

The Shaping of the Tax Audits Regime in the new Common Consolidated Corporate Tax Base (CCCTB) legislation: Proposed Solutions for Substantives and Procedural Provisions

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participate to the debate on potential developments of the CCCTB project in this historical time for possible decisions which can have a far-reaching impact on the future of European Tax Law.

I. INTRODUCTION

Amongst the many administrative aspects that the introduction of the Common Consolidated Corporate Tax Base (CCCTB)¹ would involve, the regulation of tax audits is deemed to be one of the most important for the functioning of the new regime. In fact, the CCCTB, while allowing multinational companies to avoid the need to comply with many different national regimes (by means of a new attractive and simple regime for determining the taxable base), and to remove the remaining tax obstacles to cross-border business within the Community, thanks mainly to the consolidation, should not compromise the financial interests of Member States, i.e. should not become the vehicle for tax evasion or avoidance practices. In reconciling these two objectives of the new legislation, the shaping of the tax audits regime would have a key role to play. The present work, which focuses mostly on multinational groups eligible to consolidation (due to their being the main intended beneficiaries of the new regime), assumes as a starting points some questions and choices of general character that have been indicated during the work of the CCCTBWG, and aims at proposing the key features, from the substantive and procedural viewpoints, of a tax audits regime that would be inspired by both objectives which should guide the new Directive: “competitiveness” (from the viewpoint of simplicity too) of the CCCTB regime on the one hand, safeguard of the financial interests of Member States (together with the necessity of proper functioning of the internal market) on the other .

II. THE KEY ISSUES: THE STATE OF WORK (SUMMARY)

The CCCTB WG, in its 2006 working document, “administrative and legal framework/questionnaire”², listed several issues related to the common base audit arrangements: the period of time covered by a tax audit; the decision about which service should be allowed to check the accounts of which company; the initiative of tax accounts auditing; the timing and modalities of the tax auditing; the consequences of a tax account audit. On each of these issues, the Commission services suggested several points for discussion that, on the whole, cover all the choices to be made in shaping the tax audit arrangements related to the CCCTB: a) whether Member States rules providing limitations in time as regards the tax years potentially subject to auditing should be harmonised; b) whether national tax administrations should only be able to check the tax accounts of the companies applying the CCCTB who are located in their country, and whether the 1977 directive on mutual assistance provides a sufficient legal framework for the necessary exchange of information between national tax administrations; c) whether only the tax administration of the country of location should be entitled to decide that a company’s tax accounts have to be

¹ In pursuance of the strategy, which the Commission established in 2001 (COM(2001)582 of 23/10/2001, Towards an Internal Market without tax obstacles – A strategy for providing companies with a consolidated corporate tax base for their EU-wide activities) and confirmed in 2003 (COM(2003)726 of 24/11/2003, An internal market without company tax obstacles: achievements, ongoing initiatives and remaining challenges), to allow businesses with subsidiaries and branches throughout the European Community to determine their taxable base according to an EU set of rules allowing them the EU-wide consolidation of profits and losses.

² European Commission, 2 March 2006, CCCTB\WP\030\doc\en, Administrative and legal framework/questionnaire, pp 5-7 (this working paper, as well as all others subsequently cited in this work, is available at: http://ec.europa.eu/taxation_customs/taxation/company_tax/common_tax_base/index_en.htm)

checked, or whether the tax administrations of other Member States in which the group entities are located should be involved in the decision or be able to request from the host state to check the accounts of the company at issue; d) whether the CCCTB legislation should limit the duration of the auditing, and whether the auditing procedure should be harmonised or should rely on national rules; e) whether, in the event of an increase in the tax base of a company, belonging to a group applying the CCCTB, which increases the share of the other MS involved in the overall tax base sharing, these Member States should be involved in the decision-making process, i.e. in the adjustment of the initial tax base increase. These points were, only in part, addressed in a subsequent working document, “Points for discussion on ‘Administrative and Legal Framework’”³, which highlighted the need for clarity about who conducts a tax audit and how the respective administrations collaborate during the audit, the desirability of common solutions concerning the commencement of an audit, the possibility of relying on existing national rules as regards the procedural aspect (how the competent authority actually proceeds) and the desirability of a common approach to some elements of the audit procedure, e.g., a common maximum length of the audit or a common statute of limitation. This working document was regarded, by the UNICE Task Force on CCCTB, as a good start to the *introduction* of the topic, but “too much focused on current practices and not enough on how administration in a new and truly competitive system should look like”⁴. The UNICE Task Force, in particular, emphasized that, because one of the most fundamental benefits of a CCCTB is to reduce the compliance costs of having to deal with different national systems monitored by different national tax authorities, the CCCTB must, in addition to a single set of rules, allow for a single compliance in a single location, i.e. a one-stop-shop approach⁵. This would imply that one tax return in one country for the entire group has to be filed, and that the one-stop-shop authority is solely responsible for the tax audit of the group. The UNICE recognised that the one-stop-shop authority, specifically the tax administration of the State of location of the parent company, will sometimes be unable to carry out the audits in other Member States, and that it would need to ask the local authorities to support it in the execution of the tasks at hand, but stressed that the crucial point is to allow the taxpayer to only have to interact with one tax administration⁶. Thus, from the procedural viewpoint, the ways of structuring the interaction between the one-stop-shop tax authority and the local authorities that could be considered, which were not indicated in the UNICE Task Force document, would constitute the key aspects.

The one-stop-shop approach was also indicated as the ideal one in the last 2006 working document, “Progress to date and future plans for the CCCTB”⁷, which indicated that Member States would exchange the information to perform checks and audit on the basis of the existing mutual assistance directive and recovery directive, possibly enhanced to improve their functioning for CCCTB purposes, but recognised the need for further work to explore how this would be possible⁸. This document also

³ European Commission, 19 May 2006, CCCTB\WP\036\doc\en, Points for discussion on ‘Administrative and Legal Framework’, 19 May 2006, p. 7

⁴ Comments on document CCCTB\WP\036 Common Consolidated Corporate Tax Base Working Group – Points for discussion on ‘Administration and Legal Framework’ – p. 1

⁵ Ibid

⁶ Ibid, p. 2.

⁷ European Commission, 20 November 2006, CCCTB\WP\046\doc\en, Progress to date and future plans for the CCCTB.

⁸ Ibid, p. 16

highlighted the different views still existing between Member States more favourable to a centralised management of the CCCTB, including a single audit mechanism, and other Member States in favour of a decentralised management of the system, according to which administrative aspects such as tax declarations, tax audits and the issue of explicative circulars on the CCCTB legislation would remain within the competence of individual Member States⁹. After setting out, in a working document intended to indicate a technical outline, the proposed choices concerning the basic structure of the CCCTB, the tax base of individual companies, the consolidation etc,¹⁰ the latest and related document, “CCCTB: possible elements of the administrative framework”, which followed the one-stop-shop approach, specified the key concepts to be applied in the shaping of the new administrative framework. These are the concepts of “principal taxpayer” – which would be the ultimate parent company of the group – of “competent tax authority” – which would be the authority designated by a Member State for the purpose of the Directive introducing the CCCTB – and of “principal tax authority”, which would in principle mean the competent tax authority of the Member State in which the principal taxpayer is resident¹¹. In addition, the document defines the “audit” as any activity conducted by a competent tax authority to verify compliance with the Directive by a taxpayer or group of taxpayers¹², it restates the need for a common time limit for finalising tax audits¹³ and mentions a “jointly determined audit approach, which for obvious reasons of practicality, would be partly carried out by local tax administrations”¹⁴.

Amongst all points highlighted in the working papers, the most recent discussion on tax audits, at the Conference “CCCTB: the possible contents of Community Law provisions”¹⁵, seemed to show wide consensus on the fact that as a general rule the principal tax authority should take the tax audits initiative, and that the tax authorities of the countries concerned show work together as members of an “auditing team” of which the principal tax authority should be “the captain”¹⁶.

In addition to the discussions on the administrative and legal framework, the discussions on the substantive rules which would govern the CCCTB, and which would impact on the choices to be made in designing the tax audit regime, seem to have reached consensus on fundamental issues such as the definition of residency and permanent establishment (PE), and the main principle for taxation of residents. On the first aspect, companies will remain resident of a particular Member State, although there was agreement on the fact that having common criteria for tax residence in the CCCTB legislation would ensure a broad and common definition of tax residence at

⁹ Ibid, p. 17.

¹⁰ European Commission, 26 July 2007, CCCTB/WP057\doc\en, CCCTB: possible elements of a technical outline.

¹¹ European Commission, 13 November 2007, CCCTB/WP061\doc\en, CCCTB: possible elements of the administrative framework, p. 7-8.

¹² Ibid, p. 8

¹³ Ibid, p. 2

¹⁴ Ibid, p. 3

¹⁵ Co-organised in Vienna on 21-23 February 2008 by the Institute for Austrian and International Tax Law of the Vienna University of Economics and Business Administration and the European Commission (hereinafter: the Conference).

