CORPORATE TAXATION
AND THE
EUROPEAN COMPANY STATUTE

CEPS TASK FORCE REPORT

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This report is based on discussions in the CEPS Task Force on the Corporate Tax Regime of the European Company Statute, chaired by Alastair Sutton, Partner at White & Case. The Task Force met twice over a concentrated period of time in the summer and autumn of 2007. Participants in this CEPS Task Force included senior executives from a broad range of industry and financial services, representatives from business associations, academia and the European institutions. A full list of members and invited guests and speakers appears in the annex. CEPS gratefully acknowledges financial support for the Task Force from BP. The report greatly benefited from the contribution of Vieri Ceriani, Senior Manager, Banca d’Italia.

The members of the Task Force engaged in extensive debates in the course of these meetings and submitted comments on earlier drafts of this report. Its contents contain the general tone and direction of the discussion, but its recommendations do not necessarily reflect a full common position agreed among all members of the Task Force, nor do they necessarily represent the views of the institutions to which the members belong.
EXECUTIVE SUMMARY

Three years after a fiery lift-off, the European Company Statute (ECS) is anything but popular. Although the numbers appear to be improving gradually, only a few companies have taken the leap to become certified as a European Company (SE). Several impediments have been suggested as being responsible for this slow process, with fiscal issues singled out for particular attention. Against a stifling political backdrop for tax-related reform, these risks and costs can deliver a lethal blow to the already faltering legislation.

A range of fiscal issues arise during and following the birth of a SE. In the initial phase, the primary concern is the taxes triggered by the transfer of assets. These practices run counter to the freedom of establishment and free movement of capital fundamentals set out in the EC Treaty. Once properly implemented, new EU laws on the taxation of mergers should prevent some of these obstacles.

But this is not sufficient. More work is needed to eradicate ‘exit taxes’ that are used to thwart the change of residence. Recent laws do not explicitly address this issue. The European Court of Justice has shown its eagerness to uproot these measures, but the Court is effective only on a case-by-case basis. A Community-wide legal arrangement is needed to effectively combat the use of exit taxes.

The problems are far from over once the conversion is accomplished. Provided they survive the initial hurdle, major fiscal complications await an SE. The main concerns are the undue application of the Value Added Tax (VAT) and uncertainties on transfer pricing.

As for the VAT, the most important concern is that the intra-group transactions between a parent company and its foreign affiliates may be deemed taxable by some member states. The taxation of these transactions creates a problem of cascading, especially in the financial services and insurance sectors, although a resolution seems to be in sight for this sector. More generally, there is a need for an initiative for VAT-grouping. Cross-border arrangements are virtually non-existent within the EU in this area. It is highly desirable that the European Commission carries on with its current intention to modernise the VAT, especially taking into account the needs of cross-border businesses.

In the area of transfer pricing, current regulations that attempt to restrict tax-motivated profit adjustments lead to significant costs and risks for companies. The Common Consolidated Corporate Tax Base (CCCTB) promises to wipe out these inconveniences once and for all. The CCCTB project appears as a natural tool for SEs that would like to reduce their compliance costs and risks. However, there is some uncertainty at present about the future of the project. Several low-tax member states have objected to the establishment of a consolidated base. Given its ambitious goal, it is essential for the CCCTB project to lunge forward and embrace as many pan-European corporations and SEs as possible.
1. Introduction

Three years have passed since the deadline for member states to implement the European Company Statute (ECS) into their national laws. At the time of its inception, the future looked bright for the new company statute. Some pointed to the significant cost savings that would result from becoming a single European entity. Others were less optimistic. They pointed to the apparent irony that an age-old attempt to harmonise the different corporate models would in fact lead to more diversity. There was even fear among some observers that the regulation would lead to legal arbitrage, as corporations would shop for the most advantageous jurisdiction in which to settle. Although the reasons varied, all observers agreed that the vehicle would prove irresistible for an assorted set of companies. As for the regulators, the regulation was widely regarded as a crucial measure to complete the Single Market and to improve the competitiveness of European companies.

The high expectations were not unreasonable. Indeed, the pan-European vehicle yearns to achieve a remarkable aim. It gives companies operating in more than one member state the option of being established as a single company under European Union law. This should enable them to operate throughout the EU under a single set of rules and with a unified management and reporting system, rather than being subject to the different national laws of each member state in which they have subsidiaries.

To date, however, only a few firms have chosen to convert their existing structures to a Societas Europaea (SE).

Box 1. The European Company Statute

The European Company Statute (ECS) was adopted on 8 October 2001 by the Council Regulation on the Statute for a European Company (2157/2001) and the Worker Participation Directive (2001/86/EC).

The ECS allows four procedures for creating an SE. An SE can be established:

1. as a holding company with public or private limited companies located in at least two different member states;
2. as a joint subsidiary of companies from at least two different member states;
3. through the merger of two or more existing public or private limited companies located in at least two member states; or
4. by transforming a national company that has operated in two (or more) Member States for at least two years.

The SE must have its registered office in the same member state as the head office. It can be moved from one member state to another on the basis of a simple procedure. The SE incorporates the possibility of one-tier and two-tier boards, in view of the fact that both are common in the EU. The minimum capital of an SE is €120,000, in order to ensure that SMEs can make use of it.

As a crucial requirement, an SE can only be created if there is a consensus on the degree of worker involvement, set out by the Worker Participation Directive. A set of default arrangements detailed by the Directive apply if these negotiations are not fruitful.
The popularity of the ECS can be judged by looking at the number of registered SEs. At first sight, the situation does not seem so bad. Indeed, the number of corporate entities that have chosen to convert to the SE structure appears to be increasing.

Figure 1 below, which charts the growth of SEs from January 2005 to July 2006, distinguishes between operational and non-operational SEs. The diagram shows that the number of operational SEs has improved more or less constantly since July 2005. This is also the case for non-operational off-the-shelf companies.

Figure 1. Growth in the number of SEs

Though steadily growing, the ECS is still in its infancy.

Note: Non-operational entities include companies with no active operations or employees and ‘off-the-shelf’ companies that offer newcomers an opportunity to setup their businesses quickly. Operational entities include those with active operations and employees.

Source: SEEurope (2007).

As informative as it may be, the evolution in the number of SEs does not tell us much about the vehicle’s popularity. In order make a sound judgement, the numbers should be compared with the legislation’s target audience. In 2004, the EU had over 40,000 large enterprises, most of which had significant cross-border operations. However, as Figure 1 shows, by November 2007, there were only 61 (distinct) operational corporations with registered SEs. This underlines the fact that the ECS is still not quite as popular as expected. More worrying, coming at top of the list of reasons for creating an SE is the desire to establish a truly European image. Although

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1 There are a few instances in which a corporate structure includes two or more SEs. This appears to be quite popular for off-the-shelf companies, although a handful of operational corporations have also chosen to create more than a single SE. In the figure, corporations that contain several SEs are counted only once in order to give a balanced view of their contribution to the total number of SEs.

2 A large enterprise is defined as one having 250 or more employees.
branding is a completely valid and reasonable motive, it is a far cry from the cost-benefit equation that was expected to entice the corporations to join the ECS.

