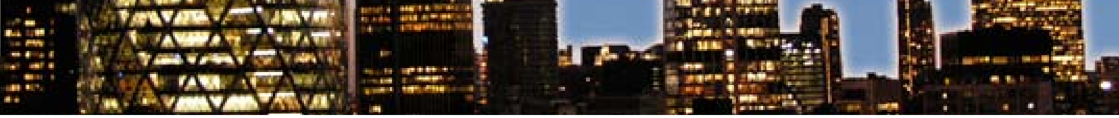
Costly, Complex and Counter-productive

The Case Against the Common Consolidated Corporate Tax Base

Damon Lambert

The Bruges Group



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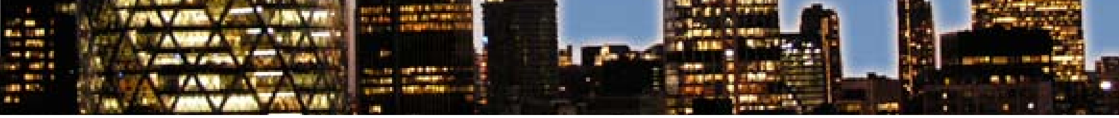

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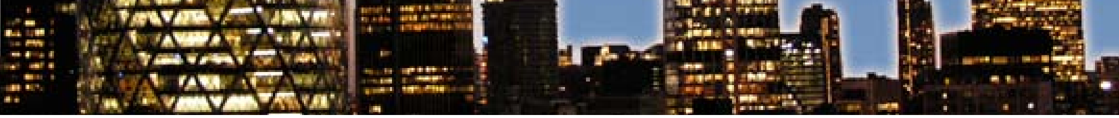
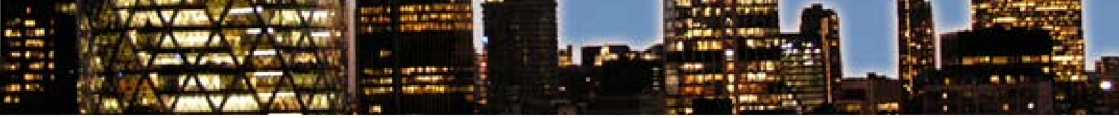


THE AUTHOR

Damon Lambert is the UK Corporate Tax Director of a major European Bank. Previously, he worked for 11 years in KPMG's financial sector practice where he specialised in advising on mergers and acquisitions, primarily for financial sector multinationals. The advice he provided to clients included amongst other issues the impact of the EU and the ECJ on UK tax law. Damon is a qualified Chartered Accountant. He regularly writes on European Tax matters and was a member of the working party on the Tax Reform Commission instigated by George Osborne, co-authoring the chapters on business taxation and tax reforms in other jurisdictions.

This work is Damon Lambert's personal opinion.



Executive Summary

The CCCTB will cost each person in the UK £1,200

Over a 10 year period the Common Consolidated Corporate Tax Base (CCCTB) will reduce the UK's GDP by £73 billion, costing each person living in the UK £1,200, equivalent to UK taxpayers having to pay a 1.5p increase in the basic rate of income tax for each of those years or each UK inhabitant paying over £1,200 each. Furthermore, the CCCTB would mean that Britain would lose a total of £58.4 billion of investment over that period.

The CCCTB is undemocratic

The CCCTB will be imposed by the unelected European Commission, such an unrepresentative body should not be imposing tax laws. The Commissions' distance from the different geographies and businesses will mean insufficient consultation with the business it will affect and hence create poor, uncommercial and impractical tax laws.

The EU is not the right body to administer corporate taxes

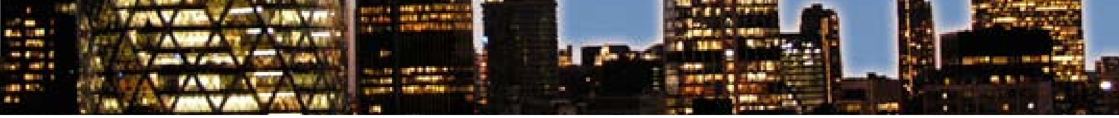
The EU should not take on the member states' role as a collector of taxes, but the introduction of the CCCTB may cause the EU to take on such powers. The EU lacks the experience and knowledge of national tax authorities; and will be an imperfect tax collector.

The CCCTB will be administratively burdensome

The CCCTB will cause many businesses to need to maintain a second set of accounts just for the purposes of the CCCTB tax return. Business will need to extract additional asset valuations, sales data and employment values increasing the deadweight of tax.

The CCCTB will distort investment decisions

The CCCTB will make assessing the post-tax return on investments highly complex as each investment will impact the tax payable in all the member states that a Multi-National Corporation (MNC) operates in. The impact of the allocation method of the CCCTB will actually be to make investments in low tax states more attractive and high tax states less attractive. The fact that high taxing member states have not yet deduced this shows how little consideration they have given to the practical aspects of the CCCTB.



The CCCTB will work against the effective working of the Single Market

Member States will have financial reasons to seek to impede businesses from establishing in other member states, because the additional investment will deplete their tax revenues. The allocation method of the CCCTB will mean new investment decisions are made considerably more complex because of the manner by which the allocation ratios will alter and impact the MNC's tax bill.

The CCCTB will enhance uncertainty for both businesses and member states

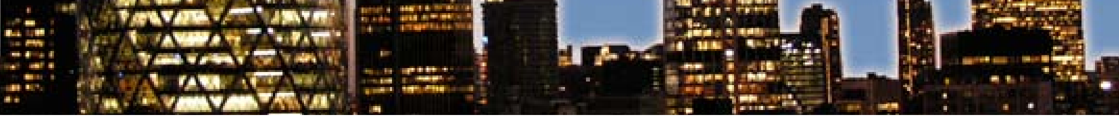
The CCCTB will effectively abolish decades of tax guidance and precedent that enables tax authorities and businesses to deal with grey areas. The likely judge of the CCCTB will be the European Court of Justice (ECJ). This is an unclear arbitrator that often fails to deal with detail. Also, previously tax disputes focussed around the meaning of "profit", now the allocation basis means taxpayers and authorities will also dispute the meaning of "employee", "asset" and their values as a method of saving or raising taxation.

The European Commission has major problems to resolve in the tax areas it does have responsibility for

The EU's Tax Commissioner advises that VAT fraud may cost the taxpayers of the EU up to €250 billion. That money can comfortably fund at least a medium size member state government for an entire year, so surely the European Commission should concentrate first on resolving this massive, and criminal, problem.

