Tax Competition within the European Union – Is the CCCTB Directive a Solution?

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Abstract

The author addresses the phenomenon of taxable profit-shifting operations undertaken by multinationals in response to countries competing for corporate tax bases within the European Union. The central question is whether this might be a relic of the past when the European Commission's proposal for a Council Directive on a Common Consolidated Corporate Tax Base sees the light of day. Or would the EU-wide corporate tax system provide incentives for multinationals to pursue artificial tax base-shifting practices within the EU, potentially invigorating the risk of undue governmental tax competition responses? The author's tentative answer on the potential for artificial base shifting and undue tax competition is in the affirmative. Today, the issue of harmful tax competition within the EU seems to have been pushed back as a result of the soft law approaches that were initiated in the late 1990s and early 2000s. But things might change if the CCCTB proposal as currently drafted enters into force. There may be a risk that substantial parts of the EU tax base would instantly become mobile as of that day. As the EU Member States at that time seem to have only a single tool available to respond to this – the tax rate – that may perhaps initiate an undesirable race for the EU tax base, at least theoretically.

Keywords: tax competition, tax planning, European Union, Common Consolidated Corporate Tax Base, factor manipulation

JEL codes: H25, K34

1 Introduction

On Tuesday, 11 June 2013 the Foundation European Fiscal Studies and *Erasmus Law Review* organised a conference entitled *Company Tax Integration in the EU; A Necessary Step to Neutralize 'Excessive' Behaviour within the EU?* – a subject that is very interesting and quite topical. The issues of 'aggressive tax planning' and 'harmful tax competition' have moved strikingly up political agendas recently.[1] Many believe that multinationals also should contribute their 'fair share' to society, particularly in the current times of austerity where expenditure cuts and tax raises pressurise the welfare state.[2] I was assigned the honourable task of participating in the conference and elaborating on the following subject: *Tax Competition within the European Union – Is the CCCTB-Directive a Solution?* Conference reports have been published in *EC Tax Review* and the Dutch tax weekly, *Weekblad Fiscaal Recht*.[3]

This article is the result of my endeavours. Playing the hand that I have been dealt, I address the apparent current issue of taxable profit-shifting operations undertaken by multinationals in response to countries competing for corporate tax bases within the European Union (EU). The central question is whether this might be a relic of the past when the proposal released by the European Commission on 16 March 2011 for a Council Directive on a Common Consolidated Corporate Tax Base (CCCTB) sees the light of day,[4] or would the EU-wide corporate tax system provide incentives for multinationals to pursue artificial tax base-shifting practices within the EU, potentially invigorating the risk of undue governmental tax competition responses? Obviously, time will tell, but for now my tentative answer to the question whether the potential for artificial base shifting and undue tax competition exists is in the affirmative. Today, the issue of harmful tax competition within the EU seems to have been pushed back as a result of the soft law approaches that were initiated in the late 1990s and early 2000s. But things might change if the CCCTB proposal as currently drafted enters into force. There may be a risk that substantial parts of the

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1. For some comments *see* Oliver R. Hoor and G. Bock, 'The Misleading Debate about Corporate Tax Avoidance by Multinationals', 70 *Tax Notes International* 907 (27 May 2013).
2. For an in-depth analysis *see* Reuven S. Avi-Yonah, 'Globalization, Tax Competition, and the Fiscal Crisis of the Welfare State', 113 *Harvard Law Review*, at 1573 (1999-2000).
3. *See* Martijn Schippers, 'Company Tax Integration in the European Union – a Necessary Step to Neutralise "Excessive" Behaviour within the EU' – Report on the Conference Held on Tuesday 11 June 2013 in Rotterdam', 22 *EC Tax Review* 258, at 258-263 (2013, No. 5); and M.L. Schippers, *Company Tax Integration in the European Union, Verslag van de conferentie 'Company Tax Integration in the European Union – a Necessary Step to Neutralize 'Excessive' Behavior within the EU', gehouden op dinsdag 11 juni 2013, te Rotterdam*, WFR 2013/1165.
4. Proposal for a Council Directive on a Common Consolidated Corporate Tax Base (CCCTB), COM(2011) 121/4, 2011/0058 (CNS) ('CCCTB proposal'). Legislative references concern the CCCTB proposal unless expressed otherwise.

EU tax base would instantly become mobile as of that day. As the EU Member States at that time will have only a single tool available to respond to that – the tax rate – this may perhaps initiate an undesirable race for the EU tax base, at least theoretically.

Before proceeding on the subject matter, the following remarks should be submitted. First, it is noted that the research question leapfrogs some pivotal issues. The CCCTB currently exists only on the drawing board. It is uncertain whether it shall ever enter into force. Its adoption requires the unanimous consent of the EU Member States – or the early adopters under the enhanced cooperation procedures. The CCCTB proposal, however, faces political resistance in various EU Member States.[5] Further, it is uncertain what the directive will eventually look like were it to be adopted. The draft is currently being debated at the different EU institutional levels. The European Parliament has voted for amending the proposal on various points.[6] The Commission cannot accept some of those.[7] The proposal has also been discussed within the Council.[8] Regardless, for the purpose of the analysis in this article, it is assumed that the CCCTB has come to light. Furthermore, unless specifically addressed otherwise, any references to the CCCTB regard the original proposal of 16 March 2011. Finally, I scrutinise the proposal on its own merits. It is accordingly assumed that the CCCTB is the only corporate tax system in place within the EU. By doing that, I basically follow the path set out by the European Parliament and the European Economic and Social Committee that the CCCTB would apply mandatorily.[9]

Second, the language used implies that the article should address the issue of tax competition within the framework of the EU. Regarding outbound investments of EU investors in non-EU countries and inbound investments of non-EU investors in the EU, the CCCTB would basically operate as a traditional corporate tax. The proposal's key properties, the tax consolidation and the intra-EU division of the tax base through a sharing mechanism do not operate across the water's edge, that is, the outer geographical borders of the EU's territories. As a consequence, the tax competition and tax planning issues that currently arise in international taxation will likely uphold under the CCCTB regarding third-country investment.[10] For the purpose of the present inquiry, however, this issue falls outside its scope and is therefore not explicitly considered.

Third, I must frankly concede that I am a tax lawyer. I am neither a trained economist nor a behavioural scientist. Neither am I a statistical analyst. This article, therefore, does not provide an in-depth empirical impact assessment forecasting economic or behavioural effects that the CCCTB's application may initiate upon its entry into force. For that purpose, I respectfully refer to the literature on this matter.[11] My aim is to forward some tentative comments on the potential arbitrage that in my view may be initiated under the CCCTB Directive. To substantiate my argument, I seek to carefully and logically build the analysis. Where appropriate or convenient, reference is made to available materials and analyses, for instance by analogue on the United States (US) and Canadian formulary systems from which the CCCTB sharing mechanism has substantially been lifted.

2 Tax Competition within the EU

2.1 Tax Competition: A Matter of AETRs and MNE Investment Location Decisions

The research question implicitly considers the phenomenon 'tax competition' to constitute a problem. It implies that tax competition is problematical as it resorts to the CCCTB as a potential solution, at least within the context of the EU. This begs an answer to the question as to what tax competition is in the first place and, second, the extent to which this should be considered to pose an issue.

Tax competition and its flipside phenomenon 'tax planning' revolve around average effective tax rates

5. Various EU Member State parliaments have issued 'yellow cards'.
6. *See* European Parliament legislative resolution of 19 April 2012 on the proposal for a Council directive on a Common Consolidated Corporate Tax Base (CCCTB) (COM(2011)0121 – C7-0092/2011 – 2011/0058(CNS)) ('EP legislative resolution').
7. *See* Commission Communication on the action taken on opinions and resolutions adopted by Parliament at the April 2012 part-session (SP(2012)388), 30 May 2012 ('Communication SP(2012)388').
8. *See* Comments of the Presidency of the Council on the CCCTB proposal (doc. 8387/12 FISC 49) published by the Council of the European Union, 16 April 2012, no. 2011/0058(CNS).
9. This after an introductory period; EP legislative resolution, above n. 6, Amendments 14, 21, 22; changes proposed to recital 8, Arts. 6a (new) and 6b (new), and Opinion of the European Economic and Social Committee on the proposal for a Council directive on a Common Consolidated Corporate Tax Base (CCCTB), COM(2011) 121 final – 2011/0058 (CNS), ECO/302, 26 October 2011 ('Opinion EESC'), at 1.4. Notably, under the Commission Proposal the CCCTB would apply electively. It would accordingly constitute the 29th corporate tax system within the EU. Potential tax competition and tax planning effects that may result from this are not assessed in this article.
10. *See* for a comparison Walter Hellerstein, 'Tax Planning under the CCCTB's Formulary Apportionment Provisions: The Good, the Bad and the Ugly', in: Dennis Weber (ed.), *CCCTB Selected Issues* (2012) 221-252, at 223 and 234 (n. 72) calling this the system's 'Achilles heel'.
11. *See e.g.* Commission Staff Working Document, *Impact Assessment, Accompanying Document to the Proposal for a Council Directive on a Common Consolidated Corporate Tax Base (CCCTB)*, SEC(2011) 315 final, 16 March 2011; and Leon Bettendorf, Albert van der Horst, Ruud de Mooij, Michael Devereux and Simon Loretz, *The Economic Effects of EU-Reforms in Corporate Income Tax Systems*, Study for the European Commission, Directorate General for Taxation and Customs Union, Contract No. TAXUD/2007/DE/324, October 2009.

(AETRs)[12] imposed by countries on investment returns and the investment location decisions of multinational enterprises (MNEs). It appears that internationalisation, the emerging global marketplace, the increased mobility of resources and the upcoming of profit maximisation–driven MNEs have initiated a process of tax-motivated responses to investment location decisions, from the sides of both the MNEs and the countries involved.[13]

As tax may be considered to constitute a corporate cost, the hypothesis is that MNEs respond by allocating their resources geographically to countries adopting comparatively lower AETRs on investment proceeds: 'tax planning'. The intuition is that governments respond to this by reducing the AETRs that they impose on investment returns – to attract foreign investment and to preserve domestic investment, prerequisites for the stimulation of economic growth and job creation. This drives other countries to join the race, pushing them to reduce their AETRs also: 'tax competition'. The result would be an ongoing chain of behavioural responses of MNE investment location decisions and country tax rate reduction decisions. The latter, as already noted, is an attempt by these countries to attract investment to their territories to enable themselves to subject the investment returns to taxation for the purpose of yielding revenues to finance expenditure: the 'race to the bottom hypothesis'.