What can explain the lack of interest in the SE? Several factors might be responsible, for a company that opts for the SE faces a plethora of costs and risks. These impediments range from the costs and uncertainties arising from the obligatory negotiations on worker involvement to those that result from the redesign of operational procedures. The Task Force chose to focus exclusively on fiscal obstacles, without going deep on the other equally important dimensions. This approach has not been chosen to undermine the importance of other issues but simply to highlight the significance of fiscal problems in the current environment, which appears particularly hostile to tax-reform. It is also important to emphasise that most of the tax problems discussed in the report are common to all pan-European companies, not just the SEs.

Digging deeper into tax-related impediments, it is possible to distinguish between two phases. The first phase comprises the fiscal problems that arise during restructuring. Mainly to preserve their tax base, some member states have chosen to restrict the outflow of capital. The recent actions of the European Commission and the European Court of Justice (ECJ) have resolved some of these problems.

The second phase refers to the period following the initial phase, focusing on the fiscal uncertainties and risks that may await an SE even after it endures the initial costs of conversion. In terms of indirect taxes, the ‘VAT-groupings’ that provide VAT exemptions within a group cannot be readily expanded to cover cross-border transactions. There are also reasonable concerns about VAT cascading, i.e. the taxation of intermediate goods, services, etc. purchased, especially in the financial services and insurance sector. Resolution of these problems is certainly in sight, but the on-going work has to be closely monitored and the Commission’s initiatives in this area have to be supported.

On the direct tax front, a variety of questions that surround the proposed Common Consolidated Corporate Tax Base (CCCTB) are investigated. Conceived as a voluntary instrument for multinational enterprises that seek to streamline their fiscal liabilities and diminish their compliance costs, the project appears as a natural tool for an SE. However, given the resistance of certain member states, it is not certain when (and even if) the regime will see the light of day. And even if it does, the current details of the project suggest that the new regime may not be all-embracing and thus may not solve the problems encountered by some SEs.

CEPS’ aim in producing this report, and more generally in initiating this Task Force, has been to examine the problems that inhibit companies from choosing the ECS as a vehicle for simplifying their structures. It is hoped that the report will help make the ECS accessible to all companies with significant cross-border operations within the EU.

The next section outlines the fiscal costs that arise during the conversion process. These costs are directly related to the taxes that arise from the transfer of assets, which may be necessary for SEs born out of restructuring of existing companies. The third section addresses the longer term, focusing on costs and risks that are due to direct and indirect taxes. Special attention is paid to the current consolidated tax base project, which is, however promising, not directly applicable to SEs. The fourth section gives a list of policy recommendations and offers conclusions. Two case studies outlining the experience of BP and Nordea are presented in an annex at the end of the report.
2. **OBSTACLES DURING CONVERSION**

One of the key aspirations of the SE project is to facilitate the freedom of establishment, allowing companies to move within the European Union as effortlessly as within a single member state. National laws that obstruct this very fundamental freedom also impede the conversion process. This tight knot has recently started to unravel as the Commission and the ECJ have acted to discipline the individual member states. The next subsection focuses on the direct taxes that arise during restructuring. The section closes with a short discussion of the difficulties that arise during mergers.

### 2.1 Direct taxes due to restructuring

It was recognised early on that tax issues may constitute grave roadblocks to the ambitious plan set forth by the 1970 Proposal for a Council Regulation for the ECS. In line with this concern, the proposal contained provisions for:

1. Limiting tax consequences of the title of ownership to stockholders;
2. Compensation for losses incurred due to restructuring; and
3. Tax exemptions for the transfer of main offices.

While the original text was prescient on the impending impact of fiscal obstacles, the 2001 Council Regulation contains no specific provisions to clear away these obstacles.

The absence of fiscal provisions in the 2001 Regulation is not surprising and certainly not an exception. There is an enormous resistance in the EU to fiscal reform, mounted by an almost paranoid feeling that any step forward in fiscal matters will be a step closer to the full harmonisation of tax laws and the unavoidable loss of national sovereignty. Unable to defend community-wide fiscal priorities for decades, the EU’s fiscal void has instead been filled by the independent rulings of the ECJ and the stand-alone legislation adopted by the Commission. The patchy nature of these initiatives and rulings result in grey areas that continue to undermine the overall success of the market integration.

As far as the ECS is concerned, a key issue has been the problems that emerge from cross-border transfers and mobility. Intended to be one of the defining characteristics of the ECS, cross-border mobility is nonetheless hampered by the lack of

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4 The three tax-related provisions are taken from Lenoir (2007).
tax provisions. Simple costs that arise during the conversion procedure have simply been ignored. For example, certain favourable regimes and privileges have to be rescinded once the conversion takes place. It is not clear if these rights can easily be reinstated once the restructuring takes place.

A more dominant problem is the existence of ‘exit taxes’ that are activated once assets move out of a member state. Converting an existing structure to an SE typically leads to the cross-border transfer of assets, acquisitions and mergers. Most member states attempt to prevent such transfers with the use of various impediments, such as the taxation of the capital gains.

Some of these points were addressed by the 1990 Taxation of Mergers Directive. The Directive allowed companies to defer their tax liabilities arising from company mergers, divisions, and transfers of assets. The Directive was amended in 2005, which extends its scope to the ECS, attempting to facilitate the costless transfer of the registered offices and the conversion of branches into subsidiaries.

Although the amended Taxation of Mergers Directive goes a long way towards minimising these obstacles, some impediments have not been fully addressed. The ECJ’s resolve to stop such practices is evident from its 11 March 2004 Hughes de Lasteyrie du Saillant v. Ministere de l’Economie ruling. The case is illustrative of how member states adopt tax provisions that create obstacles to the outflow of capital. Under French law, French residents who possess equity rights in the country are liable when they leave the country to pay a provisional sum on the difference between the initial (purchase) price and the reassessed price on departure. When he left France in 1998, the plaintiff, the late M. de Lasteyrie du Saillant, was held liable for these unrealised gains. The ECJ ruled that the practice of imposing taxes not applicable to domestic residents was an infringement of the freedom of establishment and was, therefore, against one of the most fundamental rights established in the European Community (EC) Treaty.

As far as the French law is concerned, the ECJ ruled that the tax was not designed to restrict the change of residency in all cases. Instead, it was designed to limit moves motivated solely by tax purposes. The law in question indeed allowed the taxes to be deferred and eventually waived them if the relocation was deemed to be permanent, that is, if the taxpayer remained abroad for more than five years. The sticky point that proved too vexing for the ECJ was that the French tax authorities required M. de Lasteyrie du Saillant to post a bond, which would have been waived once it was established that the move was permanent. The Court ruled that the practice, however temporary, was nevertheless tantamount to a permanent hindrance to the freedom of establishment set out in the EC Treaty.

The de Lasteyrie ruling applied to individuals, but it may nevertheless be used as a precedent for companies. The decision certainly has an enormous impact on the legality of the practice of exit taxes. Indeed, the Commission, well aware of the limitations and ambiguities of the amended Taxation of Mergers Directive, adopted a

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5 Directive 90/434/EEC.
6 Directive 2005/19/EC.
7 ECJ Case C-9/02.
Communication on 19 December 2006, addressing the implications of the ECJ’s ruling on Hughes de Lasteyrie du Saillant.

