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THE EU CONSOLIDATED INCOME TAX REVISITED

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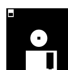

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Abstract

This article reviews the main technical and policy problems which the implementation of two formats of comprehensive solutions, discussed in the recent report by the Commission on 'Company Taxation in the Internal market' would require. Both approaches imply the consolidation within the EU of net profits, but diverge as regards the competence to fix the rate. The paper also suggests some variants to these two basic models.

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THE EU CONSOLIDATED INCOME TAX REVISITED

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I/ Introduction

The recent Report of the European Commission--The last fifty pages of the voluminous report of the European Commission on 'Company Taxation in the Internal Market', released on October 23, 2001, will no doubt stir lively debates.[1] As a matter of fact, they open bold, even revolutionary perspectives for the imposition of the profits of multinational enterprises (MNE's) which conduct cross-border activities in the EU, through their subsidiaries or branches.

Four comprehensive solutions'are examined in the Report. They are sketched in section III.. One amongst them, the 'EU Tax on Consolidated Profits of Multinational Enterprises" (EUCIT), was originally proposed by the undersigned in an article in 1997. But in the meantime, a number of developments, mentioned in section II, have converged to render the search for a more 'holistic' solution not only conceivable, but desirable—as evidenced by the thrust of the Report and by the explicit statement in the 'Communication from the Commission to the Council, the European Parliament and the Economic and Social Committee, which accompanied the Report and which states: "The Commission therefore believes it is only logical to steer its company taxation policy towards achieving a comprehensive solution to the existing cross border tax obstacles in the Internal market " (p.16).

The political orientations, so far-- The Report itself does not yet take a definitive stand in favour of one of the alternatives and urges more analysis of the many technical problems, that would have to be solved before a comprehensive scheme could be achieved. But it quite openly states that a move towards such a EU-wide solution should be actively contemplated, as it would signify a substantial improvement of the corporate tax scene.

Yet, at this stage, in the 'Communication from the Commission to the Council, the European Parliament and the Economic and Social Committee, some political choices have already been made; this is also reflected in the Report. One fundamental principle has been affirmed, namely that "… it is necessary (…) for the Member States , to determine the applicable national corporate tax rates " (p.16) while provid(ing) companies with a consolidated corporate tax base for their EU-wide activities and develop(ing) an appropriate apportionment mechanism which can be agreed by all participants" (ibid.). This position has been steadfastly defended by Commissioner Bolkestein, in charge of financial and fiscal affairs, and has been agreed by the Commission itself. In arguing in favour of this stance, the Communication invokes the principle of subsidiarity", according to which the level of taxation is a matter for the Member States to decide". The Communication also states that "this essential sphere of national competence in the area of company taxation would –intentionally—remain untouched and Member States would be left with the autonomy to adjust the most important element or tax revenues "(p. 17) .

The business world, represented in the expert panel II, which has assisted the Commission, is on record of insisting that Member States retain the competence for the determination of the rates; this would "ensure that there was an opportunity for an appropriate element of transparent tax competition between Member States"(p.376 of the Report). The business world also views the continuation of differentiated rates as a safeguard against a rise in the tax burden on companies, as competition with regards to rates amongst the Member States is likely to exert a downward pressure on them.

Consequently, the recent stance of the Commission narrows down the choice of a comprehensive scheme to the Common Consolidated Base Tax (CCBT) on the one hand, and the Home State Taxation(HST), on the other hand. The EUCIT, fitted with a single tax rate at EU-level, is not retained at present; whereas, as already mentioned, the fourth conceivable broad alternative system, the Single Compulsory Harmonized Tax Base is not a realistic proposition and is not further discussed in the Report.

Although differentiated national rates are presently preferred by the business world and by the Commission, only the subsequent debates will indicate whether the EUCIT, which features a single rate, is definitely buried. Some voices have already been heard in favour of a single rate.[2] Besides, the Commission's Communication refers to a major finding of the Report, in its innovative[3] Part II . The quantitative analyses that were conducted found that nominal tax rates are the most important determinant of effective tax rates. The Communication states that "to the extent that taxation matters, introducing a common rate in the EU would be likely to go some way in reducing locational inefficiencies " (p. 8). In other words, when positing the national competence with respect to company tax rates, the Commission accords precedence to the sovereignty of Member States as regards the nominal rate-setting over the allocational inefficiencies which the differences in nominal rates involve and which are repeatedly mentioned in the Report (p. 167, 423).

All in all, in all likelihood, the EUCIT, and/or some of its variants, although not favoured at present, will remain on the drawing board as one of the alternative models that could achieve a 'comprehensive solution' to the problems of profit taxation, besetting MNE's that operate in the EU arena.

This article has the limited scope of revisiting the EUCIT, from two main angles. It essentially discusses, in section IV , the main technical problems, that would have to be solved, and the related political options made, previous to the launching of a EUCIT scheme; several of these 'prerequisites' would also have to be met in other comprehensive models, more particularly in the CCBT. Besides, in the course of the analysis, variants on the original formats of the EUCIT and the CCBT emerge. The hurdles to be overcome are daunting, but the rewards to be reaped by the adoption of a more holistic system within the EU are worth those troubles, as analysed in the final section V.

II/ Factors that drive towards Comprehensive Approaches

The Commission's Report contrasts with the(Ruding) Report of the Committee of Independent Experts on Company Taxation" (March 1992) which did not find a "sufficiently strong justification for the total harmonization of corporate taxes "(p. 201); yet, it advocated the removal of special tax regimes designed to attract

internationally mobile business. But since about ten years, several developments impart a strong momentum to the search for comprehensive solutions. As a matter of fact:

a) The advent of the Single Market leads enterprises to repositioning themselves within the (now) Single Market. Business views the EU increasingly as a single area of involvement; the commonality of the currency in 12 out of the 15 member countries, within Euroland, reinforces global perspective. Hence, MNE's tend to replace the country-by-country organizational set-up by one, whereby activities are typically organized per product line in a EU-wide framework.

b) Moreover, optimizing the value chain within MNE's is now increasingly achieved by entrusting each portion of the economic processes to different, but interdependent facilities in various countries(and not only within the E.U), in which they enjoy a comparative advantage (in terms e.g. of high-level skills, or lower labour costs),which strengthens their competitiveness. Firms are increasingly integrated across national frontiers. Hence a growing gap and inconsistency between the way international business is conducted and how their profit-generating activities are made liable to corporate income taxes. As a matter of fact, the present arrangements are predicated on the 'separate entity' paradigm, whereby each of the entities that compose a MNE – the parent company , and the affiliates (i.e. both incorporated subsidiaries and branches, which are not vested with legal personality)—is taxed separately. As both the 'residence' country of the parent company and the'source'country, where the profits of the affiliates originate, are in principle entitled to impose the profits of the affiliates, the latter would be hit by an unbearable level of international double taxation.

Bilateral double taxation agreements and unilateral retrenchments by the home countries alleviate such international tax duplication. What could, somewhat euphemistically be called an 'international corporate tax system' consists therefore of a mosaic of national tax laws, whose intricacies are exacerbated by the rules that govern the cross-border dimensions of each national corporate tax system. It is often exceedingly difficult to delineate, and adjudicate, which portion of the overall profit of an MNE- group, with its densely interwoven activities, should be attributed to each of its members.