2.2 'Fair Tax Competition' and 'Harmful Tax Competition'

2.2.1 *Multinationals: Tax-Induced Shifting of Real and 'Paper' Investment; Tax Law: Only Latter Problematical*

The tax-induced shifts in MNE investment location decisions may involve shifts in both real economic activities and artificial economic activities. In international taxation the aim is to divide the corporate tax base into taxing jurisdictions with reference to the location of investment. In the presence of AETR differentials, such a geographic distribution of taxable profit creates incentives to locate both real and 'paper' investment in no-tax or low-tax jurisdictions.

The first type of investment location distortions involves shifting into these low-tax or no-tax jurisdictions of the firm inputs like labour and capital that have been attracted from the labour and capital markets. This entails a tax-induced shifting of real profit towards these jurisdictions, and a consequent shifting of taxable profit. Various studies suggest that AETR differentials do affect location decisions.[14] That particularly is, as rents prove, increasingly firm-specific rather than location-specific. It should be mentioned, though, that the tax responsiveness to real activity seems less apparent than the tax responsiveness to locating 'paper' investments.

The second type – the tax responsiveness to locating 'paper' investment – typically involves a legal shifting of intangible resources available within the MNE to low or no-taxing jurisdictions. This occurs through 'tax sheltering', that is, the intra-group legal shifting towards these jurisdictions of the firm's financial resources or intellectual property. Commonly utilised tools in this

12. AETRs are calculated by dividing the tax payable (numerator) by the pre-tax income (denominator), Willem Vermeend, Rick van der Ploeg and Jan Willem Timmer, *Taxes and the Economy; a Survey on the Impact of Taxes on Growth, Employment, Investment, Consumption and the Environment* (2008), at 73. Notably, financing decisions respond to marginal effective tax rates. Typical corporate tax systems subject realised nominal returns to equity to tax accordingly favouring debt financing over equity financing. *Cf.* Howell H. Zee, 'Reforming the Corporate Income Tax: The Case for a Hybrid Cash-Flow Tax,' 155 *De Economist* 4, at 417-448 (2007); and Serena Fatica, Thomas Hemmelgarn, and Gaetan Nicodeme, Taxation Papers; 'The Debt-Equity Tax Bias: Consequences and Solutions', *Working paper* no. 33, July 2012, European Commission Directorate-General Taxation & Customs Union. The CCCTB operates a traditional base definition, tax-subsidising debt financing over equity financing also. This issue is not discussed further since it falls outside the scope of the assessment.
13. *See* Ruud de Mooij and Sjef Ederveen, *Taxation and Foreign Direct Investment: A Synthesis of Empirical Research*, International Tax and Public Finance 10, no. 6, November 2003, at 277-301, Michael P. Devereux, 'Taxation of Outbound Direct Investment: Economic Principles and Tax Policy Considerations', 24 *Oxford Review of Economic Policy* 4, 698-719, at 710-711 (2008); Michael P. Devereux, 'Taxes in the EU New Member States and the Location of Capital and Profit', Oxford University Centre for Business Taxation, *Working Paper*, No. 0703, Michael P. Devereux, 'Business Taxation in a Globalized World', 24 *Oxford Review of Economic Policy* 4, at 625-638 (2008); Michael P. Devereux, Ben Lockwood and Michela Redoano, 'Do Countries Compete Over Corporate Tax Rates?', 92 *Journal of Public Economics*, at 1210-1235 (2008); and J. Voget, *Headquarter Relocations and International Taxation*, Oxford University, Centre for Business Taxation, Oxford, 2008.
14. *Ibidem*, as well as Harry Huizinga and Luc Laeven, 'International Profit Shifting within Multinationals: A Multi-Country Perspective', Economic paper No. 264, European Commission, Directorate-General for Economic and Financial Affairs, December 2006; Michael P. Devereux and R. Glenn Hubbard, 'Taxing Multinationals', NBER Working Paper Series, *Working Paper* 7920, National Bureau of Economic Research, September 2000; Alan J. Auerbach, Michael P. Devereux and Helen Simpson, 'Taxing Corporate Income', paper prepared for the *Mirrlees Review*, *Reforming the Tax System for the 21*st *Century* (2008), at 17-18; Ruud A. de Mooij and Michael P. Devereux, 'An Applied Analysis of ACE and CBIT Reforms in the EU', 18 *International Tax and Public Finance* 1, at section 3.3 (2011); Ruud de Mooij, 'Will Corporate Income Taxation Survive?', 153 *De Economist*, at 277-301 (2005); Reuven S. Avi-Yonah, 'Between Formulary Apportionment and the OECD Guidelines. A Proposal for Reconciliation', *World Tax Journal* 3, at 6 (February 2010); Reuven S. Avi-Yonah and Ilan Benshalom, 'Formulary Apportionment – Myths and Prospects; Promoting Better International Tax Policies by Utilizing the Misunderstood and Under-Theorized Formulary Alternative', *World Tax Journal* 371, at 393 (October 2011); Reuven S. Avi-Yonah and Kimberly A. Clausing, 'Reforming Corporate Taxation in a Global Economy: A Proposal to Adopt Formulary Apportionment', The Hamilton Project, *Discussion Paper* 2007-08, The Brookings Institution, June 2007, at 9-10, Ana Agúndez-Garcia, 'Taxation Papers; The Delineation and Apportionment of an EU Consolidated Tax Base For Multi-Jurisdictional Corporate Income Taxation: A Review of Issues and Options', *Working paper* no. 9, October 2006, European Commission Directorate-General Taxation & Customs Union, at 7, as well as OECD, Addressing Base Erosion and Profit Shifting, OECD Publishing, 12 February 2013 ('OECD BEPS Report'), and OECD, *Action Plan on Base Erosion and Profit Shifting*, OECD Publishing, 19 July 2013 ('OECD BEPS Action Plan').

respect are the setting up and tax-establishing of controlled legal entities within such jurisdictions and the subsequent arranging of intra-group legal transactions to create tax-recognised income streams directed towards those jurisdictions. This is established quite easily because of the mobile characteristics of these intangible resources and the absence of third-party market realities in the controlled intra-firm environments within which these transactions generally take place. Textbook profit-shifting arrangements involve intra-group debt financing and licensing arrangements. These generate tax-deductible interest and royalty payments in the countries where real investment takes place. Such tax planning tools have been readily made available under the tax systems of countries for MNEs to be utilised to arbitrarily shift real profit to low or no-taxing jurisdictions.

To protect their domestic tax bases, countries typically respond by introducing anti-abuse measures – 'sticks regimes' – in their corporate tax systems. Examples of these are 'deduction limitations' and 'controlled foreign company' rules.[15] Alternatively and additionally, countries respond by imposing withholding taxes on outbound intra-group payments of dividends, interest and royalties. However, the room available for these measures is often limited as their application drives AETRs upwards, potentially rendering these countries relatively less attractive as a location for real investment. Further, the leeway for imposing source taxes on such outward-bound intra-group payments often encounters legal constraints. This holds internationally under the double tax convention networks of countries, which commonly limit taxing entitlements at source regarding such payments,[16] that is, save for the application of various anti-abuse mechanisms such as 'beneficial ownership requirements', 'limitation on benefits clauses' and 'main purpose tests'. The same holds within the EU as the 'Parents-Subsidiary Directive' and the 'Interest and Royalty Directive' operate to a similar extent.[17]

Although both the real and artificial shifting of profits may be considered undesirable from an economic standpoint, tax law, both international and European, typically considers only the latter problematical. It is the tax-induced shifting of corporate profit through intra-group legal structuring lacking economic substance that raises the chief concerns. These are the types of 'excessive' behaviours that need to be neutralised. Where MNEs engage in artificial profit-shifting arrangements to maximise their post-tax investment returns, such behavioural responses are generally labelled as 'aggressive tax planning'.[18]

2.2.2 *Countries: Tax-Induced Competing for Real and 'Paper' Investment; Tax Law: Only Latter Problematical*

In tax law, similar views are generally expressed in regard to tax-induced responses of governments to MNE artificial profit-shifting operations.[19] By differentiating between 'harmful tax competition' and 'fair tax competition', issues are considered to be raised predominantly where countries engage in the first by adopting measures – 'carrots regimes' – that unduly affect MNE location decisions:[20] the adoption of measures by countries that provide tax incentives to MNEs to artificially shift corporate profits towards their territories. The reason, obviously, is that this goes at the expense of the tax bases and tax revenues of the origin countries where real investments take place. Such practices are commonly considered to produce unjustified market distortions and revenue losses.