In the Communication, the Commission drew attention to the fact that the 2005 amendments to the Taxation of Mergers Directive ensured that the transfer of the registered offices of an SE from one member state to another would not be hampered by taxes on assets that were left behind. However, the amended Directive stipulates nothing on the assets actually transferred, either from the member state of origin or yet from a third member state. The Communication (p. 5) states that

... the Commission considers the principles of the de Lasteyrie apply to such ‘transferred’ assets.

In complying with the Court’s decision, the Commission further notes (p. 6) that if a member state

... allows tax deferral for transfer of assets between locations of a company resident in that [Member State], then any immediate taxation in respect of a transfer of assets to another [Member State] is likely to be contrary to the EC Treaty of freedoms.

With these words, the Commission highlights what it considers to be the principle for setting apart fair play from laws that restrict movement. The rules applied by a member state to its departing residents must correspond with those applied to its domestic residents. Any other way is deemed to be contrary to the fundamental freedoms established in the treaty.

The 2006 Communication should be seen as an attempt to balance the freedom of establishment on the one hand and the right to fiscal sovereignty on the other. The two principles are at odds when a member state feels obliged to erect barriers in order to prevent the erosion of its tax base. As the OECD’s and the EU’s initiatives against harmful tax competition demonstrate, some of these impediments are indeed justified.9 What the ECJ and the Commission have been opposing is the extreme-end of this position: Laws that discriminate between domestic transfers from cross-border transfers within the EU are discriminatory and should be relinquished.


9 The OECD (1998) endorsed a series of recommendations to distinguish legitimate measures from harmful ones. Among these were “the absence of a requirement for substantial activities”, which is a relaxation of the usual residence requirements and “the ‘ring-fencing’ of regimes”, which prevents non-residents who have no substantial activity from benefiting from the jurisdiction’s public infrastructure. The EU’s Code of Conduct for business taxation was set out in the Conclusions (98/C 2/01) of the Council of Economic and Finance Ministers of 1 December 1997. The Code of Conduct requires member states to restrain practices that are deemed to be harmful. Drawing on OECD (1998), the criteria for identifying detrimental measures include tax incentives for activities that are isolated from the domestic economy and granting of tax advantages even in the absence of any real economic activity. Both initiatives arise from a need to address harmful measures put in place to attract capital by creating a ‘residency-lite’ status to individuals or companies who are not interested in residing in the jurisdiction. In effect, the status confers tax reductions not available to residents but protects the tax base by preventing the entities from taking advantage of the public services.
2.2 Cross-border mergers

Another major obstacle to forming an SE is that fact that cross-border mergers have not been recognised in some EU members. The absence of national legislation in this regard, for some member states even after their adoption of the 2001 Regulation for the European Company Statute, is indeed stunning.

Recently, the inadequacies of national laws have come under public scrutiny with the ECJ’s Sevic Systems ruling of 13 December 2005. The case arose from the 2002 merger request made by Sevic Systems AG, based in Germany, and the Security Vision Concept SA, established in Luxembourg. In entering into a merger agreement, the two firms agreed to dissolve the Security Vision Concept, transferring its assets to Sevic in Germany. The German authorities refused the merger, pointing to the absence of provisions governing cross-border mergers in German law.

Germany was not the only member state that lacked laws authorising cross-border mergers. Indeed, as recently as 2003, national legislation in the Netherlands, Sweden, Ireland, Greece, Finland, Denmark and Austria had also failed to recognise cross-border mergers. This is all the more surprising given that the ECS Regulation had been supposedly implemented by some of these member states at that point in time.

In order to eliminate these obstacles standing in the way of the ECS as well as to address other problems regarding employee rights, the Cross-Border Mergers Directive was adopted by the Council of Ministers on 26 October 2005. Apart from requiring that cross-border mergers, divisions, etc. become part of national legislation, the Directive addresses other issues that may arise in a pan-European context. Among the various elements tackled is the protection of existing employee rights to board-level representation. The Directive proposes a solution that is much in the spirit of the Directive on Employee Involvement in European Companies (2001/86/EC), which involves a negotiation-based solution. It is noteworthy that upon the implementation of the Cross-border Merger Directive, all companies taking part in a cross-border merger will be subject to the same requirements as an SE. Indeed, one of the main aims of the Directive was to pave the way for small and medium-sized companies to merge without the need of becoming a SE. The Directive is to be implemented by all member states before the 15 December 2007 deadline.

The ECJ’s Sevic Systems ruling should be seen in light of these developments. The decision highlights the Court’s eagerness to uphold the freedom of establishment, even though a new law had recently addressed that very point.

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11 ECJ Case C-411/03.
12 For more on this, see Commission’s 18 November 2003 memorandum, MEMO/03/233.
3. Obstacles after Conversion

The previous discussion centred on impediments that arise during conversion. Provided they survive the initial hurdle, major fiscal complications await an SE before it becomes operational. On the indirect tax front, how the VAT will be applied to an SE remains a major question. As for direct taxes, the main issue is whether the consolidated tax base project, which is a simple and unambiguous regulatory solution to tax-motivated cross-border profit allocation, will ever see the light of day.

3.1 VAT triggered by cross-border operations

One concern among companies weighing the costs and benefits of the ECS has been the indirect taxes that cross-border transactions typically incur. There are two separate but similar uncertainties that may make the post-conversion picture look blurry. First, it is not certain if the indirect tax agreements with national authorities will relapse once the restructuring takes place. After a company and its branches or subsidiaries take the form of a single SE entity, each element will probably have to apply to obtain identical agreements. This is not only a costly but also a risky procedure. Certain agreements between the corporations and the national tax authorities obtained in the past may no longer be available after the conversion.

Perhaps a more pressing need is a clarification regarding whether cross-border operations between a SE’s branches and its parent company will be considered as transfers within the same entity and, thus, will be out of the scope of VAT. There is a growing uncertainty on this issue, not only in the context of the European Company but also in the current environment where cross-border operations, such as mergers and acquisitions, have proliferated.

A complicating factor is that the existing national VAT grouping rules are far from being homogenous throughout the EU. In particular, a large number of member states do not allow such groups, although that number is constantly shrinking. The current EU legislation lacks provisions for cross-border grouping. Given that not all member states recognise tax groups within their countries, it is questionable to what extent these same states would be willing to accept cross-border arrangements.

There is quite a bit of support for mechanisms that avoid the taxation of transfers and services between dependent entities. A recent decision of the ECJ has stirred a lot of hope for companies awaiting guidance on cross-border VAT grouping. In Ministero

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For example, VAT groups have been allowed in Belgium since 1 April 2007, and will be in use in Spain starting from 1 January 2008.
dell’Economia e delle Finanze, Agenzia delle Entrate v. FCE Bank plc, the ECJ has agreed, on 23 March 2006, that services rendered by a company in one member state to its branch in another member state are outside of the scope of VAT.\footnote{ECJ Case C-210/04.} The Court justified its decision by referring to Art. 4.1 of the Sixth VAT Directive, which requires that a ‘taxable person’ is one “who independently carries out in any place any economic activity”.\footnote{Directive 77/388/EEC.} Accordingly, the Court ruled that subjecting the branches of a company that bore no independent financial risk and had no own capital would violate the principle put forth in this article.