The difficulties are particularly acute as regards the 'transfer' or 'internal' prices that are practised within MNE's on internal flows of goods and services. The national tax administrations want to thwart gambits, whereby the prices on intra-MNE transactions would be modulated, so as to siphon off part of the taxable profit to a taxwise more lenient jurisdiction. The transfer pricing regulations, which have become codified and put into practice by a growing number of countries, are based on the 'arm's length price' criterion, which, in essence, administers the 'separate entity' basic norm of international taxation to intra-MNE transactions. The ' arm's length price' standard posits that the prices of internal transactions should equal the price that would obtain on similar transactions between unaffiliated business entities. Although this yardstick is economically sound, its implementation to the myriad of internal transactions, for which often no 'comparable price' between unrelated parties, is available, raises almost insurmountable hurdles. Today's transfer pricing regulations have become

exceedingly complex and even acrobatic, with resulting high compliance costs both for the MNE's and for tax administrations.

c) As a result of the 'separate entity' and ' arm's length price' standards, companies with EU-ambitions may have to deal with up to 15 different tax legislations and regulations, and with the related interpretative glosses. The representative organizations of international businesses, and more particularly the UNICE, are on record of favouring more comprehensive approaches.[4]

d) Another impetus derives from the initiatives within the EU-- and also in the wider OECD area-- to eliminate preferential fiscal provisions that are harmful to competition. Unjustifiable differences in tax parameters should not interfere with 'neutrality' or 'economic efficiency'. This policy objective is particularly relevant to the EU, which aims at achieving a single internal market. Thus, to eliminate such distortions in 1998 a 'Code of Conduct' was agreed upon: action is being taken to roll back 66 preferential treatments in national tax legislations, that have been identified by the Primarolo group as 'harmful'. Similar state aids through the tax medium are equally aimed at.

e)In the same context, one should mention the endeavours of the OECD, against the use and abuse of tax havens. The events of September, 11, 2001, are likely to re-enforce these actions, as the funding of terrorist activities, deals in drugs and criminal money are often intertwined with tax evasion.

f) The recently agreed 'European Company' statute simplifies the legal aspects of running a business within the EU and 'europeanizes' to some extent the company law. But the new statute contains no provisions in the tax field; it follows that the businesses in the format of the 'societas europaea', in terms of company law will, as before, face up to 15 different corporate profits tax legislations. This intensifies the pressure to complement the new statute with a suitable tax regime, which would have to be conceived in a comprehensive manner, that transcends national tax legislations.

g) Finally, the debate about the future political framework of the EU can no longer be avoided. Some authorities have made a plea for a federal superstructure, of sorts. Within such framework, the federal level of government could well be provided with revenues out of (some) 'own taxes' and not any longer solely with 'own resources' (which consists of revenues levied by Member States and transferred to EU level). Some variants of comprehensive schemes, and certainly the EUCIT, could then become prime candidates for a genuine EU tax. The present ceiling on EU revenues, amounting to 1,27 % of the aggregate Gross Domestic Product, may well will prove inadequate to shoulder the prospective responsibilities of the E.U, beyond 2006, especially as a result of the accession of up to 10 candidate-countries. This would add a budgetary argument for the introduction of a genuine EU tax, apart from the structural one of supplying the EU with a tax handle of its own.

III/ The major Characteristics of the four Alternative Comprehensive Models

The Commission's Report discusses, at great length, four basic alternatives of comprehensive models. They are briefly presented here, in ascending order of Europeanisation, i.e. of lifting the normative competence in the field of company taxation from the Member States to EU level.

A/ Model I: Home State Taxation (HST)

The intellectual pedigree of the HST is rooted in that of 'mutual recognition', a concept that is a vector of integration within the E.U, and is resorted to in the area of financial services. Thanks to such 'passport', Member States B, C… allow financial intermediaries, domiciled in A, to offer financial products in their own territories.

The basic underlying idea of HST is that the taxable profits originating from the affiliates (subsidiaries or branches) of MNE's in other Member Countries, i.e in host countries, would be determined and computed according to the tax code of the Home State, i.e. that of the parent company.

Logically, the taxable bases of the parent company and those of its affiliates in countries that participate in the HST scheme would be consolidated , implying loss compensation. But each of the countries involved would apply its own tax rate(s). To avoid that the tax administrations would become entangled in the complexities of determining the geographic source of the profits, in the light of the presently prevailing 'separate entity' paradigm, a 'formulary apportionment mechanism', similar to that in model II, to be sketched in a moment, would have to be agreed upon.

The proponents of the HST model, which has already been analysed in considerable detail,[5] view their model as a optional one: companies, located in participating Member States, would be free to join or to stay out; in the latter case, the taxable base of an affiliate would, as at present, be shaped by the legislation in its own, i.e. in the host country.

As the Report stresses, the Member States that would adhere to a HST scheme should have previously reached a fair degree of convergence in the definition of their taxable bases, and more generally, in their tax structures. Hence, it is not anticipated that the HST system could be adopted by all Member States simultaneously; it is more likely to be implemented by a limited group of like-minded Member States.

B/ Model II: The Common (Consolidated) Base Tax (CCBT) [6]

This approach, suggested by UNICE and the European Round Table, advocates the adoption-- preferably by all Member States, or at least a number amongst them-- of a new EU code, as regards the definition of the taxable base. MNE's would then be imposed on the consolidated results of their units that are operated within the EU.

However, this 'Europeanisation' of company taxation does not extend to the rate setting: each Member State that joins the scheme would retain the right to fix its own rate(s). But as the traditional 'separate entity' approach would be too tedious, and is of questionable precision, recourse to a system of 'formulary apportionment' is contemplated. The system of 'unitary taxation', that applies at the level of the individual States in the USA , and of the Provinces in Canada, could in essence be replicated; fairly easily ascertainable 'activity indicators', viz. the value of assets, labour costs and sales, are thereby retained , to determine the percentage share of the

jurisdictions involved in the consolidated taxable base of each taxpaying company. In the EU context, each Member State would then apply its own rate to its percentage share of the base. Such indirect criteria act as proxies for the 'real' profits that would have been determined according to the 'separate entity' methodology; in other words each Member State would, kin principle, be entitled to that part of the taxable basis, which is deemed to originate within its borders—resulting in what has been termed a 'juste retour'.

In the view of the proponents of the CCBT, the scheme would be an optional one : companies would in essence be free to adopt the scheme; if they do not join, the various units within the same MNE, would, as today, remain subjected to the tax laws, in each of the Member States, in which they earn profits (or incur losses).

C/ Model III : The European Union Company Income Tax (EUCIT)

This model, on which this article focuses, goes one step further. It not only proposes a common consolidated tax base, as under model II , but also a single rate, which would be fixed at EU level; in other words, Member States would no longer be empowered to fix their own rates.

In the original version of the model,[7] the revenues deriving from the EUCIT, would, quite logically, accrue to the EU, to defray its own expenditures. Accordingly, the new tax would be a genuine EU tax, and not only represent revenue shared by the EU out of national tax resources. In this sense, the EUCIT is conceived not only within the framework of a federal, or supranational system—which also characterizes the CCBT and even the HST, as the Member States would have to divest themselves of the competence to design the taxable base—but it would be a parameter of a real system of fiscal federalism, which organizes the public expenditures and the fiscal revenues of the various levels of government, in casu, those at the EU level and at that of the Member States.

As the revenues would , in principle, accrue to the E.U itself , there would be no need for a primary, formulary apportionment of the EUCIT over the Member States, such as the one contemplated for the CCTB. Besides, the EUCIT does not look at proxies but at actual profits, that are determined in line with the customary accounting practices of businesses.

Depending on the perimeter of applicability of the EUCIT, its resulting yield might happen to exceed the needs of the EU. In such case, a secondary formulary apportionment system could be devised. This could adopt the criteria of, say, the American or Canadian system at state level, as under model II; in such case, for each of the taxpaying MNE's, one would have to construe the values of the proxies. But as the EUCIT is conceived as a building stone to a system of fiscal federalism, it would be more appropriate, and simpler, to follow the logic of equalization systems, that are applied in federal systems: instead of aiming at the ' juste retour', the allotment of the extra proceeds of the EUCIT could be designed so as to redistribute part of the proceeds in favour of the relatively poorer Member States. In other words, instead of re-allocating such extra revenues over the Member States in the light of micro-level indicators, relating to each individual MNE, 'macro keys, such as the Gross Domestic Product could be retained.[8] How the allocational pattern of the proceeds from the

EUCIT would be organized and how it differs from that under the CCBT is further investigated in section IV 3/.