Harmful tax measures basically revolve around the granting of beneficial tax treatment, 'tax shelters', to cross-border economic operations that require no substantial business presence or 'economic substance' within such countries. Typically, it involves the low or no-taxation of proceeds from intra-group distributions of financial resources or intellectual property. These are internationally mobile and legally transferred easily. And as noted earlier, the intra-group remunerations in this regard are generally deductible for tax calculation purposes in the countries where real investment takes place. Such harmful regimes are typically referred to as 'offshore regimes', 'group financing regimes', 'headquarter regimes' or 'IP holding regimes'. Sometimes these are paired with taxpayer confidentiality mechanisms on the basis of which the low-taxing jurisdictions involved do not disclose tax-relevant administrative and financial information to other jurisdictions. Further, the availability of such beneficial regimes is often restricted to foreign investors. They are 'ring-fenced'. Local

15. Regarding third-country investment relationships, the CCCTB proposal, above n. 4, is no exception as it contains interest deduction limitations and CFC rules also (Arts. 80-81 and 82).
16. *See* Arts. 10, 11, 12 OECD Model Tax Convention on Income and on Capital.
17. *See* Council Directive 2011/96/EU of 30 November 2011, and Council Directive 2003/49/EC of 3 June 2003 (amended by Council Directive 2004/76/EC of 29 April 2004 and Council Directive 2006/96/EC of 20 November 2006).
18. It is worth noting that with regard to the Dutch corporate income tax system, the Dutch State Secretary for Finance has announced that the Dutch government will take measures in this area. See State Secretary for Finance letter to Parliament, 30 August 2013 (No. IFZ/2013/320).
19. *See* Stefan Mayer, *Formulary Apportionment for the Internal Market*, IBFD Doctoral Series, Volume 17, IBFD, Amsterdam, 2009, at 264-267, and Carla Pinto, *Tax Competition and EU Law*, EUCOTAX Series on European Taxation, Kluwer Law International, The Netherlands, 2003, at 10 et seq.
20. Within the EU the selective granting of beneficial tax treatment to attract real investment raises illegal state aid issues (Art. 107 TFEU). EU Member States are not allowed to selectively tax-favour certain industries or branches of economic activity as these impede a neutral and fair flow of economic activity within the internal market. Examples of regimes potentially constituting an illegal fiscal state are the selectively granting of 'tax holidays', 'accelerated allowances' and the establishment of 'tax-free zones'. On this matter, see e.g. Commission notice 98/C 384/03, OJ C 384 of 10 December 1998, at 3, and Report on the implementation of the Commission notice on the application of the state aid rules to measures relating to direct business taxation, C(2004) 434 of 9 February 2004.

investors are typically ineligible to opt for their application.

Fair competition, particularly the competition for real investment through 'tax rate competition', is generally considered beneficial from a tax law perspective. For instance, the Commission submits in the Explanatory Memorandum accompanying its CCCTB proposal: '[f]air competition on tax rates is to be encouraged. Differences in rates allows a certain degree of tax competition to be maintained in the internal market and fair tax competition based on rates offers more transparency and allows Member States to consider both their market competitiveness and budgetary needs in fixing their tax rates'.[21] Also, the Council acknowledged that fair tax competition produces positive effects when it adopted its 'Code of Conduct for business taxation', which, among others, deals with EU-wide coordinated actions to tackle harmful tax competition – see further details hereunder.[22]

Regardless of the merits of analytically differentiating between 'fair' and 'unfair' tax competition, I go with the territory and adhere to the views of the Commission and the Council. I accordingly consider that concerns are raised where it involves the tax-induced artificial profit shifting of MNEs and the incentives created for doing that by taxing jurisdictions. That is, also considering the conference topic addressing 'excessive' behaviours, which for the present inquiry neatly translates into 'aggressive tax planning' regarding MNE behaviours and 'harmful tax competition' as to country responses.

2.3 Work Done in EU Addressing 'Harmful Tax Competition'

Both internationally, for instance within the context of the Organisation for Economic Co-operation and Development (OECD),[23] and within the EU much work has already been done in pushing back harmful tax practices. In the late 1990s, the Council of Economics and Finance Ministers adopted the Code of Conduct for business taxation. With that it initiated a 'soft law' process 'peer-pressuring' the EU Member States to roll back existing harmful tax measures, and to dissuade them from introducing any such measures in the future. This process is being monitored by the Code of Conduct Group.

Although the Code is not legally binding, it does have political force since all EU Member States committed to adhere to the approach taken. The Code may be considered to have served its purpose quite well. Since the adoption of the Code, the Code of Conduct Group has assessed over 400 tax regimes within the EU and the EU Member States' overseas countries and territories. Around 100 have been eliminated upon their identification as constituting a harmful tax measure.[24] In addition, various administrative assistance tools are currently in place within the EU, enabling EU Member States to inform and assist each other on their taxpayers' tax affairs.[25] The presence of harmful corporate tax measures within the EU seems to have been significantly pushed back as a result of these efforts. To substantiate things somewhat further, it is noted that this argument may also be induced by pointing at the shift in recent work undertaken in this area. The work on harmful tax practices within the EU's institutions has recently been concentrating on establishing approaches to counter such practices of third countries.[26]

Further, efforts undertaken more recently at political levels – again both within the EU[27] and internationally (OECD/G20)[28] – increasingly focus on pushing back tax planning strategies undertaken by MNEs through the sophisticated utilisation to their benefit of mutual differentials in the tax systems of countries. MNEs are being accused of employing the disparities or 'mis-

21. *See* Explanatory Memorandum to the CCCTB proposal, above n. 4, at section 1.
22. *See e.g.* Conclusions of the ECOFIN Council Meeting on 1 December 1997 concerning taxation policy (OJ 98/C 2/01). The Code defines harmful tax measures as 'measures (including administrative practices) which affect or may affect in a significant way the location of business activity in the Community, and which provide for a significantly lower level of taxation than those that generally apply in the Member State concerned'.
23. Reference is made to the work of the OECD's 'Forum on Harmful Tax Practices'. The Forum was created as a follow-up to a 1998 report entitled *Harmful Tax Competition: An Emerging Global Issue*. It focuses on transparency and information exchange. For some recent work, see OECD Secretary-General report to the G20 Finance Ministers, 19 April 2013, at *Part II: Current Tax Work of Relevance to Tackle Offshore Tax Evasion and Tax Avoidance.*
24. The numbers have been taken from Communication from the Commission to the Council, the European Parliament and the European Economic and Social Committee, *Promoting Good Governance in Tax Matters*, COM(2009) 201 final, 28 April 2009. Also, *'Questions and Answers'* (MEMO/12/949) that accompanied the Commission's *'December Package'* , i.e., its communication to the European Parliament and the Council entitled 'An Action Plan to Strengthen the Fight against Tax Fraud and Tax Evasion', (COM(2012) 722 final) ('EC Action Plan'), its recommendation on aggressive tax planning (c(2012) 8806 final) ('ATP Recommendation'), and its recommendation regarding measures intended to encourage third countries to apply minimum standards of good governance in tax matters (c(2012) 8805 final), which the Commission released on 6 December 2012 ('3rd Countries Recommendation'). Further, Commission's press release entitled 'Clamping Down on Tax Evasion and Avoidance: Commission Presents the Way Forward' (IP/12/1325). The package followed up on the communication from the Commission to the European Parliament and the Council on concrete ways to reinforce the fight against tax fraud and tax evasion including in relation to third countries (COM(2012) 351 final) of 27 June 2012. In addition, it is worth noting that the European Commission views the patent box regime in place in the United Kingdom's international tax system as harmful tax competition. See European Commission, Code of Conduct Group (Business Taxation), 'UK – Patent Box', Room Document # 2 of 22 October 2013. It considers that 'the advantages under the regime are granted even without any real activity and substantial economic presence in the Member State involved'. It further considers that 'the rules for profit determination do not adhere to internationally accepted principles'.
25. *See e.g.* Council Directive 2011/16/EU of 15 February 2011 and Council Directive 2010/24/EU of 16 March 2010.
26. *See e.g.* 3rd Countries Recommendation, above n. 20.
27. *See e.g.* ATP Recommendation, above n. 20. *See also* European Commission, Staff working paper, 'The Internal Market: Factual Examples of Double Non-Taxation Cases', Consultation Document, Brussels, TAXUD D1 D(2012) ('Consultation Document').
28. *See* OECD BEPS Report, above n. 14; OECD BEPS Action Plan, above n. 14; OECD, *Hybrid Mismatch Arrangements; Tax Policy and Compliance Issues*, OECD, Paris, 2012.

matches' in the corporate tax systems of countries to reduce their overall effective tax burdens without substantially altering their investments. It has been argued that this, for instance, occurs by making use of so-called 'Hybrid Instruments', 'Hybrid Entities', 'Hybrid Transfers', 'Dual Residence Entities', '(Double) Deduction/No Inclusion Transactions' and 'Foreign Tax Credit Transactions'.[29] The common denominator of these arrangements is the use of differentials in countries' taxable unit definitions, tax base definitions and tax base allocation mechanisms.

However, as these recently and quite heavily discussed tax practices of MNEs revolve around utilising the mismatches between two or more taxing systems, it may be considered debatable whether the disparities in the tax systems of countries, the EU Member States' included, should be labelled as constituting harmful tax measures. Perhaps I am a traditionalist, but in my view, harmful tax measures involve the utilisation by MNEs of targeted favourable tax benefits made available through the tax system of a single tax jurisdiction. This is not the case with mismatch arrangements as these involve the use of differentials between at least two tax systems, although the Code of Conduct Group has been discussing mismatch issues lately.[30]

3 CCCTB – The Solution?

3.1 Would the CCCTB Provide Incentives for Artificial Profit Shifting, Potentially Reinvigorating Undue Tax Competition within the EU?

The peer pressures in the 1990s and early 2000s seem to have produced considerable success in pushing back harmful tax measures in the EU Member States' corporate tax systems. Within the EU the issue of harmful tax competition may be considered to have been mitigated.

Perhaps, therefore, the research question addressed in the introduction requires some modification; namely, today, the issue of harmful tax competition seems to have been successfully resolved, at least within the EU. Hence, let me rephrase the assigned query and consider whether the CCCTB, if enacted, would provide incentives for MNEs to artificially shift corporate profits across the EU. If the answer to this question is in the affirmative, this may trigger the potential for an undue, or perhaps at least unforeseen, race between the EU Member States for attracting and preserving MNE corporate tax bases within their territories.

As part of the analysis, as said, I assess the CCCTB on its individual merits. Although understanding political realities perhaps pointing in alternative directions, I assume that the CCCTB is operational EU-wide and applies mandatorily – to analytically cancel out the potential effects of a CCCTB competing with the corporate tax systems of the 28 EU Member States.[31] I will accordingly follow the European Parliament's tracks in this respect.[32] Further, as the CCCTB is currently under debate and its final version is consequently indistinct, I refer to the initial proposal of the European Commission. Where relevant or convenient, reference is made to the amendments submitted by the various parties involved in the legislative process.