The direct application of the FCE Bank ruling to the European Company, however, is not immediate: member states might feel allowed to continue to apply VAT whenever the organisational structure of an SE allows its branches/subsidiaries to take financial risk and own capital. This is more likely to occur when the SE is a holding company or in the case of the joint-subsidiary structure as envisioned by the ECS. In all these cases, the independence argument raised by the ECJ may lead to the taxation of intra-group transactions.

The application of VAT to transactions between the parent company and its foreign dependencies implies a financial burden for the generality of the SEs. It may be that the taxes on internal transactions would be credited against tax liabilities, but this can only happen with a delay. The reimbursement of excess credits will also take time.

Most importantly, the taxation of internal transactions could create a serious problem of cascading for companies operating in financial services, including the banking and insurance sectors. Paradoxically, the issue is problematic precisely because these sectors are exempt. In other sectors, VAT paid on such purchases is simply taken off from the firm’s indirect taxes on sales. However, since the final services are not taxed, financial institutions cannot recover the indirect taxes on their purchases of intermediate goods and services. For these companies, the VAT paid on internal cross-border transactions could become an unrecoverable cost. In all the cases identified above, there will be undue inefficiencies created by indirect taxes since the taxation of intermediate products disturbs the efficient allocation of goods and services.\footnote{Although almost all forms of taxation are considered to be harmful, it is well known that some are less distortionary than others at raising a given amount of revenues. Indeed, it can easily be shown that the negative effects of intermediate taxation may be reduced, without changing the amount going to government coffers, by simply replacing the intermediate taxes with taxes on final goods and services. The misallocation of resources that arises due to the taxation of intermediary goods and the second-best alternative were demonstrated analytically in the seminal article by Diamond & Mirrlees (1971).}

The problems raised by the treatment of financial services under the current Community law are well known and have been recently underlined by the European Commission.\footnote{Extensive discussion of these issues may be found in IBFD (2006) and PricewaterhouseCoopers (2006).} Following public consultations launched in 2006, the Commission recently finished work on a proposal for a Directive aimed at allowing financial
institutions and insurance firms to claim the VAT on their purchases and intra-group transactions, provided that they opt for taxing their services. Also, the Commission has recently conducted further consultations to address double taxation within the EU.

Only time will tell whether these problems will be resolved in the near future. One thing is certain, however. Given that it has been so hard to achieve some sort of harmonisation on the VAT, it is probably not very realistic to expect an instant solution.

3.2 Absence of a pan-European corporate tax regime

A significant problem standing in the way of the formation of a European Company originates from the current direct tax arrangements. National tax authorities have distinct ways of calculating profits, allowing different types of deductions and accounting methods. Moreover, the absence of a pan-European regime also generates costs and risks for corporations engaging in other intra-group profit allocation activities. Some national tax authorities may be willing to restrict loss-offsetting. Particularly important for SEs, intra-group payments – such as interest payments or royalty payments – may be challenged as loans originating from the Head Office, which are not allowed.

Perhaps most critically, the intricate sets of rules that are put in place to prevent tax-motivated transfer pricing practices generate significant compliance costs. Indeed, a survey published by the Commission in 2004 confirms that transfer pricing is one of the chief compliance costs faced by large companies. The same can be said for the monitoring costs of national tax authorities that scrutinise the legality of these activities.

Apart from direct compliance costs, the regulations also create uncertainties for corporations that are simply trying to abide by the rules. Owing to the complexity of the regulations currently in use, it is not always clear which practices may raise a red flag. This is especially worrying for corporations relying on cross-border operations.

Even discounting these costs and risks, the current set-up provides an incomplete solution without completely eradicating the incentives to look for ways to reduce taxes by moving profits from one tax regime to a more preferable one.

In short, the assortment of incentives provided by the current patchy system makes life harder for all parties. A decisive solution is needed to make life easier for law-abiding multinational corporations while at the same time reducing monitoring costs for tax authorities. The Common Consolidated Corporate Tax Base (CCCTB)

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19 The Commission's proposal for a Directive (COM (2007)747) to modernise the VAT was issued on 28 November 2007.

20 The consultation, entitled “Introduction of a mechanism for eliminating double imposition of VAT in individual cases”, ended on 31 May 2007. More information can be obtained from DG TAXUD’s website or the following URL: http://ec.europa.eu/taxation_customs/common/consultations/tax/article_3316_en.htm.

21 The survey’s results are published in European Commission (2004).
promises to wipe out these inconveniences once and for all. It does so by pooling an entity’s EU-wide profits so that transfers have no impact on a company’s tax obligations.

The envisaged mechanism has three key properties. First, it consolidates a corporation’s EU-wide corporate income base using a common set of rules, that is, a uniform set of deductions and accounting rules. The proposed scheme thereby aims at reducing the compliance costs. It also puts an end to the income-shifting activities of multinational corporations.

Second, the tax base is consolidated within a company group and is apportioned to each entity according to a formulary apportionment. Transfer pricing rules will not be necessary and the detrimental effects of income shifting between the member states will be curbed. It should be emphasised that the project does not attempt to harmonise the tax rates. Individual member states will retain the ability to set their own tax rates as they please.

Most importantly, the CCCTB is a voluntary measure, allowing eligible corporations to choose to opt-in or opt-out. This will mean that only eligible corporations that see potential gains need to consider the measure. Other corporations can continue to fulfil their tax obligations under the national systems.

This section will delve into transfer pricing regulations and provide a detailed explanation of how the CCCTB offers hope. There has been some resistance to the project, which will be briefly examined. Lastly, the eligibility criteria for having an option to join the consolidated base may end up excluding a large variety of multinational groups, including certain SEs. These points will need to be addressed in order to ensure that the project will achieve its ambitious goal while at the same time lending itself as a useful tool for as many pan-European corporations as possible.

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22 The CCCTB project was set to motion in the 23 October 2001 Communication (COM(2001)582), later confirmed by the 24 November 2003 Communication (COM(2003) 726).
3.2.1 Transfer pricing regulations

Tax authorities around the world have devoted a lot of energy to restrict the use of transfer pricing as a tax-planning tool. In many cases, the lack of a simple guidance—such as the market price—complicates things, making compliance costly and creates uncertainties for firms that are willing to abide with the law.

Several solutions were proposed to ensure that transfer pricing fulfills its actual use, that is, to compensate the transferred goods, services or information received. According to the arm’s length principle, transfer prices should reflect market prices, which unrelated parties would agree upon.23 Of course, this is only a notional solution and may lead to different interpretations. A related solution, which often employs the arm’s length principle, is based on cooperation between the tax administrations of member states and companies. Advanced Pricing Agreements (APAs) specify the way group transactions among taxpayers established in two or more member states will be taxed.24 In addition to the problems associated with the arm’s length principle, the agreements are also very time-consuming and cumbersome to obtain. Moreover, the agreements do not provide an impregnable solution since companies are asked to voluntarily cooperate with the tax authorities to agree on the parameters that will be applied in future transactions.

The CCCTB promises to be a comprehensive solution for the problems relating to transfer pricing. By pooling a company’s EU-based profits, the regime simply removes the fiscal impact of intra-group profit allocation within the EU.25 Apart from the obvious compliance benefits, the regime will also reduce the monitoring and auditing responsibilities of national tax authorities.