D/ Model IV. A Single, Compulsory 'Harmonized Tax Base'

This model would imply the substitution of all present, 15 corporate tax systems by a single one, "to be applied across the E.U, to all enterprises" (i.e. to all corporate entities)(Report, p. 377). By definition, the tax legislations would be harmonized -- in fact unified. Equally, the base would be a consolidated one. As the revenue out of that tax would accrue to the Member States, and not to the E.U, a formulary apportionment system would be applied, as under scheme II. Contrary to the previous three models, all corporate entities would be subjected to this tax; they would not be allowed to opt out of this tax.

While obviously permitting a monumental simplification and substantial savings in compliance costs, this model is not a realistic proposition, before very long. It is therefore not further discussed in the Report, which mentions it only for the sake of completeness.

IV/ Technical and Political Prerequisites for the European Union Company Income Tax and for the Common Consolidated Tax Base

The efficient implementation of the EUCIT would require adequate solutions to a number of fundamental, and difficult issues, which most often transcend technical matters as they call for political choices. Many of these problem areas are common to the CCBT and even to the HST; but the latter model will not be systematically brought into the picture here, as its underlying philosophy differs considerably from that of the EUCIT and the CCBT. In discussing these problem areas, I often start from objections that can be raised against the EUCIT , or the CCBT, and then proceed with rejoinders.

The following items come up for discussion hereafter :

- 1. the perimeter of the EUCIT . To which categories of companies should it apply?
- 2. the taxable base of the EUCIT, including its consolidation over the Member States
- 3. the applicable rate and the allotment of the proceeds of the EUCIT to the EU itself and/or to the Member States
- 4.whether all or only a limited number of Member States should join
- 5. legislating for the EUCIT.
- 6. administering the EUCIT
- 7. the political acceptability of the EUCIT

IV.1.The Perimeter of the EUCIT . Applicable to which corporations ?

A/ Introduction

The EUCIT, but also the alternative comprehensive schemes, raises the question of which companies should be liable to it. This issue of 'eligibility' boils down to two subquestions. First, should the perimeter of the EUCIT be restricted to one or to a few categories of multinational companies that are operating through affiliates in other Member States? Secondly, should subjection to the EUCIT be mandatory or result from a free option by the

eligible companies? These issues are treated here in a rather summary fashion, as they are analysed elsewhere in a more detailed way by this author.[9]

There are a number of arguments why a universal application of the EUCIT (and of the CCBT) to all enterprises that possess the juridical qualification of a limited liability company cannot realistically be contemplated. First, almost by definition, it would de facto not apply to companies that operate only in their home country; and despite the further cross-border integration process, many , family-type companies will retain a purely national , or even regional horizon. . Secondly, the very rationale of the EUCIT is to cater primarily to the specific profile and tax problems of companies that operate in a large number of Member States; the same can be said about the CCBT and even of the HST. Thirdly, the budgetary needs of the EU superstructure are likely to remain limited, as the EU supranational acts essentially by enacting Regulations or Directives, that aim at achieving, and preserving, a genuine Internal Market; the outlays that are made directly through the EU budget will almost certainly remain comparatively low, as the sectors that are gobbling up the budgetary resources – education, health , public administration—will, and should, remain the preserve of the National States; hence, any federal superstructure in the EU will be a 'light'edifice sui generis, which intermediates much less budgetary means than central governments in federal states, such as Germany or Belgium. The subsidiarity standard will retain its prominence. And finally,
tax administrations would be overwhelmed if they would have to tackle all companies under a novel tax law. As the Report states: " Thus, ideally any comprehensive approach should be extended to all companies. There are, however, practical arguments in favour of a gradual approach, starting with some companies and thereafter extending to include others" (p. 403).

With respect to the EUCIT , but also the CCBT , there are three categories of companies which, at first glance, emerge as suitable candidates for the 'partial' implementation of the EUCIT, but also for the CCBT. They are (i) large enterprises, which have attained a high degree of multinationality within the EU (ii) companies listed on stock exchanges within the EU and (iii) companies which qualify as a 'Societas Europaea'(see above section II f/), Admittedly, restricting the perimeter of the EUCIT , or of the CCBT , to such categories, involves a discrimination amongst enterprises that all carry the legal label of a 'company'; this issue is taken up, after the three 'candidate-categories' have been discussed.

B/ Large multinational companies

The original version of the EUCIT envisaged to restrict its perimeter, at least in a first stage, to a limited number of large MNE's that operate in the EU. These are the enterprise groups, for which the problems that are inherent in the present, ' separate entity' arrangements are most acute, indeed.

In this vision, one should apply the EUCIT only to (large) MNE's that e.g. (i) attain a sizeable turnover within the EU and (ii)) are operating out of, say, at least 6 Member States. Where the borderline should exactly be drawn, would depend on the anticipated amount of revenues from the EUCIT and on administrative considerations. [10]

Obviously, the EUCIT would also apply to MNE's headquartered outside the EU, say in the United States, provided they fulfil the same conditions for eligibility as do EU-headquartered MNE's. To this effect, such firms should designate one of their affiliates in the EU as the unit in charge of complying with the EUCIT.

C/ Companies listed on a stock exchange within the EU

These firms could constitute an alternative set of companies, suitable for application of the EUCIT , or the CCBT. According to data from the European Federation of Stock Exchanges, on regulated stock exchanges, such companies presently add up to about 7.500. Several arguments can be advanced in favour of restricting the EUCIT to listed companies. They are often quite large: their list would overlap to a considerable extent with the set of companies, that were considered in the previous paragraph. Listed firms must comply with high accounting standards which, as from 2005,will become unified, in line with the IAS standards. In the meantime the many differentiated procedures as regards the admission to the listing, the supervision of securities market and several other aspects will hopefully become harmonized, if not unified, by the year 2005, provided the action program, proposed in the Lamfalussy Report[11] of early 2001, is implemented. And the move towards consolidation of the still excessive number of stock exchanges in the EU, already underway[12] is likely to gain further momentum and to result eventually in the creation of a pan-European stock exchange. All these developments will enhance the comparability of the performances of the listed companies before tax; a common tax regime would extend such comparisons to the after tax results.

D/ Enterprises established as ' European Companies '

After a hibernation, which has lasted 30 years, the 'Societas Europaea" (S.E) has finally come to life. It harmonizes several aspects of the company legislations of the Member States, although it falls short of creating a unique, EU body of company law: on several segments of company life, each S.E will still be governed by the laws of the state where it is headquartered, so that there will still be 15 somewhat different national company legislations. The benefits of the S.E status, in terms of a less cumbersome management and of lower administrative costs are nonetheless noteworthy. Thus, S.E 's are enabled to operate as a single corporate body: it follows that they could even function in other Member States, without the need to establish subsidiaries, but could content themselves with operating through branches. The S.E will also be able to submit their financial accounts to investors in consolidated format.

But the Regulation on the S.E's does not contain any stipulation as regards their tax treatment. Accordingly, the prevailing rules, i.e. those embedded in the 'separate entity' paradigm, remain applicable to the parent company and its foreign affiliates; each of the members of the multi-national group remains confronted with the corresponding tax laws of the country, where it operates.

The absence of an appropriate tax complement to the S.E statute explains the lukewarm reactions of the business world to the new legal instrument of the S.E. It also explains why the Commission's Report on Company Taxation states that " the rules governing who may establish a European Company are relatively well developed and restricting a comprehensive approach to this category of company would be straightforward and justifiable "(p. 407). The Communication, remarking that "the concept of the European Company is closely linked to that of a common company taxation system" suggests that " an appropriate 'pilot project ' might usefully be introduced for such companies" (both references on p. 18).

The 'Societas Europaea" does emerge as the prime candidate for a 'partial'application of a comprehensive tax scheme. One significant virtue would be that both for 'fiscal' and the 'commercial' purposes, crossborder consolidation would be allowed.