3.2 CCCTB: 'A Comprehensive Solution'

The Commission envisages the CCCTB as constituting *a comprehensive solution* for the inequities and inefficiencies that are currently present under the application of 28 different corporate tax systems in the EU.[33] The tax systems of the EU Member States currently hinder, both in their unilateral and mutual operation, the envisaged fair and free cross-border intra-EU trade and investment operations of European economic operators within the internal market.

The Commission considers that, from a direct taxation perspective, the full potential of the internal market may be realised only under an EU-wide corporate tax system for EU businesses, the CCCTB. Its key properties are, first, a common taxable unit definition. That is, substantially as all companies that have a tax nexus within the EU which belong to the same group, the 'group members', are required to consolidate their profits and to eliminate their intra-group transactions.[34] Across the water's edge, as already noted, the CCCTB operates as a traditional corporate tax adopting the concepts of 'separate accounting' and the 'arm's length standard' (SA/ALS). Second, the CCCTB provides for a common tax base definition. It has been chosen to adopt a traditional realisation-based nominal return to equity standard, that is, a corporate tax base definition as commonly adopted

29. *Ibidem*, and *see* Consultation Document, above n. 27.
30. *See* EC Action Plan, above n. 24.
31. Kindly note that Croatia has joined the EU per 1 July 2013.
32. European Parliament proposed to amend the initial CCCTB proposal for various reasons, among them to arrive at a mandatory application of the CCCTB for all (but small and medium-sized enterprises) after a brief transition period; EP legislative resolution, above n. 6, Amendments 14, 21, 22; changes proposed to recital 8, Arts. 6a (new) and 6b (new). The Commission cannot accept this; Communication SP(2012)388, above n. 7.
33. Communication from the Commission to the Council, the European Parliament and the Economic and Social Committee, 'Towards an Internal Market without Tax Obstacles; A Strategy for Providing Companies with a Consolidated Corporate Tax Base for Their EU-Wide Activities', COM(2001) 582 final, 23 October 2001. Here the Commission established its policy for developing the CCCTB. It confirmed it in its Communication from the Commission to the Council, the European Parliament and the European Economic and Social Committee, 'An Internal Market without Company Tax Obstacles Achievements, Ongoing Initiatives and Remaining Challenges', COM(2003)726 final, 24 November 2003.
34. Administratively, the CCCTB proposal, above n. 4, adopts the 'one-stop-shop' approach for tax return filing purposes. The return may be filed with the tax authorities of a single EU Member State. This would be the country in which the parent company of the group, the 'principal taxpayer', resides for tax purposes.

in the current tax systems of the EU Member States.[35] Third, the tax base is subsequently shared among the EU Member States on the basis of a predetermined formula. The formula factors seek to apportion the tax base by reference to firm inputs (assets, labour) at origin and firm outputs (revenues) at destination. The sharing mechanism has essentially been lifted from the formulary mechanisms to divide taxable corporate profits to subnational levels of government that are currently in place in the US and Canada. Conforming to the language used in these countries, the approach taken may be referred to as 'formulary apportionment' (US) or 'formulary allocation' (Canada), commonly abbreviated as FA.

Through the adoption of a single set of rules on corporate taxation throughout the EU, tax competition within the EU's territories under the CCCTB is pictured to revolve solely around transparent tax rate competition. That is, since the only tool available for EU Member States to influence intra-EU MNE location decisions would be the tax rate that the EU Member States may autonomously apply to the harmonised consolidated tax base that has been assigned to their territories under the common sharing mechanism.

Notably, the European Parliament has voted in favour of introducing the possibility for EU Member States to make use of tax credits to reduce the post-shared tax base, that is, to enable them to *adopt certain incentives for businesses*.[36] Research on equivalents in the Canadian formulary allocation system suggests that such a tool would likely initiate tax competition between EU Member States for intra-EU investment.[37] The Commission has submitted that it cannot accept this amendment for technical reasons.[38] In my view, the utilisation of tax credits for businesses may entail the risk of triggering fiscal state aid issues and should therefore be considered a route not to be followed.[39]

3.3 CCCTB: Incentives for Artificial Tax Base Shifting?

3.3.1 Various Issues Would Be Resolved under the CCCTB

Such a more or less unitary approach where the group's profits are shared geographically by means of a formulary mechanism ('unitary taxation') reflecting inputs and outputs is generally considered to produce less opportunity for engaging in artificial tax avoidance operations.[40] That is, first, in comparison with the SA/ALS system as currently in place both internationally and within the EU. The cancelling out of the recognition of intra-group legal reality within the EU would entail a significant step towards mitigating many of the current issues in international taxation, as it takes away the key tools currently employed by countries and MNEs for engaging in artificial profit shifting.[41] The relocating of the firm's intangible resources through controlled legal transactions would be rendered impossible. It may be noted that aggressive tax planning operations typically do not occur outside the controlled environment within the functionally integrated MNE firm.[42] With respect to third-party transactions, it may be argued that a sufficient 'self-policing mechanism' exists in the form of the opposing underlying economic interests that drive third-party market transactions in a competitive business environment.[43]

Secondly, a coordinated approach would put an end to the unfair 'overtaxation' and 'undertaxation' of proceeds from intra-EU cross-border investment relative to domestic investment proceeds. It would also halt the tax-induced distortions that result from differentials in taxable unit definitions, tax base definitions and tax allocation mechanisms. Indeed, the disparities and mismatches hammering the uncoordinated international tax regime would be effectively brought to an end under a coordinated EU-wide corporate taxation approach. The sole tax differential remaining within the EU would be a rate differential.

Thirdly, a known property of formulary regimes to geographically divide MNE profit is that they provide an incentive to locate apportionment factors in low-taxing jurisdictions.[44] Indeed, the theoretical literature and

35. As the CCCTB proposal, above n. 4, subjects the nominal return to equity to tax, it tax-favours debt financing over equity financing. Further, under the adoption of SA/ALS also, intra-firm debt financing is recognised for tax base definition and tax base allocation purposes. As these arrangements do not add value to the firm, their tax recognition provides an incentive for MNE firms to engage in 'CCCTB-base erosion and profit shifting' through intra-group debt financing arrangements across the water's edge. The CCCTB follows traditional responses by introducing interest deduction limitations to protect their domestic tax bases.
36. *See* EP legislative resolution, above n. 6, Amendment 9; changes proposed to recital 5.
37. *See* Joan Martens Weiner, 'Taxation Papers; Formulary Apportionment and Group Taxation in the European Union: Insights from the United States and Canada', *Working paper* no 8, March 2005, European Commission Directorate-General Taxation & Customs Union, at Chapter 6.
38. *See* Communication SP(2012)388, above n. 7.
39. *See* also Weiner, above n. 37, at 51-52 (footnote 75).
40. *See e.g.,* Hellerstein, above n. 10, at 222.
41. *Cf.* Maarten F. de Wilde, 'A Step towards a Fair Corporate Taxation of Groups in the Emerging Global Market', 39 *Intertax* 62, at 62-84 (2011).
42. *See* for a comparison Mayer, above n. 19, at 177: 'Profit shifting between two entities mainly takes place when they are under common control, whereas below that level external shareholders can be expected to oppose measures that artificially reduce one company's profits or increase its tax burden.' *See* also Benjamin F. Miller, 'None Are So Blind as Those Who Will Not See', 66 *Tax Notes* 1023, at 1030 (February 13, 1995): 'For entities that are 50-percent-or-less owned, a self-policing mechanism exists in the form of the other shareholders.'
43. Perhaps some arbitrage may arise to the extent that the CCCTB group definition would prove not to align with the firm as a single economic unit. This is not discussed further as I tentatively consider this possibility to be of some lesser concern than the potential for arbitrage under the sharing mechanism discussed hereunder. For some analysis on the CCCTB Group definition, *see* Workshop on the Common Consolidated Corporation Tax (CCCTB), Room Document 1: 'Eligibility Tests for Companies and Definition of a CCCTB Group', TaxudD1/ CCCTB/RD \001\doc\en, 30 August 2010. On group definitions generally *see* De Wilde, above n. 41, at 62-84.
44. *See* Hellerstein, above n. 10, at 233. *See also* Opinion EESC, above n. 9, at 1.2.6, as well as Albert van der Horst, Leon Bettendorf, and Hugo Rojas-Romagosa, 'Will Corporate Tax Consolidation Improve Efficiency in the EU?', Tinbergen *Institute Discussion Paper*, TI 2007-076/2, September 2007.

empirical research available on formulary systems suggest that in the presence of AETR differentials, MNEs engage in profit shifting through factor shifting where tax jurisdictions respond by tax-competing with each other to attract and preserve investment.[45] Also, formulary systems bring tax competition.

These profit-shifting incentives would disappear under an EU-wide harmonised tax rate – the potential path suggested by the European Parliament[46] – or the adoption of a revenue-sharing mechanism.[47] Derivatively, location distortions would be mitigated to the extent that rate bandwidths or minimum rates would be introduced.

The Commission, however, has expressed that it cannot accept rate coordination.[48] It considers that the CCCTB proposal is meant not to touch upon tax rates. It sets forth that '[t]he determination of tax rates is treated as a matter inherent in Member States' tax sovereignty and is therefore left to be dealt with through national legislation'.[49] Rate harmonisation would also likely face political resistance in the EU Member States as this would involve a substantial transfer of fiscal autonomy from the states to the union.

3.3.2 *In Search of Arbitrage Potentials under the Sharing Mechanism*

3.3.2.1 Subject of Analysis: Only Potentials for Artificial Tax Base Shifting

Under the 'fair' versus 'harmful' tax competition paradigm, tax-induced factor shifting may not be considered problematical if and insofar as the location distortions would involve the shifting of real inputs and outputs.[50] However, the converse may be considered to hold to the extent that the CCCTB would enable MNE firms to engage in artificial factor-shifting operations, being encouraged to do so by EU Member States setting the comparatively lowest of EU AETRs.

