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THE CONCEPTIONS OF TAXATION OF HOLDING COMPANIES IN THE EUROPEAN UNION

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ABSTRACT

In times of globalization, the activity of international holding companies has become crucial for the economy of the European Union.

Increasingly, holding companies employ aggressive tax optimisation in their strategies. While the tax policies of individual EU Member States have turned out to be of little effectiveness. Simultaneously, the lack of a common and harmonized tax policy for countering tax optimisation has become a serious problem for the European Union. Therefore, the European Commission strives to develop a fiscal concept which will – on the other hand – allow to effectively combat international tax optimisation adopted by holding companies and – on the other hand – be integral with the internal tax systems of individual Member States.

The paper constitutes an attempt at conducting a comparative analysis of various conceptions of taxation of international holding companies. Special attention is devoted to the CCCTB conception (which is a legislative proposal put forward by the European Commission as well as the ECUIT, CHSTB, and HST which may be seen as important sources of experiences and supporting solutions.

INTRODUCTION

At the time of economic globalization, holding companies are gaining more and more significance. They are the ones setting trends in the operations of economic entities. The cross-border holding companies are of special importance. They have become the most widely used legal form of operation. However, their activity is hindered by a multiplicity of tax jurisdictions which differ considerably from one another. This problem is also observable within the European Union.

The fundamental basis of the Community law is the total elimination of all the obstacles to the operations at the internal market. The lack of regulations relevant for holding companies conducting cross-border activity constitutes one of such obstacles. The tax base for companies being part of such a group is calculated according to the rules operative in the countries where these companies have their registered offices. Determining what part of the group's total income should be attributed to a given company in the country of its residence poses serious problems, especially in the light of complicated rules and procedures concerning transfer prices. As a consequence, cross-border activity generates higher administrative costs connected with taxation. There is also a risk that groups of companies will use the available instruments in order to avoid or evade taxation. In order to satisfy the expectations of groups of companies, the European Commission has attempted to solve the problem by creating the concept of the Common Consolidated Corporate Tax Base (CCCTB). The CCCTB constitutes an advanced draft for a directive which is first and foremost aimed at creating legal basis for removing obstacles to the operation of the internal market of the EU. The purpose of this concept is to create a tax base for companies conducting cross-border activity on a joint market (COM [2011] 121 and published on 16 March, 2011).

Besides the CCCTB conception, the European Commission has also made other proposals which could constructively solve the problems brought about by taxation of international holding companies. And simultaneously, they could contribute to harmonization of the tax law in the EU. Those are:

- the European Union Corporate Income Tax (ECUIT);

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- the Compulsory Harmonised Single Tax Base (CHSTB);
- and Home State Taxation (HST).

These are important conceptions that make constructive discussion on the issue of taxation of international holding companies possible. Comparative analysis of all these three conceptions will allow to identify what are their good sides and what are their drawbacks. It is also intended to demonstrate the scale of the problem related to taxation of holding companies that conduct cross-border business activity in the EU.As part of this elaboration, an argument is put forward that the most realistic conception which meets the expectations of not only the EU Member States but also the holding companies is the CCCTB conception. However, this conception is not faultless either and therefore, prior to making the final judgement, it is worth looking at the solutions offered by other conceptions (the ECUIT, CHSTB, and HST).

Common Consolidated Corporate Tax Base

The CCCTB is currently the most advanced concept aimed at harmonisation of taxation of companies in the EU. Therefore, it seems justified and at the same time necessary to carry out an analysis of the measures offered by the CCCTB and its structures, which will form the basis for further discussion. The above-mentioned analysis will also serve to indicate the economic and tax-related consequences that will follow from the CCCTB concept for international holding companies operating within the EU and for the budgets of particular EU member states as well.