One problem, as I see it, is that the number of firms applying for S.E 'commercial ' status is likely to be very large, once a fiscal complement, say in the shape of CCBT or of EUCIT, is available. Both the tax and the commercial aspects of running a S.E would become much simpler and less costly. The response to the S.E would then become highly positive, and even enthusiastic. A large number of companies would then be candidates for S.E status, the more that the eligibility criteria contained in the Regulations on the S.E 's are quite ' open ended'. Thus, mergers and acquisitions between firms in different Member States, the setting up of a common Holding Company, or of a common subsidiary, are avenues for access to S.E status. These subsets of S.E's are likely to be rather large companies. But besides, any company, incorporated according to its national legislation, can transform itself into an S.E, provided that it operates a subsidiary in another Member State since at least two years. This clause allows small and medium sized enterprises to venture abroad under the S.E flag. (It is also noteworthy that eligible companies are not obliged to adopt the S.E format, but must freely opt for it).

The wide access to S.E status has the obvious advantage that it does not discriminate between large and smaller enterprises. But one may fear that a large flow of candidates for S.E status, would overwhelm the capacities of the tax administrations-- even if the latter, thanks to the consolidated approach, would soon benefit from a substantial reduction of their work load. A phased introduction of a comprehensive corporate tax to SE's might then be considered , as pointed put in the Communication. One could conceivably start with large MNE's ? This point requires more analysis.

E/ Optional or Mandatory Systems ?

Leaving the free choice to the MNE's is perhaps politically more palatable, at least in the early stages of a comprehensive model. The Report, while also stressing several drawbacks, seems nonetheless to support the optional road. Business representatives on the Experts' Panel Two also advocate the optional entry to the CCBT and the HST '(see the Report ,p. 403). Yet, the Communication does not mention or even discuss the issue of the optional or compulsory application of the CCBT or the HST; the issue apparently remains open.

In the 1997 article on the EUCIT, I have argued in favour of its mandatory application to all MNE's that would, equally in an obligatory way, be encompassed in the perimeter of the EUCIT. Elsewhere,[13] and equally with respect to the other comprehensive schemes, I have come to reject the optional 'facility', not only for the EUCIT but also for the other comprehensive schemes. However, such position is held under the assumption, that a comprehensive scheme would only be applied in a partial way, i.e. restricted to a specified set of companies, such as larger MNE's , listed companies, or those with S.E status.

As a matter of fact, the possibility for firms to opt for the EUCIT or the CCBT would entail a differentiated treatment of firms that are economically quite similar, say large MNE's. Besides, considering that a comprehensive scheme would permit inter-national loss compensation and significantly lower the compliance costs of companies, most likely only a small proportion of the eligible firms would prefer to remain under the old, intricate system. It follows that whether to opt or not to opt may prove to be largely a non-issue. Why then retain the optional route to the EUCIT or the CCBT, if it would be availed of by only a small percentage of the companies?

Hence, a compulsory format appears preferable to an optional one. This principle would also be in order if the CCTB or the EUCIT would be applied to companies that have obtained the S.E status. As the legal concept of S.E cannot be circumscribed to a given set of companies, that would correspond to objective yardsticks, such as their size or their being listed on stock exchanges, the access to the commercial side of the S.E statute must, of necessity, result from the free choice of the firms themselves. But, once they have secured the S.E status, leaving the freedom to choose in favour of the fiscal side would unnecessarily complicate tax administration. Furthermore, as the S.E rules already imply the consolidation of the accounts, for purposes of commercial reporting, one fails to see why the firms, that would have been granted S.E status, would turn down the opportunity to secure fiscal consolidation, which is an essential component of the holistic schemes.

F/The issue of discriminatory treatment

The preceding analysis warrants the conclusion that a partial application of the comprehensive tax format, appears unavoidable, were it only in the light of administrative considerations. This then involves a fiscal discrimination between the companies that are included in the scheme, and those that are left out. This would be equally the case, if the companies were permitted to exercise, or to reject, the option to join.

The discrimination inherent in partial approaches raises a genuine problem, as a different fiscal treatment should be avoided, to the extent possible. But such divergences are warranted, when the enterprises that are incorporated as legally autonomous companies and which wear the same legal cloth, present widely diverging economic features. Thus, there is little similarity between large multinational enterprises with their large number of affiliates, and, at the other end of a highly varied spectrum, a family enterprise, which in order to benefit from the limited liability of shareholders, is formally established as a corporate body. In the latter, the owner-shareholder most often also acts as the manager, in a large company the two functions are delinked. Besides, fiscal considerations are often a major motive for the incorporation of a family firm: as long as the profits remain undistributed, the owner-shareholder can avoid the impact of higher marginal rates in the personal income tax. [14] Thus, differences in the fiscal treatment of economically different companies may be justified--apart from considerations of administrability. Neither should one overlook that national corporate profits taxes often differentiate between large and ‘ small and medium-sized companies ‘.

In conclusion, there are solid arguments for hooking a comprehensive company tax on one of the three segments of companies, that were outlined above, despite the inevitable discrimination vis-à-vis companies that fall outside the purview of the tax. There is less justification for applying, say the EUCIT, only on companies which would have opted for it, as this would unduly discriminate with other firms with comparable economic features .

Other things being equal, the companies to which the comprehensive model would apply would normally enjoy a lower effective tax burden, as they would be able to offset losses; besides, their tax compliance costs would also significantly be lowered. To re-establish the balance with the group of companies that would remain outside a comprehensive scheme, the Report (p.403,416) moots the idea – which is apparently supported by business representatives —that ‘special rates’ might be applied. This would imply that the ‘ in’s ‘ be subjected to a somewhat higher rate than the ‘out’s’.

IV.2/ The Taxable Base of the EUCIT

Both for the EUCIT and the CCBT, a new tax code would have to be crafted and agreed upon. What would be the contents of such novel corporate tax, that would exist alongside the other national tax systems? Let us first look at the design of the taxable base – an undertaking that would be common to the EUCIT and the CCBT. Then, I comment on a hallmark of all comprehensive patterns of EU corporate taxation, namely the consolidation of the taxable bases of all units of the same multinational group within the EU-area.

A/ Defining the taxable base of a novel corporate tax

It may be objected that it would be laborious to secure a consensus amongst the Member States , with respect to the taxable base of the EUCIT ,or the CCBT. The base is made up of a large number of essential structural elements, hat are actually modulated in differing ways in the various national tax legislations, indeed. One is led to remember that the efforts to achieve harmonization in the EU of only some of those areas, have so far proven unsuccessful.

But this conclusion is overly pessimistic as :

- The Commission's Report, in its Part II, A/ contains a detailed 'qualitative analysis' of company tax systems in the EU. Apart from (i) the tax rates, nine other 'structural elements' of a typical corporate tax system are being surveyed, namely (ii) tax accounting rules (iii) depreciation (iv) provisions (v) losses (vi) capital gains (vii) mergers and acquisitions (viii) group relief/consolidation (including inter-group dividends) (ix) inventories and (x) expense deductions. It was found that "…there are substantial qualitative differences in certain areas" but that " in a number of cases the changes that would be required to bring Member States closer together would not appear to be major and in a number of categories one could question the 'need' for the detailed differences" (p. 67). Hence, on several of those structural parameters, agreement would be rather easy.

-There is a high degree of agreement about the overall philosophy that should shape the taxable base of corporate income taxes. As a matter of fact, from the 1980's onwards, an international consensus has emerged, to weed out a large number of allowances, deductions and the like, that narrow the taxable basis, but , as a quid pro quo, to markedly reduce the nominal tax rates. National tax laws have quite often been adjusted accordingly. It has become acknowledged, indeed, that 'tax expenditures '(i) have doubtful incentive effects, as most often they do not trigger the decision to invest and merely amount to a windfall profit for firms that would have invested anyhow; (ii) they often discriminate between sectors and distort competition; and (iii) they render the tax system and its administration more complex.

-The EU now acts against harmful tax competition

-Some policy goals, as the need to foster R and D, that are pursued by way of tax incentives, are basically shared by all Member States and could be entrusted to the E.U level, i.e. made part of the EUCIT , instead of being operated in each national tax law. This is even more the case for tax incentives that would pursue explicit EU objectives, such as investments in less developed regions.