¹⁶ Definition which were used by Paul Farmer (Dorsey&Whitney, London), discussant at the session of the Conference devoted to administrative issues including tax audits, and by Prof. Pasquale Pistone (Vienna University of Economics and Business Administration), chairman of such session, to indicate the integrated approach to tax audits that is regarded as necessary.

national levels. The definition of PE, and the attribution of profit to it, would make use of the work carried out in the framework of the OECD, complemented by more detailed guidelines to avoid diverging interpretations of the OECD Principles. As regards the main principle for taxation, the choice would be for the world-wide taxation principle, but much of the income from third countries would be exempt.

In light of this overall state of progress in the discussion, critical issues emerge as regards the shape of the tax audits regime.

III. THE SCOPE OF THE TAX AUDITS CONCERNING THE CCCTB REGIME

As recalled above, the latest working document specifies that for the purposes of the CCCTB regime audit would mean “any activity such as enquiries, inspections or examinations conducted by a competent tax authority *to verify compliance with the Directive* by a taxpayer or group of taxpayers”¹⁷. It also specifies that each taxpayer would be required to keep records and supporting documents in sufficient details to ensure the proper application of the Directive and to allow audit by the competent tax authorities¹⁸, and that tax returns would in any event include, among other, details of the calculation of the tax base¹⁹. If all this is considered together with the choice, indicated in the previous working document, whereby the new Directive introducing the CCCTB would define the tax base but *not the methodology for adjusting the individual company accounts to arrive at the tax base*²⁰, it appears to suggest that the Directive and its implementing measures would require the taxpayer to indicate in the tax returns *which* adjustments have been made to calculate the common tax base by moving from the company accounts, but *would not prescribe the adjustments to be made*. These latter would be indicated by national laws, and, in consequence, the tax audits aimed at verifying that these adjustments have been made correctly would verify compliance with national provisions.

From this, there would be implications as regards the scope of the tax audits governed by the Directive, the distinction between these and the pre-existing national tax audits related provisions and the interrelations between the latter and the former. The tax audits provisions of the CCCTB legislation would in fact provide for enquiries, inspections and examinations intended to verify whether the individual items of income and of deductible expenses as identified (by either the CCCTB Directive or implementing measures under the Comitology procedure) were correctly computed (e.g., to verify that no item included within the list of non-deductible expense was treated mistakenly by the taxpayer as deductible expense), and would also, in the case of consolidated groups, need to verify that the apportionment mechanism was properly applied by the taxpayer. This follows from the fact that, as the administration would be based on a system of self-assessment, the principal taxpayer of a consolidated group would be responsible for filing a consolidated tax return for all members of the group which would report, together with the consolidated tax base, the share of this tax base of each company and PE broken down between Member States and the tax liability in each State.

¹⁷ Ibid, p. 8

¹⁸ Ibid.

¹⁹ Ibid.

²⁰ Due to the fact that companies will start from accounts prepared under different national generally accepted accounting principles: see European Commission, 26 July 2007, CCCTB/WP057/doc/en, CCCTB: possible elements of a technical outline, p. 5.

If accepting that the methodology for adjusting individual company accounts to arrive at the tax base would not be indicated by the Directive, this methodology would remain within the ambit of national laws. Accordingly, national provisions on tax audits would need to cover the control of whether the methodology for adjusting the company accounts (prepared under national general accepted accounting principles) to arrive at the tax base²¹ was correctly applied by each individual company (in addition to verifying that items of revenues and expenses were properly recorded). It was stated that Member States will have to accept that the CCCTB cannot replicate all the features of all their existing tax base, and that, in some cases, this will imply a different treatment of specific items from the existing national tax bases²². As a result, should the CCCTB Directive limit itself to identifying the elements of taxable and exempt income, and of deductible and non-deductible expenses, national laws would need to specify whether the adjustments to the company accounts should first determine the national tax base, and subsequently move from the national tax base to the common tax base, or whether these adjustments should directly arrive at the common tax base. The two alternatives would, in turn, need to be reflected in the tax declaration forms. In the first case, national authorities, when carrying on tax audits to verify the correctness of the adjustments to the company accounts for arriving at the common tax base, would have the opportunity of automatically verifying the adjustments for arriving at the would-be national tax base too. This would give them, as well as the taxpayers, the possibility of verifying immediately the “competitiveness” of the CCCTB provisions in comparison with national provisions.

In consequence of the choice of leaving to national provisions the adjustments that will be necessary to arrive at the common tax base, the interrelations between the verification of the compliance with the CCCTB provisions contained in the Directive and the verification of the compliance with national provisions would be in the sense that the outcome of the former would need to rely on the latter. In other words, the outcome of the part of the tax audits relating to the new taxable base (and to the implementation of the Directive) aimed at verifying whether only exempt income was excluded and whether only deductible expenses were deducted by the (principal) taxpayer, would reveal that the taxable base according to the new CCCTB rules was correctly determined *if the methodology for arriving at this tax base*, falling within the ambit of the verification of the compliance with national provisions (due to the fact that the Directive would not deal with this methodology), *had been correctly applied*. In turn, the correct application of this methodology does need to rely on the compliance with national accountancy and tax rules concerning the recording of all items of income and expenses, i.e. on the compliance with all national provisions intended to ensure the proper starting base for the application of the methodology. Therefore, a positive outcome²³ of all enquiries, inspections and examinations carried out under national tax auditing rules remaining outside the envisaged scope of the Directive and aiming at verifying both the application of the methodology on the proper starting base and the correctness of this application, would ultimately result in a positive outcome of the tax audits falling within the proposed scope of the CCCTB Directive, but the opposite would not necessarily hold true. In other words, a tax audit

²¹ Which, in most Member States, is based on the adjustments of profit and loss account, whereas in other States is based on the balance sheet method.

²² COM(2007)223 final, Implementing the Community Programme for improved growth and employment and the enhanced competitiveness of EU businesses: Further Progress during 2006 and next steps towards a proposal on the Common Consolidated Corporate Tax Base (CCCTB), p. 6.

²³ I.e., a finding that the methodology was correctly applied to the proper starting base.

governed by the CCCTB Directive, which, by assumption, were limited to verifying²⁴ that the calculation of the tax base has been indicated in the tax returns, and that items of income and expenses shown by the tax returns fall within the list of taxable income and deductible expenses that would be contained or annexed to the CCCTB Directive, would not be able on its own to check a starting point (company accounts and adjustments) which, according to the choice that was regarded as inevitable, would fall outside the scope of the Directive and thus outside the scope of the audit itself as defined by the Directive (“any activity...conducted by a competent tax authority to verify compliance with the Directive..”).

This realisation suggests that an audit intended to verify compliance with the Directive provisions should always be accompanied by an audit intended to verify compliance with all national provisions which, even if left outside the scope of the Directive, are inherently linked to the new regime, and part of which (dealing with how to arrive at the common tax base) would need to be introduced by Member States adhering to the CCCTB by the deadline for implementation of the new Directive. It also seems to have important implications for the time limitations in tax audits as well as for the hypothesis about the working of the audit arrangements.

IV. THE TIME LIMITATIONS FOR TAX AUDITS

4. A COMMON NEED FOR DIFFERENT POSSIBLE CASES

Although some of the main benefits of the CCCTB project – such as the ability to overcome the need to comply with intra-group transfer pricing rules and to allow loss consolidation in a similar way to many internal regimes - are considered to arise from consolidation²⁵, the Commission’s orientation - which, however, seems to be still under discussion - would include within the consolidation only companies which are more than 75% owned, while identifying as members of a group for the purposes of opting or not opting for the CCCTB those companies which are more than 50% owned²⁶. An individual company, whether consolidated or not, who has one or more PEs in other Member States, would file a consolidated return reporting the consolidated tax base, the share of this base of the head office and every PE broken down between Member States and the tax liability in each State. From the viewpoint of time limitations for tax audits, the need for a common time limitation can be assessed by considering three different situations: a) tax audits for groups which, in all Member States where they operate, only have more than 75% owned companies (i.e., consolidated companies); b) tax audits in the case of groups which, in all Member States concerned, only have more than 50% but less than 75% owned companies (i.e., non consolidated companies); c) tax audits in the case of groups which, in any Member State, have both consolidated and non-consolidated companies.

4.1. Time limitation for audits of groups which have only consolidated companies

²⁴ In addition to the application of the sharing mechanism.

²⁵ European Commission, 26 July 2007, CCCTB/WP057\doc\en, CCCTB: possibile elements of a technical outline, p. 21

²⁶ Ibid, p. 4. During the Conference, the usefulness of having two thresholds was actually called into question.

