Revenue Law Journal

Volume 19 | Issue 1 Article 6

2009

The Arm's Length Principle and the CCCTB: Solutions to transfer pricing issues for individual countries and the European Union?

Nerissa Haskic

The Arm's Length Principle and the CCCTB: Solutions to transfer pricing issues for individual countries and the European Union?

Abstract

The increase in the use (or abuse) of international entities for tax avoidance and evasion, the increase in cross border trade and the birth of intangibles have given rise to a tightening of laws on transfer pricing. The Commissioner of Taxation in Australia asserts that most transactional transfer pricing methods are applicable in Australia. However, the EU has had issues in uniformly applying transactional methods and thus the idea of the Common Consolidated Corporate Tax Base - CCCTB - was born. This article compares the Australian and EU systems and gives a comprehensive overview of the CCCTB, its benefits and shortfalls, and some recommendations.

Keywords

transfer pricing, arm's length principle, international tax avoidance, Common Consolidated Corporate Tax Base (CCCTB)

THE ARM'S LENGTH PRINCIPLE AND THE CCCTB: SOLUTIONS TO TRANSFER PRICING ISSUES FOR INDIVIDUAL COUNTRIES AND THE EUROPEAN UNION?

NERISSA HASKIC*

The increase in the use (or abuse) of international entities for tax avoidance and evasion, the increase in cross border trade and the birth of intangibles have given rise to a tightening of laws on transfer pricing. The Commissioner of Taxation in Australia asserts that most transactional transfer pricing methods are applicable in Australia. However, the EU has had issues in uniformly applying transactional methods and thus the idea of the Common Consolidated Corporate Tax Base - CCCTB - was born. This article compares the Australian and EU systems and gives a comprehensive overview of the CCCTB, its benefits and shortfalls, and some recommendations.

INTRODUCTION

Twenty years ago, transfer pricing was considered a specialist subject which was limited to a few specialists and a handful of public servants and tax administrators.[1] Now, revenue authorities have tightened the laws regarding transfer pricing, because of its growing use and abuse in commercial transactions between related parties. It has become a major tax issue for Multinational Enterprises (MNEs) and Small-Medium Enterprises (SMEs).

The arm's length principle is the universal method of determining the right transfer pricing to be used between related parties. However, will this system work for a region such as the European Union? While a particular system may work for one country, where a number of countries in a union are concerned the system may have drastically different effects. This paper focuses on the new European Union transfer pricing framework, the Common Consolidated Corporate Tax Base ('CCCTB'). However, for the purpose of drawing comparisons between frameworks, the Organisation for Economic Co-operation and Development ('OECD') model and the Australian transfer pricing system will also be examined.

---

* LLB, BIR(Bus) (Bond), law clerk, Short Punch & Greatorix Lawyers, Gold Coast. I thank Dr Michelle Markham for her support and guidance in my studies in international taxation.

1 Monica Erasmus-Koen, 'A Common Consolidated Corporate Tax Base: Possible Elements of the Sharing Mechanism' (2008) 17(3) *Tax Management Transfer Pricing Report* 109.

TRANSFER PRICING

Transfer pricing are the pricing policies and practices that are established when physical goods as well as services and intangible property are charged between associated business entities.[2] MNEs account for 60% of global trading transactions, so the majority of cross border trade is between related entities and is transfer priced.[3] The main reasons that companies started to use transfer pricing is to help identify which parts of the enterprise are not performing well, to escape double taxation when repatriating profits and ultimately to reduce tax.[4]

This is becoming a major problem for revenue authorities who see substantial losses of tax revenue as a result. Consequently, the legislative rules and other guidelines regarding transfer pricing have become increasingly stringent and affect both large MNEs and SMEs. Improperly employed transfer pricing practices within such entities will usually be considered as tax avoidance schemes, which attract high penalties.[5]