--As already mentioned, progress is also in sight as regards accounting rules. ned . By 2005, listed firms will have to adopt the IAS standards, as regards their disclosure to shareholders. The EUCIT or the CCTB legislator would have to decide to what extent the accounting standards for commercial reporting should also be applied in the tax field. Practices of Member States differ in this respect;[15] this is

discussed in the Report, p.318-24. It should not be too difficult to devise, for tax purposes, a (single) scheme benchmarked to 'best practices.

B/ Consolidation of the taxable bases

This essential feature of the new comprehensive schemes views the various units of MNE' s within the EU as interconnected members of the same family. This 'group' concept is actually enshrined in the legislations of most Member States(although not in Italy, Belgium and Greece), but only in a domestic setting; the German 'Organschaft' provides a well-known example. The negation of the group concept implies concretely that the losses of a subsidiary within Belgium cannot be offset against the profits of its Belgian parent company. Losses in branches ('permanent establishments' in the tax jargon), which are not vested with legal personality, on the other hand, can usually be compensated against the profits of their parent company.

Thanks to EU-wide consolidation, it would become possible to offset the losses in a subsidiary in another Member State against the profits of the parent company. For tax purposes, the results within the EU, of the whole group, would be treated as an interrelated, single taxable object. This carries the connotation that the EU scene should no longer be viewed as an area of juxtaposed national markets, but as a large single market.

The consolidation does not only affect the status of subsidiaries that incur losses. It also, by definition, implies that internal transactions between members of the same enterprises are eliminated so that only those conducted with external counterparts – the only one's that generate a flow of real profits for the enterprise – are reflected in the accounts. Consolidation accordingly would solve the thorny problem of transfer pricing within the EU—provided the various Member States program the same tax burden (as is the case in the EUCIT). Or, if tax rates remain differentiated amongst Member States (as under the CCBT) the extent to which companies would be tempted to indulge in transfer pricing gambits would depend on the dispersion of the rates between the Member States and the scope for transferring values of the proxied factors(such as ' sales turnover ') to leniently taxed jurisdictions.

One objection might be that consolidated accounts for the EUCIT and CCTB schemes and even for the HST, only cover the EU Member states, whereas the larger MNE's typically consolidate on a worldwide basis, when they report to investors. [16]. The restriction to the EU-area would involve some extra work, indeed. But consolidated accounts are built up from the various 'national' accounting data in the countries where the affiliates are located. Most importantly, submitting a single consolidated return to the fisc for the EU-operations, already represents a vast simplification, as compared to the present country-by-country segmentation of the accounts . Moreover, the Euro already eliminates the need to 'translate' data from the currency of a given Member State into that of the parent company.

IV.3/ The applicable Rate(s) and the Allotment of the Proceeds to the European Union and /or over the various Member States

These are two parameters, where the EUCIT and the CCBT evidently part ways. Hence , it is advisable to first discuss the EUCIT, then to turn to the CCBT—both in their original formulation – and finally to ascertain whether the analysis suggests variants.

A/ The European Corporate Income Tax (EUCIT)

In the original blueprint, the EUCIT would, in principle, be accruing to the EU budget, and not to the Member States. It would be one of the revenue sources of the EU. The very fact that the EUCIT carries a single rate, obviates the need to split the EU-consolidated base over the Member States—as is the case in the CCBT. .

The proceeds would represent not only a component of the 'own resources ' of the EU, transferred upwards d from the Member States, but would be a genuine 'own tax'' (as the EU would have the competence to design it). This makes sense, as the high degree of integration of the economic activities of the taxpaying MNE's, and the difficulties inherent in segmenting the consolidated net profits over the various jurisdictions in which they originated, argue for the assignment of the EUCIT to the level of the EU itself, within a system of fiscal federalism.

It can be objected that, if, in a primary allotment, the proceeds were fully accruing to the EU itself, they may easily exceed the budgetary needs of the EU; for the EU as a whole, the corporate income taxes amounted to 3,2 % in 2000. (see the data in the Report, p. 22). Hence, a mechanism should perhaps be devised to achieve a secondary redistribution of this 'surplus' over the Member States. How could this be done?

Such excess proceeds should obviously not be 'returned' to the Member States in proportion to the taxable profits that have their 'source' in each of them. Such an approach, the single rate of the EUCIT notwithstanding, would reopen the 'Pandora's box' of the 'separate entity' approach, with all its attendant difficulties, which the very EUCIT scheme (but also the CCBT) intends to overcome. Hence, if one were to achieve the demarcation of these 'geographical, national sources', one should apply simpler, 'formulary' criteria.

Could the 'formulary allotment', replicated from the American, or preferably the (simpler, because more uniform) Canadian model of 'unitary taxation' – discussed in more detail in the next section -- provide a solution for such secondary redistribution? In my view, this would be counterproductive. Such allotment system would entail a needless complication, as it uses a set of proxies that are divorced from the traditional 'accounting' approach to the determination of taxable profits, which enterprises are accustomed to practise; it would also mean that such proxies must be calculated for each the taxpaying MNE's, with attendant compliance costs for the taxpayers and the need for the tax administration of the Member State where the MNE operates its headquarters, to ascertain whether the values of the proxies, that have been declared for the foreign affiliates, conform to reality.

The proper approach for achieving a secondary re-funneling of excess revenues from the EUCIT, would consist in the adoption of an allocation at the 'macro level', and no longer at the 'micro level' of the taxpaying enterprises concerned. This would circumvent the complication just mentioned ; it would also allow to implement theories and practices of federal state, that go beyond the mere implementation of the 'juste retour' yardstick. This issue requires some further elucidation.

The constitutional arrangements in federal states typically guarantee that the subnational entities get a substantial portion of their ’own’ fiscal resources’ out of the a specified percentage of proceeds from taxes that are levied at the federal level. Following such ‘vertical’ sharing of the tax pie, ‘horizontal’ allotment keys must be agreed upon, to determine how the portion reserved for the subfederal level, is to be divided further amongst the various entities at that level. This can be performed, according to alternative criteria; the two major, and opposite yardsticks are:

(i) the ‘derivation’ or ‘ juste retour ‘ principle, whereby each subnational unit is entitled to the proceeds that originate within its territory. This criterion favours the richer entities.

(ii) the ‘differential needs’ principle, whereby, in the light of measurable objective indicators, as e.g. the per capita income levels, some degree of redistribution is achieved to the benefit of the comparatively poorer members.

Some degree of solidarity and hence, of fiscal redistribution (‘equalisation’, ‘Finanzausgleich) in is a congenital dimension of a federal system, as otherwise the very existence and essence of a federal system would be negated. But this cannot be carried too far, lest the more affluent members of the federation would go it alone. So, the two antithetical distributional keys are often combined and reconciled.

After this digression, let us return to the EUCIT . The disposal of possible EUCIT excess proceeds would have to be designed within the broader framework of the EU budget and strategies, and the calibration of the contributions of each Member State to the EU budget.

As regards the ‘juste retour‘ criterion one should look for reliable ‘keys’. Those geared to an allocation on the micro level – most prominently amongst them, the ‘unitary tax ‘ systems in the United States and in Canada – are suited to comprehensive systems, and more particularly to the CCBT, in which the need arises to determine the share of the overall consolidated net profits to which each of the Member State involved is entitled , and on which it can impose its own rate.