Accordingly, only the potential for artificial tax base shifting within the EU through factor manipulation may be considered problematical. It is noted that to the extent that the CCCTB would promote artificial factor shifting, this may be considered quite a problem indeed. This may particularly be considered to hold since the CCCTB seems to lack sufficient tools to counter such practices, were these to come to pass. The CCCTB's anti-abuse provisions, for instance, like the 'General Anti-Abuse Rule' – targeting artificial legal arrangements set up to avoid tax – seem to merely refer to excessive behaviours concerning the tax base calculation.[51] The abuse of apportionment rules seems to fall outside the confines of the CCCTB's anti-abuse rules.[52] Furthermore, the 'Safeguard Clause' in the proposal, which is directed at correcting unfair outcomes under the general formula, seems to apply only when all the EU Member States' authorities involved agree.[53] Accordingly, the safeguard clause seems to require unanimous consent. Moreover, some uncertainties exist as to whether the rulemaking authority of the Commission regarding the sharing mechanism would enable it to adopt substantial changes to the legislative act.[54] I am not a cynic, but it may be fair to say that it remains to be seen how much room will effectively be available at the end of the day to resolve the issues that might emerge concerning MNE factor manipulation activities and EU Member State tax competition responses.

3.3.2.2 Formulary Apportionment: Dividing Profit Fairly by Reference to Inputs at Origin and Outputs at Destination

Generally, formulary mechanisms seek to divide corporate profit among tax jurisdictions by using a predetermined fixed formula.[55] Like any corporate tax base division mechanism, formulary systems seek to establish a taxable presence concept to geographically locate the firm's economic presence within a jurisdiction ('nexus'). Furthermore, formulary systems seek to establish a methodology to subsequently evaluate the income that the respective firm derives at that particular geographic location ('allocation'), that is, to geographically allocate the taxable profit to that jurisdiction.

For this purpose, formulary systems typically apportion corporate earnings with reference to firm inputs and firm outputs, respectively, reflecting the supply and

45. *See* Charles E. McLure, Jr., 'The State Corporate Income Tax: Lambs in Wolves' Clothing', in: Henry J. Aaron and Michael J. Boskin (eds.), *The Economics of Taxation* (1980), at 327-346; R. Gordon and J.D. Wilson, 'An Examination of Multijurisdictional Corporate Income Taxation under Formula Apportionment', 54 *Econometrica* 6, at 1357-1373 (1986); Austan Goolsbee, and Edward Maydew, 'Coveting Thy Neighbor's Manufacturing: The Dilemma of State Income Apportionment', 75 *Journal of Public Economics*, at 125-143 (2000); Kelly Edmiston, 'Strategic Apportionment of the State Corporate Income Tax', 55 *National Tax Journal* 2, at 239-262 (2002). For comprehensive overviews, reference is made to Garcia, above n. 14; and Weiner, above n. 37.
46. European Parliament proposed to introduce the possibility for future rate harmonisation; EP legislative resolution, above n. 6, Amendment 10; changes proposed to recital 5a (new). If the CCCTB would apply mandatorily as well, that would effectively introduce a fully centralised 'EU Company Income Tax' (EUCIT).
47. *See* for a comparison Thomas Horst, 'A Note on The Optimal Taxation of International Investment Income', 98 *Quarterly Journal of Economics* 4, at 793-798 (June 1980); Devereux, above n. 13, at 706; and Malcolm Gammie, 'Corporate Taxation in Europe – Paths to a Solution', *British Tax Review*, at 233-249 (2001).
48. *See* Communication SP(2012)388, above n. 7.
49. *See* Explanatory memorandum to the CCCTB Proposal, above n. 4, at section 3.
50. This effect may be considered to occur if and to the extent that the CCCTB's sharing mechanism would actually attribute the tax base geographically to the locations of real inputs and real outputs (though in my view it does not, as discussed hereunder) – *i.e.*, in the presence of AETR differentials. *See* for a comparison Horst et al., above n. 44, at 2-3.
51. *See* Arts. 80-83.
52. *Cf.* 'Comment by Dennis Weber on the CCCTB Proposal', Vakstudie H& I, Highlights and Insights on European Taxation, 2011/6.1, at 57. Perhaps some room upholds under the EU's 'abuse of law doctrine'. Matters seem indistinct here, though. For some analysis *see* Peter Harris, 'The CCCTB GAAR: A Toothless Tiger or Russian Roulette?', in: Weber (ed.), above n. 9, at 271-297.
53. *See* Art. 87.
54. *See* Art. 97. *Cf.* Hellerstein, above n. 10, at 232, and Chapter 5.
55. *See* for a comparison Michael J. McIntyre, 'The Use of Combined Reporting by Nation-States', in: Brian J. Arnold, Jacques Sasseville and Eric M. Zolt (eds.), *The Taxation of Business Profits under Tax Treaties* (2003), at 245-298.

demand sides of income production.[56] Essentially, they seek to approximate the inputs geographically with reference to the remunerations that the firm pays in return for utilising its workers and assets in the business process ('allocation'). Conceptually, the aim is to localise these workers and assets at origin, that is, where they exercise their employment contracts and where the assets are functionally utilised in the business process ('nexus'). Outputs are in essence sought to be approximated with reference to the remunerations, that is, the gross receipts that the firm receives in return for the goods and services it provides ('allocation'). Conceptually, the aim is to localise the firm's customers at destination, that is, where these customers utilise or consume the goods and services that were provided to them ('nexus'). As regards the assigning of outputs at destination, the analytical comparability with the value-added taxation system in the EU ('EU-VAT') is apparent.

Formulary apportionment accordingly recognises income production as the outcome of the interplay of both supply and demand.[57] It attributes income to both the country of investment ('origin state') and the country where the goods and services are marketed ('destination state'). Further, formulary systems modestly seek to provide a fair geographical division of income rather than identifying the 'true' geographic source of income – recognising that corporate income essentially lacks geographical attributes.[58] The weighting of factors, accordingly, is considered a matter of judgment.[59]

Notably, profit division on the basis of formulary mechanisms conceptually differs from the profit division approaches in international taxation. Internationally, the corporate tax base is sought to allocate income merely with reference to the tax jurisdictions of origin (i.e., the location of firm inputs). The international tax regime makes use of the concepts of nationality, residence and situs to establish corporate taxable presence within a taxing jurisdiction ('nexus'). The concept of SA/ALS has been used almost universally to subsequently evaluate the firm's geographical presence at origin ('allocation'). The above-mentioned carrots and sticks regimes apply regarding the artificialities and ensuing distortions that the nexus and allocation processes produce. The countries where the firm's goods and services are marketed – the destination states – are typically neglected in international taxation.

Also, the CCCTB sharing mechanism divides corporate profits within the EU through a 'nexus' and 'allocation' process. The CCCTB formula echoes the traditional equally weighted three-factor 'Massachusetts formula' developed in US state income taxation in the 1950s.[60] In the original CCCTB proposal, the formula takes the following form:[61]

3.3.2.3 Conceptual Peculiarities in the Sharing Mechanism

Regardless of the merits of composing the formula accordingly,[62] some peculiar elements may be recognised in the sharing mechanism. Before I proceed, kindly note that I will not engage in a comprehensive analysis of the formula factors or their weighting – US practices for instance reveal a tendency towards favouring the putting of higher weights on the sales factor;

56. It would be consistent to apportion both profits as losses. The CCCTB, however, only apportions profits under the sharing mechanism (Art. 86(2)). Losses are carried forward on a non-shared basis. This creates complexities where mergers and acquisitions are involved in the presence of ring-fenced loss carry forwards. These need to be geographically divided to make sure that CCCTB losses do not cross EU Member State tax borders, *see* Chapters X and XI CCCTB Proposal, above n. 4. This is not discussed further. *See* on this matter Jan van de Streek, 'The CCCTB Concept of Consolidation and the Rules on Entering a Group', 40 *Intertax* I, at 24-32 (2012); and Jan van de Streek, 'The CCCTB Rules on Leaving a Group', 40 *Intertax* 6/7, at 421-430 (2012).
57. *Cf.* Peggy B. Musgrave, 'Principles for Dividing the State Corporate Tax Base', in: Charles E. McLure, Jr. (ed.), *The State Corporation Income Tax: Issues in Worldwide Unitary Combination* (1984), at 228-246.
58. *Cf.* e.g., McIntyre, above n. 55, at 253, Walter Hellerstein, 'International Income Allocation in the 21st Century: The Case for Formulary Apportionment', 12 *International Transfer Pricing Journal* 103 103-111, at 104 (2005); and Peggy B. Musgrave, 'Interjurisdictional Equity in Company Taxation: Principles and Applications to the European Union', in: Sijbren Cnossen (ed.) *Taxing Capital Income in the European Union, Issues and Options for Reform* (2000), at 46-77.
59. *Cf.* Garcia, above n. 14, at 33. *See* for a comparison Common Consolidated Corporate Tax Base, Working Group, *Working Paper* No. 60, 'CCCTB: Possible Elements of the Sharing Mechanism', TAXUD TF1/GR/FF, CCCTB/WP060\doc\en, 13 November 2007 ('WP 060'), at 6: 'The Commission Services consider that the weighting of the factors is not a technical issue and recommend that any discussion on the weighting be carried out at political level…'
60. *See* for some reading and analysis Walter Hellerstein and Charles E. McLure, Jr., 'The European Commission's Report on Company Income Taxation: What the EU Can Learn from the Experience of the US States', 11 *International Tax and Public Finance*, at 199-220 (2004), Garcia, above n. 14; and Weiner, above n. 37.
61. *See* Art. 86(1).
62. European Parliament proposed to increase the weight on inputs (labour: 45%, assets: 45%) and reduce the weight on outputs (sales: 10%); *see* EP legislative resolution, above n. 6, Amendments 16 and 31; changes proposed to recital 21 and 86. Parliament argues that this would be more in line with the attribution in international taxation of taxing entitlements to the country of source. Notably, the Committee on the Internal Market and Consumer Protection proposed to take out the sales factor altogether for similar reasons and for the factor being perceived to be manipulable: 'An independent sales agent (located in a non-CCCTB State) could be contracted as an intermediary to do the sales on behalf of the group to the relevant market, and thereby move the destination of the sales from the 'intended' state to the state of choice', Opinion of the Committee on the Internal Market and Consumer Protection for the Committee on Economic and Monetary Affairs on the proposal for a Council directive on a Common Consolidated Corporate Tax Base (CCCTB), (COM(2011)0121 – C7-0092/2011 – 2011/0058(CNS)), 25 January 2012. I am not sure whether such manipulation would significantly arise. Further, I doubt whether this behaviour should qualify as aggressive tax planning – to the extent that it would arise. That is, since such a scenario would involve third-party market transactions, real economic activity accordingly, underlying the sharing of the tax saving. In addition, the intermediary third party would charge a fee for its services as it would bear the economic risk involving the performance of its full-fledged distribution function. In other words, without the passage of economic risk, there may be be no third-party sale. Further, such a tax planning operation would likely trigger additional transportation costs. *Cf.* Hellerstein, above n. 10, at 237. Regardless, the Commission cannot accept the amendment; Communication SP(2012)388, above n. 7, considering an equally weighted three-factor formula the most appropriate solution.