3.2.2 Formulary apportionment

An important aspect of the CCCTB project is how the EU-wide taxable income of a group will be shared among the different member states in which a company has been active. Currently, Canada and the US are the only developed countries that use a consolidated tax base and both have used formulary apportionment to allocate the consolidated base for nearly a century. As suggested by many authors, the US scheme suffers from non-uniform application of the weighing factors, but the main characteristics of the two traditional formulations are quite similar.26

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23 The arm’s length was established by Article 9 in OECD (2004).
24 On 26 February 2007, the Commission decided to adopt EU-wide guidelines (COM(2007)71) for advance pricing agreements (APAs), based on the best practice principles identified by the EU Joint Transfer Pricing Forum.
25 In addition to transfer pricing, the CCCTB will also resolve problems relating to loss-offsetting. In essence, the two concepts are closely related, both involving shifting of taxable income from one location to another.
26 For more on this issue, see Hellerstein & McLure (2004) and Martens-Weiner (2005).
In July 2007, the Commission published a Working Paper (CCCTB/ WP/ 057) detailing the technical elements of the CCCTB project. The paper was discussed in the eleventh meeting of the Working Group on the CCCTB, attended by experts from all member states and held on 27-28 September 2007. A summary record for the meeting was later made available (CCCTB/ WP/ 059). Two additional Working Papers, detailing the potential elements of the sharing mechanism (CCCTB/ WP/ 060) and the administrative framework (CCCTB/ WP/ 061), were issued in mid-November 2007. On 10-11 December 2007, the Commission held its first public meeting to discuss the technical elements and remarks contained in these papers.

Probably the most striking element of the project is the fact that eligible corporations will be able to opt in or out of the CCCTB. In order to incorporate corporations that are not wholly contained within the EU, the Working Paper suggests that the measure should be extended to non-EU companies with several permanent establishments residing in the EU as well.

The eligibility criterion for consolidation is of major importance. The Commission appears to prefer a group definition based on an ultimate ownership of at least a threshold amount. Only entities that are owned by at least this threshold will be a part of the group. A high threshold is problematic since it impedes large groups from being consolidated. However, some member states have shown a preference for high thresholds in order to effectively protect the rights of minority voters. Following negotiations in the September 2007 Working Group meeting, the threshold of having at least 75% ownership was agreed as a compromise solution. The December 2007 meetings showed that the businesses have a natural tendency to favour low thresholds.

There is also the question of whether the future Directive could or should contain all the technical details. For example, one of the most important pillars of the project, the so-called ‘first C’, is harmonising the tax base and can only be achieved by bringing the 27 base definitions in line. But an extremely detailed Directive would be complex, hard to implement, and would have to touch on issues beyond its authority. In order to make the implementation procedures simple, the Commission seems to prefer to leave out some of the details to be handled later on as implementing measures, based on the comitology powers conferred on the Commission by Article 5 of Directive 1999/ 469/ EC. This appears to have raised some concerns among some member states. The comitology decisions can be agreed by majority voting, which could undermine the unanimity rules set out in the EC Treaty. In any case, having a common set of rules is crucial for ensuring that the implemented Directive can really resolve the tax planning problems. It seems quite likely that the proposal will have to be more technical on this issue.

A related issue concerns to the accounting standards to be used to calculate the base. The Commission has recently ruled out the use of IAS/ IFRS standards (COM(2006)157) since they are neither suitable for tax purposes nor fully implemented fully by all member states. Unless a specific method for calculating the base is explicitly provided in the legislation, the national GAAP (Generally Accepted Accounting Principles) will be taken as a starting point. Obviously, such a practice could lead to different base definitions under certain circumstances.

As for the chief administrative details, each group is to have a principal taxpayer, either the parent EU company or, in cases where the group is distributed, an entity chosen by the group. Among other things, the principal taxpayer has a responsibility to self-assess and present its group’s base to the tax authority of member state it resides in, i.e. the principal tax authority. The principal authority may issue amended assessments based on audits carried out by the relevant tax authorities. Where the re-assessments give rise to disputes between two – or more – tax authorities, the issue is to be referred to a central arbitration panel comprised of experts.
The traditional formulary apportionment attempts to distribute the consolidated income by using a pre-determined formula that takes account of factors that are believed to contribute to the generation of income. In principle, the apportionment could include a wide variety of factors. However, two classes of factors have been distinguished. On the one hand, one may include factors that contribute to the origin of income, such as the amount of labour employed and capital used by the company. Such a mechanism would reward those jurisdictions in which actual production takes place, i.e. the supply side. On the other hand, one may consider the contribution of the destination-based factors. Implementing such a scheme would highlight the effect of activities like sales and marketing on the generation of income, i.e. the demand side.

The choice of factors has significant consequences on the tax burden borne by the company. It is easy to see that the use of factors essentially transforms the corporate tax

Box 3, cont.

At the December 2007 meetings, the participants have raised the possibility that this centralised panel structure could be too slow to reach a decision and may make audits less predictable, augmenting the risks faced by businesses. Although these concerns are reasonable, it is quite unlikely that they will materialise. As other participants have remarked, the panel would eventually have substantially more experience and authority in dealing with tax issues than other judicial bodies involved in cross-border disputes. Therefore, it is more likely that it will speed up the procedure and perform its job better, leading to more predictability.

A more heated debate took place when the sharing mechanisms were discussed. Once the tax returns are collected, the uniform base is to be distributed among different Member States. Each tax authority can then decide the amount it wants to keep, leaving the rest for the corporation. The sharing mechanism would need to be derived from several factors to determine how much each member state gets. Among the candidate factors are

- sales, excluding intra-group transfers, measured either at origin or at destination;
- labour input, either the number of employees or the total wages as a unit of measure; and
- assets, possibly excluding intangibles, inventories and financial assets.

The discussion of the sharing mechanism focused predominantly on the inclusion of sales as a factor. A recent KPMG (2007) survey found that including sales received broad support from businesses. However, there is less accord over whether the factor should take account of the origin sales or the destination. The Commission seems to prefer the latter as a better way of measuring real sales, particularly because it is less able to be manipulated. In order to minimise the possibility that non-productive activities are taxed, sales to jurisdictions outside the consolidated group are factored out of the apportionment formula. Many participants pointed out that the use of sales by destination as a factor would increase the tax obligations of many firms. Some have pointed out that sales by destination would also lend themselves to manipulation, putting the very use of sales in question.

The work on a draft proposal will be finished by the summer of 2008. The Commission seems committed to have a proposal for a Directive out by early fall 2008. This will ensure that the legislation will receive support during the French presidency.
to a tax on factors.\footnote{This was first suggested by McLure (1980) and was empirically verified by Goolsbee & Maydew (2000).} For example, if the formulary apportionment includes the value of property as a factor, then the corporate tax paid by the company in a particular member state will increase with the amount of property owned in that state. If the only apportionment factor is the property value, then the corporate tax would be equivalent to a property tax.

The most traditional formulary apportionment systems are the three-factor formula, based on an equally weighted combination of payroll, property and sales and the two-factor formula (the so-called Massachusetts formula), based on 1/3 weight for payroll and 2/3 weight for sales.