In 2007, Ernst & Young conducted a transfer pricing survey on 850 MNEs across 24 countries. The results illustrated just how important transfer pricing issues are to this type of enterprise.[6] For example, 40% of all respondents identified transfer pricing as the most important tax issue facing their group and 81% of subsidiary respondents believe that transfer pricing will be 'absolutely critical' to their organisations over the next two years.[7] 78% of respondents also believed that a transfer pricing audit would be highly likely in the next two years.[8]

THE OECD FRAMEWORK

The OECD has tried to formulate a common approach on transfer pricing, given the need for cooperation in international cross border transactions.[9] The OECD Guidelines (including the 1995 OECD *Transfer Pricing Guidelines for Multinational*

---

2 Andrew Lymer and John Hasseldine, *The International Taxation System* (2002, 1st ed) 159.

3 Roy Rohatgi, *Basic International Taxation: Volume II* (2007, 2nd ed) 239.

4 Ibid.

5 Ibid.

6 John Hobster, *2007-2008 Global Transfer Pricing Survey* (2008) Ernst & Young Global <http://www.ey.com/Publication/vwLUAssets/Tax_TP_Insight_0308/$FILE/TP-Insight-0308.pdf > at 28 June 2008.

7 Ibid.

8 Ibid.

9 Above n 3.

Enterprises and Tax Administrations) as well as a Model Convention attempt to provide a framework for transfer pricing.[10]

The OECD Model Tax Convention (the Convention) is updated regularly and is an important tool for countries in number of areas.[11] These include:

- in negotiation of bilateral and multilateral tax agreements;
- as a resource for lawyers and accountants to aid in interpretation of treaties for their clients; and
- as a resource for Governments to develop international transfer pricing and corporate tax policy.[12]

The OECD Transfer Pricing Guidelines make it clear that the concept of transfer pricing should not be confused with tax fraud, or tax avoidance, even though transfer pricing transactions may be used for such purposes.[13]

The framework on which the OECD bases its international guidelines is the arm's length principle.[14] However, there is no express global definition of the arm's length principle, nor is it applied uniformly.[15] Article 9 of the Convention, which refers to 'Associated Enterprises' offers some framework.[16] However, it is often inadequate in solving disputes arising from certain transactions or giving direction as to procedure or minimisation of risk of an audit. This is because it requests that the Contracting

---

10 Ibid.

11 Organisation for Economic Co-operation and Development, *OECD Model Tax Convention* (2008), OECD <http://www.oecd.org/document/37/0,3343,en_21571361_33915056_34681637_1_1_1_1,00.html > at 11 October 2008.

12 Ibid. Bilateral and multilateral tax agreements are used to clarify the situation when a taxpayer may be subject to tax in multiple countries.

13 Michelle Markham, 'Transfer Pricing of Intangible Assets in the US, the OECD and Australia: Are Profit-Split Methodologies the Way Forward?' (2004) *University of Western Sydney Law Review* 8, 55.

14 John Neighbour, 'Transfer Pricing: Keeping It at Arm's Length' (2002) *OECD Observer* <http://www.oecdobserver.org/news/fullstory.php/aid/670/Transfer_pricing:_Keeping_it_at_arms_length.html> at 29 June 2008.

15 Michelle Markham, 'Transfer Pricing' (unpublished paper on International Taxation, Bond University, 4 June 2008).

16 Organisation of Economic Co-operation and Development, *Articles of the Model Convention With Respect to Taxes on Income and Capital* (2003) OECD <http://www.oecd.org/dataoecd/52/34/1914467.pdf > at 30 June 2008.

States reach an agreement on what is an acceptable arm's length price to be paid for the transfer.[17]

Also, key parts of the Article, such as 'Associated Enterprise', are not expressly defined in this article, or the Convention. Rather, the precise meaning is only provided after the taxpayer acts, and certainty comes only by interpretation in the courts.[18] This makes it difficult for any issues to be resolved before action is taken by a taxpayer.[19]

Whilst the OECD does not recommend a specific methodology to be used, they recommend that taxpayers select a transfer pricing methodology that will best reflect an arm's length transaction in terms of the facts, circumstances, evidence and reliability of the methodology used.[20]

