

“Effective Corporate Tax Rate” and “Digital Business Establishment” in the Corporate Tax Base Proposals

Udo BUX

I. INTRODUCTION

On 25 October 2016, the Commission presented two proposals for two Council directives on a **Common Corporate Tax Base**, COM (2016)0685 (CCTB) and a **Common Consolidated Corporate Tax Base**, COM (2016)0683 (CCCTB). They both are based of **Article 115 TFEU** (Council decides after consultation of EP-special legislative procedure). As approximation under this Article shall directly affect the establishment or functioning of the internal market the **Council decides by unanimity** (exception for fiscal provisions in Article 114, par.2 TFEU). The purpose of the proposals is to establish common rules for corporate taxes and to make it possible for corporations to submit a single consolidated tax declaration for the corporation's activities to the tax authority in only one EU Member State. The proposals shall ensure a corporate tax system that encourages **fairness in the internal market** as currently businesses with cross-border activity have to comply with up to **28 divergent corporate tax systems** (generally, corporate income is taxed at national level).

The **CCTB** -COM (2016)0685 proposal is the '**first step**' in a two-stage approach towards an EU-wide corporate tax system and lays down common corporate tax rules for computing the tax base of companies and permanent establishments in the Union. The tax base is designed broadly, meaning that all revenues will be taxable unless expressly exempted. The proposal will also grant a **deduction for small starting companies** without associated enterprises, which are particularly innovative.

Once the common base is secured, consolidation shall be introduced:

The **CCCTB** -COM (2016)0683 proposal is the '**second step**' in a staged approach towards an EU-wide corporate tax system with **cross-border consolidation** of the tax results amongst members of the same group. The proposal shall be mandatory for groups of companies beyond a consolidated turnover above EUR 750 million. Groups will deal with a single tax administration in the EU ('principal tax authority')

or 'one-stop-shop'.) This will be based in the Member State where the parent company of the group ('principal taxpayer') is resident for tax purposes.

Effective corporate tax rate

The CCCTB proposal is not about **tax rates**, nor about the "effective tax rate". "**Effective tax rate**" can be described as the average rate (e.g. 10 %) at which a corporation is taxed. Member States will continue to decide their own corporate tax rates, as is their sovereign right. The **effective tax rate for a corporation** is the average rate at which its pre-tax profits are taxed. Tax rate is the percentage at which a corporation is taxed, it's based on an individual's taxable income or a corporation's earnings. It is a simple mathematical parameter. Apart from this commonly accepted definition, there is no legal definition of an effective tax rate in legislation on international or European level. The external study commissioned by DG TAXUD "The Impact of Tax Planning on Forward-Looking Effective Tax Rates" by ZEW¹ gives many examples of effective tax rates and calculation models to reach an average tax rate of a certain percentage.

Digital Business Establishment

The proposals are about ensuring fair taxation **where profits are generated**. Nobody denies the principle that companies should pay tax at the place of their activity. A company who wants to benefit of the freedom of establishment in the internal market (as defined by Article 49 – 55 TFEU) needs to have such an **establishment, be "established"**. The jurisprudence of the Court of Justice on the meaning of the term "establishment" is voluminous. The most famous rulings are: Centros, Überseering, Inspire Art, Sevic, and Cartesio².

In the literature, an establishment in the meaning of the TFEU, is commonly defined as follows: it has to be an **activity as self-employed person**, with the intention of **profit-making** (Article 54, subpara.2 TFEU), it has to be **cross-boarder** and it has to be a **stable, long term engagement**.³

A digital business model can be defined as "the global network of economic and social activities that are enabled by platforms such as the internet, mobile and sensor networks". Digital businesses are mainly based on intangible assets rather than on fixed assets (except a few pilot stores instead of several retail stores).⁴ It is therefore not surprising that many digital companies are artificially avoiding

¹ "The Impact of Tax Planning on Forward-Looking Effective Tax Rates" Centre for European Economic Research (ZEW), https://ec.europa.eu/taxation_customs/sites/taxation/files/taxation_paper_64.pdf