Share Group Member A

$$= \left(\frac{1}{3} \frac{Sales^{A}}{Sales^{Group}} + \frac{1}{3} \left(\frac{1}{2} \frac{Payroll^{A}}{Payroll^{Group}} + \frac{1}{2} \frac{No\ of\ employees^{A}}{No\ of\ employees^{Group}} \right) \right.$$

$$\left. + \frac{1}{3} \frac{Assets^{A}}{Assets^{Group}} \right) * CCCT\,B$$

today, many states even adopt sales-only formulae.[63] Furthermore, I will not go into the details regarding the definitions used or the factors' scopes of application. I will also not pursue an in-depth analysis in regard to their evaluation and geographic localisation.[64] My aim is merely to submit some remarks on the properties that I regard as potentially producing undue or at least unforeseen arbitrage.

3.3.2.4 Using International Taxation Concepts to Establish Nexus

As already seen, some conceptual peculiarities may be recognised in the CCCTB sharing mechanism.

First, it is noted that the CCCTB proposal uses the same nexus concepts that are currently in place in international taxation to establish tax jurisdiction. As regards the establishing of the firm's taxable presence within an EU Member State, the proposal does not refer to the presence of workforce, assets or turnover in that country. That, for instance, would be the case under the alternative application of 'factor presence tests'.[65] It should be noted that the use of such an approach would be conceptually more sound, as these tests appreciate the ratio underlying formulary apportionment to a greater extent. Factor presence tests directly refer to the geographical location firm inputs and firm outputs for taxable profit division purposes – see further details hereunder.

The CCCTB proposal makes use of international tax nexus concepts and attributes the tax base to *group members*, that is, the companies that are part of the CCCTB group.[66] The geographical presence of these group members is recognised with reference to their tax place of residence within an EU Member State or their presence in an EU Member State through a 'permanent establishment'. Corresponding with common international tax practices, the localisation of a 'group member' with reference to its tax residence is determined on the basis of the respective company's 'place of incorporation' or its 'place of effective management'; the same holds for the permanent establishment concept. Following international tax law approaches, the localisation of a 'group member' under the CCCTB proposal occurs by assessing whether a business venture is being conducted by a non-resident group company through a 'fixed place of business' – like a store or branch – situated within the territories of an EU Member State.

3.3.2.5 Using Factor Allocation Approaches Inconsistent with Inputs at Origin and Outputs at Destination

Second, the CCCTB proposal does not consistently allocate the formula factors geographically to the inputs at origin and outputs at destination. A discrepancy seems to have been created between the taxable profit division under the formula factors in the sharing mechanism and the geographic location of real firm inputs and firm outputs. This holds, for instance, for the labour factor and the sales factor.

The labour factor does not seem to allocate the tax base to the jurisdiction of origin where the firm's workers physically exercise their employment contracts. Instead, employees and payroll are allocated to the group member(s) from which the employees receive their remunerations. To the extent that employees substantially exercise their employment contracts under the *contro and responsibility* of group member(s) other than the group member(s) paying the salaries and wages, the factor is allocated to the first mentioned group member(s).[67]

63. *See* Multistate Tax Commission, *Multistate Tax Compact Article IV – Recommended Amendments*, 3 May 2012, at 10-14 ('MTC 2012a'), and Multistate Tax Commission, 'Multistate Tax Compact Article IV Recommended Amendments as Approved for Public Hearing' – December 6, 2012 ('MTC 2012b'). For an overview of the formulae adopted by the US states as of January 1, 2013, *see* David Spencer, 'Unitary Taxation with Combined Reporting: The TP Solution?', 25 *International Tax Review*, at 2-5 (April 2013).
64. *See* for some analysis Antonio Russo, *Common Consolidated Corporate Tax Base: The Sharing Mechanism, Some General Considerations*, in: Weber (ed.), above n. 9, at 207-219, and the literature references in that publication.
65. Under a 'factor presence test', tax nexus within a taxing jurisdiction would arise where any of the factors (property, payroll, sales) or a combination thereof is present within that jurisdiction, subject to a *de minimis* threshold (wages paid, assets values, turnover). *See e.g.* Mayer, above n. 19, at 202-205, Walter Hellerstein, 'State Taxation of Electronic Commerce,' 52 *Tax Law Review* 425 at (1996-1997), and Charles E. McLure, 'Implementing State Corporate Income Taxes in the Digital Age,' 53 *National Tax Journal* 4, at (2000). *See also* WP 060, above n. 59, at 15; and Multistate Tax Commission, *Federalism at Risk, A Report of the Multistate Tax Commission*, June 2003, at Appendix D. For some comparison, *see* Reuven S. Avi-Yonah, 'International Taxation of Electronic Commerce', 52 *Tax Law Review* 507, at (1996-1997); and Dale Pinto, 'The Need to Reconceptualize the Permanent Establishment Threshold', 60 *Bulletin for International Taxation* 7, at 266-279 (2006).
66. *See* Art. 86(1), Arts. 4-6 and 54-55 in conjunction with Chapter XVI. *Cf*. Hellerstein, above n. 10, at 225.
67. *See* Arts. 90-91. Notably, fixed assets are allocated to the EU Member State of the group member(s) effectively owning them, *see* Arts. 92-94 in conjunction with 4(20). If the economic owner does not substantially utilise these assets in its business process, they are attributed to the group member(s) that effectively does. Intangible assets are not expressly allocated under the CCCTB proposal, above n. 4. As a consequence, these piggyback on the profit division in proportion to the factors expressly dealt with.

The sales factor does not seem to consistently allocate tax base to the jurisdiction of destination where the firm's customers functionally utilise or consume the goods and services provided to them.[68] For example, the sales factor allocates exempt revenues such as exempt gross proceeds from (third-country) shareholdings (e.g., dividends, capital gains),[69] revenues from – loosely phrased – portfolio investments and hedging transactions to the *beneficiary*. That is, to the extent that these revenues have been earned *in the ordinary course of trade or business*.[70]

As I am not entirely sure how to interpret the 'beneficiary' receiving such revenues 'in the ordinary course of trade or business' under the sales factor, I tentatively follow the suggestions that Hellerstein has submitted in this regard and the analogous guidance provided by the Court of Justice in the area of EU-VAT on portfolio investment activities.[71] Using transfer pricing terminology, I take it to mean that these types of gross receipts are attributed to the group member that beneficially owns these[72] and functionally performs the MNE's (third-country) shareholding management functions, treasury functions, cash-pooling functions and/or functionally manages the MNE's hedging positions. These types of functions performed may be considered to constitute the key components of the firm's ordinary trade or business operations.[73] Should this hold, the sales factor at this point effectively utilises an origin-based connecting factor.

3.3.3 *Potential for Arbitrage: Factor Manipulation*

Would these peculiarities and inconsistencies in the sharing mechanism produce arbitrage potentials? Is there a possibility for employing them to arbitrarily shift the tax base to the comparatively lower-taxing EU Member State, potentially igniting unforeseen tax competition responses? Would the CCCTB produce a potential for a 'race to the bottom 2.0' under the CCCTB?

Of course, matters remain to be seen. However, a potential may be recognised for tax planning operations and tax competition responses. In my opinion, the arbitrage would revolve around:

1. 'Labour factor manipulation' through 'payroll group members';
2. 'Sales factor manipulation' through 'beneficiary group members';
3. 'Sales factor inflation' through 'beneficiary group members' engaging in 'shareholding-revenues-carousels'.

Before proceeding to a description of the potential planning strategies, it may be noted that all, essentially, are rooted in the use of the same nexus concepts as utilised in international taxation today, that is, the tax place of residence and the permanent establishment. The arbitrage that the use of this approach creates is not reversed in the subsequent tax base allocation process.

First, as regards the geographical localisation of a group member within an EU Member State's tax jurisdiction with reference to its tax residence, it may be deduced from well-known tax practices that it may not prove too difficult for MNEs to influence this. That is, as this matter would revolve substantially around ceremonial events like the chosen company laws governing the respective legal entity or the geographic location where the decisions concerning its governance are taken.[74] These events may be relatively easily directed towards the tax jurisdiction(s) of choice, regardless of the location of real investment. Particularly the international convergence of company laws, the cross-border mobility of corporate managers – 'fly-in-fly-out management' – and the digitisation of the global economy render these tax-connecting factors rather meaningless and easily steered. As a result, the CCCTB proposal seems to provide MNEs a readily available tool to geographically locate group members in a 'home country' at their discretion to influence the tax base allocation under the sharing mechanism; that is, if the subsequent sharing process would not resolve things – which to my mind is the case.

