed Account and the Foreign Income Account. The full imputation system eliminates economic double taxation.
Distributions from the FTA, the IPA and the UA do not give rise to any tax refunds in the hands of the shareholders, however, a distribution from the FIA and MTA entitles the shareholder to claim one of the following types of refunds:

- $\frac{2}{3}$
- $\frac{5}{7}$
- $\frac{6}{7}$
- full refund of the company income tax.

A distribution from the FIA or MTA enables the shareholder to apply for a refund of the corporate tax. The refund is equivalent to $\frac{6}{7}$ in the case of trading income and to $\frac{5}{7}$ in the case of certain passive interest and royalties. A company deriving foreign source income may also utilize the Flat Rate Foreign Tax Credit (FRFTC) by
increasing the net foreign source income or gains by 25% and then deducting the FRFTC from the Malta tax. Upon a distribution of such foreign source income a shareholder may avail himself of a 2/3rds refund of the Malta tax.

<table>
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<tr>
<th>COMPANY</th>
<th>Participating Holding EUR</th>
<th>Foreign Income Claims FRFTC EUR</th>
<th>Passive Interest and Royalties EUR</th>
<th>Trading Income EUR</th>
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<tr>
<td></td>
<td>1000</td>
<td>1000</td>
<td>1000</td>
<td>1000</td>
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<tr>
<td>Tax</td>
<td>350</td>
<td>437.5</td>
<td>350</td>
<td>350</td>
</tr>
<tr>
<td>FRFTC @ 25%</td>
<td>0</td>
<td>250</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Tax @ 35%</td>
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<td>187.5</td>
<td>350</td>
<td>350</td>
</tr>
<tr>
<td>Credit for FRFTC</td>
<td>0</td>
<td>250</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Malta Tax due</td>
<td>350</td>
<td>187.5</td>
<td>350</td>
<td>350</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>SHAREHOLDER</th>
<th>Gross Dividend received EUR</th>
<th>Tax charge at 35% EUR</th>
<th>Credit for tax at source EUR</th>
<th>REFUNDA</th>
<th>Refund to shareholders EUR</th>
<th>Effective tax rate %</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1000</td>
<td>350</td>
<td>350</td>
<td>full</td>
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<td>0%</td>
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<tr>
<td></td>
<td></td>
<td>350</td>
<td>350</td>
<td>2/3rds</td>
<td>350</td>
<td>6.25%</td>
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<td></td>
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<td>350</td>
<td>350</td>
<td>5/7ths</td>
<td>250</td>
<td>10%</td>
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<tr>
<td></td>
<td></td>
<td>350</td>
<td>350</td>
<td>6/7ths</td>
<td>300</td>
<td>5%</td>
</tr>
</tbody>
</table>

Table 7.1: Tax Refund Mechanism
The tax refunds apply to the payment of tax made by the following types of entities:

- Companies incorporated under the laws of Malta
- Companies not incorporated under the laws of Malta which are managed and controlled in Malta
- Companies not incorporated in Malta and not managed in Malta but which operate through a branch.

Following the above example, companies which may claim refund will eventually pay a corporate tax between 0% and 10% only. In order to benefit from this low effective tax rate, a considerable number of foreign companies shift their income to Malta. High tax countries like France and Germany argue that this income shifting to low tax countries is resulting in a loss of revenue for them. This is one of the reasons why France and Germany back up the CCCTB proposal. With the introduction of CCCTB this income shifting will not be possible because profits will be shared in Member States according to the sales, labour and payroll factor and taxed in the Member States accordingly.
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