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Comparison of European, Canadian and U.S. formula apportionment on real data

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Abstract

The harmonization of the tax regime of EU Member States represents one possible way to intensify their economic integration. Tax harmonization by a Common Consolidated Corporate Tax Base constitutes a similar system to which has been used in Canada, USA or Switzerland since the last century. The present paper describes the principles of formulas apportionment which are used in Canada and the USA and proves different distribution of the tax base in comparison with the formula apportionment as published in the proposal to the Council Directive on a Common Consolidated Corporate Tax Base of 16 March 2011.

Keywords: CCCTB; formula apportionment; tax base; tax harmonization; consolidation;

1. Introduction

The harmonization of the tax regime of EU Member States represents one possible way to intensify their economic integration. On the other hand, the tax system of each country can differ in relation to its economic or social structure, and certain types of taxes can perform different roles in the national tax system.

As Salin (2007) says, the idea of tax harmonization is often associated with the concept of a globalized tax system, which represents something like a worldwide tax system with cooperation of tax administration. But globalization means competitiveness at a global level. In the other words, individuals try to differentiate from each other at the global level, not to be more and more similar. Therefore, if we want to have a globalized tax system, it

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has nothing to do with tax harmonization, but it means an existence of tax differences in terms of tax competition. Also, McLure (2007) argues that a reasonable level of tax competition may strengthen the fiscal discipline of Member States and constantly reduce tax obstacles. On the contrary Dankó (2012) says that tax harmonization with common rules of determination of the tax base could contribute to the fiscal sustainability and the competitiveness of European business

As mentioned in Gordon (2011), according to the European Commission the only way of tax harmonization is implementation of a Common Consolidated Corporate Tax Base (CCCTB hereinafter), which would be able to eliminate tax obstacles arising from cross-border business activities. Tax harmonization by the Common Consolidated Corporate Tax Base constitutes a similar system to which has been used in Canada, the USA or Switzerland since the last century. The present paper describes the principles of formulas apportionment which are used in Canada and the USA and proves different distribution of the tax base in comparison with the formulary apportionment as published in the proposal to the Council Directive on a Common Consolidated Corporate Tax Base of 16 March 2011.

The article is divided into three main parts. The main principles of Canadian and U.S. formula apportionment as well as European formula apportionment based on the proposal Directive are described in Theoretical background. The core results of the investigation are represented in Results. The main ideas and finding are summarized in Conclusion.

2. Theoretical background

The proposal to the Council Directive on a Common Consolidated Corporate Tax Base of 16 March 2011 defines general rules such as realization principle, principle of measurability, consistency and principle of one tax year. CCCTB will be used by company groups with a high degree of economic dependence which will meet the criterion of 50 % voting rights and 75 % capital share or the right to profit. CCCTB will also only be applied by enterprises which are operating within the EU, i.e. water's edge principle. This basically means consolidation of company group income with a source on the territory of the European Union. An income with a source in third country will be taxed by the rules of the country where the company is based.

Three basic steps were defined for CCCTB determination in the proposal Directive. First of all each company calculates its taxable profit based on accounting principles, this taxable profit will be adjusted according to the requirements of CCCTB. For example all intercompany transaction should be eliminated. As Petutsching (2010) describes, the consolidated tax base will be redistributed among the EU Member States on whose territory the company group operates. The distribution of the tax base will be based on three economic factors: the reported tangible assets, payrolls as a number of employees in connection with labor costs and sales. The destination principle will be used for sales. All intangible and financial assets will be excluded; it is possible that countries with a large share of services will be disadvantaged, on the other hand countries with labor-intensive industries will benefit from formula apportionment. By the proposal Directive all factors in formula apportionment should be calculated with equal proportion. If there is a missing factor a higher portion of others would be used. There is also the possibility for some special formulas like in Canada, for example in finance sector or freight transportation.

By Mintz (2007) the CCCTB could reduce the overall tax base of company group due to possible loss offsetting between them. As mentioned in Devereux and Loretz (2007) this would be allowed only in a year where the loss is reported. But in the case of overall loss of company group it would be allowed to carry it forward. By Mintz (2007) the Member States will impose their own tax rate to avoid any disruption of their fiscal sovereignty. The countries will have direct control of tax revenues and tax administration. As Devereux and Lorets (2008) note, the revenue from new investment made by company group will be taxed by an average rate based on the tax rate of countries where the company group is based.

As Mintz (2007) says, the CCCTB system with consolidation is more similar to the system applied in the USA, the alternative Common Corporate Tax Base is closer to the Canadian system which allows companies to decide for consolidation or not. By Fuest et al. (2006) the Canadian and the U.S. model are significantly different in the allocation of taxable income. By Cline and Neubig et al. (2010) in Canada there is formula apportionment for income distribution of legal entity which operates by permanent establishment in different provinces, but in USA is formula apportionment used for income distribution of company group. The findings of Hellerstein and McLure's