Conversely, in the EUCIT, there is no need to apply a ‘ micro-level’ allotment, but it could and should resort to ’macro level’ apportionment key(s). As the Report notices (p. 415), “allocation at such a macro level might really only be appropriate if it were the tax itself, which was being allocated , in which case such a macro level allocation implies a common rate of tax “

Subject to further refinement, the GDP’ s of the different Member Countries, are likely to provide a suitable and politically acceptable ‘horizontal distribution’ key’. As a matter of fact , in the realm of corporate-- as well as individual – income taxation , the ‘source‘ countries, where the taxable profits originate, have a prior taxing claim over the residence countries. There probably also exists a fairly close correlation between the GDP’s of the Member States and their proceeds from the various corporate tax systems, especially as in the EUCIT system tax rates (and bases) would no longer diverge. Alternatively, GNP values could also be applied; this would be slightly more advantageous for Member States which headquarter a number of large MNE’s , such as the larger Member States and, say , the Netherlands and Sweden, as compared to , say, Belgium.

But, as just stressed, systems of fiscal federalism , are not exclusively predicated on the ‘ derivation’ yardstick. The keys for re-allocating revenues to the subfederal level can be

modulated so as to achieve some degree of net redistribution of fiscal resources, to the benefit of the poorer Member States. This is also already practised, to a limited degree, in the present EU budget , with respect to the 'GNP contributions' by the Member States. Hence, in the EUCIT the secondary redistribution of the excess proceeds could be modulated so that the poorer Member States would get a higher share than the portion that would conform to the 'juste retour' principle.

What if, instead of endowing the EU itself with the prime proceeds from the EUCIT , it were decided that the proceeds from the EUCIT, its single rate notwithstanding, would would be allocated fully to the Member States and divided amongst them? This is a conceivable variant of the EUCIT, which is mentioned in passing on p.377 of the Report.

If the full re-distribution over the Member States were based on the same micro-level allocational approach as in the CCBT , i.e on the 'unitary tax ' methodology , the resulting system would be tantamount to the CCBT itself. But it is also conceivable that a macro-key, say GDP, be applied to the apportionment of the proceeds of the tax, levied with a single, EU-legislated rate. The resulting format would be a hybrid between the EUCIT and the CCBT . The macro-approach to the re-distribution of the (primary) proceeds from the tax , with its retrocession in globo, would be simpler to handle than if the micro-based unitary tax approach were applied. But the single rate feature would contradict the very rationale, why the CCBT is advocated in the Communication by the Commission, which postulates the right of the Member States to fix their own rate on the share of the consolidated taxable base, allocated to each of them. And such a tax would no longer qualify as an 'own tax' proper at EU level; the name ' European Consolidated Income Tax' would become a misnomer, as it no longer be encapsulated into a system of fiscal federalism.

B/ The Common Consolidated Base Taxation

As already mentioned in section III, the CCBT, as actually presented in the Report, differs from the EUCIT in two essential dimensions. First, each Member States retains the right to fix its own rate on that part of the EU-consolidated taxable base, which is allocated to it. Besides, the share of the taxable base, would be determined by the values of proxies, to be calculated for each MNE, i.e at a micro-level.

The Report considers the 'unitary tax' systems that are operated at the subfederal level in the United States and in Canada as possible models for the CCBT. Contrary to the American approach, in Canada the parameters, applied by the Provinces, are much more harmonized— apart from the rates. "All of the provinces use the same two-factor property and sales formula and generally use the federal income tax base, with only minor differences in the weights " [17]

The recourse to such system is likely to score an improvement over the present arrangements, derived from 15 different corporate tax systems. But foremost experts on the North American 'unitary tax' systems, who have also thoroughly investigated whether these formats are recommendable to the EU, voice severe caveats. [18] They stress that one should not leave to Member States the right to fix themselves the factors in the formula, and their relative weights, as otherwise they would induced to give preference to factors that favour them . Neither has there been any evidence that market forces in the USA were moving the formulas in the different States towards convergence. The authors also show that the use of factors as proxies for the accountancy-derived real profits transform the corporate income tax into a direct tax on the factors in the formula and that the effective rate on a factor is commensurate with the use of that factor. [19] With tax rates at variance amongst the Member

States, transfer pricing gimmicks are not fully foresclosed with respect to the factor 'sales ' or 'gross receipts', which can artificially transmigrate to lower-taxed jurisdictions-- especially with the rise of digitally-intermediated transactions. The final verdict that "a formula apportionment system would not necessarily be less complex than is presently the case " [20] pours a cold shower on any enthusiasm to transplant the 'unitary tax' model to the European scene—although the criticism is apparently addressed more to the 'chaotic' situation in the USA than the more harmonized model in Canada. One may add that the 'unitary tax' formulas are not embedded in the customary framework for assessing taxable profits, namely on the basis of accounting data and standards; in this respect, the EUCIT scores better than the CCBT. This would be particularly the case if only a subgroup of Member States would apply the CCBT-with-'unitary tax' apportionment, and the others would stay outside it; the tax authorities would then operate two quite different methods for assessing taxable profits.

Differentiated tax rates, at national levels, entail distortions in the allocation of resources and involve welfare losses. This is acknowledged in the Report. Although it basically accepts ' tax (rate) competition', it warns against too wide a divergence (thus, on p. 423 and **). A 10 % rate in Ireland and a 0 % rate in the prospective member Estonia is apparently proscribed. The dispersion of the national rates in the CCBT should accordingly be constrained to a fairly narrow band, which the EU would have to determine. This , obviously, narrows the reach of the fiscal sovereignty of Member States.

In such circumstances, variants to the original CCBT are worthy of attention. One consists in a micro-level allocation on the basis of the 'value added' in each of the MNE's covered by the CCBT. Subject to further enquiry, the Report, p. 414, seems rather favourably disposed towards such approach. In the EU, contrary to the USA and Canada, enterprises are subjected to the Value Added Tax. The data they have to maintain for the VAT could, with some adjustments (excluding exports, including imports; depreciating capital investments instead of immediately expensing them) be availed of to construe such micro-level yardstick.

But why not then turn to the macro-level apportionment key that was suggested above for a 'secondary' redistribution in the framework of the EUCIT? As a matter of fact, Gross Domestic Product aggregates the values added in production in a country. Such a variant of the CCBT would be considerably simpler to handle than the original specimen; it would not impose reporting procedures on the companies; moreover, the final outcomes are unlikely to diverge much than if the 'values added' in the enterprises were to be established at the micro-level.

IV/ 4 / Full or Selective Participation by Member States

This is another issue, raised by the comprehensive schemes. Do they require the participation of all Member States, or only by a subgroup amongst them, which would be willing to embark on the novel scheme? In terms of EU principles, the Nice Treaty legitimates the 'enhanced cooperation' amongst 'like-minded' Member States that would agree to move faster along the path of European integration.

But such partial participation ratio would be far from optimal. The high degree of integration of the activities of enterprises in the EU owes much to the fact that they view the EU as a single market; and the basic rationale of holistic schemes is that they offer an appropriate tax treatment to such integrated pattern of business. Besides, if, in a somewhat overcharged example, only some smaller Member States would participate, the scope of the EUCIT or the

CCBT would be significantly narrowed: such countries usually headquarter few MNE's, which would operate few affiliates in the other participating Member States. And again, if apportionment formulas are adopted, that deviate from the usual accounting methods for measuring taxable profits, companies, and tax administrations, would have to operate two widely different systems for each of the two subgroups, with attendant complications.

The Report discusses this issue and states : " Clearly, to qualify as 'comprehensive' a grouping would have to involve a number of Member States but discussions in the panel if exports did confirm that notwithstanding the fact that participation of all Member States would be preferable, a partial implementation would be a step in the right direction; In the same way the creation of harmonized base by a limited number of Member States would be seen as progress. " (p. 401). [21]

IV/ 5/ Legislating for the EUCIT

The drafting of a single, and novel corporate tax law, in itself, is not much of a problem, provided a consensus is reached on its contents. This would provide the opportunity to prepare a 'clean' piece of legislation, which would substitute for the present national tax statutes, that have been revamped repeatedly, by bits and pieces, and do not show structural neatness or harmony. A substantial improvement, in terms of simplicity could thereby be achieved. One may point to the centrally-planned countries that recently transited to a market economy: they had to introduce new tax laws. Thus, in 1994, in the PR of China.