The transactional methodologies have been said to be the most direct way to determine transfer pricing. However, the difficulty is finding identical transactions, which can be compared to the one in question.[21] Problems arise here in many cases, especially with intangible items, as there is simply no comparable.[22]

The OECD Guidelines are what their title suggests, merely guidelines. Most countries have developed their own transfer pricing rules and methodologies. Australia has modified the transactional methodology and the European Union has moved to a completely different framework altogether with a view to resolving some of the issues attaching to comparable transactions.[23]

TRANSFER PRICING- AUSTRALIA

Division 13 of the *Income Tax Assessment Act (*Cth*) 1936* and the 'Associated Enterprises' article of each of Australia's Double Taxation Agreements attempt to

---

17 Above n 12.

18 Eduardo A Baistrocchi, *Transfer Pricing in the 21st Century: A Proposal for Both Developed and Developing Countries* (2005) University of California <http://repositories.cdlib.org/bple/alacde/20> at 2 July 2008.

19 Ibid.

20 *OECD Guidelines* (1995) para 1.69.

21 Above n 11.

22 Ibid.

23 Ibid.

codify the arm's length principle, except neither refers to any methodologies which provide direction on calculation of an arm's length price.[24]

In Australia, the Federal Commissioner of Taxation ('Commissioner') has provided tax rulings as a guideline on calculation. *Tax Ruling 97/20* provides that the acceptable methods to be used are the transactional methods, including the 'Comparable Uncontrolled Price (CUP)', the 'Resale Price (RP)' and the 'Cost Plus (CP)' methodologies.[25] If these methods cannot be used to determine the pricing, then transactional profit methods may be applicable, such as the 'Profit Split' and 'Transactional Net Margin Methods' (TNMM).[26] However, it expressly excludes formulary apportionment as an accepted methodology.[27]

A policy unique to the Australian Taxation Office (ATO) is that they may utilise 'secret comparables'.[28] Situations may arise where taxpayers will not be able to discover which other MNE or transaction they have been compared to. This is a significant disadvantage for taxpayers, as they cannot view the basis on which their transfer pricing practice has been audited, nor can they appeal the decision as there would not be a reasonable argument to do so.

Given Australia's economic position and the rather stringent tax system, many MNEs choose to establish businesses in countries with more tax effective systems. Therefore Australia has not seen much litigation over transfer pricing.[29] The Administrative Appeals Tribunal first ruled on an issue regarding methodology in the *Roche case*.[30]

Theoretically, the Commissioner strives to apply the most suitable method guided by the internationally accepted methods stemming from the OECD Guidelines.[31] Whether the positives outweigh the shortcomings of the arm's length system is debatable. The use of secret comparables is not effective, especially in terms of intangibles as there will almost always be significant disparities between the comparables thus giving a somewhat false indication. This is mainly because most

---

24 Michelle Markham, 'Transfer Pricing of Intangible Assets in the US, the OECD and Australia: Are Profit-Split Methodologies the Way Forward?' (2004) *University of Western Sydney Law Review* 8, 55.

25 *Taxation Ruling 97/20*, *Income Tax: Arm's Length Pricing Methodologies for International Dealings,* Chapter 3, para 3.1.

26 Ibid.

27 Ibid.

28 Michelle Markham, 'Transfer Pricing' (unpublished paper, Bond University, 4 June 2008).

29 Above n 11.

30 *Roche Products Pty Limited and Commissioner of Taxation* [2008] AATA 261.

31 Above n 11.

intangible or Intellectual Property is unique in character. The ATO argues that secret comparables are effective and are only kept 'secret' for privacy reasons. From a taxpayer's point of view, keeping the comparables a secret erases any form of appeal or review of the decision made by the ATO. This situation requires reform.

Whilst the arm's length principle may work well in theory for single countries, such as Australia, whether it will work for a collective region such as the European Union is a different matter entirely.