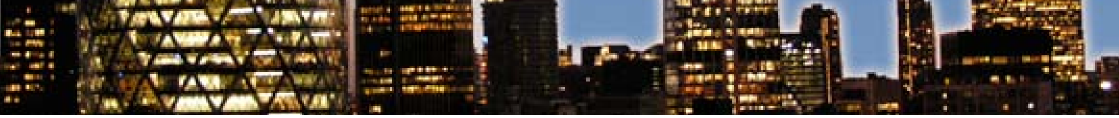
Now is not the time

The CCCTB will cause each member state to effectively gamble their future corporation tax revenues dependent on how the allocations work. Given that many governments are struggling to fund their existing commitments and many new member states have ageing, and hence increasingly non-working populations, to introduce a new tax with uncertain revenues would be fiscally reckless.



The CCCTB will make Europe uncompetitive

The CCCTB will deter Europe from being competitive in a global market. Furthermore, the CCCTB is not required when low tax member states have shown the way to economic growth and increasing tax revenues. Member States with low corporation tax rates and broad bases have had high economic growth and rising tax revenues. Conversely, high tax states with narrower bases have had materially lower growth and slower growing revenues. It is clear that high tax member states need to cut their levels of taxation if they are to become more competitive, and not introduce a complex and confusing new method of calculating taxable profits. High tax member states should not risk the economic growth of the low tax members by seeking to introduce a minimum corporate tax rate as some CCCTB supporters have advocated.



INTRODUCTION

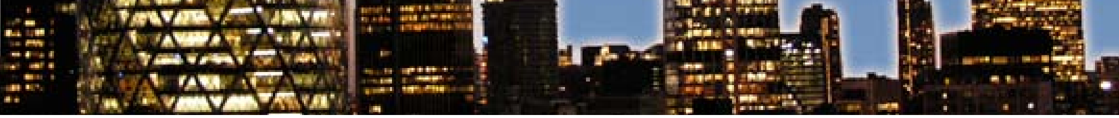
What is the CCCTB?

Since 2001, and with no popular mandate, the European Commission has been working on trying to establish a Common Consolidated Corporate Tax Base (CCCTB). The intention of the CCCTB is that businesses operating in more than one member state, instead of having to determine their corporate tax bills for their business in each state they operate by reference to the laws of that country will simply need to produce a single EU-wide computation of its profits; the national authorities will then tax a share, to be determined by a formula, of those profits.

The EU Commission wishes to bring forward legislation by late 2008; albeit that date now may be postponed until 2009. The EU is arguing that the creation of a CCCTB will remove many obstacles to the smooth functioning of the Single Market, and hence generate benefits for the EU. Yet within the CCCTB lie many problems.

The EU has proclaimed that the current system of each member state having its own separate taxation rules blocks businesses from working across borders. Currently, the plans for a CCCTB are most strongly supported by the states of Old Europe; all of whom were members of EU12. Those member states who are most keen to implement the CCCTB are those which also have the highest corporation tax rates in the European Union. On the other side fighting the CCCTB is Ireland, which wishes to prevent any challenge to its low, and highly successful, 12.5% corporation tax rate.

This paper seeks to analyse the CCCTB and, should the EU become responsible for corporate taxes, examine what the likely consequences of this policy will be for businesses and member states. Also to be analysed is how it will operate at a practical level, and what its impact on the Single Market will be.



Background

What is the CCCTB and how will it operate

The European Commission has been working on the development of the CCCTB since 2001. All Member States, including the UK government, which has long proclaimed a “red line” on taxation, have sent representatives to the CCCTB meetings.

A legislative proposal is to be made by the European Commission in late 2008; however after 7 years, of according to Laslo Kovacs, EU Commissioner for Taxation, “working intensively”[1] there are still substantial complexities of instigating the CCCTB which the European Commission has yet to resolve, and hence the proposal is now expected in 2009.

How does it work?

The CCCTB works by:

- Computing the taxable profits of a Multi-National Corporation (MNC) operating in the EU using a common methodology which the EU will prescribe and legislate
- The total taxable profits of the MNC will then be apportioned to individual member states on a pre-determined formula. The member state will then apply its corporation tax rate, potentially subject to a minimum but not a maximum percentage, to its allocation of the profits
- Details of the formula have not yet been agreed; but the allocation may be driven by a number of factors; e.g property values, number or cost of employees, even the location where goods are sold may be used. What will not be considered in the suitable allocation key is the accounting profits registered in the accounts of the MNC’s operations in each member state.

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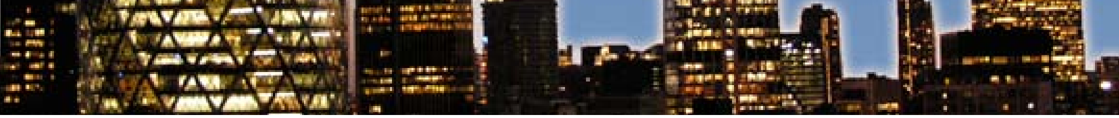
1 Keynote speech of Commissioner Laszlo Kovacs at the Congress of the International Fiscal Association, 31st August 2008



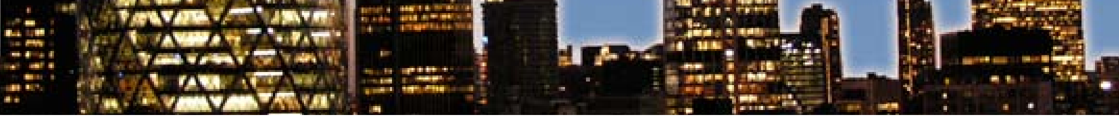
The CCCTB Will Be Undemocratic

What authority does the EU have for introducing the CCCTB?

The European Commission is proposing that the CCCTB be voted in, with the Commission having the legislative ability to fill-in the detail. It is a dangerous precedent to allow an unelected body with no experience of drafting corporation tax legislation, which still remains highly unscrutinised. Furthermore, the European Commission has no constituencies to listen to when formulating tax law. This means that it is highly likely that the process of developing the CCCTB will result in ivory tower tax legislation; fine in theory, unworkable in the commercial world.

There is no popular desire in both high and low taxing member states for a common system

The threat of losing the ability to set corporate tax rates was one of the major factors in persuading Ireland to vote “No” to the Lisbon Treaty. Similarly, the 2005 French “Non” vote to the original EU Constitution was triggered partially by a desire for France to retain its current social-market economic model rather than become a low tax economy. Given the clear signals that the people do not want the EU to set their tax laws, the Commission is acting contrary to popular desires across the EU.



A Pan-European Tax Authority

The European Commission will use, through necessity or political desire, the CCCTB to create a pan-European tax authority

> “Finally to be successful, the CCCTB must have a system of centralised management and administration. In other words there should be a “principal tax authority” … for filing the consolidated return and making a single assessment.”[2]

However, the European Commission is not a suitable body to administer corporation tax.