Assuming that Member States would agree on the principle, and on the main contours of the EUCIT, or the CCTB, it would be preferable to have such holistic scheme adopted by the European Parliament, were it only because of the democratic principle of ' no taxes without representation'. Anyhow, the Parliament would insist in having its voice heard.

One may nonetheless question whether the Parliament is equipped for that task? There may be a flood of amendments, some of them inspired by myopic national or sectional interests, that would harm the coherence of a the novel EUCIT or CCBT law. Hence, the technical preparation of the EUCIT, or CCTB legislation, should not be entirely entrusted, in an 'open ended' fashion, to the Parliament. A strong leadership of the Commission and of the governments would be required to avoid derailments along the intended route. But the Parliament, obviously, must be associated with the preparatory work.

IV/6/ Administering the EUCIT

Whereas the CCBT would naturally be audited by the fisc of the country where the MNE is headquartered, the EUCIT, a EU-tax proper, could conceivably be audited –especially if u only a limited number of MNE's would fall within its perimeter. This was the position expressed in the original 1997 article on the EUCIT. But, alternatively, that task could, as at present, be left with national tax administrations. This is, no doubt, in present circumstances, a more realistic proposition, as national tax administrations would be reluctant to cede their competence in this area.

Admittedly, entrusting the administration to a single EU- corps of officials, would ensure an even-handed application to all taxpayers covered by the scheme. But auditing at the national level has several advantages: it can be performed in the language of the taxpaying company. Tax administrations would have to build a corps of auditors, skilled in dealing with companies

with complex, border-crossing ramifications; but such specialization already exists today in most countries. Tax auditors of the EUCIT would soon develop common standards of administration. And if disputes between taxpayers and the fisc in the home country escalate into judicial proceedings, the latter would be adjudicated by the national courts, according to the new EUCIT legislation. The European Court of Justice would soon be called upon to interpret the law, thus contributing to the body of tax rules in this area, that would attain a high degree of evenness.

Another problem may arise in holistic systems. To what extent do the tax authorities of the Member States involved in a given auditing case, still have to cooperate with each other, although, under the EUCIT , and the CCBT , the MNE only has to submit a tax return to the fisc of the jurisdiction is headquartered ? It is acknowledged that the application of the residence principal in inter-national taxation runs into the difficulty of identifying and measuring the taxable incomes in the host countries. [22] This difficulty occurs particularly with respect to individual income taxes. As regards corporate taxation, and subject to further analysis, the very fact that the EU-consolidated accounts would be certified by professional accountants provides a strong protection against the occultation of taxable profits in the host countries. If the taxable base (in the CCBT) or the tax proceeds (in the EUCIT) would not be apportioned according to accounting standards, but in reference to proxies, the problem would be that of the truthfulness of the values attached to the factors in the formula's. But even a 'unitary tax' approach would probably be less susceptible to erosion by evasion gimmicks, than the present complex ' separate entity ' procedures.

IV/ 7/ The Political Acceptance

An essential prerequisite before the EUCIT , and even the CCTB and HST formats can be put into place, consists in their acceptance by the governments of the Member States. No doubt, the present unanimity rule in fiscal matters is a major obstacle on the way to political acceptance of far-reaching comprehensive schemes. This is probably particularly the case for the the EUCIT, which vests the authority to fix the rates with the EU.

Entrusting the competence to legislate in the field of company taxation to the EU adds a federal, supranational element to the EU construction. The EUCIT moves furthest , and is clearly cast within the framework of a fiscal federalist order. But also the CCTB involves the abandonment of the fiscal sovereignty over an important segment of fiscal legislation, namely that of defining the taxable base. (And even in the HST , the host countries would no longer design the taxable base of the affiliates of foreign enterprises but would acquiesce in applying the tax code of the home country.)

Tax sovereignty is highly valued by states and national governments; it is a symbol of their overall sovereign status, and it hands them an instrument of fiscal policy, not only with a view to modulating overall effective demand, but also to pursue specific sectoral or micro-economic results. The argument for preserving national sovereignty in the fiscal field carries more weight since the other main handle of macro guidance, that of monetary policy, has been transferred since 1999 to the European Central Bank.

But the capacity of a Member State to appropriate the revenues out of the taxable profits, that should be attributed to it, within the present 'separate entity' system, is to some extent illusory, because such revenues are eroded by transfer pricing and other tax planning gambits. It also runs increasingly into technical difficulties. From the angle of tax administrations, the

present arrangements involve high costs and some loss of revenues, on account of tax avoidance and outright evasion and. As analysed in a recent article,[23] the basic reason why, in an integrating economic space, fiscal sovereignty is increasingly being eroded, lies in the mobility of taxable objects. Globalization enhances the scope and the speed of such mobility.

Besides, purely in terms of budgetary means, the transfer of revenues out of the corporate income tax to the EU authorities, under the EUCIT scheme, would be neutralized by a commensurate reduction of the revenues, such as those out of the VAT , that are currently devolved upwards to the EU.

It may be objected that, under the EUCIT, one tax handle, that of modifying the rate of the corporate income tax, would no longer be available to the Member States but be vested with the EU. While this must be conceded, several considerations downgrade the relevance of such objection. First, the timing of discretionary countercyclical fiscal measures is seldom judicious, considering the time lag between the identification of an adverse economic situation and the enactment of remedying tax measures, especially if the consent of parliament is required. Fortunately, the 'built-in-elasticity' of tax revenues already acts in a countercyclical direction. Moreover, as the economies of the Member States increasingly coalescence, modifications of the tax rate, in the EUCIT, for macro-economic purposes, may as well be pursued at EU level, and could be enacted with less delays. And finally, national governments would still have command over several other tax handles, such as the personal income tax.

A similar remark applies to the micro-economic or sectoral objectives, that would be pursued by changes in the tax rates. First, the scepticism widely shared by scholars (but much less by the business sector and by political leaders… about the efficacy of such tax incentives, discussed earlier(see IV/ **), should discourage an ample recourse to tax instruments. Besides, where the pursuit of objectives through the tax medium remains recommendable, as, for example, in favour of R and D activities, such concerns are likely to be relevant for the whole EU. Hence, an EU- wide approach may be superior to separate and uncoordinated national initiatives, which, as a side effect, would cause distortions in the Internal Market.

V/ The Rewards and the Pains of Comprehensive Models

A/ The difficulties involved

A comprehensive model of corporate profits taxation in the EU can only be designed if previously a satisfactory solution is found for a host of technical problems and if difficult political choices are arrived at. This paper discusses some of the major issues involved; and yet, it does not pretend to be exhaustive or to explore the 'fine print' of detailed prescriptions, which fill tax laws. Only a strong dose of 'political will' of the Member States would allow to overcome such difficulties. Thanks to the unanimity rule, which is still prevailing in fiscal matters, a single Member State can block attempts to move towards such a novel, and far-reaching comprehensive scheme; the 'enhanced cooperation' between only a few member states, while conceivable, is not recommendable. In the light of all these hurdles, some may feel that the orientations sketched in the Commission's Report and in the Communication, are fated to soon fall into oblivion.

This is nonetheless an excessively pessimistic projection. The various factors, surveyed in section II of this article, and particularly the desiderata of large businesses and the recent institution of a EU corporate vehicle, provide a strong push towards the conceptual

acceptance and the subsequent implementation of a comprehensive scheme, that would be more attuned to the high level of integration of businesses in the EU.

Most importantly, there is growing recognition that a comprehensive schemes would mean a significant improvement, both for taxpaying companies and fiscal administrations, over the present convoluted ways of tackling the profits of MNE's in the EU. A well-designed holistic approach, although not perfect, would score much better than the present 'separate entity' methodology, in terms of the criteria to evaluate a ' good' corporate tax sysstem in the EU , [24] viz.

-efficiency or allocational neutrality : taxes should interfere as little as possible with the preferences of economic agents. Especially in a single market, the localisation of investments and the operations in a 'level playing field' should not be distorted by tax parameters ; they should compete in a 'level playing field'.