TRANSFER PRICING - EUROPEAN UNION

In March 2000, the European Council launched the 'Lisbon Strategy'. It goals included the EU becoming, 'the most dynamic and competitive knowledge-based economy' in the world, by 2010.[32] Improving taxation policies throughout the EU as a means of achieving the Lisbon goals has been a common refrain. It is also repeatedly said that transfer pricing is one of the largest obstacles to streamlining corporate taxation and achieving their goals.[33]

The EU is a special case where transfer pricing is concerned, being a region or group of countries with full economic integration, not an individual nation.[34] This concept of the 'Internal' or 'Single' market is essentially steered toward free movement of capital, goods, services and people thereby erasing barriers and simplifying existing rules.[35] Some legislative powers are given to the European Commission and the European Court of Justice in determining certain matters, especially those with public policy considerations. The functionality of the internal market is an EU responsibility under the Treaty and transfer pricing policy promotes this.[36]

---

32 The Commission on Taxation, *An optional Common Consolidated Corporate Tax Base in Europe: Implications for Businesses Worldwide* (2007) International Chamber of Commerce <http://www.iccwbo.org/uploadedFiles/ICC/policy/taxation/Statements/180-496%2011-06-07%20final%20_no%20cover%20note(1).pdf> at 15 July 2008.

33 Above n 1.

34 Monica Erasmus-Koen, 'A Common Consolidated Corporate Tax Base: Possible Elements of the Sharing Mechanism' (2008) 17(3) *Tax Management Transfer Pricing Report* 109.

35 European Commission, *The EU Single Market* (2008) The European Commission <http://ec.europa.eu/internal_market/top_layer/index_1_en.htm > at 21 July 2008.

36 Aisha Butt, *Formulary Apportionment in the European Union* (2004) University of Lund <http://web2.jur.lu.se/Internet/Biblioteket/Examensarbeten.nsf/0/CA4DC3FA734FA121C1256F9D006FED4D/$File/exam.pdf?OpenElement> at 5 July 2008. Article 94 of the European Treaty states that harmonisation of taxes can only occur where the provisions are directly intended to affect the establishment or functioning of the common market.

This poses problems for the arm's length principle, as this framework does not consider whether 'reliable pricing adjustments' to a third-party comparable price are needed or could be made to reflect economic synergies which stem from working as an integrated group.[37] Further, it does not take into consideration the integrated decision making process of the EU. Nor does it consider the large-scale administrative efforts needed to conduct arm's length calculations in such an environment.[38] Some reform is required to better promote the Lisbon Strategy goals.

THE PROPOSED CCCTB

In 2001, the European Commission identified a possible resolution to the immediate problem stemming from the arm's length framework.[39] This solution was the Common Consolidated Corporate Tax Base (CCCTB) and work on establishing this framework formally began in 2004.[40] All 27 Member States of the EU participated in a workgroup to create a legislative proposal for an optional directive on the framework by September 2008.[41]

The European Commission thought this the 'only systematic way to address underlying tax obstacles' which exist for companies that have associated enterprises in several countries within the internal market.[42] Cross border transactions in the EU are subject to multiple national tax bases and this poses major transfer pricing issues.[43]

---

[37] Above n 1.

[38] Ibid.

[39] Laszlo Kovacs, 'The European Commission's project for a Common Consolidated Corporate Tax Base (Speech delivered at CFE Conference, 28 September 2006).

[40] Ibid.

[41] Frank Zipfel, *One Europe, One Tax?* (2007) Deutsche Bank Research <http://www.dbresearch.de/PROD/DBR_INTERNET_DE-PROD/PROD0000000000216084.pdf> at 18 July 2008. A directive requests member nations to include the particular concept into their domestic/national law. There is flexibility with directives as to form and method of implementation into national law. This is opposed to regulations which are binding and directly applicable. (http://info.hktdc.com/euguide/1-5.htm).

[42] The European Commission, *Common Tax Base* (2008) The European Commission <http://ec.europa.eu/taxation_customs/taxation/company_tax/common_tax_base/index_en.htm>.

[43] The Commission on Taxation, An optional Common Consolidated Corporate Tax Base in Europe: Implications for Businesses Worldwide (2007) International Chamber of Commerce <http://www.iccwbo.org/uploadedFiles/ICC/policy/taxation/Statements/180-496%2011-06-07%20final%20_no%20cover%20note(1).pdf> at 15 July 2008.