Second, as to the geographical localisation of a 'group member' within an EU Member State tax jurisdiction by reference to the presence of a permanent establishment, it may be deduced from known tax practices that this may likely produce rather arbitrary results also. The permanent establishment concept requires the establishment of a physical–geographical presence within a tax jurisdiction. The mere presence of workers within a country is typically insufficient to make a permanent

68. Services *e.g.* are allocated to the group member located in the EU Member State where the services are physically carried out, Art. 96(2). Such a 'place of performance rule' reflects the origin side rather than the supply side. The recognition of the supply side in this respect – the destination of income – would allocate the factor to the location of the customer or the EU Member State where the services are marketed. In EU-VAT, e.g., services are often tax-located in the country where the customer is located. This is not discussed further as the location of services physically performed, albeit being the country of origin seems hard to manipulate.
69. *See* Art. 11(c)(d).
70. *See* Art. 95(2) in conjunction with Art. 96(3).
71. *See*, respectively, Hellerstein, above n. 10, at 237-241, and Court of Justice, cases C-60/90 (*Polysar*), C-155/94 (*Wellcome Trust Ltd.*), C-306/94 (*RégieDauphinoise*), C-80/95 (*Harnas & Helm*), and C-142/99 (*Floridienne*).
72. Note that I refer by analogue to the 'beneficial ownership' concept in international taxation.
73. *See* Hellerstein, above n. 10, at 239. To substantiate the argument, Hellerstein refers by analogue to *Microsoft Corp.* v. *Franchise Tax Board*, 39 Cal. 4th 750, 139 P.3d 1169, 47 Cal. Rptr. 3d 216 (2006). Analogues to Court of Justice jurisprudence on EU VAT, the performing of portfolio asset management and shareholding management functions may perhaps be considered part of ordinary trade or business operations where these functions performed 'are effected as part of a commercial share-dealing activity, in order to secure a direct or indirect involvement in the management of the companies in which the holding has been acquired or where they constitute the direct, permanent and necessary extension of the taxable activity'. *See* Polysar, above n. 71, *Wellcome Trust Ltd*., above n. 71; *RégieDauphinoise*, above n. 71; and *Floridienne*, above n. 71.
74. *Cf.* McIntyre, above n. 55, at 270.

establishment, though.[75] Further, note that the emergence of the Internet and e-commerce has diminished the need for establishing a tangible presence within a country to enter its market.[76] A virtual presence through a website may often suffice, particularly where it concerns e-tailers supplying IT services or e-goods.[77] As a potential consequence, the proceeds from e-commerce activities may be left virtually untaxed in the 'host country'. Like the current international tax regime, the CCCTB proposal misses the digital economy completely.[78] Let us proceed and scrutinise the potential for factor manipulation – in increasing relevance.

3.3.3.1 Ad 1. 'Labour Factor Manipulation' through 'Payroll Group Members'

Payroll, as already noted, would be apportioned to the group member(s) paying the salaries and wages and, alternatively, the group member(s) under whose 'control and responsibility' the employees exercise their employment contracts. As regards the latter, that is, the apportioning of the labour factor to the 'substantive employer group member' would occur, provided that the required reassignment thresholds are met. Please note that the location of work performed, as mentioned earlier, seems irrelevant.

The apportioning of tax base with reference to the group member paying the salaries or, alternatively, under whose control and responsibility the employment contracts are exercised may invite MNEs to set up and tax-establish 'payroll group members' in the comparatively lower-taxing jurisdiction to which the workforce is subsequently assigned,[79] even though the firm's workers may actually exercise their employment contracts across the EU. Perhaps, this may hold even in the case of workers who are posted on the basis of intra-group secondment contracts. Note that the presence of workers within a country, as discussed, does not in itself trigger the presence of a permanent establishment. Although a 'substantive employer' concept has been put in place, I have some doubts whether the concept is sufficiently robust to effectively counter such labour factor manipulation operations.

The magnitude of the risk of triggering labour factor manipulation involving payroll group members may prove to ultimately depend on the interpretation of the terms 'control and responsibility' in the text of the draft directive. The risk may be greater to the extent that these terms would need to be interpreted narrowly c.q. legally, for instance with reference to the exercising of *legal control and responsibility* of the group member involved. But the risks may significantly arise even under a less restricted interpretation i.e., were the tax base, for instance, attributed to the group member to whom the *economic risks* involving the utilisation of the MNE's workforce have been assigned. In transfer pricing, it is well known that the economic risks involving the conducting of economic activity are quite mobile and can be legally assigned to group companies by MNE discretion.

The consequence of using such a labour factor allocation test may be that one-third of the EU-wide tax base becomes instantly mobile as of the entry into force of the CCCTB. The reality of such a planning tool, as already noted, may prove to ultimately depend on the interpretation of the terms 'control and responsibility'. The issue, for instance, may be substantially mitigated to the extent that these would need to be interpreted as corresponding with the location where the employment contracts are physically performed. However, as this does not seem to correspond with the language used in the text of the draft directive, the potential for arbitrage may be considered present, at least theoretically.

Of course, it could be decided to wait and see how the Court of Justice shall interpret the language used when it is called upon. Perhaps the court will resolve the matter by extensively interpreting the directive text, for example, with reference to its ratio. Or perhaps not. Perhaps, therefore, it may be worth assessing the possibility of altering the sharing mechanism, an approach that I would recommend taking. Perhaps it may be considered to adopt a 'factor presence test' to share the intra-EU tax base. On the basis of such a test, the taxable presence of a firm within an EU Member State would be established with reference to the presence of a workforce within a tax jurisdiction. Nexus would be based on the physical presence of the firm's workers exercising their employment contracts within a taxing jurisdiction. The establishment of the firm's taxable presence could be subject to a *de minimis* threshold

75. That is, perhaps save for the 'services permanent establishment' laid down in Art. 5(3)(b) of the United Nations Model Double Taxation Convention between Developed and Developing Countries. The operation of this nexus concept establishes tax jurisdiction regarding '[t]he furnishing of services, including consultancy services, by an enterprise through employees or other personnel engaged by the enterprise for such purpose, but only if activities of that nature continue (for the same or a connected project) within a Contracting State for a period or periods aggregating more than 183 days in any 12-month period commencing or ending in the fiscal year concerned'.
76. *See* Avi-Yonah, above n. 2, at 1596.
77. An e-tailer is an enterprise that conducts its business online.
78. *See e.g.* Lee A. Sheppard, 'The Digital Economy and Permanent Establishment', 70 *Tax Notes International* 297 (Apr. 22, 2013), Charles McLure, Jr., 'Alternatives to the Concept of Permanent Establishment', 1 *CESifo Forum* 3, at 10-16 (2000); Avi-Yonah, above n. 65; and Pinto, above n. 65.
79. *See* for a comparison Hellerstein, above n. 10, at 242-243.

$$\text{payroll EU Member State A} = \text{payroll} * \frac{\text{working days employers in EU Member State A}}{\text{working days employers in EU}}$$

('payroll EU Member State A exceeding amount € x').[80] The subsequent allocation of the taxable base to that state could be loosely inspired on the distributive rules for employment income found in Article 15 OECD Model Tax Convention on Income and on Capital (see the formula above). That would perhaps effectively cancel out artificial tax base-shifting incentives within the EU through labour factor manipulation. Namely, under the application of such a factor presence test, the shifting of the taxable base would require a physical relocation of MNE workers from one EU Member State to another – a shifting of real inputs accordingly.[81]

3.3.3.2 Ad. 2 'Sales Factor Manipulation' through 'Beneficiary Group Members'

Gross receipts from portfolio investments and revenues from hedging instruments, as noted, are apportioned to the 'beneficiary'. This holds to the extent that the group member derives these revenues 'in the ordinary course of trade or business'.

The apportioning of the tax base under the sales factor to the group member that is entitled to the gross proceeds from these intangibles may invite MNEs to set up and tax-establish 'beneficiary group members' in the comparatively lower EU Member State taxing jurisdiction. It is also conceivable that MNE groups would set up special vehicles for tax planning purposes to which the portfolio investments and hedging positions are being legally assigned. The assets involved have quite mobile and intangible characteristics; they have the potential of producing a significant turnover, and a moderate extent of labour force is required to perform the relevant functions concerned. These things combined may perhaps render the sales factor vulnerable and subject to manipulation at this point. Unwanted tax competition responses may be the consequence.

US state income tax law provides some examples by analogue of tax avoidance strategies that MNEs may pursue in this area.[82] First, reference can be made to a Californian state income tax case involving a software enterprise that obtained gross revenues from its sales of short-term portfolio investments through the performing of a treasury function.[83] It performed the function involved at its headquarters in the State of Washington, a state that does not levy a state income tax. The portfolio investment revenues accounted for 73% of total gross receipts (while producing less than 2% of net income). These revenues accordingly overshadowed the company's core outputs, the selling of software. As a result, significant amounts of state income tax base were at risk of being shifted towards Washington, which would leave it untaxed. The California Supreme Court resolved the matter by requiring the software company to apply the sales factor to the net portfolio investment income. Referring to the language used in the CCCTB proposal – 'total sales', 'proceeds', 'revenues'[84] – this solution may, however, be unavailable under the CCCTB.

Second, reference can be made to another Californian state income tax case, which deals with the application of the sales factor on gross receipts from the sales of commodity futures that had been made to hedge against price fluctuations.[85] The case involved an enterprise engaged in the selling of grain products like flour and cereal. The company engaged in hedging transactions to insure itself against fluctuations in the cost prices of the raw grain materials that it used in its business process. These enabled it to cancel out grain price fluctuation risks to stabilise its profit margins. The company functionally managed its hedging positions at its headquarters located in Minnesota. The Californian Court ruled that the gross receipts from the selling of commodity futures were included in the sales factor. As the undertaken hedging transactions produced substantial turnover (not profit), a significant part of the state income tax base was shifted from California to Minnesota. The California state income tax legislature responded by excluding amounts received from such hedging transactions from the sales factor per 1 January 2011.[86] Assuming that this issue may arise under the CCCTB by analogue – and I do not see why it would not – the CCCTB appears to be in need of being amended at this point also.

3.3.3.3 Ad. 3 'Sales Factor Inflation' through 'Shareholding-Revenues-Carousels'

Moreover, the sales factor apportions exempt shareholding revenues like dividends and capital gains to the beneficiary also. Notably, eligible shareholding proceeds will be exempt from the tax base under the CCCTB's 'participation exemption regime'.[87] It is these I refer to.