The creation of the CCCTB is a result of the proceedings of the Working Group appointed by the European Commission, which has been operating since November, 2004 and whose members have been experts from both the member states and the EC. Later the composition of the Working Group has been expanded with the representatives of business and academic centres. The first propositions within the concept of the CCCTB were put forward already in 2001 in the Communication of the European Commission entitled: Towards an internal market without tax obstacles. The initial propositions within the concept of the CCCTB have been further developed by the EC in an informal document issued on 7 July, 2004, entitled: Common Consolidated EU Corporate Tax Base which was published in A Common Consolidated EU Corporate Tax Base, Commission Non-Paper to informal Ecofin Council, 10-11 September, 2004.

The proposition of the CCCTB is a response to the requests submitted out of the need to harmonize corporate taxation within the EU by way of elimination or reduction of the number of abundant problems concerning, among others: complying with many restrictions connected with the use of transfer prices, impossibility or limitation of the possibilities to settle cross-border losses, and last but not least the issues regarding the phenomenon of international double (or even multiple) taxation. The concept of the CCCTB is based on several fundamental assumptions. The main one is the presentation of common rules for calculating a tax base (i.e. the CCCTB as a common base). Such a base would be used by entities regardless of the place where they conduct economic activity. This is applicable especially in the case of entities that conduct their activity on the territories of several countries, which causes them to be subject to a few tax jurisdictions (Spengel, 2007: 6; Supera, 2011: 26).

The second pillar of the concept of the CCCTB is the consolidated tax base of related companies which are granted the status of the CCCTB Group (with the CCCTB as the consolidated base). The common tax base would be the total income subject to taxation generated by the CCCTB Group, i.e. by all the member companies of the Group. Intra group transactions would not be included in the consolidated tax base and would be neutral to taxation. Consequently, the entities being members of a Group would not be forced to comply with the regulations concerning transfer prices with respect to financial operations taking place between the Group members. Another benefit would be the possibility to settle losses within the whole Group without delay. Finally, the processes of dividend distribution among the members of a Group would be taxation neutral (Spengel,2007: 6; Supera, 2011: 26).

After consolidation has been performed, it is necessary to determine the share of each Group member company in the consolidated tax base. The tax will be calculated with regard to the determined share on the basis of a tax rate relevant for the country of residence of a given company. One should note that the CCCTB concept is aimed at creating a common system for calculating a tax base whereas setting the tax rates remains the sovereign right of each member state (Spengel,2007: 6; Supera, 2011: 27)Predominantly, a holding company establishes a CCCTB Group, if it has a subsidiary in another member state. Various compositions of entities within a group are possible. Hence a company being an EU member state resident might create a group with:1/ its permanent establishment situated in another member state, and (or)2/ a permanent establishment in EU owned by its subsidiary which is a resident of a member state, and (or)3/ its directly or indirectly related companies which are residents of one or more member states, and (or)4/ one or more companies being residents of the same member state, if all these companies are subsidiaries of a company of third country (Spengel, 2008: 34; Tenore, 2008: 480.).One must keep in mind that there are still much more combinations of possible relationships built up in order to form a CCCTB Group.

The crucial advantage of starting a CCCTB Group is the possibility of intra group settlement of losses. Such settlement will be made by way of consolidation. While combining the tax bases of all group members, the loss incurred by one entity will be automatically compensated by the income of other entities within a group. If the value of the consolidated base is negative, the loss should be carried forward – in order to compensate it with income generated in future periods, or back – in order to compensate it with income generated in previous periods. It is necessary for the purpose of ensuring taxation of net income.The concept of the CCCTB stipulates two mechanisms of carrying losses over time. The first consists in allocating a loss to each group member company in line with the sharing mechanism. The attributed share in the losses of a group may be carried in time on the level of each entity

belonging to the group and compensated with the share in the positive tax base in the previous or forthcoming years. The second mechanism consists in carrying losses on the level of the group. It seems that the first mechanism assumes some kind of symmetry in terms of treatment of both losses and tax revenues since both the share in income and in losses within the consolidated tax base are attributed to each group member (Bourgeois & von Frenckell, 2008: 202; Staringer, 2008: 135). In accordance with the CCCTB concept, losses incurred by a company before entering a group will not be taken into account in the consolidation of the tax base. Such losses should be offset against the share in the consolidated tax base attributed to a given company. The domestic provisions concerning settlement of tax losses in time ought to be applicable in this case. As a consequence, tax losses incurred before consolidation remain subject to the domestic tax system in which they were made.