The main objective of the CCCTB is to create economic efficiency within the internal market and benefits for taxpayers through reduction of the Effective Tax Rate (ETR), creation of a 'one-stop shop' for compliance by having only one set of rules and elimination of transfer pricing and double taxation within the CCCTB.[44]

Principles

The word 'consolidated' in the acronym CCCTB suggests the meaning in this context. Under the CCCTB, EU Resident companies with permanent establishments ('PEs') in at least two member states would be able to group their taxable income and only comply with one set of rules.[45] Non-EU resident companies with two or more PEs or Subsidiaries in the EU would also be subject to the CCCTB.[46] Theoretically, this would eliminate many of the existing intra-community transfer price difficulties, allow for cross-border loss offsetting, simplify many operations involving international restructuring and avoid many instances of double taxation.[47]

The heart of the framework is the concept of the 'sharing' mechanism.[48] This is similar to formulary apportionment, which comparatively speaking, is an unacceptable methodology in Australia. The main goals of 'sharing' are to make administration and auditing easier, to distribute the tax base in a fair and equitable manner and to eliminate tax competition within the EU internal market.[49] This 'sharing' would only apply in a purely domestic situation.[50] This means that it would only apply to the EU PEs or subsidiaries and the relationship between these and the non-EU entity would remain at arm's length.[51]

---

44 Krister Andersson, *Comments on CCCTB\WP\057*, European Commission Working Group (2007) <http://ec.europa.eu/taxation_customs/resources/documents/taxation/company_tax/common_tax_base/BusinessEurope_comment_WP065.pdf> at 21 July 2008.

45 Commission Non-Paper to Informal Ecofin Council, September 2004: 'A Common Consolidated EU Corporate Tax Base,' (2004), p. 1.

46 CCCTB Task Force, *Working Paper No. 60- CCCTB: Possible elements of the sharing mechanism* (2007) European Commission Working Group <http://ec.europa.eu/taxation_customs/resources/documents/taxation/company_tax/common_tax_base/UniceComments_WP060.pdf> at 20 July 2008.

47 Ibid.

48 Above n 1.

49 Above n 44.

50 Ibid.

51 Ibid.

'Sharing' applies to all taxable income, both active and passive.[52] It apportions the consolidated income under designated factors including payroll, property and sales within the group in accordance with a particular formula.[53] This formula is as follows[54]:-

$$\text{Tax Base A} = \left(\frac{1}{m} \frac{\text{Sales}^{A}}{\text{Sales}^{\text{Group}}} + \frac{1}{n} \left(\frac{1}{2} \frac{\text{Payroll}^{A}}{\text{Payroll}^{\text{Group}}} + \frac{1}{2} \frac{\text{Number of employees}^{A}}{\text{Number of employees}^{\text{Group}}} \right) + \frac{1}{o} \frac{\text{Assets}^{A}}{\text{Assets}^{\text{Group}}} \right) * \text{CCCTB}$$

$$\text{with } \frac{1}{m} + \frac{1}{n} + \frac{1}{o} = 1$$

Through apportionment, corporate income tax is transformed to direct tax under the specific factors.[55] These factors cannot always be variables in the general 'formula' as shown above, as they are generally most vulnerable to manipulation and in most cases only reflect the way in which income is generated and the extent of reliance on manufacturing and marketing activities.[56] This needs to be addressed, as it does not give an accurate reflection of the factors within the formula. Furthermore, the formula will remain uniform across all factors and domestic variations to this formula should not be allowed.[57] The factors in attribution of profit can also be linked to help aid in anti-avoidance.[58] For instance, examining the usage of certain property, the physical location of employees or third party customers may provide direct or indirect links to actual or potential manipulation of the system by taxpayers.[59] It must also be noted before further discussion that the factors are apportioned on such terms that it implies each factor has the same rate of return. [60] This means that the real rate of return under each factor is not correctly reflected and thus ultimately lends to an artificial calculation.