The Commission intends to be the guardian of the CCCTB, to be responsible for initiating any changes to the CCCTB when required, and ensuring it is correctly adopted. However, being a successful tax authority requires considerable acumen, knowledge of business and markets, with highly trained inspectors (most UK Inspectors of Taxes handling multi-national corporations are highly intelligent who are often educated to a very high level) with the nous only years of experience teaches you as to when to change the law and when to challenge non-compliant taxpayers. Whilst the European Commission intends to leave much of the donkey work to the existing local revenue authorities; it has none of the experience relevant to run the high level strategic side of such an authority. This is shown by its interfering with VAT where, despite multi-million pound fraud operations, it has taken years of wrangling to counter Missing Trader Cross-Border VAT fraud when the nature and scale of the activity should require immediate action.

There is also not a good reason for a vital part of the executive to be handed over from the member states to the European Union. The EU is no doubt aware that the CCCTB may require a key government function to be passed from national control to their own realm. In addition to the EU’s practical unsuitably to this key role, the management of corporation tax should be run by those responsible to democratic institutions, not an unelected bureaucracy.

The dangers of the Commissions’ inability to consult with business

Recent UK experience has shown that tax laws created without businesses being adequately consulted can result in over-complexity that could have been avoided. Amongst the adverse affects can be the punishing of compliant businesses.

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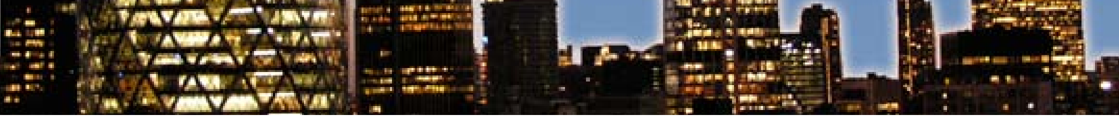
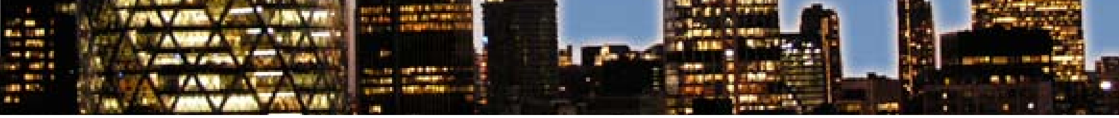
2 Comments from the Tax Executives Institute Inc address by Thomas Neale, Head of Task Force for the CCCTB



The level of consultation with real business on the CCCTB is low to non-existent; it is also highly difficult to consult given the broad range of businesses and economies across the EU and the geographical distance from the Brussels base. Consequently, it is inevitable in a regime intended to be so wide-ranging that there will be unforeseen knock-on effects that would be avoided if corporation tax laws are allowed to continue being set by national authorities; where adequate consultation with business can be practically conducted. Furthermore, the inflexibility of the CCCTB will make it arduous and tardy for those effects to be eliminated through subsequent legislation.



The Administrative Burden of the CCCTB

According to the European Commission the CCCTB will save businesses both costs and administration time, a mantra consistently repeated by the CCCTB's advocates. However, these boasts assume that the CCCTB will be simple and straight forward but when further analysed it is, in truth, complex.

Presently, corporations in the member states prepare accounts, or more formally financial statements. These serve several purposes including; regulatory reporting, informing creditors, informing shareholders etc. Many member states use these readily available statements to derive the measure of taxable profit arising in a company.

Business may need two sets of accounts

The CCCTB intends to ignore those financial statements, and instead produce its own measure of profit. This will be inspired by the International Financial Reporting Standards (IFRS) which not all member states, sometimes for good reasons, have adopted. Hence many companies will have to restate their financial statements in IFRS, a costly and otherwise unnecessary procedure, especially for the often smaller privately owned firms.

As IFRS only "inspires" the CCCTB and does not determine it, further adjustments, and hence tax administration, will be required. Complaints have already been made that the CCCTB will require current stock valuations to be ignored, and entirely new calculations, likely to require system changes, to be used just for the purposes of the CCCTB rules.[3]

Businesses will need to do additional valuations and work complex formulae

The saga then continues. The CCCTB apportionment will require further valuations of employees, property assets, potentially financial assets and a determination potentially of sales, either by origin or destination; information that will need further extraction and valuation. These workings will then need to be plugged into what, given its different variables, we can only presume will be a complex formula in order to allocate taxable profits to member states. New reporting systems to obtain and produce the additional information the CCCTB will require will be a significant implementation cost for many businesses.

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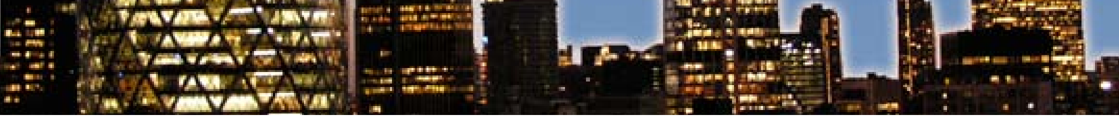
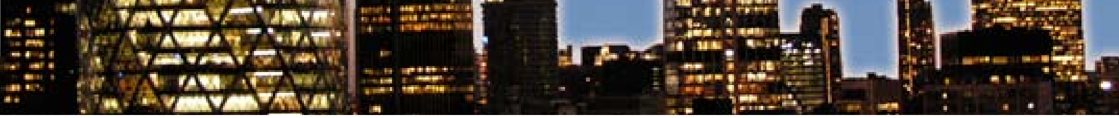
3 The CCCTB will require Stock to be calculated on a First in, First Out basis, increasingly rarely used by business



Therefore what the CCCTB achieves is not the simplification of tax filings as promised; nor the application of a simple tax rate to accounting profits, but instead will require an alternative set of accounts for many companies, followed by revaluations of certain assets and activities; and then the use of complex and yet unpublished formula to determine taxable profits; increasing the administrative burden.

The EU's defence is that the CCCTB will prevent the need for businesses to have to price cross-border transactions at arm's-length. This defence is largely a red herring, businesses tend to do that anyway; how else can MNCs assess the profitability of their different divisions. Also MNCs with several units do have genuine arm's-length negotiations between those units, especially if the results impact upon the personal bonuses of those involved!



The CCCTB and the Single Market

1. It is not the lack of a single CCCTB that is making the EU uncompetitive

The European Commission proclaims that to enable a true Single Market to exist the CCCTB is crucial.