-effectiveness: the ability of governments to implement their tax legislation and to enforce the intended tax liabilities, so that both double taxation and under-taxation are absent

-low compliance costs : thanks to simplicity, certainty and transparency of tax legislations

-inter-nation equity : the Member States in the EU appropriate their rightful part of corporate tax revenues . This (rather elusive) concept does not necessarily imply a 'juste retour ' flow of revenues; as argued above, the Member States could bend the distributional format of revenues towards some degree of solidarity with the poorer Member States.

B/ The Rewards

1/ The EUCIT would indeed entail substantial benefits for the companies covered by the scheme, but also for tax administrations. As a matter of fact:

- the eligible MNE's would no longer have to deal with up 15 national tax systems and their intricate inter-national tax rules; they would submit one tax return. This would represent an immense simplification and reduction of compliance costs. - the consolidation of profits and losses of all entities of the same MNE , in the EUY area, eliminates a number of problems that bedevil the inter-national arena, viz.

- Losses would be consolidated with profits between all units of the MNE ; The overall net result of the MNE within the EU would become the object of the corporate tax.

- Both subsidiaries and branches would be consolidated. Actually, they receive a different fiscal treatment, because of their diverging legal specification, although their economic substance is similar.

-The distinction between residence and source principles would no longer be relevant in the corporate tax area [25]

-Transfer pricing problems, today viewed as the most important problem in the international tax arena, would be eliminated, within the EU. This relates not only to the firm's transactions in goods and services, but also to the treatment of services that are centralized at headquarters (ex. R and D, or financial services). Manoeuvers to shift taxable profits to a lower-taxed country would become self-defeating upon consolidation. (Admittedly, the scope for transfer pricing disputes remains for transactions with affiliates outside the EU. But most trade in the EU occurs still occurs with other Member States; and the tax authorities could henceforth concentrate their efforts more on intra-MNE transactions with outside countries.

-Special preferential regimes, within the EU, say, tax haven affiliates, would become useless. The profits, possibly siphoned off to such lower taxed depositories, would be recouped upon consolidation.

-Double taxation agreements between Member States would be applicable to substantially less items (namely to companies not covered by the EUCIT , and individuals)

With outside countries, such as the USA, a single agreement with the whole EU would replace the 15 pre-existing bilateral agreements .
-Economically, the EU-area would, from a tax viewpoint, constitute a 'level playing field' for the firms, subjected to the EUCIT ; tax distortions would be eliminated.
- Almost certainly, assessments would be more effective than at present, as (i) some major avenues for 'tax avoidance' particularly transfer pricing modulations , would no longer be relevant; (ii) the somewhat higher tax burden on operations through foreign affiliates, as compared to purely domestic ones' would no longer, would also disappear.[26]

2/ Most of those benefits would also be reaped under the aegis of the CCBT. The EU-wide consolidation of profits is a common feature of the EUCIT, indeed. In terms of allocational efficiency, the CCBT scores less favourable. The tax burdens resulting from the new corporate tax would vary between Member States. Whether such divergence would tempt MNE's to practise transfer pricing manoeuvres , would depend on whether the 'formulary apportionment system', that would be put in place, is impervious to such avoidance gambits. The 'unitary tax ' system in the United States and even in Canada does not give such guarantee-- apart from being alien to the way profits are customarily accounted for. The conceivable substitution of a 'macro' distributional key for one the 'micro-level' may possibly alleviate this concern. As against this, the CCBT recognizes the authority of the Member States to fix themselves the rates on corporate profits. As explained in section I, the Report privileges the sovereignty of Member States, and the resulting competition as regards the rate setting, at the cost of allocational unneutralities.

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FOOTNOTES

[1] What I title ' the Report ' in this article , is (too) modestly called a ' Commission Staff Working Paper ' .

[2] Thus , at a conference in Rotterdam , in which Commissioner Bolkestein outlined his general strategies, the Dutch Deputy Minister of Finance Bos argued that the Member States need to focus on coordinating tax rates , rather than on rates or bases separately.
[3] The effective tax rates, resulting from the interaction of the nominal rates and of the taxable bases, have been calculated on hypothetical , but stylised '<u>marginal</u>' investment projects , both transnational and domestic one's (whereby the post-tax rate of return equals the market interest rate) rate, following the methodology that has been pioneered in the eighties by King and Fullerton. In the Commission's Report , Devereux and Griffith have extended this analysis and also measure the effective <u>average</u> tax rate(whereby the investment project earns an extra-profit). In the Report, another methodology, predicated on a 'model firm' , and designed by the University of Mannheim, essentially confirms the basic finding of the former approach that the nominal tax rates are the main determinant of effective tax rate differences
[4] See UNICE's "Position paper on Company Taxation in the Single Market ", November 11, 1998.
[5] See Lodin, S.O and Gammie , M. "Home State Taxation ", Amsterdam: IBFD Publications
[6] The following three models are collectively subsumed in the Report, p; 384, note 187 ,as 'approaches based on harmonization', to distinguish them from the 'mutual recognition ' method of the HST scheme. They do involve the drafting of a new tax code, at EU level, indeed.

[7] See Plasschaert,S. , " An E.U Tax on Consolidated Profits of Multinational Enterprises"," European Taxation", 1997/1
[8] The Report , p. 414 –17 has introduced the distinction between allocations on the 'micro', and on the 'macro' levels.
[9] Plasschaert,S., " Comprehensive Approaches to EU Company Taxation : to which Companies should they apply ? ", forthcoming in ' European Taxation' , 2001/1
[10] Clues could also be found in some other EU directives , as that on the 'information and consultation of employees', which are also led to circumscribe the area of their applicability**.**

[11] See the "Final Report of the Committee of Wise Men on the Regulation of European Securities Markets " , February, 15, 2001.
[12] As exemplified by the merger of the bourses of Paris, Amsterdam and Paris into Euronext.
[13] See the reference under note (10)
[14] In this connection, it must be reminded that a major justification for corporate income taxation derives from the need to thwart manoeuvres to avoid individual income tax through a corporate vehicle. Hence, there should be at least a corporate tax on undistributed earnings.
[15] Typically , Member States in the Southern half of the EU tend to conform tax rules to accountancy standards; in the Northern Member States , accounting rules for tax purposes diverge from those for financial reporting.
[16] Under quite stringent conditions, Danish parent companies can apply for joint taxation with its wholly owned domestic and foreign subsidiaries. This is discussed in the Report , p. 342.
[17] Martens Weiner ,J., "The European Union and Formula Apportionment : Caveat Emptor ",in "'European Taxation", December 2001. .
[18] See Martens Weiner, under footnote 18 ; and Mc Lure, Ch. and Weiner,J. , " Deciding whether the Eureoapn union should adopt formula apportionment to company income " , in "Cnossen, S. '(ed.) Taxing Capital Income in the European Union ", Oxford University Press, 2000.
[19] This last finding was already substantiated by Mc Lure, CH. In " The State Income Tax : Tax Lambs in Wolves'", in Boskin, M.J. (eds), " The Economics of Taxation", Washington : The Brookings Institution, 1980. '
21 See Martens Weiner, mentioned under note 18
[21] On should notice that the hypothesis of groupings with limited participation refers more specifically to the HST scheme than to the EUCIT or the CCBT, as evidenced on p. 382.
[22] As stressed by Tanzi, V. in " Taxation in an integrating World ", Washington: The Brookings Institution, 1995.
[23] Mc Lure, Ch. "Globalization, Tax Rules and National Sovereignty", Bulletin for International Fiscal Documentation", August 2001.
[24] See the Report, p. 25-30 and 421-23 , and Plasschaert,S., as cited under note 9

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[25] This distinction has already been breached by the jurisprudence of the European Court of Justice, invoking the four freedoms and the principle of 'equal treatment'. The Report, p. 307-17 contains an interesting analysis of the case law of the CJ as regards direct taxation.
[26] As documented in " Taxing Profits in a Global Economy: Domestic and International Issues" , Paris: OECD, 1992.