If a given company leaves the CCCTB Group, the tax losses will remain within the group and will not be attributed to a company which leaves the group. Such losses will be settled with future income of a group (Spengel, 2008: 39; Tenore, 2008: 480). Another key instrument of consolidation within the CCCTB is deferred recognition for the purpose of taxation of profits and losses incurred from intra group transactions. The final settlement of these transactions is dependent on the kind of asset which is the object of a transaction. Assets subject to amortisation are considered separately. Recognition of such profits or losses for the purpose of taxation, which are incurred on account of transfer of such assets as a result of intra group transactions, should as a matter of principle be deferred until a given asset leaves the group (e.g. when it is sold). The CCCTB concept assumes that the income subject to taxation of each group member is calculated in the same way as among unrelated entities. The results of such individual settlements are combined on the level of a group where intra group profits and losses are neutralised in a separate joint statement of the group.

One of the important aspects of the CCCTB is that its application is voluntary. This would allow entitled entities to choose if they prefer to be taxed according to the rules based on the CCCTB (Kołowski, 2011: 155; Staringer, 2008: 124) or on the basis of domestic tax regulations. Companies which are entitled to use the CCCTB may apply for being taxed in accordance with the rules included in the CCCTB concept. This tax regime is valid for five years and is automatically renewed for the period of successive three years unless a motion for cessation of the practice of applying the CCCTB rules is filed.

Undeniably, it is a topic for discussion whether the voluntary form is more beneficial than an obligatory one. There are certainly many arguments for and many against each particular option. An issue advocating voluntariness of the CCCTB is often raised since it would allow to avoid the accusation of discrimination and infringement of the basic freedoms, if domestic regulations might turn out to be more advantageous that those within the CCCTB concept (Hey, 2008: 100; Keen, 2001: 759; Spengel, 2008: 124). Additionally, voluntariness of these tax options will make the implementation of this concept in the member states "easier": since there will be no need to introduce changes in the existing tax systems (Litwińczuk, 2006: 13; Sinn, 1997: 258). On the other hand, the biggest drawback of a voluntary form is that it will be associated with quite heavy cost needed to cover the tax administration because apart from the existing domestic fiscal bodies, new tax administration bodies will have to be created for the purpose of the CCCTB, which will be financed from the budgets of the member states (Andersson, 2008: 14; Fuest, 2008: 731; Schreiber, 2008: 125; Staringer, 2008: 128).

European Union Corporate Income Tax

The European Union Corporate Income Tax (EUCIT) is a certain alternative to the national systems of taxation of holding companies. The EUCIT conception applies exclusively to international entities. Within the framework of this conception, tax is imposed on the level of the European Union (EU) on entities conducting cross-border business activity. This means that it would be revenue to the EU budget at least in some part and that would make it a European tax. A European tax has been reappearing for some time in, among others, proposals for the establishment of a European income tax on entrepreneurs or the so called eco-tax which would be applicable in the whole EU.

The EUCIT conception proposes several variant solutions for the introduction of the EU income tax on holding companies. It may be an EU tax, a national tax, or a mix of an EU and national tax. In the first variant, the EUCIT tax imposed on international entities would be administered by a European tax authority, the rate of the tax would be harmonized, and the tax itself would solely be revenue to the EU budget. The second variant proposes that a method be developed for division of the common tax base, which would serve to assign an appropriate share in this base to the relevant Member State. This share would be taxed by a Member States with its own tax rate. The third variant, which may be characterized as an intermediate solution between the two previous ones, proposes that the common harmonized tax base be taxed with two different rates. The harmonized EU rate would be used to calculate the revenue to the EU budget earned from the tax on holding companies imposed on international entities. Whereas national rates, which would be set sovereignly by the Member States, would determine the amount of revenue to the national budgets earned from this source (Cerioni, 2008:30). Transfer of part of the income from taxation of holding companies to the EU budget, and the resultant reduction of the revenue earned by a Member State, would bring about certain changes to the way expenses are covered with the funds from the EU budget (e.g. financing new areas with the EU budget funds).