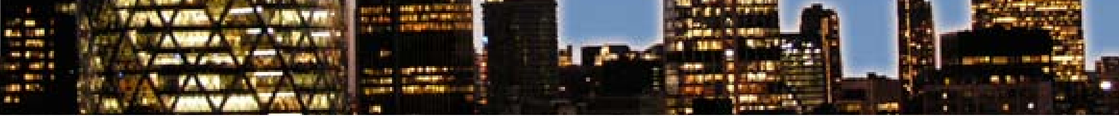
The Commission considers that the multiplicity of different tax laws across the EU is preventing the Single Market from working effectively. Whilst the current tax regimes throughout the EU have their administrative problems; the introduction of Flat Taxes in Eastern Europe has been a success. And most EU states do not tax dividends received from another member state or the profits of branches in other countries. The fact that these Participation Exemptions exist across most of the EU means that the largest hurdles to the Single Market have already been removed. Having different tax rules are an inconvenience, whatever the systems, but not one large enough to effectively prevent investment provided the member states do not impose onerous or over-complex taxes.

The largest problems against a fully functioning Single Market are:

- The high corporate tax rates found in the states most keen on implementing the CCCTB; which are amongst the highest in the OECD
- The EU's Working Time Directive and the inflexibility of in-place workforces common in most EU countries
- The increasing regulatory burden driven by EU's own Single Market regulations
- And if the CCCTB is introduced, the increased compliance requirements and higher tax burden likely to result from that

2. The CCCTB will make the EU inflexible and unable to react to the demands of a global economy

The European Commission claims that a uniform tax system will empower businesses. This is clearly not the case. Businesses once the CCCTB is established will be entombed in a one-size-fits-none system. The inability of the EU to alter VAT on financial services, a far smaller project than the CCCTB, after years of discussion with the member states indicates how unresponsive the CCCTB will be to change. Most member states will actually elect or re-elect governments on



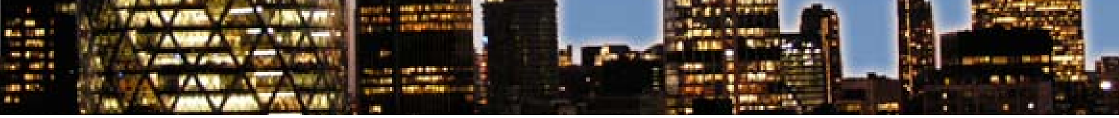
a more regular basis than the EU will practically be able to amend the CCCTB. This will make reform of the system if it is established almost impossible as it will require all 27 members of the EU to agree to amend the rules thus effectively setting them in stone.

Currently, businesses can relocate if the rules of a tax jurisdiction prohibit or impede the growth of that business, through impractical, quasi-protectionist, or outdated measures. For example, the UK government has made its tax system over-complex, and especially uncompetitive for cross-border businesses by rules that deter the free dividending of capital from other member states to the UK, for investment elsewhere in the EU. Consequently, several businesses are relocating from the UK to other countries that allow tax-free investments in other jurisdictions.

Given the inflexibility of the CCCTB, the problems with a pan-European government consultation with business, the lack of democratic scrutiny; plus an increasingly changing global economy, the CCCTB will become outdated and uncompetitive in a short period of time.

The CCCTB will also not permit local variations. There may be good local reasons for deviating from the CCCTB where it is suitable to do so but this will be impossible. For instance, in the UK, with its heavy financial sector, where businesses may find the allocation bases unsuitable for the City of London; ditto those with large shipping industries. Furthermore, where the CCCTB's one-size-fits-all rules cause taxable profits to deviate from accounting profits, hence generating a market distortion, member states will not be able to apply a local cure to that problem.

Currently businesses will if pushed jump intra-EU borders to find a tax regime that best facilitates its expansion. With the CCCTB, businesses facing unreasonable tax regimes may instead have no option but to dent the Single Market and leave the EU altogether to find a competitive tax regime that better supports future investment.



The CCCTB effectively punishes those member states that create the conditions for enterprise and hence make the EU more uncompetitive

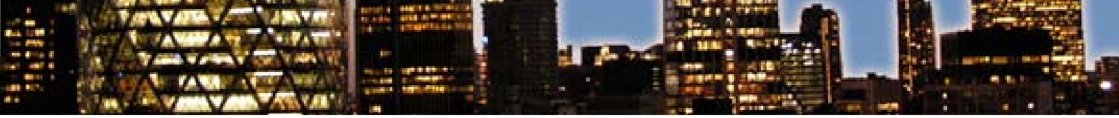
Effective governments in the Single Market create the conditions for enterprise by:

- Creating a well educated labour force
- Removing unnecessary hurdles to start-up or expansion
- Enabling businesses to employ flexibly
- Having a low rate of corporation tax, enabling more profits to be kept in the business and reinvested
- Avoiding having National Champions or subsidies that potentially give preference to existing home-grown business over new or foreign enterprises

It should seem only reasonable that member states that create such conditions and hence encourage inbound investment or internal entrepreneurs are rewarded through the greater profitability of such businesses through their percentage of corporation tax revenues. This presently happens in the Eastern European states and Ireland who have been well-rewarded for creating those conditions for economic growth; enabling them to have growth rates in recent years not seen in Old Europe for decades.

Under the CCCTB, the additional profits created are not taxed by the member state in which they arise; but are spread across the EU countries the relevant group operates in; thereby potentially rewarding a member state the MNC has chosen not to invest in due to unfriendly business administration.

Such a measure would appear to punish member states that encourage enterprise; and indeed would appear to deter rather than encourage the development of a Single Market.



The Impact of the CCCTB on Businesses

The CCCTB will distort investment decisions resulting in sub-optimal business decisions

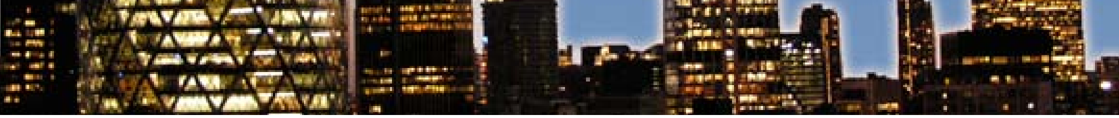
Perversely, because the CCCTB will not tax profits on where they arise, but where they are allocated, it will alter the post-tax cost of investment, hence bringing in market distortions to investment decisions. Long-term this is likely to result in market inefficiencies, distortions caused by tax, deliberate or accidental, almost inevitably result in sub-optimal business decisions being made.

Capital investment

Currently, tax rules work where by if a Group spends £100m on machinery based in Newcastle, it will broadly obtain corporate tax relief at 28% on that item, unless the UK changes the rates. Under the manner by which the CCCTB will work there is likely to be tax relief for that item, only it will effectively be spread amongst the participating member states and hence relief will be obtained at the average rate for the group.

The problem with a formula dependent basis driven by certain values is that every time you alter one of the key drivers, you alter the amount of corporation tax payable. Hence the effective tax rate could alter, not just due to the member states increasing or reducing their tax rates, but because the group wishes to buy or sell operations in a particular member state, thus altering the labour, property or other factors that determine the apportionment of taxable profits. Consequently, where the value of the asset acquired in the UK might be viewed in simple terms as being say £72m (ie £100m less £28m of tax relief); going forward it would be £x (ie £100m less £x of tax relief not yet determinable).