Table 1 summarises the amount of taxes paid by a company that operates in two member states under three schemes. The benchmark scheme is equivalent to a corporate tax system where any positive profit is taxed at the relevant tax rate. The other two cases are respectively the two-factor scheme and the three-factor scheme in which the total base is equivalent to the total income generated in all three countries. In order to simplify the exercise and make figures comparable, it is assumed that the same tax rates are applied in all cases.

The example depicted in the table assumes that the company has decided to locate most of its productive resources in Country A, while making most of its sales and marketing in Country B, which is a relatively large market. Country C is home to a small facility, probably serving a small market. The last three rows depict the tax obligations of the company in each of the three countries under the benchmark and the two- and three-factor formulary apportionment rules.

Table 1. Example comparing 2- and 3-factor formulary apportionment

<table>
<thead>
<tr>
<th></th>
<th>Country A (30% tax)</th>
<th>Country B (5% tax)</th>
<th>Country C (30% tax)</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Payroll</td>
<td>€125</td>
<td>€100</td>
<td>€25</td>
<td>€250</td>
</tr>
<tr>
<td>Property</td>
<td>70</td>
<td>20</td>
<td>10</td>
<td>100</td>
</tr>
<tr>
<td>Sales</td>
<td>200</td>
<td>1500</td>
<td>300</td>
<td>2000</td>
</tr>
<tr>
<td>Profits</td>
<td>-100</td>
<td>180</td>
<td>20</td>
<td>100</td>
</tr>
<tr>
<td>Benchmark</td>
<td>0</td>
<td>9.00</td>
<td>6.00</td>
<td>15.00</td>
</tr>
<tr>
<td>3-Factor Case</td>
<td>13.00</td>
<td>2.25</td>
<td>3.50</td>
<td>18.75</td>
</tr>
<tr>
<td>2-Factor Case</td>
<td>7.00</td>
<td>3.17</td>
<td>4.00</td>
<td>14.17</td>
</tr>
</tbody>
</table>

Loss-offsetting helps reduce the taxes paid in Countries B and C under the two consolidated base regimes. However, the taxes paid in Country A where the country has significant productive presence are significantly higher. Profits no longer determine how the tax burden is distributed. The 3-factor system is not beneficial for the company since the company has a relatively large property in the high-tax regime.
of Country A. Dropping property as a factor, the 2-factor system leads to low tax revenues since labour and sales are concentrated in the low tax regime. Therefore, holding the current distribution of resources fixed, the 2-factor system would be preferable for the company.

Naturally, the simple analysis above implies that comparing one case with another will always find a winner and a loser. However, it should be kept in mind that there are possible savings from reduced compliance and monitoring costs under the CCCTB system, which will aid both the fiscal authorities and the taxpayer.

3.2.3 Resistance to the project

Like most other pan-European legislative proposals, there is resistance to the CCCTB project. Currently, Estonia, Malta, Ireland, Slovakia and the UK oppose the proposal. Although there is limited information about the exact reasons for each country, Ireland’s Department of Finance and several Irish business organisations – including the Confederation of Business Individuals (CBI), the Irish Bankers Federation (IBF) and the Irish Business and Employers Confederation (IBEC) – have been particularly vocal about their rationale.

Coming on top of the list of arguments against the CCCTB project is a fear that it will lead to a harmonisation of the corporate taxes within the EU. This is certainly a fear among member states that have low tax rates, such as Estonia with zero tax on retained earnings, Ireland with its 12.5% rate and Slovakia with its 17% rate. Being on the lower end of the corporate tax spectrum within the EU, these countries are certainly hesitant that the CCCTB will eventually unravel to harmonisation, just like the imposition of the minimum standard tax rate requirement in the 6th VAT Directive.29

The Irish Department of Finance also raises the point that the proposal restricts fiscal flexibility. First, the use of the tax base as a policy tool is diminished with the application of EU-wide common set of rules to calculate the consolidated base. This is indeed one of the distinguishing characteristics of the scheme. Moreover, the system will be rather inflexible as any change to the previously agreed base will require unanimity.

Apart from the fear of eventual harmonisation, another reason for opposing the consolidated base is that some small member states clearly benefit from income-shifting activities. Indeed, many companies shift their non-productive activities into these member states in order to minimise their tax payments. As the eventual implementation of the CCCTB will dismantle these opportunities, companies will no longer find these locations as preferable and may direct their attention to looking for other opportunities. According to this reasoning, it should not be surprising that some business groups would be against the CCCTB project.

Along the same lines, the apportionment rules may also be troublesome for the national authorities of countries that fear a reduction in their tax revenues. It was noted

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29 Directive 77/388/EEC set the minimum standard rate to 15%, applicable until the end of 2000, which was recently extended until the end of 2010 by Directive 2005/92/EC.
above that most apportionment rules that are currently in use treat sales as a factor to distribute the consolidated EU-wide income among the member states. Although sales is one of the many factors used as a proxy of actual economic activity, its use may divert corporate taxes from net exporters, such as Ireland.

Table 2. Extensive use of sales as a factor leads to inferior tax revenues

<table>
<thead>
<tr>
<th></th>
<th>Country A (5% tax)</th>
<th>Country B (30% tax)</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Payroll</td>
<td>€ 100</td>
<td>€ 100</td>
<td>€ 200</td>
</tr>
<tr>
<td>Property</td>
<td>20</td>
<td>80</td>
<td>100</td>
</tr>
<tr>
<td>Sales</td>
<td>200</td>
<td>1800</td>
<td>2000</td>
</tr>
<tr>
<td>Profits</td>
<td>30</td>
<td>70</td>
<td>100</td>
</tr>
<tr>
<td>Benchmark</td>
<td>1.50</td>
<td>21.00</td>
<td>22.50</td>
</tr>
<tr>
<td>3-factor case</td>
<td>1.50</td>
<td>21.00</td>
<td>22.50</td>
</tr>
<tr>
<td>2-factor case</td>
<td>1.17</td>
<td>23.00</td>
<td>24.17</td>
</tr>
</tbody>
</table>

Table 2 illustrates how tax revenues can diminish for small countries. Country A is a small-sized low-tax country. The depicted company has allocated its labour force equally in the two countries. The profits in Country A are low due to low sales. The company has only a small portion of its property in Country A, but needs, say, a large storage space in Country B. The 3-factor case leads to identical results as the benchmark. However, the 2-factor case, which assigns a greater weight on sales factor, leads to revenue losses for the tax authorities in Country A.

It should not be forgotten that the scheme, if implemented as is, will be voluntary, implying that companies may choose not to take part in it. Although this will diminish the validity of the business industry’s argument above, the tax authorities are by all means correct in suspecting that their revenues will diminish. Indeed, recent research by Devereux & Loretz (2007) suggests that the voluntary consolidated base arrangement would lead roughly to a 1% reduction in tax revenues, while a mandatory system would augment the revenues by 8%.

3.2.4 Concerns about eligibility criteria

The CCCTB will treat a group of eligible entities that have chosen to opt-in as a single tax unit. A chief concern of the Task Force has been that the CCCTB’s definition will exclude some multinational groups, including certain SEs. In order to make the project achieve its ambitious goal of simplification of tax compliance, the project needs to embrace as many corporations as possible.