It must be stated that owing to harmonization of tax rates proposed as part of the EUCIT as well as the political circumstances surrounding the harmonisation of taxation of holding companies in the EU, the chances of introducing this conception are small. I believe that at the current stage of integration of the European Union, introduction of this conception is unrealistic due to almost complete elimination of the sovereignty of a Member State as far as taxation of holding companies is concerned (Hellerstein, 2012:105).

Compulsory Harmonised Single Tax Base

The conception of a Compulsory Harmonised Single Tax Base (CHSTB) consists in replacing the national systems of taxation of holding companies with the CHSTB conception. The national system in each Member State is superseded by a uniform tax mechanism, i.e. the CHSTB. Its personal scope of application encompasses all the previously included taxpayers of corporate income tax, both entities conducting cross-border activity and the ones running domestic businesses. The CHSTB conception is not an alternative for the national tax systems but it is – by definition – supposed to be a replacement. Owing to the CHSTB, tax authorities of all the Member States and their taxpayers would be using a single – the same – tax system dedicated to holding companies.

The main assumption of the CHSTB conception is consolidation (after the tax base is calculated in accordance with a common set of rules) and subsequent division of the consolidated tax base among Member States in order to allow them to impose a domestic tax rate on their share in the base. The essence of the CHSTB conception is that each Member State retains the right to set tax rates. It is worth noting that both the EUCIT and the CHSTB conceptions opt for an introduction of common rules for calculation of the tax base. As a result of harmonization of taxation of holding companies – carried out in line with the assumptions of these conceptions – there would be a new system of taxation of legal persons established in the EU (Hamaekers, Holmes, Głuchowski, Kardach & Nykiel, 2006: 59).

The EUCIT conception solves the problem of optionality or compulsoriness of the European income tax on holding companies neither on the level of the Member States, nor taxpayers. It must be noted though that the EUCIT conception is dedicated exclusively to taxpayers running cross-border activity. If the EUCIT is introduced as an obligatory solution, there would be two systems of taxation of holding companies applicable in each Member State: the one based on the EUCIT conception for international holding companies and the previously existing domestic system for the remaining holding companies.

The CHSTB conception is the only one that proposes that domestic tax systems be completely superseded by a new system of taxation of holding companies created within the framework of this conception. Hence only one system of taxation of holding companies would be in operation, if the CHSTB conception were introduced in the EU. Whereas if the EUCIT were introduced, there would be 29 systems in operation (i.e. 28 preserved domestic systems and one EU-wide system based on the conception of a common tax base). Therefore, the CHSTB would be most efficient in eliminating the compliance and administrative costs and ensure full comparability of the tax burdens imposed in individual Member States (Lang & Domes, 2007: 82).

It is worth noting that the EUCIT and CHSTB concepts propose to abandon the application of the arm's length rule in international relationships among related parties. This would minimize the problem of using transfer pricing and ensure full offset of cross-border losses. One must bear in mind though that the proposed conceptions require a method of division of the consolidated tax base to be developed so that Member States may tax their share in the base with their own tax rate (Herzig, 2008: 551). It is thus worth noting that these conceptions pose similar threats which arise from division of the common consolidated tax base. Such a hazard might be created only if the EUCIT were introduced with a common tax rate. Moreover, if the European income tax on holding companies were fully contributed to the EU budget, there would be no need to divide the tax base calculated in line with the rules postulated by the EUCIT.

The CHSTB conception most fully reflects the idea of an internal market as a uniform market operating similarly to domestic ones. Adoption of this conception would bring about all the desired positive effects:

- elimination of compliance costs connected with the operation of 28 systems of taxation of holding companies;
- elimination of the necessity to use transfer pricing;
- introduction of full consolidation of cross-border profits and losses;
- tax neutrality of restructuring transactions.