Potentially the European Commission has already spotted this problem and will no doubt argue for the benefits of a single EU set corporation tax rate. Already, there are arguments developing that there should be a minimum corporate tax rate for the CCCTB; but predictably, there are no such plans to introduce a maximum corporate tax rate.



Problems with the allocation basis – its inherently illogical

The allocation basis proposed is intended to allocate profits, partly driven by the cost of employees. However, the European Commission intends to exclude the cost of outsourced activities. Consider how bizarre this decision is; the key objective of outsourcing is effectively to manage and save costs, and hence enhance profitability, hence if services in a member state are outsourced, the profits arising in that member state should increase. Why should tax payments change because premises are leased rather than owned; but they will because property values will drive the allocation yet premises may be sold and leased back because that's an effective method of low cost financing and enhancing profitability. However, because the allocation is done on the cost of employees and the value of assets, despite the fact that outsourcing and low-cost financing will increase profitability, the taxable profits arising in the member state where those business decisions are implemented will conversely, and illogically, reduce.

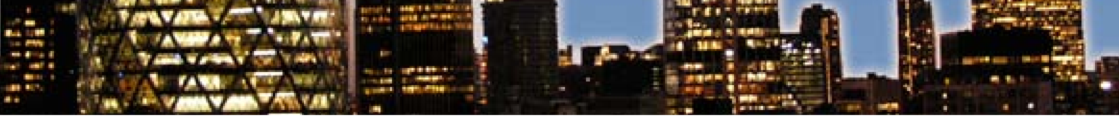
Proof that the CCCTB will be a deterrent to investment in high tax jurisdictions; and an actual incentive to invest in low tax jurisdictions

Take the example of a group operating in several EU states. Its tax profile is currently as follows for profits of €5 billion:

Location	Allocation	Profits €bn	Tax Rate %	Tax €m
France	30%	1.5	33.33	500
UK	30%	1.5	28	420
Portugal	25%	1.25	25	312.5
Poland	15%	0.75	19	142.5
Total	**100%**	**5.0**		**1,375**

The tables in this section are simplifications. The actual calculations will be far more complex and require detailed valuations of assets, employees and potentially other factors.

It then decided to either build or acquire a factory, in a member state which has high corporation tax at a rate of 31.4% (the actual current corporate tax rate in Italy). This factory makes no profits over the first 5 years of development but takes up 20% of the revised allocation.



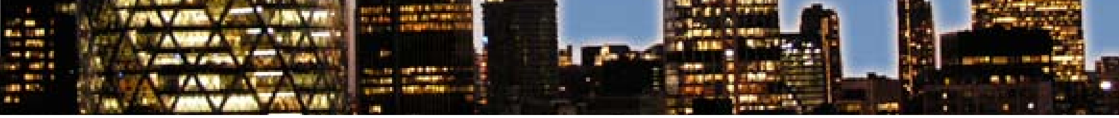
Location	Allocation	Taxable profits before Italian investment	Tax before Italian investment	Taxable profits per CCCTB	Tax Rate %	Tax per CCTB	Increase / (decrease) in tax €m
France	24%	1.5	500	1.2	33.33	400	(100)
UK	24%	1.5	420	1.2	28	336	(84)
Portugal	20%	1.25	312.5	1	25	250	(62.5)
Poland	12%	0.75	135	.6	19	114	(28.5))
Investee Member State	20%	0	0	1.0	31.4	314	314
	100%					**1,414**	**39**

As is shown above the tax revenues of the existing locations are altered under the CCCTB even though the corporate operations have the same profitability and consume the same state resources in those member states. By choosing to invest in Italy, the group cannot determine the post-tax cost of the investment merely by examining the budgeted post-tax profitability of the new enterprise, it instead has to budget what the various factors that go into the allocation basis do to alter the tax payments due in each of the other member states that it operates in. Without actually making any taxable profits in the new country, the investment, purely through additional corporate tax, generates a return for the Group of -3.25%[4] on the additional capital/labour provided; providing a substantial disincentive to invest.

Taking the same table but assuming an additional €1 billion of taxable profits in Italy

Location	Allocation	Taxable profits before Italian investment	Tax	Taxable profits per CCCTB	Tax Rate	Tax per CCTB	Increase / (decrease) in tax
France	24%	1.5	499.95	1.44	33.33	479.952	-19.998
UK	24%	1.5	420	1.44	28	403.2	-16.8
Portugal	20%	1.25	312.5	1.2	25	300	-12.5
Poland	12%	0.75	142.5	0.72	19	136.8	-5.7
Italy	20%	0	0	1.2	31.4	376.8	376.8
	100%	5		6		**1,414**	**321.802**

4 Calculated as the €39 total tax over the additional €1,200 investment



Note that the increase in profits, is actually taxed at a rate higher than the 31.4% Italian corporate tax rate, but instead at 32.1%[5]; i.e investing in higher rate jurisdictions now comes with a higher marginal tax rate, and hence reduced post-tax returns. Therefore the CCCTB will not actually deal with EU's low tax/high tax divide in favour of the Old Europe high tax jurisdictions but will instead actually accentuate the division and make the high tax jurisdictions even less attractive.

The CCCTB will actively encourage investment in low corporate tax rate member states

Taking the same figures as before but with a different new investee member state - e.g. Ireland and its 12.5% corporate tax rate

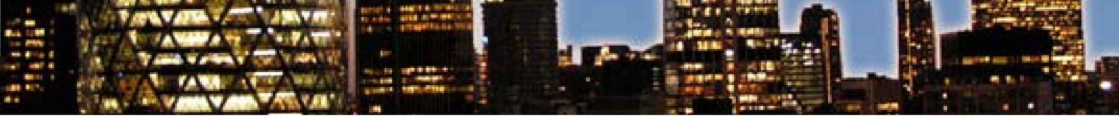
Assume no profits in Ireland but all other assumptions as before

Location	Allocation	Taxable profits before Irish investment €m	Tax before Irish investment €m	Taxable profits per CCCTB €m	Tax Rate	Tax per CCTB €m	Increase / (decrease) in tax €m
France	24%	1.5	500	1.2	33.33	400	-100
UK	24%	1.5	420	1.2	28	336	-84
Portugal	20%	1.5	312.5	1	25	250	-62.5
Poland	12%	1.5	142.5	0.6	19	114	-28.5
Ireland	20%	0	0	1	12.5	125	125
	100%	5	**1375**	5		**1,225**	**-150**

Note, here the reduction in tax is £150m; investing in a non-profitable Irish business actually generates return on the labour and capital invested, as measured by the CCCTB purposes of 12.5% without the Irish business making a single € of pre-tax profit; providing a massive incentive for MNC's to invest in Irish business, almost regardless of the commerciality of the venture invested in.