In the case of consolidated companies, a choice not to harmonise the national rules providing limitations in time as regards the tax years potentially subject to auditing would risk compromising the smooth functioning of the system; it would also give rise to issues concerning the tax sovereignty of individual Member States. The limitations in time set by national rules have the ultimate purpose, from the taxpayers' viewpoint, of providing for legal certainty about which past tax years' profits or losses could be subject to reassessment and, from the tax administrations' viewpoint, it has the purpose of circumscribing the auditing powers. Assume a parent company resident in Member State A, which opt for the CCCTB in year 1, and a subsidiary resident in Member State B included in the consolidation in year 1, and that the limitations in time set by the two Member States concerned are different. E.g., Member State A allows tax audits up to the tax period closed 3 years previously, whereas Member State B up to the tax periods closed 5 years previously. It can be supposed that the CCCTB option would be valid for 5 years. Also assume that the CCCTB Directive, after defining tax audits as including the activities necessary for verifying the compliance with its provisions, leaves to national laws the definition of the methodology for arriving at the tax base. If the Directive only established a common time limits for enquiries, inspections and examinations aimed at verifying compliance with its provisions which, by choice, would not include the methodology for arriving at the tax base, while leaving national laws the definition of time limits for audits intended to verify compliance with national provisions which would include this methodology, different time limits set by national laws could jeopardise the legal certainty in the context of the new regime and compromise its functioning (and its attractiveness) from taxpayers' viewpoint.

E.g., the tax authorities of Member State B carry on in year 5, under national provisions (by assumption, not affected by the CCCTB Directive), the audit of a tax period which is no longer subject to auditing according to the law of Member State A – such as, e.g., year 1 - and, as a result of the audit, find out that, for the tax period concerned, the methodology for arriving at the common tax base was not properly applied, and that the subsidiary resident in its jurisdiction should have declared an higher amount of profit before consolidation, which then is adjusted accordingly.

In case of introduction of a threshold, below which adjustments to the tax base need not be shared²⁷, no problem would arise if the amount of the adjustment falls within this threshold. Nevertheless, this threshold, if introduced, should necessarily consist of a low amount: it could thus be expected that the great majority of adjustments deriving from audits would need to be shared amongst all the jurisdictions where the group operates. In the author's view, in these cases, the tax authorities of other Member States concerned, which would be informed about the audit initiative and about its final outcome due to the exchange of information in the ambit of the audit procedure²⁸, would have a claim arising in this Member State and would need to be entitled to require the tax authority who has taken the initiative and carried out the audit to provide them with any additional information that may need for the recovery of this claim, consistently with Art. 4(1) of Directive 76/308/EEC²⁹.

Assuming therefore that, a result of the audit in Member State B, it is discovered that an higher amount of consolidated profit should have been declared under the

²⁷ This possible choice was mentioned in European Commission, 19 May 2006, CCCTB\WP\036\doc\en, Points for discussion on 'Administrative and Legal Framework', 19 May 2006, p. 6

²⁸ As proposed *infra*, V, 5.3. and 5.4.

²⁹ The so-called "Recovery Directive".

CCCTB legislation in the consolidated tax return concerning the tax period at stake, and that it would need to be shared, so that (to a greater or less extent depending on the outcomes of the sharing mechanism), this would be relevant for the parent company resident in Member State A too, i.e. for the principal taxpayer who has presented the consolidated tax return to the tax authorities of Member State A. Due to the fact that this tax return would thus be not correct, but *neither* the national laws of Member State A *nor* the CCCTB Directive itself could have allowed the principal taxpayer to expect a re-assessment for that tax period, it would seem questionable whether the tax authority of Member State A could issue the re-assessment and ask for the information for the recovery of what would be its claim: it could be argued that the need to offer the principal taxpayers legal certainty *in its own jurisdiction* would prevent the tax authorities of Member State A from issuing the re-assessment, i.e. that it would paradoxically require them to accept that, for a past tax year outside the time limitation set by national provisions, the share of the consolidated tax base of Member State A was under-declared. Otherwise, in addition to the issue of (lack of) legal certainty from the principal taxpayer's viewpoint, the tax revenues of Member State A would thus need to depend on the tax audit initiative by tax authorities of Member State B as regards tax periods which, under the domestic law of Member State A, would no longer be subject to auditing. This would also apply if, after the initiatives by tax authorities in Member State B, the subsidiary located there challenged the findings of their national tax authorities before the competent courts in that jurisdiction, because in any case Member State A would have no control on the final outcome. Arguably, it may be asserted that Member State A would ultimately gain if the final outcome of the audit initiative by tax authorities of Member State B were an increase in the overall taxable profit, and thus in its own share of that profit, and that in such case it would have an interest in a "mutual recognition" by Member States of each others' provisions on tax audits, including those concerning time limitation. Nonetheless, the result *would be opposite* in the case that Member State A allows tax audits up to the tax period closed 5 years previously and Member State B does so up to the tax period closed 3 years previously, because in this case the tax authorities of Member State A would find that the impossibility of co-operation with the tax authorities of Member State B prevents them from auditing a tax period, of the subsidiary located there, whose outcome has affected the overall group profit for one of the tax years that the may be auditing in compliance with the legislation of Member State A.

The differences existing in limitations in time for tax audits would also risk being used by multinational groups, in their structuring strategies, for tax-planning purposes. It was pointed out that, if some countries are more taxpayers-friendly than others, this could trigger a kind of forum-shopping³⁰: the time limitation for tax audits is certainly one of the factors that could make one jurisdiction appear more tax-friendly than another. Moreover, the case-law of the ECJ indicates that forum-shopping driven location decisions may, when abuse of the freedom of establishment is proved, constitute a distortion in the functioning of the internal market³¹.

³⁰ European Commission, 19 May 2006, CCCTB\WP\036\doc\en, Points for discussion on 'Administrative and Legal Framework', 19 May 2006, p. 7

³¹ And justify limitations to the freedom of establishment: this can be inferred both from the ECJ company law rulings (e.g., ECJ 9 March 1999, C-212/97 *Centros* [1999] ECR I – 1459, Par 28 and 38; ECJ 30 September 2003, C-167/01, *Inspire Art* [2003] ECR I-10805, Par. 96 and 105) and from the ECJ corporate taxation rulings (e.g., ECJ 12 September 2006, *Cadbury Schwepperts*, [2006] ECR I-7995, Par. 35, 37, 63 and 64).

Accordingly, the time limitation for tax audit of consolidated groups should be set by the Directive introducing the CCCTB by means of clear and precise provisions, such as to have “direct effect” if not properly and/or timely implemented³². In addition, to avoid interpretative doubts, tax audits should be defined in the Directive as any activity such as verifications, enquiries, inspections or examinations conducted by a competent tax authority *to verify compliance with the Directive and with national provisions*, such as those specifying the methodology for arriving from company accounts prepared under national GAAP to the common tax base by a taxpayer or group of taxpayers. Alternatively, if a narrower definition of tax audits in the CCCTB Directive were embodied, the common time limit should be set by the Directive not only for the audits intended to verify compliance with its own provisions, but also for the audits intended to verify compliance with provisions of national laws which, even if left outside the new Directive, are essential (such as those concerning the methodology of adjustments) for the correctness of the final calculation of the tax base introduced by the Directive: in the author’s view such choice, by its very purpose, would comply with the subsidiarity and proportionality principles.

An issue raised by the setting of a common time limitation for audit concerning companies included in a CCCTB group could be, from the viewpoint of individual Member States, whether it would be acceptable to have one time limit (e.g., up to the tax period closed 4 years previously) for companies included in a CCCTB group, and another time limit (e.g., up to the tax period closed 5 years previously), which could be the one already set by pre-existing national laws, for companies which are not part of such groups. In particular, if the time limit applicable to companies opting for and included in the CCCTB were more favourable than the time limit applying for companies outside the scope of the CCCTB, and, of course, if the CCCTB were only made available to multinational groups, the question could be whether this difference in treatment might constitute a sort of “discrimination” towards domestic companies. The response does not appear to be suggested by EC law, at least if the difference in the time limitations for tax audits is taken alone, because this difference could not, or not necessarily, create an economic benefit for companies falling within the CCCTB and could thus not fall within the definition of State aids³³. Arguably, should the CCCTB be limited to multinational groups, it would be for national legislators to decide whether to align the time limitations concerning audits applicable to domestic companies who are ineligible for the CCCTB to those applicable to CCCTB companies.

The indication, by the Directive, of a common time limit for tax audits would avoid the above mentioned issues in the cases of consolidated parent companies and subsidiaries all located within the EC and which receive no income from third countries. However, if a member of the consolidated group receives income from third countries, this income, according to the world-wide taxation principle, could be included in the CCCTB and shared according to the apportionment mechanism; specifically, according to the intentions, much of the foreign income would be exempt³⁴, but any part of it consisting of portfolio dividends and passive income (royalties, patent income, and interest), as well as income from PEs and income from

³² As specified by the well settled ECJ case-law: Craig, De Burca, *EU Law, Texts, Cases and Material*, (2008), p. 279-282.

³³ The question has been notoriously raised, as a matter of debate, with regard to the CCCTB regulation on its whole.