---

52 Above n 1.

53 Ibid.

54 Ibid.

55 Ibid.

56 Ibid.

57 Above n 44.

58 Above n 1.

59 Ibid.

60 Ibid.

Payroll

Three elements must be ascertained in order to calculate the share of the tax base for this factor.[61] These elements include the scope, value and location of the workforce.[62]

In relation to scope, the average number of employees is determined by an average of employees at the beginning of the year and at the end, including those who are outsourced or seconded personnel.[63]

With regard to cost, it is suggested that this would be a deductible expense in the calculation of the tax base.[64] The reason for this is to cause the calculation of the tax base to be relatively straightforward by virtue of the link between deductible costs under the CCCTB and the 'sharing' mechanism.[65]

Location is ascertained by considering the place in which the employees perform services. Should an employee have no base of operation for at least three consecutive months per year, the payments will be assigned to the associated entity which includes the said employee on its payroll.[66]

A significant problem under this factor is that the corporate tax is transformed into a labour tax. This may provide an incentive for companies to shift part of their labour force, particularly call centres or information technology research and/or development, to low-tax jurisdictions.[67]

Property

The same three elements must be ascertained with the payroll factor.

In determining scope, only tangible property assets would be taken into account.[68] The Commission has three reasons for excluding intangibles. The first is that it is more practical to exclude them, as their inclusion would be susceptible to manipulation.[69] The second is that it is difficult to value intangibles, consequently

---

61 Above n 44.

62 Ibid.

63 Above n 1. The definition of 'employee' would be in accordance with domestic legislation and on a mutual recognition approach.

64 Above n 44.

65 Ibid.

66 Above n 1.

67 Ibid.

68 Above n 41.

69 Ibid.

resulting in high compliance costs for companies and complex calculations.[70] Thirdly, there is an argument that income from intangibles is already included in the formula indirectly, via the other factors.[71] It is argued that income from intangibles would be included within salaries for employees who deal with intangibles, tangible assets used to create those which are intangible and proceeds from goods or services which include the value of intangibles in their value.[72] To allow for a straightforward valuation, it is suggested that the written down value would be the most appropriate, as it would most accurately represent the market value of the asset.[73]

Lastly, with reference to location, in most cases the location of the property would correspond with the location of the economic owner.[74] A similar principle which applies to that of location of employees who do not have a base applies here. The commission states, 'Where assets are depreciated by an entity but effectively used by another entity, this rule would assign it to the latter'.[75]

Whilst this is a relatively risk and cost effective way of apportionment under this factor, the main glitch is in the treatment of intangibles. It is foreseeable that this will become a major issue should the CCCTB be implemented, as should intangibles remain excluded there will be ample room for manipulation due to the nature of many industries centring upon the use and production of intangibles. Perhaps a market value calculation, separate to the formula but to be included in the base asset value used in the formula, may be a more suitable system.

Sales

Sales is the most contentious factor as there are really only two ways to measure this, sales by origin or sales by destination.[76] The former is superfluous because it would most likely replicate the payroll and property distribution, resulting in double taxation.[77] The latter would replicate the effect of value added tax, thus also resulting

---

70 Ibid.

71 Ibid.

72 Ibid.

73 Ibid. The market value was seen as the theoretically correct value of an asset but was disregarded due to the difficulties and compliance costs related to measuring it, ie, the costs and difficulties of revaluing all assets each year would be disproportionate to the benefits of using market value as opposed to tax written down value.

74 Ibid.

75 Ibid.

76 Above n 1.

77 Ibid.

in double taxation.[78] In addition to this, the rise of trade in intangibles makes it difficult in some cases to ascertain the origin or destination of sales.[79]

All proceeds from sales, excluding VAT, other taxes and duties and intragroup sales, exempt, passive and extraordinary income would have to be calculated instead.[80] This is unless the total proceeds do in fact represent the 'ordinary course of trade or business'.[81] Further, the Commission states that they would have the goods or services taxed in the member state in which they are physically delivered or provided to a third party.[82]

Clearly sales are a contentious factor. With the CCCTB directive proposal expected to be released in September of 2008, it is quite alarming that the working group have not yet developed a concrete answer on this issue. It seems in some of these factors that despite the best intentions of making the apportionment system practical and 'user-friendly', the situation is not unfolding in this manner.