Home State Taxation

The character of Home State Taxation (HST) is special as is assumes that both income generated by foreign subsidiaries and foreign establishments would be taxed in line with common rules consistent with the tax regulations applicable in the home state. A home state would be considered the country of residence of the parent company. A host state would be the country of residence for tax purposes of the subsidiary or the country where the permanent establishment is situated, as appropriate. An HST Group (Home State Group) would be formed by way of establishing a link between a company and its permanent establishments.

All the transactions within the HST Group would be made in line with the law applicable in the home state. In transactions made between the Group and related parties from outside the Group, the provisions of law of the home state of the establishments would be applied as well. The nature of the HST conception itself makes it obvious that domestic rules on transfer pricing should cease to be applicable in individual states with respect to the relationships between members of an HST Group. Analogously, offset of losses would take place in line with the provisions of law applicable in the home state (Hohenwarter, 2007: 124).

After calculation of the income generated by the members of an HST Group in line with the provisions of law applicable in the home state, the income would be assigned (in accordance with the established method of division) to individual states where small and medium-sized enterprises run their business. Therefore, it would be necessary to determine the manner of division of the common tax base (calculated in line with the rules applied by the home state – in the case of HST) among the particular Member States. Each Member State would impose a domestic tax rate on the share in the tax base assigned

to it, and the members of an HST Group would still remain taxpayers in their countries of residence. Tax forms would be filled in and filed only in the home states. The remaining states would receive copies. Tax audits would be carried out by the tax authorities of the home states in possible cooperation with the tax authorities of the host states. It is worth noting that the HST conception is not applicable to incomes earned on the territories of third countries. These incomes would be taxed in accordance with the previously applicable rules stipulated in agreements concluded with third countries (in regard of, among other things, various rates of withholding tax). Income from outside the EU would enlarge the income of a member of an HST Group after division of the tax base. It might, however, give rise to the necessity to file more than one tax declaration in relation to particular incomes – one in the home state and another in the host state (Pietrzak, 2005: 62).

This solution would be unavailable to small and medium-sized enterprises whose parent companies are residents outside the EU or in a Member State that has not adopted the conception. Furthermore, entities operating in certain sectors could not participate in the project either, which is a consequence of the existence of specific tax regulations that apply to them. They would continue to use the domestic tax rules.

The HST conception is special in character not only because its personal scope of application is limited to small and medium-sized enterprises but also due to the fact that it makes use of the existing systems of taxation of holding companies. In contrast to the conceptions using a common tax base presented earlier, this approach utilizes the already existing systems of taxation. It is not necessary for a Member State to adopt a new system of taxation of holding companies in order to introduce the HST conception; the only requirement is mutual recognition of each State's already existing tax system by another State (Farmer & Zalasiński, 2007: 14).

The HST conception neither proposes a new tax system nor indicates an already existing system as the one applicable to all the Member States. It merely specifies which of the existing systems is to be applicable to an HST Group. Its members would have a common tax base which would be divided among the individual EU Member States and would then undergo taxation with domestic rates. To recapitulate, one might state that the main features of the HST conception are:

- the personal scope of application is limited to small and medium-sized enterprises conducting cross-border activity;
- is to be accepted as part of a short term pilot project;
- its introduction is to take place through agreements between Member States that mutually recognize their tax regulations;
- is fully based on the existing systems of taxation of holding companies – no new system is created as a result of its adoption and the conception does not lead to harmonization.

CONCLUSIONS

In conclusion, it must be stated that the directions of possible reforms in this respect are of immense importance. They are key not only for the sake of countering international tax avoidance but also harmonizing the tax law applicable to holding companies. Indubitably, these two processes are inextricably related to each other.