³⁴ European Commission, 26 July 2007, CCCTB/WP057\doc\en, CCCTB: possibile elements of a technical outline, p. 30.

major shareholdings should the corporate tax rate in the source country be low, would be included and accompanied by a tax credit for the tax paid in the third country. In consequence, a difference in the time limitations for tax audits between the sources countries and the EC countries involved would create an issue of legal certainty in case the time limit set by third countries covered a longer period than the one set by the CCCTB Directive (e.g., time up to 5 years previously in the third country/ies concerned, time limit up to 3 years previously set by the Directive within the Community), and the tax authorities of third countries carried out an audit concerning a tax period which would be excluded from auditing under the Directive and which resulted in a reassessment of the income for that tax period. The issue would be, arguably, whether the share of the tax base of the EC countries concerned may be made dependent, for a tax period no longer subject to audit according to their national legislations, on the tax audit initiatives of the authorities of third countries concerned. Nonetheless, a similar issue would also exist from third countries' viewpoint, because in the case of a group with the parent company resident outside the EC and more subsidiaries resident in different EC Member States these subsidiaries could constitute a consolidated group³⁵, and the common time limit for tax audits on these subsidiaries set by the CCCTB regime may be different from the time limit set by the third country of residence of the parent company (so that either the tax authority of the third country could find it impossible to include in the scope of its audit for a given tax year that part of income of this parent company deriving from the EC-subidiaries if the tax year at issue can no longer be subject to auditing according to the time limitation set by the CCCTB legislation, i.e. if this latter sets a shorter time limitation, or the third country would have to decide whether to accept that its revenues may depend of the tax audit initiative of any Member State adhering to the CCCTB in the opposite case).

It was noted above that, when this issue arises amongst EC Member States, the response could depend on the desirability of a "mutual recognition principle" or of a choice of harmonisation, alternatives which would need to be assessed in light of the need to achieve the Treaty's goals in terms of proper functioning of the internal market, and of the subsidiarity and proportionality principles.

In the relations between EC Member States and third countries, there is a perceived need to avoid the differences of treatment that agreements at bilateral level between each individual Member State and each third country could otherwise generate³⁶, and which could trigger forum-shopping phenomenon by multinational groups who intend to opt for the CCCTB. For this purpose, two solutions could be envisaged for the two potential scenarios.

Should all Member States adhere to the CCCTB, the EC should ideally negotiate an agreement with any third countries. This solution, while consistent with the (long-term) prospect of the EC negotiating tax treaties with third countries instead of Member States³⁷, would not affect bilateral tax treaties (DTCs) concluded by Member States with third countries beyond the extent to which these DTCs are already, as it

³⁵ Ibid, p. 22 et seq.

³⁶ E.g., the International Chamber of Commerce, in its policy statement "An optional Common Consolidated Corporate Tax Base in Europe: implications for business worldwide", states that "As a long-term goal, common tax treaties with outside countries should be negotiated from a single location and then applied uniformly in CCCTB countries", p. 3.

³⁷ Which prospect was presented, in the Workshop of Experts on "EC Law and Tax Treaties" held in Brussels on 5th July 2005, as one of the alternatives for relations with non Member States: Lang, EC Law and Tax Treaties: possible solutions (presentation), p. 5.

was highlighted, affected by EC law³⁸, given the specific scope of the agreements at stake. These agreements should indicate which components of income derived from subsidiaries or PEs located in third countries would fall within the CCCTB (and would need to be indicated by the principal taxpayer in the consolidated tax return, together with the related tax credit) and, vice-versa, which components of income remitted by the EC subsidiaries to the extra-EC parent would enter into the taxable income of this latter. Moreover, as a feasible strategy at least for the short time, they could expressly provide for a “mutual recognition”, as between the EC and third countries, of the time limitations set for tax audits by the CCTB legislation and by the legislation of any third country: thus, if the time limitation for tax audits set by the CCCTB legislation is shorter than the one set by the third country concerned, EC countries would have to accept the outcomes resulting from the initiative of the third country’s authority which could affect tax years no longer subject to auditing according to the CCCTB Directive, and vice versa. These agreements could, moreover, provide for a regular exchange of information specifically concerning the start and the outcome of tax audits initiatives undertaken by the authorities of both contracting third countries and Member States, which provision would be more capable of ensuring the exchange of this information than the exchange of information provisions already contained in the DTCs³⁹. Lastly, they could set out a time framework for the alignment, at least over the medium run, of the time limit for tax audits (which, ultimately, would be in the common interest).

Should only a group of Member States adhere to the CCCTB, i.e. should the CCCTB be introduced through “enhanced cooperation”, the agreement could be entered into between each participating Member State and each third country, as well as between each participating Member State and each non-participating Member State: the participating Member States could agree amongst themselves, at political level, to negotiate for the same provisions in their individual agreements with both non participating Member States and third countries (which would lead to a coordination, amongst participating States, in the relations with other States).

4.2. Time limits for tax audits of non-consolidated companies

In the case of groups which have only non-consolidated companies, the situation of individual companies which are considered to be members of the group would not seem to be different from the current one with regard to some key aspects: due to the lack of consolidation, transfer pricing rules would still need to apply for intra-group transactions, and cross-border loss compensation would only be admissible within the limits identified by the ECJ case-law⁴⁰. The differences would lie, except for the determination of the tax base according to the uniform rules laid down by the new

³⁸ European Commission, EC Law and Tax Treaties, working document, 9 June 2005 (Ref.: TAXUD E1/FR DOC (05) 2306) for the Workshop of Experts on 5 July 2005, p. 7-8.

³⁹ Which latter provisions, generally based on the OECD Model, remain open to the interpretative issues highlighted by the literature: inter alia, Van Brunschot, The Judiciary and the OECD Model Tax Convention and its Commentaries, *Bulletin-Tax Treaty Monitor* 2005, p. 5, with regard to the OECD Model and Commentaries, concludes that “It is an art in itself to interpret these sources. Such an interpretation is, however, necessary before it can be used to help interpret actual treaties” (p. 11); also Pijl, The OECD Commentary as a Source of International Law and the Role of the Judiciary, *European Taxation* 2006, p. 216 (p. 218, p. 224).

⁴⁰ Which, with the Marks & Spencer ruling (ECJ 13 December 2005, C-446/03, *Marks & Spencer* [2005] ECR I-10837, Para. 34, 39 to 51 and 55), has opened various issues: Lang, The *Marks & Spencer* Case-The Open Issues Following the ECJ’s Final Word, *European Taxation* 2006, p. 54 (p. 66- 67).

Directive, in the appointment of a principal taxpayer which would be responsible for giving to its tax authority the notice to opt and the annual information on the structure of the group⁴¹. Accordingly, it would be appropriate to establish the obligation, for this tax authority, to inform the tax authorities of other Member States concerned about the option for the rules of the common tax base.

As each non-consolidated company would be responsible for filing its own tax return to its national authorities⁴², the “one stop shop” approach would not apply to non-consolidated groups. Different time limitations for tax audits, set by national legislations, would not seem to cause additional issues, but would only perpetuate the current situation as regards the independent conduct of tax audits by each national tax authority. The major issue, of general character, would be to what extent the determination of a tax base according to new uniform provisions, but without consolidation, would suffice to make the option for this new tax base convenient from taxpayers’ viewpoint⁴³: this question would be particularly relevant in cases where the new uniform tax bases would lead to a broadening of the tax base in comparison with national rules and the level of taxation were not maintained unaltered by the introduction of a reduced tax rate for companies opting for the new tax base.

4.3. Time limitations in tax audits for groups which have both consolidated and non-consolidated companies.

Consolidation, and the sharing of the consolidated tax base, would take place between an individual company of a Member State and its PEs, if any, in other Member States. Situations could thus exist where a multinational group includes both companies which would be ineligible for consolidation and companies which have PEs in other Member States, in respect of which the consolidation would operate (or where the group includes both companies owned by more than 75% and included in the consolidation, and companies not eligible for consolidation).

In these cases, the need for legal certainty and the obstacles to the functioning of the system, evidenced in 4.1., which would be created by different time limits set by national laws for audits intended to verify the adjustments prescribed by Member States to arrive at the common tax base would apply only to a part of the group concerned, i.e. the parent company/principal taxpayers and consolidated companies. Nonetheless, it appears reasonable to predict that a uniform time limit for tax audits of consolidated companies coupled with still different time limits for tax audits of non-consolidated companies would cause difficulties to national tax administrations, and that this would apply not only in the cases involving different jurisdictions as argued in 4.1., but also within any individual jurisdiction in which there could be both consolidated companies, or consolidated PEs, and non-consolidated companies of the same group, which could make transactions with each others. Whilst these transactions between consolidated entities and non-consolidated companies of the same group within a jurisdiction would affect the taxable profit of both parties, any difference in time limitations for tax audits concerning them, by making it possible tax audits of only one party, could prevent effective inspections and cross-investigations of operations that may need to be verified on both concerned parties.