An analysis of the CCCTB suggests that harmonisation of taxation systems between EU Member Nations is the main objective. The Commission maintains, however, that the real objective is to promote economic efficiency and create a more competitive market in terms of foreign and domestic investment.[83] While there are obvious benefits in using the CCCTB framework, such as efficiency and ease of operations, there are severe downfalls and glitches which still must be resolved.

Negative impact

The shortfalls in regard to each apportionment factor were outlined above. Other general problems also should be resolved. The main issue is that there would be two parallel systems running at the same time, given that the CCCTB would be optional.[84] Introducing the CCCTB as optional will perhaps lure more companies to adopt the system. But if the company has manageable transfer pricing practices which are already well established, changing to a new system will only provide greater compliance and administrative costs and risks. Two parallel systems will also create more administrative costs and crises than simply using the arm's length system.

---

[78] Ibid.

[79] Ibid.

[80] Ibid.

[81] Ibid.

[82] Ibid.

[83] Above n 41.

[84] Above n 1.

There is also no conclusive test to determine the precise source or origin of the income. This will not aid in prevention of avoidance. Further, apportionment between factors on equal terms must be addressed, as equal treatment will not give an accurate illustration of the broad financial status of companies, nor will it aid in prevention of avoidance.

Lastly, there is significant disparity between effective corporate tax rates between individual members of the EU. For example, the corporate tax rate in Ireland is 12.5% and the rate in France is 34.43%.[85] This is a direct reflection of domestic legislation within each country. The CCCTB may be detrimental to some countries which pride themselves on a competitive tax rate economically and politically, such as Ireland.[86] In addition, it presents policy issues with regard to sovereignty and would impact upon influence in domestic markets. On the other hand, countries which have high tax rates may or may not benefit from the system, depending on whether substantial amounts of revenue are lost from a decrease in the effective tax rates. If taxes must be raised in other areas such as VAT or personal income tax to cover a loss resulting from implementation of the CCCTB, this presents wider issues in relation to domestic economic planning and public policy. Similarly, if company tax rates must be raised, it does not necessarily mean that these other tax rates would be reduced. Significant changes would have to be undergone in either scenario and this is an undesirable situation for any country.

It was originally envisaged that there would be a proposal for an EU Directive with regard to the CCCTB in September of 2008 and possible implementation by 2011.[87] However, the European Commission has now delayed the release of this proposal.[88] Laszlo Kovacs explained there was 'more work to do' with regard to the proposal.[89]

There has not been another deadline set for the release of the proposal.[90] Kovacs states that it will be released once it is properly ready.[91] However, some commentators, such as Peter Cussons from PricewaterhouseCoopers, believe that this

---

85 IDA Ireland, *Tax in Ireland* (2008) IDA Ireland <http://www.idaireland.com/home/index.aspx?id=659> at 5 July 2008.

86 Above n 1.

87 Above n 39.

88 Joanna Faith, 'Kovacs postpones CCCTB Proposals' (2008) *International Tax Review* <http://www.internationaltaxreview.com/?Page=9&PUBID=210&SID=711012&ISS=24960&LS=EMS204234> at 8 October 2008.