The apportioning of the tax base by reference to the group member functionally performing the MNE's (third-country) shareholding management functions may trigger the risk of initiating a process whereby intra-group third-country transactions are set up to

80. *See* footnote 65. Notably, I fail to see why the number of workers would need to be taken into consideration in the composition of the labour factor. Wage level differentials are a consequence of labour market imperfections – or at least an issue analytically separate from taxation. In my view, these should not be sought to be 'corrected' through a tax base allocation system.
81. A similar approach may be feasible regarding the asset factor (nexus: 'asset values in EU Member State A exceeding amount € x'; allocation: 'assets functionally utilised in EU Member State A').
82. References to US state income tax case law and legislation were drawn from Hellerstein, above n. 10, at 237-241.
83. *See* Microsoft, above n. 73.
84. *See* Art. 95.
85. *See General Mills* v. *Franchise Tax Board*, 172 Cal. App. 4th 1535, 92 Cal. Rptr. 3d. 208 (1st Dist. 2009). McIntyre, above n. 55, addresses an equivalent issue at 286.
86. Cal. Rev. & Tax Code § 25120(f)(2)(L) (Westlaw 2011).
87. *See* Art. 11(c)(d) in conjunction with Arts. 95(2) and 96(3).

inflate the sales factor. It is conceivable that MNE groups would set up special vehicles for tax planning purposes to which the (third-country) shareholding interests are being legally assigned, that is, to subsequently inflate the sales factor via third-country intra-group transactions. Under the composition of the sales factor, MNEs seem enabled to do that. They may be able to inflate the sales factor by establishing an ongoing process of extracting dividend streams from their (third-country) shareholdings financed with capital contributions.[88] Such an establishing of circular dividend and capital contribution streams does not seem to affect the tax base in an upward sense, owing to the application of the participation exemption. Yet, these exempt proceeds are recognised as allocable proceeds for tax base sharing purposes under the sales factor. The receipts from such sales factor inflating 'shareholding-revenue-carousels' have the potential of fully eclipsing real outputs. Such tax planning operations may particularly appear, I imagine, in cases involving shareholdings in third-country entities in which the CCCTB group has a controlling interest, that is, intra-group cash-carousels across the water's edge. Taking into account that the anti-abuse rules in the CCCTB proposal do not seem to cover factor manipulation, the sales factor seems very vulnerable at this point.

The CCCTB proposal accordingly seems to potentially grant MNEs complete discretion as to the intra-EU attribution of the sales factor. The consequence may be that an additional one-third of the EU-wide tax base instantly becomes mobile as of the entry into force of the CCCTB Directive. Obviously, the reality of such a planning tool may ultimately depend on the interpretation of the terms 'beneficiary', 'the ordinary course of trade or business', 'total sales', 'proceeds', 'revenues' and 'exempt revenues'.

The issue may be substantially mitigated to the extent that these would need to be interpreted as not to include portfolio investment proceeds, hedging transactions proceeds and revenues to which the CCCTB participation exemption applies. Under such an interpretation, the respective proceeds would be excluded from the sales factor and could not affect the apportioning of the taxable base as a consequence. However, this does not seem to correspond with the language used. Arbitrage potentials may therefore be considered present, at least theoretically.

If the aforementioned arbitrage would nevertheless hold, potentially two-thirds of the EU-wide tax base is at risk of being artificially shifted across the EU upon the CCCTB's entry into force. This may be considered particularly problematical, since it may be infeasible to strike down profit shifting through factor manipulation under the CCCTB's anti-abuse rules. The CCCTB would accordingly provide MNEs readily available tools to engage in artificial tax base shifting.

This matter may arise in addition to the vulnerability of the EU tax base of being subject to traditional base erosion and profit-shifting operations across the water's edge. The CCCTB, as already noted, would basically operate as a conventional corporate tax across the water's edge, consequently triggering conventional tax planning opportunities. In view of this, it seems that future tax planning within the EU would occur in two steps. First, the EU-wide tax base would be eroded via traditional tax planning across the water's edge. Second, the eroded EU-wide tax base would be artificially shifted for up to two-thirds to the comparatively lowest EU Member State taxing jurisdiction.

If the CCCTB proposal were enacted as currently proposed, the CCCTB accordingly seems to bear the potential to reinvigorate aggressive tax planning operations and fierce tax competition responses of EU Member States attempting to attract the (eroded) tax base. Since the EU Member States would only have the tax rate at their disposal to affect MNE location decisions, perhaps the CCCTB may initiate an unforeseen 'race to the bottom 2.0'.

To be honest, I do not really see why these issues would not arise. Of course, it could be decided to wait and see how the Court of Justice will interpret the language used. Perhaps the court will help the EU Member States also at this place by resolving the matter through extensive interpretations of the directive text. Perhaps, alternatively, it may be worth assessing the option of structurally altering the composition of the sales factor in the sharing mechanism. I would favour taking that alternative approach, and advocate the following changes to the sales factor:

- First, it may be worth considering introducing the rule that only gross receipts that contribute to the production of taxable income are to be included in the sales factor.[89] That would effectively cancel out sales factor inflation opportunities through the aforementioned cash-carousels involving exempt revenues. The exempt proceeds would not affect the sales factor under the suggested approach.[90]
- Second, drawing inspiration from the work undertaken in the US by the Multistate Tax Commission on revising the Multistate Tax Compact,[91] it may be worth scrutinising the option of excluding from the sales factor receipts from the performing of treasury functions, cash-pooling functions, portfolio investment activities and hedging transactions.[92] In the US, the Uniformity Committee, for instance, has sug-

88. The dividend streams may be financed with equity, but perhaps even with intra-group third-country debt. The financing of such cash-carousels with intra-group debt may potentially even negatively affect the EU tax base as the outbound intra-group interest payments involved may be tax-deductible. Perhaps such interest deductions may end up being restricted under the anti-abuse rules.

89. *See* for a comparison, Hellerstein, above n. 10, at 238: '[T]he US subnational state sales factors … defined "gross receipts" … that they had to generate apportionable income.'

90. *Cf.* WP 060, above n. 59, at 13; and Mayer, above n. 19, at 217.

91. The Multistate Tax Commission is an intergovernmental advisory state tax agency. The Multistate Tax Compact, among others, provides for a model state income tax statute from which the US states may draw inspiration in designing their state income tax systems.

92. That is, unless the taxpayer is a securities dealer. *See* MTC 2012a, above n. 63, at 14-18; and MTC 2012b, above n. 63.

gested the following provision: '"Receipts"' means gross receipts of the taxpayer (…) that are received from transactions and activity in the regular course of the taxpayer's trade or business; except that receipts of a taxpayer other than a securities dealer from hedging transactions and from the maturity, redemption, sale, exchange, loan or other disposition of cash or securities, shall be excluded.'[93] The adoption of an equivalent approach in the CCCTB would perhaps halt the arbitrage potentials referred to in the above.

– Third, it might be considered to adopt a 'factor presence test' under the sales factor as well. On the basis of a sales factor presence test, nexus within a tax jurisdiction would be established with reference to the presence of gross receipts within that tax jurisdiction. The establishing of the firm's taxable presence could be subject to a *de minimis* threshold ('gross receipts from customers located in EU Member State A exceeding amount € x').[94] The inspiration for the designing of such a tax-connecting factor could be found in the distance sales rules in EU-VAT.[95] The subsequent allocation of the taxable base to that state could be inspired on EU-VAT as well, particularly the place of supply rules.[96] Viz., these aim at locating the customer in the destination jurisdiction. The assigning of the tax base via that means would perhaps effectively mitigate artificial tax base-shifting incentives within the EU through sales factor manipulation. Under the application of such a factor presence test, the shifting of the taxable base would require a physical relocation of the MNE's marketplace from one EU Member State to another – a shifting of real firm outputs accordingly.[97]

4 Concluding Remarks

Would the CCCTB – if enacted as currently proposed – provide incentives for MNEs to pursue artificial tax base shifting within the EU? Could these potentially invigorate the risk of undue governmental tax competition responses?

Obviously, things remain to be seen, but for now my tentative answer is in the affirmative. Currently, the issue of harmful tax competition within the EU seems to have been pushed back as a result of the soft law approaches that were initiated in the late 1990s and early 2000s. However, if the CCCTB in its current draft is enacted, there may be a risk that two-thirds of the EU-wide tax base would become mobile, at least theoretically. Upon its entry into force, the CCCTB would perhaps pave the way for 'factor-manipulation' operations, for instance through 'payroll group members' and 'beneficiary group members'. Particularly the potential for sales factor inflation through the aforementioned 'cash-carousels' may produce undesirable effects.

Time will tell. Perhaps the issue will not arise in the first place as a result of extensive judicial interpretations of the language used in the directive text by the Court of Justice. Perhaps matters will alternatively be resolved. Maybe the anti-abuse approaches will prove applicable after all. Perhaps the safeguard clause will operate effectively, or maybe the Commission will prove to have sufficient legislative powers to adopt delegated acts to effectively counter factor manipulation. Perhaps not. That may be considered problematical indeed, particularly since the EU Member States in that case would merely dispose of a single instrument to respond to MNE tax planning operations – tax rate reduction. To cancel out any potential for initiating a 'race to the bottom 2.0.' upfront, it might be worth assessing some alternatives to the sharing mechanism as currently drafted. I would, for instance, favour using quantitative 'factor presence tests' to attribute the tax base to EU Member States directly.

93. *See* MTC 2012a, above n. 63, at 15. For discussion and critique see Sutherland Asbill & Brennan LLP, 'Comments on the MTC's Proposed Amendments to Article IV Of the Multistate Tax Compact', Presented to the MTC Public Hearing, Washington, DC, March 28, 2013, 'Statement of Benjamin F. Miller for the Hearing on Proposed Amendments to Article IV of the Multistate Tax Compact', Washington D.C., March 28 and 29, 2013, and 'Additional Comment by Benjamin F. Miller with Respect to Testimony Offered at the Hearing of March 28, 2013 in Washington D.C. Proposed Amendment to Section 17 of Article IV'.
94. *See* n. 65.
95. *See* Arts. 33 and 34 Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax.
96. *See* Title V – 'place of taxable transactions', Council Directive 2006/112/EC.
97. As said, a similar approach may be feasible for consistency reasons regarding the asset factor (nexus: 'asset values in EU Member State A exceeding amount € x'; allocation: 'assets functionally utilised in EU Member State A').