⁴¹ European Commission, 13 November 2007, CCCTB/WP061\doc\en, CCCTB: possible elements of the administrative framework, p. 7

⁴² Ibid, p. 6.

⁴³ The Commission, in its Communication 2006/157, p. 7, recognised that “it is difficult to identify many advantages from introducing a ‘common’ base to operate independently in each Member State..”

The common time limit would thus appear to be necessary for tax audits covering both consolidated entities and non consolidated companies.

4.4. Overall observation

Conclusively, if globally considered, the issues of the scope of tax audits, and of time limitations, seem to require a precise definition of the audit coverage (to include the verification of the compliance with all substantive provisions, whether introduced by Directive or left to national laws, which the taxpayer should observe to arrive at the correct determination of the new tax base) and a uniform time limit, for all groups which may be eligible to opt for the new tax base. Though different time limits might be seen as simply a continuation of the current situation in the case of non-consolidated groups, the fact that most taxpayers opting for the CCCTB can be expected to be groups eligible for consolidation (or companies with PEs), and that in any Member States there will be likely to be both consolidated and non-consolidated entities, leads to this conclusion. A further element suggesting this approach is the uncertainty that, otherwise, could arise in situations of companies which were previously ineligible for consolidation and which become eligible, and/or of companies which are eligible and which, due to a lowering of the participation threshold, would become ineligible for consolidation while still eligible to the common tax base (e.g., taking into consideration 5 tax years, the case of existence of a 3 years time limits for consolidated companies and of 5 years time limit for non-consolidated companies, and the case of a company who is consolidated only in year 3, the doubt could be whether the decisive element, in establishing whether a past tax year – such as year 1 or year 2 – could be subject to audit, would be the status of the company in the tax year *during which the audit is carried out or during the tax period to which the audit refers*), and the difficulty of establishing a most appropriate rule for this purpose.

V. A HYPOTHESIS FOR SUBSTANTIVE AND PROCEDURAL TAX AUDITS PROVISIONS CONCERNING CONSOLIDATED GROUPS.

5. THE STARTING POINTS AND THE PROPOSED SUBSTANTIVE AND PROCEDURAL PROVISIONS

The latest working document shows a concern, in the case of consolidated groups, to strike a balance between a “one stop shop” approach, which would reduce the compliance costs, and a jointly determined audit approach. The principal tax authority would have primary responsibility for verification of the consolidated tax returns, and for issuing assessments or amended assessments regarding a consolidated tax return which would be automatically recognised in the relevant Member State; this authority and other competent authorities would jointly decide which additional enquiries and inspections are necessary and which authority is to carry them out; the results of any such additional enquiries and inspections would be compiled by the principal tax authority, in agreement with other authorities⁴⁴.

If these indications are accepted as a possible starting point, there are key issues still open for discussion: what would be the content of the verification of the

⁴⁴ European Commission, 13 November 2007, CCCTB/WP061\doc\en, CCCTB: possible elements of the administrative framework, p. 9.

consolidated tax returns by the principal tax authority; which tax authority should take the initiative of deciding that additional enquiries and inspections are necessary and of contacting the other tax authorities, and on what grounds. The issue concerning the content of the verification of the consolidated tax returns by the principal tax authority would depend, in turn, on which kinds of supporting documents would be directly available to this authority and stored in the central data base mentioned by the working document. For this purpose, it may be proposed that the supporting documents would in any case include the balance sheets and profit and loss accounts, i.e. both the consolidated accounts of the group and of annual accounts of individual companies included in the consolidated group (which accounts, under national company laws of Member States, must already be filed in general with a commercial registry within a certain time from the closing of the accounting year), but not the individual accounting books and/or documents (which would create more burdensome administrative fulfilments than those required by national laws). In addition to the financial statements, in case additional documents were requested by national legislations to show the data which would evidence situations where, according to criteria set by national laws, there would be scope for further enquiries, investigations and inspections, these additional documents should be forwarded and stored too, as subsequently indicated in 5.4.

In the author's view, should the supporting documents to be stored in the central database consist of the balance sheets, of profit and loss accounts, and of additional information required according to any criteria laid down by national provisions to identify the taxpayers to be subject to substantive tax audit, there would be no risk of transmission of "sensible data" such as commercial, industrial, business and professional secrets. In effect, these secrets (which any company has the interest to keep as they contribute to its competitive position in the market) ultimately lie in particular know-how or capabilities that contribute to allow the business, whatever its sector, to obtain or increase its income by innovating its products or its services: the information relevant for tax purposes, while including income and expenses, do not extend to these secrets, the safeguard of which (for ensuring the exclusive exploitation by the holder) falls within the area of industrial and intellectual property law. In addition, the information provided in the descriptive reports which are part of the annual financial statements, while indicating as explanations of upwards trends in market sales e.g. the launch of new products or services or of innovations to existing products and services resulting in new patents or trademarks, are not, as known, requested to include the commercial, industrial, business and professional secrets which lie at the root of any innovation contributing to increases of profit. This also applies to the information to be supplied in accordance with any criteria laid down by national provisions to identify the taxpayers to be subjected to substantive tax audit⁴⁵. Consequently, the suggestion that the supporting documents to be stored in the central database consist of the balance sheets, of profit and loss accounts, and of any additional information required according to the criteria laid down by national

⁴⁵ Which information usually includes mere economic and financial details or may include other details (e.g., number of employees, size of premises) concerning the productive capacity of the taxpayer and/or its past behaviour. These kinds of details are needed for the application of methods for risk assessment (i.e., for the assessment or the risk of tax evasion) and for the subsequent selections of taxpayers to be inspected, such as the "instruments for risk analysis" in France, the "sector studies" in Italy and the "indicative rates" in Germany. For a comparative view of the application of these criteria, Scorrano, *Le esperienze estere dei sistemi di stima oggettiva e dei relativi metodi di controllo*, *FiscoOggi*, 6 August 2004.

provisions to identify the taxpayers to be subject to substantive tax audit, appears to be a workable one⁴⁶.

On this assumption, and on the further assumption that the consolidated tax returns filed by the principal taxpayer and stored with the supporting documents in the central database, when indicating “The calculation of the share of the consolidated base by Member State of each taxpayer”, would also indicate the starting points concerning the elements of the proposed sharing mechanism (labour, assets, sales)⁴⁷, a hypothesis may be as follows.

5.1. *A two phases audit regime*

The verification of the consolidated tax returns by the principal tax authority could reasonably be intended as a “formal verification”, which would be a first and necessary phase of the tax audits: this verification could be conceived as a formal one because the principal authority, through the information given by the consolidated tax return (specifically, through the “details of the calculation of the consolidated tax base..” included in the consolidated tax return), would know which calculation have been made to arrive from individual tax bases before the consolidation to the consolidated tax base, would have the supporting documents forwarded by the principal taxpayer available, and, due to the details provided by the principal taxpayer, would have the data on labour, assets and sales needed to check whether the sharing mechanisms has been correctly applied on the bases of those data. The principal tax authority would thus be in a position not only to review the correctness of the calculation and to check whether the items of taxable income and deductible expenses indicated in the tax return fall within the list contained by the Directive and/or in an implementing measure, but also whether they are indicated in the company’s accounts, and whether the apportionment formula has been correctly applied by assuming as a starting point the data indicated by the principal taxpayer. It would seem that, up to this point, the examination could be carried out by the principal tax authority thanks to the high degree of uniformity of accounting practices (universally adopting the double entry bookkeeping technique) from one country to another, which makes it easy to recognise, in profits and loss accounts of companies located e.g. in three different Member States, which kinds of income and of expenses have been respectively obtained and sustained by the three companies. In addition to the notorious introduction of the obligation for listed groups to prepare their financial statements according to the international accounting standards⁴⁸, the accounting directives previously introduced by the EC as part of the company law harmonisation program, i.e. the Fourth⁴⁹ and the Seventh company law Directives⁵⁰, despite a wide number of options left to Member States as regards their implementation in national laws, have contributed to facilitating the “reading” of balance sheets and of profits and loss accounts also of unlisted companies located in a Member State by interested parties in other Member States. This contributes to make it easier a formal check on the types of income obtained and of expenses incurred by individual companies

⁴⁶ The filing of both tax returns and all supporting documents could well take place electronically rather than in hard copies.

⁴⁷ European Commission, 13 November 2007, CCCTB/WP060\doc\en, possible elements of the sharing mechanisms, 13 November 2007, p. 7-15

⁴⁸ Regulation 1606/2002/EC of 19 July 2002, OJEC L 243/1 [2002], as subsequently integrated.

⁴⁹ Directive 78/660/EEC of 25 July 1978, OJEC L 222/11 [1978], as subsequently amended.

⁵⁰ Directive 83/349/EEC of 13 June 1983, OJEC L 193/1 [1983], as subsequently amended.

included in the consolidation for the principal tax authority (with general and technical language-related assistance when needed).