89 Ibid.

90 Ibid.

91 Ibid.

delay is the result of the political reality regarding the difficulty of implementation of the CCCTB.[92]

The proposed directive at this stage will be optional and it is said that Germany, Italy, Spain and four other EU Nations would be in favour of implementation.[93] However, the United Kingdom, France and Ireland would be likely to veto this.[94] France was once a fervent supporter of the CCCTB, though their stance changed once they realised the heavy costs of the transition stage for companies.[95]

Ireland in particular would feel the negative effects of such a system, given that their corporate tax rate is highly competitive. Vincent Sheridan, President of Institute of Chartered Accountants in Ireland (ICAI), stated:

> This [CCCTB] threatens one of the main planks of our economic strategy and if introduced would render useless the protection negotiated in the EU Reform Treaty that decision on tax rates required unanimous approval.[96]

The CCCTB may be fatal to Ireland's position in the current internal market, because of the competitive tax rate they present. Ireland would also be opposed to the CCCTB because it would be inflexible, unlike their domestic laws, given that any changes or implementations must be permitted by the European Commission. Additionally, there would not be absolute certainty on interpretation issues, such as those regarding Associated Enterprises, discussed above.[97]

Should the CCCTB directive not be implemented, Laszlo Kovacs, EU Commissioner of Taxation, stated that he would support introduction of the framework through article 43(f) of the EU Treaty.[98]

---

92 Ibid.

93 Director of Finance, *Multinationals urged to consider CCCTB* (2007) Director of Finance Online <http://www.dofonline.co.uk/tax/multinationals-urged-to-consider-ccctb.html> at 15 July 2008.

94 Ibid.

95 Ulrika Lomas, 'ICAI Welcomes New French Stance on CCCTB' (2008) *Tax News* <http://www.tax-news.com/asp/story/ICAI_Welcomes_New_French_Stance_On_CCCTB_xxxx31429.html> at 21 July 2008.

96 Accountancy Age, 'ICAI President slams CCCTB as "major threat"' (2007) *Accountancy Age*.

97 FinFacts Team, *CCCTB Business News* (2007) FinFacts Business & Finance <http://www.finfacts.com/irelandbusinessnews/publish/article_10009975.shtml> at 11 July 2008.

98 Above n 1. Article 43(f) states that there must not be barriers to or discrimination in trade between the Member States and does not distort competition between them. This is the

Some major changes should take place before the CCCTB directive can be proposed or implemented in any fashion. Should it be proposed in its current form, there would be significant issues left to decide on, these being issues which should have been resolved before any decision on a proposal was reached.

RECOMMENDATIONS

The Commission should take a hardline stance on introducing the CCCTB as compulsory to avoid having parallel frameworks in place. There will be political implications with implementing such a system. If these cannot be overcome, on balance it may not be worth introducing the CCCTB as optional because of the associated risks.

Secondly, the formula must undergo changes. The Commission seeks to keep the formula as simple and 'user-friendly' as possible, but the nature of transfer pricing is not simple. Perhaps the apportionment factors should be assessed individually through company financial reports (rather than equally) and included in the formula in this form. This is because these factors will rarely be equal and should not be treated as such.

Lastly, perhaps the Commission should take a more practical rather than an efficient view on the situation. Sometimes they place simplicity first and practicality second, especially in regard to the formula for apportionment.

CONCLUSION

A perfect tax mechanism balances equity and efficiency. Achieving this is rare, because taxation, particularly international taxation which can involve complex cross border transactions, ultimately involves policy decisions which must consider whether pure economic efficiency outweighs national interest.[99] Neither the CCCTB nor the arm's length method achieves this balance and both have their benefits and shortcomings. The arm's length method is not a uniform solution to transfer pricing, though neither is eliminating transfer pricing altogether as the CCCTB purports to do. However, the CCCTB would probably suit a region such as the EU more so than an arm's length framework. Once the CCCTB is properly established, there would most likely be increased efficiency, elimination of many instances of double taxation and less scope for manipulation of the corporate taxation system.

---

basis upon which the CCCTB could be invoked as taxes are discriminatory and distortive of competition. <http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:C:2006:321E:0001:0331:EN:PDF>.

[99] Ibid.

The Commission admits they have not resolved fundamental problems, namely those surrounding the 'sharing' principle and with regard to the formula. On the other hand, by its estimated establishment date in 2011, the system may work wonders for the EU. Timing is important to the CCCTB and one of the main problems is that it has been rushed. Transfer pricing cannot be eliminated overnight. The Commission might pause and analyse the current proposal and endeavour to solve the obvious and persistent issues.