Taking the following example where taxable profits arising in Ireland are €1 billion, the additional tax on those profits, is €95m, meaning a marginal tax rate to the MNC for the Irish investment of 9.5%. The difference in tax between the Irish and Italian cases here, which have identical profits, is €227 million, an amazing 22.7% rate differential between investing in the low tax and high tax jurisdiction, which would normally be only 19%.

5 Calculated as the €321 additional tax over the additional €1,000 profits



Assume €1 billion profits in Ireland but all other assumptions as before

Location	Allocation	Taxable profits before Irish Investment €m	Tax	Taxable profits per CCCTB €m	Tax Rate	Tax per CCTB €m	Increase / (decrease) in tax €m
France	24%	1.5	500	1.44	33.33	480	-20
UK	24%	1.5	420	1.44	28	403.2	-16.8
Portugal	20%	1.25	312.5	1.2	25	300	-12.5
Poland	12%	0.75	142.5	0.72	19	136.8	-5.7
Ireland	20%	0	0	1.2	12.5	150	150
Total	**100%**	**5**	**1,375**	**6**		**1,470**	**95.002**

What does this mean for investment into the UK?

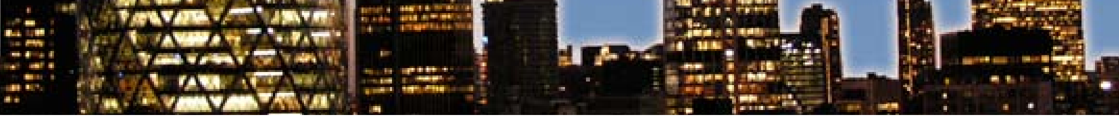
The CCCTB will give EU multinationals investing in a greenfield or nil profit UK venture, where the post-investment comprises 10% of their EU activities, on average a 2%[6] increase in their corporate tax bill without the UK entity even making a profit. That increase rises to 4.13% for a 20% investment.

The marginal UK corporate tax rate for an EU wide business which acquires a profitable UK operation would increase above 28%, by almost 1% for a UK business that was only 20% of the multinational's EU business. That increases to 2.4 percent where the investment is 50% of the businesses EU activities.

These increases are driven by the fact that the UK corporate tax rate of 28% comfortably exceeds the EU average of 23.2%.

Hence, an EU-wide implementation of the CCCTB would only make the UK even less competitive and attractive for capital investment at a time when business is leaving the UK for tax regimes that enable, rather than impede, cross-border investment.

6 Based on the EU average corporate tax rate of 23.2%



What the CCCTB Will Mean for EU Member States

The CCCTB is meant to be driven by the high tax Old Europe states who are increasingly concerned about loss of tax revenue to Ireland and the low tax states of New Europe. The above tables show the paucity of their thinking in wishing to drive through the CCCTB; if they had done any of the, frankly basic, statistical modelling above, they would have deduced that the CCCTB exacerbates the reasons to invest in low tax rather than high tax jurisdictions. A new tax system, with fundamental changes to the existing methods, should not be introduced when its keenest proponents have not even done basic research into its effects.

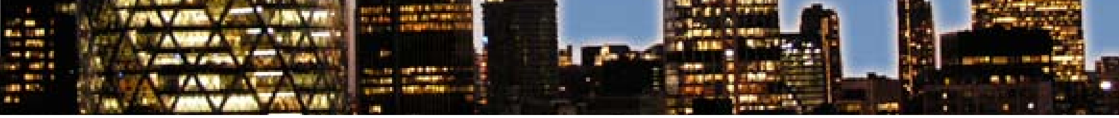
From the UK perspective, the UK's current tax rate of 28%, compared to the EU average rate of 23.2%[7] now makes it one of the high tax states. Therefore, the CCCTB will only make the UK even more uncompetitive from a corporate tax angle than it already is.

Businesses will no doubt soon conclude that there would be enhanced benefits to investing in low tax states.

The CCCTB actually adds considerable complexity to investment decisions rather than simplifying them. To determine the post-tax cost of an investment in an EU member state, whether it is a member state the business did not previously operate in, or an increase in an investment in a new state it is not enough to apply the corporate tax rate to the projected profits; instead the assets and employees of the new investment have to be valued and complex modelling undertaken to determine what the impact across all EU countries which the MNC operates in will be. For example for an MNC that lives the Single Market ideal the calculations will need to feed in its future projected profits, asset values, employee costs and sales by origin or destination from all 27 nations; a massively complex and time-consuming activity that will prevent businesses from being able to easily determine the post-tax impact of investment decisions.

The previous tables show that EU members will have good financial reasons to deter profitable businesses operating in their jurisdiction from investing in other member states. This is the opposite result of the EU's stated objective of enhancing the Single Market. For example, in the earlier tables where the investee has £nil profits, the UK effective corporate tax rate on the same UK profits effectively drops from 28% to 22.4% purely through the allocation basis of the CCCTB; actually penalising the UK for allowing the MNC to invest elsewhere in the EU.

7 KPMG Corporate and Indirect Tax Rate Survey 2008, page 15



It will also give the existing member states good financial reason to seek to block new entrants to the EU who have more competitive levels of corporation tax.

The end of existing guiding precedents

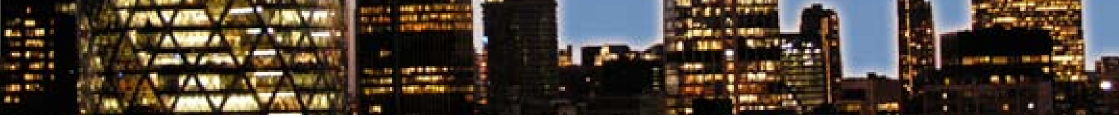
One of the key concerns businesses have about corporation tax is the need to ensure that the regime in which it operates is stable and predictable. Member states presently have their own tax statutes but surrounding that, and providing the additional detail that they require to effectively colour in the outline statute is; case law, revenue concessions, agreed industry understandings and interpretations and conventions which are de facto law. Establishing a CCCTB will effectively terminate all the existing statutes other than the tax rate. This will have the knock-on effect of deleting these reservoirs of information. Rather than relying upon decades of supporting detail businesses and indeed the revenue authorities will effectively have to start the process from scratch. This will mean that in a complex, globalised world, there will inevitably be a number of uncertainties about how certain rules should apply in certain cases and for certain businesses.

Increase in matters for business and tax authority(ies) to dispute

Currently, corporation tax is levied dependent upon the measure of taxable profit, and almost all tax disputes focus around what is or is not “profit”. Under the CCCTB the apportionment method means that disputes will not just exist as to what is “profit” but also what does “employee” mean, what does “asset” mean, and how they should be valued in determining the apportionment ratios.