In national tax regimes, after a formal verification on the tax returns, further enquiries, investigations and inspections are carried out towards taxpayers identified from time to time. To this end, there are Member States which have introduced methodologies which either determine a minimum income, based on the average income of businesses operating in any specific economic sector, which is considered as normal⁵¹, or consider the past behaviour of the taxpayer and tend to identify what would be the normal situation, from the overall economic and financial viewpoint, of businesses operating in the economic sector⁵². In all such cases, the situation shown by the individual taxpayer is compared with the “normal situation”, in order to find out whether his situation can be regarded as presenting a risk of tax evasion or avoidance. While these methodologies are mainly applying to taxpayers roughly falling within the category of small and medium enterprises, the aspect which in the author’s view can be of general interest lies in their underlying philosophy: that of maximising the possibilities of selecting, for further inquiries, investigations and inspections, taxpayers which are in situations that can be regarded as “anomalous”, and where the risk of tax evasion or tax avoidance could be supposed to exist.

In consequence, to be attractive for those eligible taxpayers subject to these national regimes, the new CCCTB legislation should “borrow” the underlying philosophy. This choice could be expected, to an even greater extent, to contribute to make the new regime attractive even for those eligible companies which are located in Member States where no similar methodologies exist, due to the greater degree of legal certainty that would in any case be offered about the situations triggering further enquiries and inspections after the introduction of the CCCTB: if under their national legislations those companies can be subject to further investigations and inspections involving access to their premises at any time, the introduction of a CCCTB Directive characterised by the philosophy under consideration – if combined, for an initial period of application of the CCCTB regime, with the mutual recognition of existing national practices – can be expected to indicate to these companies that, although inspections involving access to their premises could always take place, these audits may occur *in particular* if/when they fall within anomalous situations. The greater degree of certainty, for these companies, about when they could be subject to these audits would seem to be evident.

If accepting that the further enquiries, investigation and inspections involving access to the company’s premises, which in this work are referred to as “substantive tax audits”, should be aimed at detecting cases:

- a) of tax evasion, i.e. where either a part of the company’s income might have been not recorded in the company accounts (i.e. cases of under-invoicing) and subsequently not included in the tax returns or more expenses might have recorded than actually sustained by one of the consolidated companies in its jurisdictions;
- b) of tax avoidance, i.e. where attempts would appear to have been made to shift part of the taxable profits from one jurisdiction to another;
- c) of combinations of tax evasion and avoidance,.

⁵¹ This is the case of the Italian methodology named “sector studies” (“accertamento in base agli studi di settore”), first introduced by decree n. 331/1993 and by Law n. 427/1993

⁵² These cases can be found in the French experience of “monographies” and subsequently of electronic instruments of risk analysis and in the German experience of “indicative rates”: Scorrano, *Le esperienze estere dei sistemi di stima oggettiva e dei relativi metodi di controllo*, *FiscoOggi*, 6 August 2004.

the question could be whether, to identify the anomalous situations where these cases may occur, methodologies such as the ones above mentioned should be introduced either by the CCCTB Directive or by any subsequent implementing measure, or whether simpler criteria should be chosen for the same purpose of selecting the anomalous situations and identifying accordingly the CCCTB taxpayers towards whom to carry out substantive tax audits.

In other words, a choice would need to be made whether to introduce or not – as common modalities for selecting the CCCTB taxpayers to be inspected - methodologies which, for the different economic sectors, identify common ranges of income of EC businesses and/or common ranges of percentage values of ratios, normally used in the economic and financial analysis of annual (individual and consolidated) accounts⁵³, for EC business in the different sectors, in order to compare the situations emerging from the consolidated tax returns and accounts filed by the principal taxpayer with these ranges of income and/or ranges of percentage values. In the author's view, a similar choice, while it would make it easy to identify the CCCTB groups (and the individual consolidated units) falling outside the common ranges, would need to be viewed not only against the need of a simple administration of the system (administration whose costs could certainly be expected to increase due to the introduction of these methodologies and to their yearly application), but also against at least four other factors: 1) the difficulty of identifying common ranges between a minimum and maximum income that may be typical of businesses throughout the Community, caused by the fact that factors such as the geographical location, the vicinity to the markets of reference and the relationships with customers can well cause, for physiological economic and market reasons, the income of individual businesses included in a consolidated CCCTB group and located in different parts of the EC to vary well beyond those ranges, so that ranges of normal income might turn out to be more significant, for identifying truly anomalous situations, when applied at national level; 2) the possibility that the outcomes that could be obtained, with the parameters given by common EC ranges of percentage values of economic and financial ratios (which reflect, in turn, the company's behaviour from the operational viewpoint), can already or even better be ensured by the "mutual recognition" of these methodologies as and when applied at national level, where the socio-economic factors that may affect businesses' situations, as reflected in those ratios, may generally be more uniform; 3) the further possibility that Member States may manage, by spontaneously co-ordinating with each others these kinds of methodologies and parameters when applied, to achieve the same result that could derive from EC parameters; 4) the realisation that the use or not of these parameters, for identifying "anomalous" situations for auditing purposes, is rooted in national contexts characterised by different degrees of cooperation between taxpayers and tax administrations, and the possibly negative reactions, in terms of interest for the CCCTB regime, of those eligible businesses located in Member States where similar methodologies would not be applied and would appear unusual.

For these reasons - which, as regards the points 1), 2) and 3) may result, at least for the time being and the short term future, in the fact that a proposal to introduce the would-be EC methodologies and business parameters above indicated might not meet the subsidiarity test – it would seem preferable to defer the hypothesis of introduction of these instruments for substantive tax audit purposes to a later phase of the CCCTB regime. In other words, if accepting that (as it seemed to be in the original idea) it

⁵³ Such as the Return on Equity (ROE), the Return on Investments (ROI), the indicators of the financial position etc.

would make sense to initially introduce the CCCTB for an experimental period, during which practical experience could be gained and after which various elements, amongst which the tax audit regimes, could be revised in the light of this experience, the Directive could provide that, after a given number of years (e.g., 5 years), the tax audits substantive and procedural provisions could be subject to revision to assess ex post their effectiveness in light of practical experience and consider any amendment. Should Member States agree, after the initial phase (during which the use of methodologies and parameters such as those above considered would be subject of mutual recognition when established by any national legislation), that the introduction at EC level of these methodologies and parameters for identifying the CCCTB groups to be audited satisfies the same needs as the grounds for substantive tax audits already set out in their national laws and can be more effective in sufficiently achieving this purpose, the introduction of the methodologies and parameters considered could then become realistic and necessary, as an alternative to the mutual recognition and after due consultation with the business sector.

For the initial phase of application of the CCCTB regime, the criteria for selecting the taxpayers towards whom to carry out substantive audits, while protecting the financial interests of any Member State, should also achieve the objectives of: a) minimising the risk of being perceived, by taxpayers, as involving a greater possibility of being subject to substantive tax audits than under the national enquiries and investigations schemes, and, as previously mentioned, provide them with greater certainty, in order not to discourage (and possibly to encourage) the option for the CCCTB regime; b) offering tax authorities of the Member States concerned – whose officials should ultimately collaborate as members of an “auditing team”⁵⁴ - common rules that would allow them an effective team working. To this end, in the author’s view, it would be necessary to indicate in the Directive, by means of a provision formulated in a clear and precise manner, specific *criteria* which should be simpler than the methodologies above mentioned and which would signal anomalous situations, and on the basis of which CCCTB taxpayers to be inspected should be chosen. The purpose of these criteria should be that of allowing tax authorities a “tax risk” assessment as effective as the one deriving from the above recalled methodologies, and a focus of their substantive audits activities (and of the necessary resources) on those situations where these activities, by revealing cases of evasion or avoidance, can effectively achieve their ultimate “raison d’etre”.

In addition, in light of the fact that the principal tax authority would be expected as a general rule to take the initiative⁵⁵, and with regard to the need for tax authorities to cooperate effectively, a further reason for specifying in the CCTB Directive the criteria for selecting the taxpayers for substantive audits purposes can be highlighted by considering those cases where the principal taxpayer, the parent company, could be located in a jurisdiction with more lenient auditing practices than the jurisdictions of location of the subsidiaries⁵⁶. In such a situation, if the criteria for selecting taxpayers were not indicated in the Directive, but relied entirely on the mutual recognition of divergent national practices, the principal tax authority, by following its own practices, may not take the tax audit initiative in situations where the tax authorities of the other Member States concerned may wish it to do so towards the principal

⁵⁴ Retro, par. II.

⁵⁵ Ibid.

⁵⁶ The case was made at the Conference, by Prof. Daniel Garabedian (Universite’ Libre de Bruxelles), of parent companies located in Luxembourg.

taxpayer, and this would risk jeopardising the degree of mutual trust between tax authorities and, ultimately, their “team working” ability.