² ECJ, 4 December 1986, C-205/84, ECR 1986,3755 (3793), point 21; ECJ 9 March 1999, C-127/97 (Centros Ltd. v Erhvervs-og Selskabsstyrelsen), ECR 1999 I-1459; ECJ EC 5 November 2002, C-208/00 (Überseering B.V v Nordic Construction Baumanagement GmbH), ECR 1999 I-9919. ; ECJ EG 30 September 2003, case C-167/01 (Kamer van Koophandel en Fabriken voor Amsterdam v Inspire Art Ltd.), ECR 2003 I-10155 ; ECJ EC 13 December 2005, C-411/03, (SEVIC Systems AG), ECR 2005 I-10805. ; ECJ EC 16 December 2008, C-210/06, (CARTESIO Oktató és Szolgáltató bt.), ECR 2008 I-9641.

³ Udo Bux, EG-Kompetenzen für den Rundfunk", p.82, Frankfurt 1992

⁴ Jean-Louis MEDUS, Digital business and permanent establishment, p. 5 ;

<https://www.archers.fr/en/news/digitak-business-and-permanent-establishment-by-jean-louis-medus/>

establishment status while maintaining a minimum form of physical presence in the customer/market country by use of limited-function distributors.

Neither the OECD provides us with a useful and accurate concept for Permanent Establishment -there is no OECD concept to regulate new businesses based on intangibles assets or on digital networks. The OECD approach is not systematic but provides governments with solutions for closing the gaps in existing international rules that allow corporate profits to "disappear" or be artificially shifted to low/no tax environments, where little or no economic activity takes place.

The difficulty to define the tax jurisdiction due to the structuration of digital business' assets and activities by multinational digital companies to circumvent the permanent establishment status will remain the big challenge of the legislator and the Courts in the coming years.

Further reading

- "The Impact of Tax Planning on Forward-Looking Effective Tax Rates "Centre for European Economic Research (ZEW), https://ec.europa.eu/taxation_customs/sites/taxation/files/taxation_paper_6_4.pdf
- The OECD has identified and addressed the main tax challenges arising from the digital economy through its Base Erosion Profit Shifting (BEPS) project: <https://www.oecd.org/g20/topics/taxation/g20-finance-ministers-endorse-reforms-to-the-international-tax-system-for-curbing-avoidance-by-multinational-enterprises.htm>
- European Council conclusions, 28 June 2016, point 17 on the Anti Tax Avoidance Directive: <http://www.consilium.europa.eu/en/press/press-releases/2016/06/28-euco-conclusions/>
- Political agreement by ECOFIN Council on the Anti-Tax Avoidance Directive – Proposal for a Council Directive amending Directive (EU) 2016/1164 as regards hybrid mismatches with third countries on 21 February 2017, <http://www.consilium.europa.eu/en/press/press-releases/2017/02/21-corporate-tax-avoidance/>
- Jinyan Li, Protecting the Tax Base in the Digital Economy, United Nations Department of Economic and Social Affairs (2014) p. 5
- "The impact of the rulings of the European Court of Justice in the area of direct taxation 2010" EP study PE 457.367 <http://www.europarl.europa.eu/activities/committees/studies>
- OECD Digital Economy Outlook 2015, July 2015, <http://www.oecd.org/internet/oecd-digital-economy-outlook-2015-9789264232440-en.htm>. The report includes an overview of the current status and outlook of the digital economy; the main trends in the ICT sector, and developments in communication and regulation policy.

II. CONCLUSION

There are no commonly agreed definitions on OECD or EU level for the terms of **“Effective corporate tax”** or **“Digital business establishment”**. Also, there is currently no binding legal definition of those two important findings. As to the new forms of “establishment” (as mentioned in the TFEU), is necessary to refer to exhaustive case-law and literature. As such definitions are needed, as well for “Effective corporate tax” and “Digital business establishment”, the European legislator should endeavor to propose such definitions, at least as to its own territory.

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Contact: poldep-citizens@ep.europa.eu

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