The experience with VAT shows that having common EU Directives does not lead to a single pan-European interpretation. For example in financial services the extent of which services are “financial” and exempt from VAT varies widely from member state to member state. And the member states are currently in the third year of discussions to agree EU wide interpretations, with the final result still not in sight.

As a result, there will be no effective guidance on these matters. Both businesses and Ministries of Finance will be left guessing as to what the CCCTB tax laws mean. This will produce uncertainty for businesses, which typically hinders effective decision making, and uncertainty for governments, who will struggle to predict revenues. The uncertainty will, however, inevitably benefit tax lawyers as many matters will probably require litigation to decide.



This litigation will almost inevitably go to the European Court of Justice (ECJ). The ECJ is often an unclear arbitrator; matters are generally defined in principle and then referred back to national courts. This greatly increases the timescale over which tax litigation takes places. Plus; firstly, due to the translation from the Judge's own language the EU judgements can lose their original meaning. And secondly, the judgements are so principle based that they often add little colour to the tax specifics actually in question.

Uncertainty: how do you implement the CCCTB to replace existing rules?

The CCCTB proposals remain remarkably quiet on how the CCCTB is going to take over from existing tax rules. Take a major investment, such as the purchase of a major piece of machinery or investment in new software; typically tax relief will be provided for these over a period of years and businesses operate and indeed model the cost of such items based on the quantum and timing of tax relief on such expenditure. If the CCCTB was suddenly enforced, then an MNC will suddenly find its existing calculations are askew.

An example of profit apportionment from the UK

The one area of UK taxation where apportionment is used is in the field of life assurance where the apportionments allocate certain items, e.g. investment returns between taxable and tax-exempt businesses. This area is highly complex, the UK government is trying to resolve some of these but has not managed to do so in over two years of detailed consultation, plus the system if anything encourages tax planning to reduce the tax bill due to the increased opportunities it provides able tax planners to alter taxable profits, both by planning to reduce profits, and planning to reduce the allocations.

The European Commission has more pressing tax reforms to make

> "Tax administrations in the EU have been particularly preoccupied by VAT fraud for the last few years. Considering the size of the phenomenon, approximately €250 billion yearly according to some estimates this is not surprising".[8]

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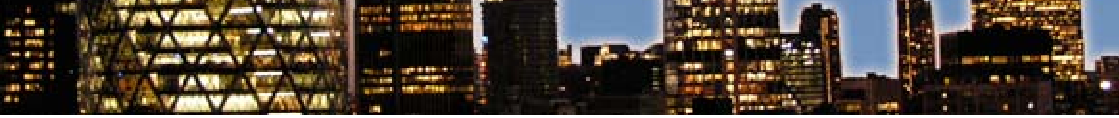
8 Keynote speech of Commissioner Laszlo Kovacs at the Congress of the International Fiscal Association, 31st August 2008



Considering the size of this €250 billion phenomenon is greater than the entire annual tax revenues of 22 out of 27 EU Member States[9], the need to work to eradicate this criminal activity should surely be the European Commission’s most pressing tax objective, not a new corporate tax basis that will have immense practical problems in its operation.

Even if the CCCTB was a good idea, it is nowhere near ready

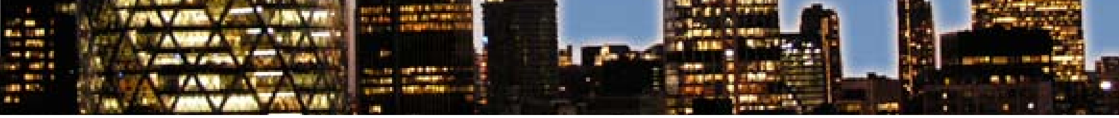
Having computed the EU-wide taxable profits; the MNC then has to allocate the profits to each jurisdiction. This formulae-based approach has yet to be determined but would be fundamental to each member states’ revenues.

Approaches suggested have included an asset-based test, value or number of employees and even measures as unusual as where the goods are sold. The fact that the latter has been mentioned shows how undeveloped the EU’s thinking is. To base the corporation tax revenues depending on end consumption when all value created and all state resources used belong to another member state would be both unfair and irrational.

There have been a number of studies seeking to determine what the impact of the CCCTB would be on corporation tax revenues, both if the CCCTB was optional and if it was compulsory. Whilst these have learned authors and have substantial research behind them, they are meaningless. Until the formulas for allocating taxable profits across the EU are decided it is impossible to estimate what the impact of the CCCTB would be in terms of tax revenue for either all of the EU, or individual member states. Even if the formulas were known they cannot take account of behavioural changes. What can be shown, as in this paper, is that an apportionment basis makes investment decisions more complex, and can actually encourage member states which MNCs operate in, to establish hurdles to the MNC investing in other EU countries.

For financial service businesses the European Commission admits considerable difficulty in determining a suitable formula. Given the multinational nature of financial services and its importance in the European Union, e.g. much of the world’s insurance is underwritten in either Germany or the UK, this is a major omission in their planning. Such a gap in thinking is indicative of a Commission that has designed a hypothetical EU wide method, but they are struggling to envisage how the CCCTB will work in practice.

9 Based on the 2006 figures published by Eurostat



Now is not the time to be fundamentally altering a key government revenue

To introduce a new method of levying revenues will be to introduce a substantial risk to government income during an economic downturn. The likely result could be volatile revenues for the transitional years and is a risk that should not be undertaken by a prudently managed Treasury.

Businesses and member states who, due to the ageing European population have increasingly burdensome public sector requirements, need certainty of tax payments and tax revenues. The CCCTB will actually increase the volatility of revenues; e.g. a new investment can alter tax revenues in a totally separate member state; an alteration in the definition of "employee" or valuation of asset would also have an impact.

Also, the view that the CCCTB will reduce tax planning is naïve. By adding in the apportionment basis, and hence meaning that taxable profits are now a factor not just of profit, but also of assets, employees and sales, will give tax professionals more variables and hence more opportunities to plan reduced tax payments.

Recent studies have shown that increasing the effective tax rate will impede GDP, reduce Foreign Direct Investment and reduce the investment to GDP ratio. The higher marginal tax rate would typically encourage businesses in the UK to use debt rather than equity funding, which in the present economic climate is perverse.

The impact of the effective increase in tax rate caused by the CCCTB is substantial[10]. Over a 10 year period theCommon Consolidated Corporate Tax Base (CCCTB) will reduce the UK's GDP by £73 billion, costing each person living in the UK £1,200, equivalent to UK taxpayers having to pay a 1.5p increase in the basic rate of income tax for each of those years or each UK inhabitant paying over £1,200 each. Furthermore, the CCCTB would mean that Britain would lose a total of £58.4 billion of investment over that period.