An objection that may be submitted, against the choice of indicating in the Directive the criteria to be used for selecting the CCCTB taxpayers towards whom substantive tax audits would be carried out, could be that such a choice would prevent changes in the revisions of audits plans, i.e. that such a choice would lead to lack of flexibility as categories of taxpayers that need to be inspected in the future may be different from those categories that may currently need to be inspected. Nevertheless, the objection does not appear to be well grounded: the criteria would be specified from the *objective viewpoint* - i.e., from the viewpoint of the *situations* triggering the substantive tax audits – and certainly would not indicate categories of taxpayers. In other words, the criteria would not distinguish “good [i.e. normal] taxpayers” from “bad [i.e., not normal] taxpayers”, but would rather serve to distinguish “good [i.e., normal] situations” from “bad [i.e., not normal] situations”, by identifying the latter as reasons for triggering substantive tax audits (in the interest also of an efficient use of resources by the tax administrations). Taxpayers falling, at a point in time, under normal situations may no longer fall under the same situations in the future, or vice-versa, so that the *identification of not-normal situations*, by means of objective criteria, would actually help (rather than hinder) the revisions of auditing plans, i.e. would help adapting the auditing plans (intended to *identify the taxpayers* to be inspected) to changeable needs, over time, for substantive tax audits of certain taxpayers rather than of other taxpayers.

As regards the objective criteria, a suggestion could be to indicate, in the CCCTB Directive, that substantive tax audits (after the formal verification carried out primarily by the principal tax authorities) may (*but, as it will be subsequently argued, not necessarily must*) be carried out when: 1) one of the companies included in the consolidation, for a given number of years prior to the group’s option for the CCCTB and for a given number of years (e.g., 3 years) after the inclusion in the consolidated group, continuously declares losses or decreasing profits from one tax years to another, reveals an anomalous situation and reduces every year the consolidated tax base and the share of each Member State; 2) there is an error in the calculation of Member States shares for 2 or 3 consecutive tax years, as a consequence of which the share of a Member State is under-declared, even if by less than 0,5%⁵⁷, in each of these tax years and the share of another Member State is correspondingly over-declared by the same percentage for the same periods; 3) the principal taxpayer has either failed to file the consolidated tax returns or to respond to other enquiries; 4) the principal taxpayers has submitted returns which are considered as not reliable due to multiple and significant errors and inconsistencies (from multiple and significant calculation errors to inconsistencies between the tax returns and the accompanying documents).

5.2. *The proposed criteria for selecting CCCTB taxpayers for “substantive tax audits” purposes: underlying reasons*

The purpose of the possible enquiries, investigations and inspections would be, in case 1) above, to detect potential cases of tax evasion, and, in case 2), to find out

⁵⁷ Which would be the margin below which no amended assessment would be issued if the error occurs (for a single tax year): European Commission, 13 November 2007, CCCTB/WP061\doc\en, CCCTB: possible elements of the administrative framework, p. 11.

potential attempts to shift the taxable base from one State to another, which attempts may be suspected to take place when the calculation made by the principal taxpayer leads to an under-declaration of the share of the Member State which has the highest corporate tax rates (and to an over-declaration of the share of the Member State which has the lowest tax rate). The first situation in case 3) (failure to file the tax returns) would follow, as a ground for substantive tax audit, from the overall structure of tax audit, in which, as subsequently highlighted, the formal verification, based on the tax returns and the accompanying documents, would always be the necessary phase, and thus from the fact that, without the tax returns, this phase could not be carried out, and the same would apply to case 4) (unreliable tax returns). However, as it will be indicated, the substantive tax audit, even in this case, should not automatically take place, given that this case would first trigger the issue of an assessment based on an estimate⁵⁸. As regards the second situation in case 3) (failure to respond to other enquiries), the proposal would be to associate it with exceptional circumstances where the time for issuing amended assessments could be extended, as subsequently indicated in 5.5.

Admittedly, tax evasion could in practice occur also in cases different from the one of continuous losses or of continuously decreasing profit declared by a company (case 1), and tax avoidance attempts could be also made in manners different from under-declaration of the share of the Member State having the highest tax rate (case 2), whereas the failure to file the consolidated tax return or to respond to other enquiries (case 3) could either conceal an attempt of tax evasion and/or avoidance or none of them (if due only to negligence). However, the first two cases may reasonably be supposed – the former when associated with an anomalous situation, the latter when occurring in more than one year - to indicate situations where tax evasion or avoidance is more likely than in other situations; in the author's view, it would thus make sense to provide for, in the CCCTB Directive, the possibility of enquiries and investigations in these situations.

It could certainly be objected that, under the ECJ case-law, the notion of tax avoidance – as the Commissions has recalled⁵⁹ – is limited to wholly artificial arrangements aimed at circumventing the application of the legislation of the Member State concerned, and that the ECJ, in identifying the factors that do not *of themselves* suffice to signal abuse, has expressly confirmed inter alia that more favourable (tax) provisions can have a role in the decision on where to set up a subsidiary⁶⁰. It can thus be deduced that the goal of minimising the tax burden is in itself a valid, acceptable commercial consideration as long as the related arrangements do not amount to artificial transfers of profits⁶¹. Consequently – the objection may be – if the goal of minimising the tax burden is in itself acceptable subject to this condition, an error which minimise the tax burden must also be acceptable at least within the same limit. Two counter-arguments could however be proposed: first, not the error in itself, but its repetition over a number of years, could be seen as concealing an attempt to achieve the same result as an artificial transfer of profits; second, the provision of this possible ground for substantive tax audit would also appear consistent with the fact that the ECJ's findings in *Marks & Spencer*, when regarding the potential deduction of losses in the jurisdiction where they could generate the highest tax value as a

⁵⁸ See *infra*, at the end of this subparagraph.

⁵⁹ Communication COM(2007) 785, the application of anti-abuse measures in the area of direct taxation – within the EU and in relation to third countries, p. 3.

⁶⁰ *Ibid*, and ECJ 12 September 2006, C-196/04 *Cadbury Schweppery* [2006] ECR I-7995, Par. 37

⁶¹ Communication COM(2007) 785, the application of anti-abuse measures in the area of direct taxation – within the EU and in relation to third countries, p. 3

distortion⁶², implicitly suggest that mere tax-savings practices from one jurisdiction to another, of which the deduction of losses in the State with the highest tax rate can be taken to be only an example to the same extent as an under-calculation of profits taxable in this State, fall within the category of artificial transfers of profits or are in any case considered to be equivalent to these latter.

To sum up, a provision, formulated in clear and precise wording so as to have “direct effect”⁶³, authorising tax administrations to carry out “substantive” tax audits in these situations should ultimately have three purposes. First, to ensure the taxpayers that no *additional* (i.e., new) grounds for substantive tax audits other than those provided for will exist as a result of the choice of opting for the CCCTB regime, and thus to contribute to the clarity of the new legislation. Second, to leave Member States, who, predictably, would be reluctant (at least in the short run) to give up their national practices for substantive tax audits, free to maintain these pre-existing grounds for tax audits and to mutually recognise them for tax audits purposes of consolidated groups under the CCCTB regime. In relation to these first two purposes, the combination of the new uniform provision and of the mutual recognition of the (pre-existing) national practices can be assumed to reduce the scope for forum-shopping phenomenon that could otherwise be created by a choice lying only in the mutual recognition⁶⁴. This result, in turn, would reasonably be go beyond what could be achieved by the individual Member States and could not be achieved other than through uniform provisions, so that the setting out of these grounds for substantive tax audits would also comply with the subsidiarity and proportionality principles. It can be added that, by reducing the scope for tax planning practices, the provision establishing in the CCCTB Directive the criteria for selecting the taxpayers for substantive tax audits purposes would help making the CCCTB consistent with the above recalled case-law, to the extent that the new regime, while allowing, thanks to the consolidation, the cross-border offsetting of losses beyond the limits set in the ECJ case-law, would at the same time contribute to prevent or at least minimise the risk of abusive practices that induced the ECJ to set those limits. Lastly, the new provision establishing these criteria for substantive tax audits would give tax authorities an indication of cases of common interest for all concerned Member States that may arise as regards the groups opting for the CCCTB regime and benefiting from consolidation (and that may not be expected to be established by national legislations, particularly in the case of under-calculation as wrong application of the sharing mechanism); in this respect too, it would thus be beyond the reach of any individual Member State and be consistent with the subsidiarity and proportionality principles.

In addition, a provision setting out these criteria for choosing the CCCTB taxpayers for substantive tax audits would be consistent with the perceived need⁶⁵ to harmonise the auditing powers of tax authorities and could represent a step towards the introduction of a basic “European taxpayer’s statute”, which would define the rights and duties of taxpayers, the limitations of powers of tax authorities and the general principles governing the relationships between tax authorities and taxpayers. Amongst these principles, there could be scope for an assumption – at least at a general level - of correct behaviour on the part of taxpayers as a fundamental principle on which tax administrations operate, which principle is already implicitly set by the OECD

⁶² ECJ 13 December 2005, C-446/03, *Marks & Spencer* [2005] ECR I-10837, Par. 50

⁶³ As established by the settled ECJ case-law.

