



New EU tax proposals could seriously damage your wealth

EU Commission proposes to introduce the "Common Consolidated Corporation Tax Base" or CCCTB for short

By David FitzGerald AITI



There is an emerging debate in the EU regarding the methods of taxing Company Profits, and the outcome of this debate could have profound effects on Irish companies, on companies located in Ireland, and on the economy in general.

There is little doubt that a significant factor in the development of the Celtic Tiger was the decision taken by Ruairi Quinn as Finance Minister in the mid 90s to reduce the Corporation Tax rate from 40% to 12.5%. This had the benefit – with other measures – to kick-start a period of economic development never before seen in Ireland. It prompted the spawning of a swathe of new indigenous Irish companies. It also, critically, enabled the IDA to sell Ireland as a good location for foreign investment. The fact that Ireland has such a disproportionately high share of US investment is linked to this development. It is probably this very success that has led other, more powerful forces in the EU to initiate a debate about Corporation Tax regimes – ostensibly on very reasonable grounds, but in reality on the premise that if tax competition hurts – don't compete – stifle it.

The background to this debate is a proposal from the EU Commission to introduce the "Common Consolidated Corporation Tax Base" or CCCTB for short.

What is the CCCTB?

The essence of the proposed new system is that Corporate Taxes, instead of the current system of being taxed on the basis of where the profits are reported, would, in effect be taxed on the basis of where the sales were made which gave rise to those profits. An apportionment of the taxable profits would be made based on the sales profile, and taxed accordingly.

Thus a company that has entities in Ireland, Germany and France is currently taxed on the basis of the profits reported in each country. The

profit profile, and tax rates could be as follows:

	Ireland	Germany	France	Total
	€k	€k	€k	€k
Profits	5000	2000	1500	8500
Tax Rate	12.5%	25%	33.3%	
Tax	625	500	500	1625
Effective Tax Rate				19%

Under the CCCTB, however, the profits would be apportioned according to sales (net of inter-group sales). The profile could then be as follows

	Ireland	Germany	France	Total
	€k	€k	€k	€k
Turnover	4000	16000	6000	26000
Allocation of Profit	1308	5230	1962	8500
Tax Rates	12.5%	25%	33.3%	
Tax	164	1308	647	2119
Effective Tax Rate				25%

Thus the overall tax on the group's profits rises from 19% under the current system to 25% under the proposed new system. This is because of the shift of tax from the lower (Irish) regime to the higher regimes. The change would significantly affect Ireland because, as the system is sales based, the level of sales would tend to be lower in a small market.

Why the Proposal?

The CCCTB has been described by the EU Commissioner for Tax & Customs Union, Laszlo Kovacs, as "...our comprehensive solution to the tax obstacles in the Internal Market and is probably our biggest project in the field of company taxation at the moment." It is described as a major priority for the Commission. The Commission, through the CCCTB, is looking to have a broad base, simple to operate, without allowing companies to escape the fair taxation of their profits. The intent is to have a consolidated system – with a sharing mechanism. The intent is also that the system should be

optional. Commissioner Kovacs has stated that Member States should make the new tax base available to those companies who wish to choose it. However there will not be a choice every year for every company – the choice will be for a whole group to decide, for a number of years.

The Commissioner is also at pains to point out that by its very nature a common tax base cannot exactly match the current tax bases of the 27 Member States, and in proposing a common tax base the Commission will inevitably have to make some choices.

Finally the Commissioner emphasises that this does not concern tax rates – it only concerns the tax base. This line of argument could be described by those opposed to it as being Jesuitical, given that the effective end result is to alter the effective tax rates from the status quo.

The Case against CCCTB

The leading opponent of the CCCTB proposal is the EU Commissioner for Internal Market & Services, Charlie McCreevy .

Mr McCreevy is clear on his attitude to tax in general. He believes that taxes, of all kinds, should be kept as low as possible. He made the point recently that if you had invested €1,000 in each of Europe's four lowest tax countries (Ireland, Latvia, Lithuania and Malta) at the start of the Millennium until August 2004 your €4,000 would be worth €6,800. The same amount invested in two of Europe's highest tax countries would have resulted in the €4,000 being worth somewhere between €1,200 and €1,600. "Higher taxes feed fatter government" is his mantra.

He is characteristically forthright on the CCCTB. In his view consolidating the tax base is a condition precedent to consolidating the rate. The real agenda of those seeking tax base consolidation is, in the long term to harmonize – upwards - tax rates. The effect of this would be to drive investment beyond Europe's borders with all the knock on negative effects on



job creation and consequential economic spiral downwards. At the very least it would reduce Ireland's relative attractiveness for Foreign Investment. And we in Ireland are very familiar with the consequences of ever-increasing taxes.

Avoiding such a situation, requires Europe's high taxing governments to address the cause of their high spending in their own countries – rather than seeking to increase their tax take at the expense of vibrant economies. However, for some of "old Europe", wedded to a very costly social model, internal change is very difficult and the attractiveness of a "painless" part solution of passing the pain to others should not be underestimated. The attractiveness of a scheme which enables, for example, French politicians, to offload the problem of reforming their public sector by sucking tax in from Ireland should not be underestimated. In essence Irish companies would be forced to pay for such bloated public sectors, as would the Irish private sector employees – with their jobs.

The Irish Department of Finance has taken up a position not dissimilar to Mr McCreevy, but in less colourful language. The Department does not favour the introduction of the CCCTB, and as reported elsewhere reminds us that "...it is important to remember that the CCCTB cannot be imposed on Member States. Unanimity is required for all decisions taken on taxation issues". It is therefore

highly unlikely, therefore, that unanimity will be forthcoming.

Who's right?

It is impossible to say, but if Charlie McCreevy is right, the implications for the Irish economy could be significant. If taken at his word, Commissioner Kovacs has no interest in extending the consolidated tax base to a consolidated tax rate. However, one cannot but recall that when Income Tax was originally introduced - in 1799 - an assurance was given that it would be a temporary little arrangement. Experience has taught to treat such assurances with a degree of scepticism. The reality for Ireland is that if the CCCTB is in fact a stepping-stone to harmonised rates, by the time we find out it will be too late.

What's next?

The Commission intends that a legislative proposal will be introduced in 2008. This debate will run and run and will probably crystallise like no other the philosophical differences between "old" and "new" (including Ireland & the UK) Europe.

What's the likely outcome?

This depends on one's perspective. Ireland (still) has complete autonomy in tax affairs (except for VAT). However, one should not underestimate the ability of the EU Commission to grind down opposition over time to their proposals. The real risk

will be if a set of circumstances arises where the Irish Government is faced with some unpalatable decision – and the price of avoiding that decision may be to agree with CCCTB.

Those with an interest in the well-being of the Irish economy, or own, run or work in Irish businesses would need to be very vigilant that no Government should be tempted to compromise on this issue. Tax Competition – as its detractors describe it – has served Ireland well and the Irish people have benefited from its effects on both indigenous industry and foreign direct investment. Any attempt to stifle this competition by any public institution should be stoutly resisted.

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