The concept of the CCCTB is undeniably an innovative and modern measure taking into account the specific characteristics of the cross-border operation of entities in the EU. It will unquestionably be attractive for the taxpayers themselves who will not be limited to economic activity within the EU. Implementation of all the above-mentioned mechanisms might constitute a challenge for the administration of the EU member states since it would require adaptation of internal regulations of 28 countries. However, the profit from the implementation of the CCCTB concept will surely compensate for this effort. It is worth mentioning that these measures are of voluntary nature hence the entities interested in the CCCTB will be able to choose between domestic measures and the CCCTB concept. On the other hand, it will lead to a high cost of the CCCTB. The optional nature of this concept will have to result in the development of tax administration on the central level, which will serve the functions appointed to it by the provisions of the CCCTB. Unmistakeably, it will allow for centralisation of administration with regard to groups of companies conducting cross-border activity and at the same time will assign new functions and tasks to these administrative bodies, i.e. verification of the consolidated tax declarations, issuing binding interpretations in terms of the provisions of the directive. Nonetheless, appointing new administration will surely lead to accusations that the cost of maintenance of this directive is high and will constitute a burden for the member states.

The issue of whether the CCCTB concept will be attractive enough for groups of companies conducting cross-border activity (international holdings) should also be considered as currently such groups may evade taxation by means of abundant measures used contrary to their aim and purpose, which is of course against the law. The scope of the directive will be very wide. The directive will be touching upon a number of issues, often new and complicated. Furthermore, the list of entities entitled to use the CCCTB system is vast since apart of groups of companies (which seem to be the main addressees of this directive), it also encompasses all kinds of companies and entities serving the function of economic entities (e.g. enterprises) as well. It might result in evincing strong interest in the directive among a wide range of taxpayers from all over the EU.

Undeniably, introduction of the rules concerning the calculation of income and the tax base directly into a directive will lead to harmonization of interpretative rules and will allow for preventing competing interpretations given by particular EU member states. Additionally, implementation of these rules will be a beneficial alternative to the measures applicable in the particular EU member states. An important advantage to the formation of a CCCTB Group will be the possibility to settle intra group losses. Such settlement will be made by way of consolidation. While combining the tax bases of all group members, the loss incurred by one entity will be automatically

compensated by the income of other entities within a group, which will certainly be the benefit of the concept of the CCCTB. Another key instrument of consolidation within the CCCTB will be deferred recognition for the purpose of taxation of profits and losses incurred from intra group transactions. It will constitute a significant economic and tax-related consequence for international holding companies. Unmistakeably, the CCCTB concept might introduce new European standards based on the model of bringing accounting and taxes together. It seems that the concept is well thought out and constitutes some kind of a compromise between the taxpayers' expectations and the representatives of the tax services in the EU member states.

As far as the remaining conceptions (i.e., the EUCIT, CHSTB, and HST) are concerned, it should also be stressed that none of them is ideal and each has some specific flaws. The HST project is not a conception of harmonization of taxation of holding companies at all. In fact, it is a very special project aimed at achieving cooperation in terms of taxation and takes into account exclusivity small and medium-sized enterprises conducting cross-border activity.

Whereas the EUCIT and CHSTB conceptions are so general in character that it is difficult to evaluate them fully. However, it is enough to take a look at the general assumptions proposed in these conceptions (which stipulate that at least some part of the revenue earned from taxation of holding companies be included into the EU budget – in the case of the EUCIT – or that the solution be common and compulsory – in the case of the CHSTB) to conclude that in the current political reality, it is very unlikely for them to be implemented.

Bearing the above analysis in mind, it should be stated that the above three conceptions of a common tax base either do not satisfy the needs of the EU in terms of harmonization of taxation of holding companies (the HST conception) or stand no chances – politically speaking – of being adopted (the EUCIT and CHSTB conceptions). Despite the substantial flaws in the presented conceptions, one must acknowledge that making attempts of this kind may contribute to the development of a compromise solution. Obviously, it will be inevitable to arrive at a consensus not only among the Member States but also seek approval from the interested international holding companies. Furthermore, these conceptions could certainly serve to perfect the CCCTB proposal.

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