There are two approaches to defining what types of entities can be called a group for tax purposes.30 The consolidated group can first be established by a test of common legal ownership. For example, the group can be composed of all entities which are

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30 This subsection relies on Hellerstein & McLure (2004).
‘predominantly’ controlled by a common owner, i.e. a parent company. The threshold for predominance may be set at 51% or 75% direct and indirect ownership. Under this definition, the legal group could include entities with no common activity or relationship other than a shared ownership structure. It is easy to see that the legal ownership test is relatively practical and clear-cut. For public companies, the information is publicly available for the most part. However, the consolidated group’s boundaries may be as easily manipulated, potentially giving rise to a new set of tax-planning strategies.

The alternative approach is based on the unitary business condition. In this case, the group is expected to be composed of entities that are not only commonly controlled but also are related to one another by a single economic aim. In other words, unitary business groups are expected to have strong economic interdependence among their constituent entities. Although more challenging to manipulate, the economic approach leads to no meaningful and practical methods for devising an impartial test.

As was discussed above in Box 3, it appears that the Commission currently prefers the legal ownership structure, with a 75% direct and indirect ownership threshold. This is a relatively high percentage. The ECS allows a flexible ownership structure and certain SEs may indeed fulfil this condition. However, the threshold may be too restrictive for other European companies. Therefore, in its current form, not all pan-European corporations or SEs will be able to benefit from the pan-European corporate tax regime.
4. CONCLUSIONS AND RECOMMENDATIONS

The report highlighted the fiscal impediments to the European Company Statute. First, the problems arising during conversion were investigated. For a newly set-up SE, that is for an existing company operating through subsidiaries or branches in different member states, the main concern is the possibility of being taxed on the transfer of assets to the new entity. Also, the birth of an SE could give rise to the so-called 'exit taxes' if the restructuring involves a change of residence.

These measures run counter to the freedom of establishment and free movement of capital fundamentals set out in the EC Treaty. After the amended Taxation of Mergers Directive\(^3\) is adopted by all member states, which was called for by the end of 2007, the transfer of assets during mergers will not be taxable. However, exit taxes are still a problem and no definitive EU law has been proposed to deal with these obstructions head on. While the ECJ has recently shown its resolve to uphold the fundamental principles on which the EU is built, it has a power to judge if and only if it receives a formal application by an affected party. Consequently, it is entirely possible that exit taxes remain a problem when corporations shy away from changing their residences and are not able to make a case to begin with.

The second part of the paper examined problems that have gone through the initial phase of conversion. The main concerns were uncertainties and risks arising from a lack of clear legal guidance. Among indirect tax issues, the most imminent problem is that the member states may impose VAT on transactions between a parent company and its foreign affiliates. This implies a financial burden for all SEs. Most importantly, the taxation of internal transfers can result in cascading for companies operating in the financial sector, which produce mainly tax-exempt services. For these companies, the VAT paid on internal cross-border transactions would remain largely an irrecoverable cost. Additionally, national VAT-grouping arrangements applied under the pre-existing company structure might not be applicable to the SE. Cross-border arrangements are virtually non-existent within the EU.

The issue of cascading in the financial sector would indeed not be disconcerting if financial services were subject to VAT like other service sectors. In any case, it is highly desirable that, following the public consultations launched in 2006, the European Commission further energetically pursues action aimed at solving the problems raised by the treatment of financial services. This issue could be addressed through a radical solution, making financial services taxable, as envisaged by the proposed of directive recently presented by the Commission. The adoption of a 'quasi-group' for financial services.

\(^3\) Directive 2005/19/EC.
institutions, as envisaged by the same directive, would also greatly contribute to alleviate the problems.

The VAT-grouping problem cannot be fully resolved at this moment since there is no common approach in this area within the EU. Some member states do not accept grouping even domestically while others allow a loosely connected set of companies to be included in the same group. At the moment, it is not possible to expect that a uniform application of VAT-grouping will emerge within the EU in the near future. However, a great deal can be achieved if more attention is devoted to the development of cross-border groupings between member states with similar laws.

As for direct taxation issues, branch profit allocation puts the taxpayer in a vulnerable position. The paper investigated the current state of the Common Consolidated Corporate Tax Base as a possible solution. The project will certainly change the scope of cross-border business, creating a wider array of opportunities and needs. If implemented properly, the measure will significantly reduce compliance and monitoring costs by resolving in one stroke transfer pricing and other profit allocation issues. Certain member states appear to be against the project, possibly out of a justified fear of losing tax revenues. Nevertheless, the project should go forward as it will significantly reduce the amount of resources devoted to compliance and monitoring activities, implying cost reductions for both corporations and national tax authorities.

There is some ambiguity about whether the CCCTB will be adopted in a form that effectively addresses all the main corporate tax problems that are met by pan-European companies in general and SEs, in particular. Although conceived as a voluntary instrument for multinational enterprises that opt to streamline their fiscal liabilities, the eligibility condition to be a part of a consolidated group may end up preventing some multinational corporations from taking advantage of the regime. Also, even though the common base and the consolidation are two distinct elements of the project, they are complementary in delivering the promised benefits. If the project went ahead with a less than full implementation of one of these elements, an important opportunity address one of the main tax obstacles to the proper functioning of the internal market, namely transfer pricing, will be lost. Therefore, neither element should be compromised. It is essential that the project is kept intact, embracing as many pan-European corporations as possible.

To summarise, the report recommends:
- a Community-wide legislative arrangement to uproot exit taxes;
- implementation of measures to stop cross-border VAT cascading; and
- continuation of the CCCTB project, ensuring that the full benefits of the project are available to as many pan-European companies as possible.
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A summary of Jurgen de Moor’s presentation at the Task Force meeting, 12 June 2007

Being one of two largest companies in Europe, BP has a sizeable corporate presence in the continent. Europe accounted for about a quarter of the group’s overall profits and capital. With its exploration, production, refining, marketing, gas, power and alternative energy facilities dispersed within Europe, BP operates through a large number of subsidiaries.

BP’s study of a single entity operating through branches

In 2005, the company considered the European Company (SE) in order to eliminate corporate barriers both within the group and in interactions with the company’s customers, suppliers, tax authorities and other external entities. The planned transformation would abolish the subsidiary structure and introduce a single entity legal structure that operates through branches located in various countries. The chief benefits from conversion were identified as:

- BP’s willingness to position itself as a true EU company;
- reduced legal and administrative costs of running an international firm;
- simplified accounting and direct and indirect tax filings and
- an improved platform for EU-wide harmonisation, i.e. systems and support.

On the one hand, the SE structure offers sufficient incentives as it is. As far as BP is concerned, there is no need to introduce supplementary tax savings to make the vehicle more enticing. A clear benefit is the reduction of VAT registrations to one per country.
On the other hand, converting a large corporate structure into an SE certainly comes with costs. It is possible to dismiss or phase out some of these costs. For example, the direct taxes from setting up a new (cross-border) entity may be defused by the extension of existing directives to SEs. Similar solutions can also be found for indirect taxes. Other potential restructuring costs, however, such as the real estate transfer taxes, are currently not addressed by EU legislation.