What is more, the above figures do not take into account the fact that if marginal UK tax rates increase, especially given that the CCCTB's allocation method works in the reverse manner for low tax states, then the UK "Taxodus" is likely to accelerate, further increasing the cost to the UK economy. MNC's will under the CCCTB be super-incentivised to move from the high tax UK to states with lower levels of corporation tax.

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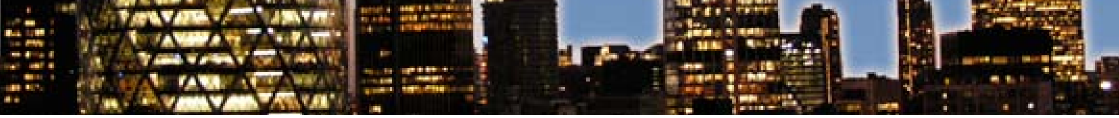
10 Based on research published in *The Effect of Corporate Taxes on Investment and Entrepreneurship* by Simeon Djankov, Tim Ganser, Caralee McLiesh, Rita Ramalho, and Andrei Shleifer of the World Bank and Harvard University. This paper shows that a 10 percentage point increase in corporate tax rate reduces GDP by 5%. Calculations assume corporate tax rates across the EU remain constant.



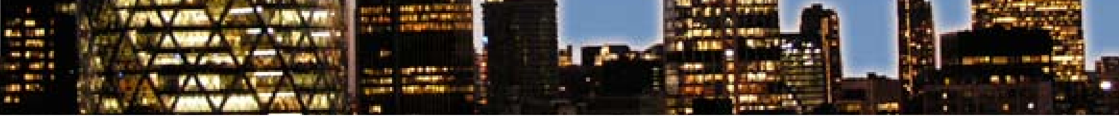
CONCLUSION

The CCCTB is unnecessary when new entrants to the EU have clearly shown the way to effective corporate tax governance

A number of tax authorities in the EU have clearly shown the path as to how to create and operate tax laws. The greatest success has been in the Flat Tax countries of Eastern Europe where the Poles, Hungarians, Czechs, Slovaks and Balts have kept a reasonably low rate of corporation tax, hence accelerating economic growth and substantially growing their tax revenues. Also, Ireland showed by reducing its corporate tax bill to 12.5%, that it is possible to generate growth and greatly increase tax revenues. In the mid 1990s the Netherlands showed with its business friendly regime for international holding companies how to create a tax administration that removed many disadvantages from genuine investment overseas and hence facilitated those wishing to undertake multinational operations. Its success is showed by the fact that most of the EU15 states have now introduced copies of many of those rules.

Ultimately, if the democratically elected governments of Germany, France, Italy, and the UK, insist upon corporation tax rates and regimes that carry a quasi-penal rate on marginal profits and deter businesses from investing, then it is not actually the role of the EU to compel economic common sense on their governments. Indeed the approach of the EU to tax is often to favour those states with outdated methodologies for taxing businesses, rather than the more enterprising countries of Ireland and New Europe.

For example, the reason why a number of multinationals are seeking to leave the UK is not due to a lack of a CCCTB, it is because the UK has failed to adopt measures most EU countries adopted in some cases over a decade ago.



An analysis of Corporation Tax Revenues across the EU shows the following[11]:

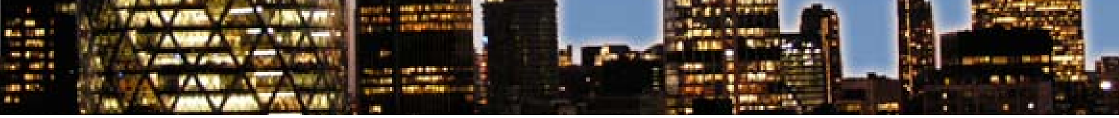
Member State	Corporate Tax Rate 2000 %	Corporate Tax Rate 2008 %	GDP Growth 2000-2006 %	Corporate tax revenue growth 2000-2006 %
Italy	38.25	31.4	16.7	51.7
France	40	31.33	28.0	27.3
Germany	51.6	29.51	23.4	23.5
UK	30	28	32.6	35.4
Netherlands	34.5	25.5	27.7	10.6
Austria	34	25	26.6	31.7
Czech Republic	31	21	46.8	138.2
Poland	34	19	38.3	44.5
Slovakia	29	19	59.7	119.5
Hungary	20	16	47.0	86.6
Ireland	24	12.5	59.5	76.5

As can be seen the member states with lower corporation tax rates have clearly outperformed those with higher levels. There are other factors to also consider, for example the economies growing at a slower pace are all in the eurozone whilst none of the faster growing economies, other than Ireland, are. And most of those low tax member states have a low tax/GDP ratio for all taxes, not just for corporation tax.

However, the tax/GDP correlation is so strong that it clearly shows the path to competitiveness. So a low level of corporation tax will enable an economy and tax revenues to grow. Indeed, by cutting corporation tax rates the low tax states have increased their tax revenues; so have some of the high tax states, but there the differential is less marked. What this proves is that cutting the rate of corporation tax will be a more effective way of enhancing the economy rather than introducing a one-size-fits-all CCCTB regime.

Several supporters of the CCCTB are advocating that there should be a minimum corporation tax rate across Europe. The danger to the economy can be seen in the previous table. If the EU's member states are to become competitive in these challenging global times Europe clearly needs the low tax economies. It should not

11 Information for GDP sourced from the OECD Data Index; information for Corporate Tax revenues sourced from Eurostat, Corporate Tax rates sourced from KPMG



risk upsetting that growth by seeking to drive-up their corporation tax rates in the name of harmonisation.

In short, the CCCTB is an Ivory Tower Brussels exercise with no electoral or popular mandate, it will be impractical for businesses, it will exacerbate, and not reduce, the importance of tax in investment decisions, and ultimately it will in contrast to its creators stated objectives, work against the efficient operation of the Single Market and the competitiveness of the EU.

THE BRUGES GROUP

The Bruges Group is an independent all–party think tank. Set up in February 1989, its aim was to promote the idea of a less centralised European structure than that emerging in Brussels. Its inspiration was Margaret Thatcher's Bruges speech in September 1988, in which she remarked that "We have not successfully rolled back the frontiers of the state in Britain, only to see them re–imposed at a European level…". The Bruges Group has had a major effect on public opinion and forged links with Members of Parliament as well as with similarly minded groups in other countries.
The Bruges Group spearheads the intellectual battle against the notion of "ever–closer Union" in Europe. Through its ground–breaking publications and wide–ranging discussions it will continue its fight against further integration and, above all, against British involvement in a single European state.

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The Bruges Group holds regular high–profile public meetings, seminars, debates and conferences. These enable influential speakers to contribute to the European debate.Speakers are selected purely by the contribution they can make to enhance the debate.

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