Once the SE structure is in place, it faces a number of tax impediments. Among the tax risks and excessive corporate tax measures that need to be resolved are:

- tax disallowance of intra-group interest and royalty payments to the branches, which may be challenged as loans originating from the head office are disallowed for tax purposes;
- breaking up of the consolidated tax groups (e.g. German Organschaft) defined solely for fiscal purposes;
- issues regarding branch profit allocation and inconsistencies that remain between the tax treatment of foreign branches and subsidiaries of foreign companies (some of these issues are mitigated by the ECJ’s Saint Gobain ruling (C-307/97) for member states only) and
- continuation of existing indirect tax licenses and guarantees and potential exposure to random audits triggered by the conversion decision.

At the end of its examination in 2005, BP found that the tax framework available for the SE had not been developed sufficiently. Therefore, the costs and risks associated with conversion would likely outweigh the benefits. Further analysis of the SE concept was shelved.

It is important to highlight that the common consolidated corporate tax base (CCCTB) will not be sufficient to resolve all the issues identified above. Nevertheless, the CCCTB project could be helpful and needs to be available for all SEs.

Jurgen de Moor
BP – Regional Tax Manager
CASE STUDY 2 – NORDEA

A summary of Margareta Leijonhufvud’s presentation at the Task Force meeting, 13 September 2007

Nordea Bank AB is the largest financial institution in Scandinavia. Its parent company is based in Sweden, with head offices in Stockholm. The company has a distributed legal structure, with subsidiaries in a number of European countries. In addition to the main group subsidiaries resident in Finland, Denmark and Norway, the group includes subsidiaries and related entities based in the Baltic states, Poland and Luxembourg.

In order to streamline and simplify its complex organisational structure, Nordea has recently examined the SE company structure. In addition to the tax issues detailed below, the investigation also concentrated on legal and corporate issues.

In order to proceed towards an SE company structure, Nordea had some tax requirements. These requirements were that the transformation must be tax neutral both during and after the transition procedure.

The chosen conversion model was that the head office would remain in Stockholm while the local banks in Finland, Norway and Denmark would thereby convert to branches under the Stockholm office.

From this perspective, the concern was that Nordea would experience several tax problems that are still not sufficiently addressed through existing local laws or EU legislation. These issues were:

- tax effects upon change of registered residence/ headquarter takes place (in the future)
- tax effects on shareholders resident outside the EU
- tax effects on local accumulated (carry-forward) losses
- tax effects on advanced bookings (reserves)
- tax effects on intra-group financing (thin cap rules)
- tax effects on group contribution (cross-border)
- possible double taxation of branch income
- exit taxes arising from restructuring
- ambiguities regarding transfer pricing rules
- future capitalisation requirements (new OECD guidelines and the effect these might have on branch income) and the
- possible incidence of VAT for transactions within the group.
The most worrying and probable cost driver arises from the uncertainties surrounding the exit taxes, carry forward losses, double taxation on branch income and VAT.

It was presumed that the new structure, containing one head office and three foreign branches, would lead to no additional VAT costs as a transaction between the parent company and a foreign branch has been considered as a non-taxable transaction. Lately, however, local tax administrations seem to have changed the interpretation of this rule and the EU VAT directive in such a manner that VAT is levied on transactions between a parent and its foreign branches. If this obstacle is not removed, the additional VAT costs can jeopardise an EU company structure. Initial calculations on VAT effects show that out of a 20% synergy effect – for example in a centralised service production - only 5.6% remain if VAT is collected on transactions between the parent company and a foreign branch.

Margareta Leijonhufvud
Former Tax Director – Nordea Bank
# List of Task Force Members and Invited Guests and Speakers

Chairman: Alastair Sutton  
Partner  
White & Case LLP  

Rapporteur: Emrah Arbak  
Research Assistant  
CEPS

## Members of the CEPS Task Force

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<td>Krister Andersson</td>
<td>Director Tax Policy, Confederation of Swedish Enterprise</td>
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<td>Daniel Broekhuizen</td>
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<td>Vieri Ceriani</td>
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<td>Vicki From Joergensen</td>
<td>Legal Advisor, Confederation of Danish Industries - DI</td>
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<td>Georg Geberth</td>
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<td>Rob Gill</td>
<td>Head of European Tax, AIG</td>
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<td>Uwe Ihli</td>
<td>Principal Administrator, European Commission</td>
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<td>Staffan Jerneck</td>
<td>Director &amp; Director of Corporate Relations, CEPS</td>
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<td>Professor Fiscal Economics, Erasmus University Rotterdam &amp; Deloitte Belastingadviseur</td>
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<td>Chief Executive Officer, CEPS</td>
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<td>Jurgen de Moor</td>
<td>Regional Tax Manager, BP</td>
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<td>Will Morris</td>
<td>Senior International Tax Counsel &amp; Director, GE</td>
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Invited Guests & Speakers

Margareta Leijonhufvud
Former Chief of Tax Officer
Nordea

Olivier Hermand
Partner
PricewaterhouseCoopers

Tom Neale
Administrator
European Commission
Founded in Brussels in 1983, the Centre for European Policy Studies (CEPS) is among the most experienced and authoritative think tanks operating in the European Union today. CEPS serves as a leading forum for debate on EU affairs, but its most distinguishing feature lies in its strong in-house research capacity, complemented by an extensive network of partner institutes throughout the world.

**Goals**

- To carry out state-of-the-art policy research leading to solutions to the challenges facing Europe today.
- To achieve high standards of academic excellence and maintain unqualified independence.
- To provide a forum for discussion among all stakeholders in the European policy process.
- To build collaborative networks of researchers, policy-makers and business representatives across the whole of Europe.
- To disseminate our findings and views through a regular flow of publications and public events.

**Assets**

- Complete independence to set its own research priorities and freedom from any outside influence.
- Formation of nine different research networks, comprising research institutes from throughout Europe and beyond, to complement and consolidate CEPS research expertise and to greatly extend its outreach.
- An extensive membership base of some 120 Corporate Members and 130 Institutional Members, which provide expertise and practical experience and act as a sounding board for the utility and feasibility of CEPS policy proposals.

**Programme Structure**

CEPS carries out its research via its own in-house research programmes and through collaborative research networks involving the active participation of other highly reputable institutes and specialists.

**Research Programmes**

- Economic & Social Welfare Policies
- Energy, Climate Change & Sustainable Development
- EU Neighbourhood, Foreign & Security Policy
- Financial Markets & Taxation
- Justice & Home Affairs
- Politics & European Institutions
- Regulatory Affairs
- Trade, Development & Agricultural Policy

**Research Networks/Joint Initiatives**

- Changing Landscape of Security & Liberty (CHALLENGE)
- European Capital Markets Institute (ECMI)
- European Climate Platform (ECP)
- European Credit Research Institute (ECRI)
- European Network of Agricultural & Rural Policy Research Institutes (ENARPRI)
- European Network for Better Regulation (ENBR)
- European Network of Economic Policy Research Institutes (ENEPRI)
- European Policy Institutes Network (EPIN)
- European Security Forum (ESF)

CEPS also organises a variety of activities and special events, involving its members and other stakeholders in the European policy debate, national and EU-level policy-makers, academics, corporate executives, NGOs and the media. CEPS’ funding is obtained from a variety of sources, including membership fees, project research, foundation grants, conferences fees, publication sales and an annual grant from the European Commission.

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