⁶⁴ And would thus be consistent with the purpose which was already indicated as regards a common maximum length of the audit and a common statute of limitation: European Commission, 19 May 2006, CCCTB\WP\036\doc\en, Points for discussion on ‘Administrative and Legal Framework’, p. 7.

⁶⁵ Which seemed to emerge from the Conference.

taxpayer's charter⁶⁶ and suggests that a general practice of carrying out substantive tax audits at any time towards the generality of CCCTB taxpayers should not be followed by tax authorities. In other words, this principle, whether implicitly or expressly stated, suggests that specific criteria should exist for selecting the taxpayers for substantive audit purposes, and that these criteria should aim at targeting situations where the general assumption of correct behaviour on the part of the taxpayers may not correspond to the reality (i.e. that, the higher the degree to which taxpayers comply regularly with tax obligations and do not show elements signalling an anomalous situation, the higher the extent to which it would make sense to trust them, in accordance with the principle considered). As regards the merit of the suggested criteria, the following observations apply.

The case of continuous losses for a given number of years (or of continuously decreasing profit) by a company could reveal⁶⁷ an anomalous situation in case the losses indicated in the company accounts and in the tax returns were accompanied, during all or most of the financial years at stake, by cash inflows, i.e. by a non-corresponding trend in the amount of financial resources available to the company (which can be verified in its bank accounts too). In fact, although according to general accounting practice (and to the IFRS Framework) income and expenses are recognised on an accrual basis and not at the moment when cash or its equivalent is received or paid, in the medium run a company which declares losses (or continuously decreasing profits) one year after another cannot normally be expected to increase its financial resources. This situation would thus be as effective as the ranges of percentage values of the economic and financial ratios mentioned in 5.1. in signalling an anomalous case (and, as a matter of fact, would correspond to a case where the economic and financial ratios would show inconsistencies with each others).

Should such situation exist, the suspect of tax evasion would thus be justified as a base for triggering enquiries and investigations involving, for each of the year of the period taken into consideration, the company's accounting books, the supporting documents (invoices issued and received, etc.), its premises and the banks accounts. The provision contemplating the case of continuous losses by one of the companies included in the CCCTB consolidation as a ground for possible tax audits beyond the formal verification by the principal tax authority should, however, establish an exception for new companies operating in particular sectors where losses in the first years of activity are normally incurred. Moreover, the burden of proof of tax evasion should remain with tax authorities, who could establish a finding of evasion where the company is unable to offer any demonstrable (and legally acceptable) justification for the situation. A choice of leaving the burden of proof to tax authorities, for this ground for tax enquiries and inspections that would be set out by the CCCTB Directive, appears to be justified in light of the fact that the CCCTB regime – by overcoming obstacles such as the lack of a general possibility of cross-border loss compensation or the risk of transfer pricing disputes, and by lowering the costs of compliance – is ultimately intended to facilitate the freedom of establishment through the Community, and in light of the further realisation that, under the ECJ case-law concerning direct taxation in cases involving the freedom of establishment and the

⁶⁶ OECD Committee on Fiscal Affairs forum on tax administration, Taxpayers' Rights and Obligations – Practice Note. GAP002 (2003), p. 8 “Your tax administration...operates on the fundamental principle that... taxpayers will act in accordance with the law when treated with respect and fairness.” : www.oecd.org/dataoecd/24/52/17851176.pdf

⁶⁷ Irrespective of the fact that the losses incurred by a company *before* entering a CCCTB group would not be taken into account in the consolidation: European Commission, 26 July 2007, CCCTB/WP057\doc\en, CCCTB: possible elements of a technical outline, p. 26

interpretation of one of the Directives, namely the Merger Directives, which are intended ultimately to facilitate its exercise, the use of that freedom for abusive (including, by definition, tax evasion) purposes can be subject to neither general presumptions set by national or EC anti-abuse provisions nor to presumptions determined by location-related decisions, but must always be proved by Member States⁶⁸.

In turn, the case of under-calculation of the share of a Member State which has higher tax rate than other Member States involved, even if by less than 0,5% of the tax base for that State, could justify the suspect that the situation is not one of an unintentional (good faith) error, but of attempts at shifting the taxable base, if this under-calculation takes places for more than one year at the expense of the same State. It could thus trigger enquiries and inspections of the company's books, premises and documents, aimed at verifying if what would appear to be an under-calculation of the share of the Member State at issue (according to the data provided by the principal taxpayer in the tax returns and shown in the accompanying balance sheets, with accompanying directors' and auditors' reports) actually corresponds to the situation of labour, assets and sales (the elements used in the sharing mechanism) – in which case the error, which may be unintentional, would be in data provided by the taxpayer – or if the actual situation regarding labour, assets and sales leads to an higher share of the tax base for the company at stake and thus for its Member State of residence. The choice to consider, in designing the sharing mechanism, the place where the employees provide their services, and only fixed tangible assets⁶⁹, would make the verification easy. In other words, according to the author a provision of the CCCTB Directive setting out, as a possible grounds for “substantive” tax audits, an under-calculation of the share of a consolidated company in a Member State, even if by less than 0,5%, for more than one year, could serve to clarify that this situation could trigger inspections intended to verify the application of the sharing mechanisms in itself. Even in this case, the burden of proofs of actual tax avoidance should remain with tax administrations, again for consistency with the ECJ case-law, and tax avoidance could be reasonably assumed to be proved when the taxpayer offers no acceptable and rationale justification (different from the error) for the repetition of the under-calculation of the tax base share of the Member State concerned.

The first hypothesis in case 3) above indicated – i.e., a principal taxpayer who has omitted to file the consolidated tax returns by the due date – would, according to the choice indicated in the CCCTBWG working document, determine the issue by the principal tax authority of an assessment based on an estimate, taking into account such information as it is available, and the principal taxpayer could appeal against this assessment⁷⁰. In case of an appeal against this estimate, which appeal could be expected to be based on a claim that the assessment has overestimated the profit, the principal taxpayer should be required to provide all documentary evidence supporting

⁶⁸ Specifically, see ECJ 17 July 1997, C-28/95 *Leur Bloem* [1997] ECR I-4161, Para. 46 to 48 (in particular, Para. 48 let. b) on the need to carry out a general examination and to establish whether there is actually tax evasion or avoidance) as regards the anti-abuse clause set by the Merger Directive, and, e.g., ECJ 16 July 1998, C-264/96 *ICI* [1998] ECR I-4695, Para. 26 regarding location-related decisions and ECJ 12 December 2002, C-324/00, *Lankhorst-Hohorst* [2002] ECR I-11779, Para. 37 as regards anti-abuse rules set by national laws. Despite the uncertainties it left, the Marks & Spencer ruling (ECJ 13 December 2005, C-446/03, *Marks & Spencer* [2005] ECR I-10837), as it was observed, in itself does not refer to the burden of proof: Lang, *European Taxation* 2006, p. 65

⁶⁹ European Commission, 13 November 2007, CCCTB/WP060\doc.en, CCCTB: possible elements of the sharing mechanism, p. 8-9

⁷⁰ European Commission, 13 November 2007, CCCTB/WP061\doc\en, CCCTB: possible elements of the administrative framework, p. 10.

its claim: it would seem reasonable that, should this evidence be totally or partly lacking, a “substantive” tax audit could take place by the date within which a decision on the appeal needs to be taken.

In the author’s view, the fact that the substantive tax audits initiative would, as a *general* rule, be taken by the principal tax authority⁷¹, makes it important to identify what could be the *exceptions*. If the choice whereby the failure to file the consolidated tax returns would trigger an estimate by the principal tax authority is maintained, the tax audit under consideration here can be one of these exceptions. It would be reasonable to provide that, in this case, the audit could be decided by the administrative body hearing the appeal (rather than by the same principal tax authority which opposes the taxpayer in the pending proceeding) and started simultaneously, on the request of this body forwarded to all tax authorities concerned, by each tax authorities in the Member States where the group has its consolidated units, which would need to bear the obligation under the CCCTB Directive to inform each others of the start of the audit, of the findings and of the conclusion. In the context of the appeal against the assessment based on the estimate, this audit would serve, ultimately, to corroborate the principal taxpayer’s claim which was at the basis of the appeal against the estimate. On the other hand, as proposed in 5.6, the second hypothesis – i.e., the failure to respond to other enquiries – could trigger an audit for verifying whether misstatements have been made by the taxpayer for wilful act or gross negligence, in connection with the extension of time for issuing amended assessments proposed by the CCCTBWG.

Lastly, case 4), i.e. the case of tax returns containing multiple and significant errors and inconsistencies, could receive a treatment similar to case 3). In effect, some Member States already equate the two cases, by providing that if the company either fails to file the tax returns or the data contained in the tax returns or records show multiple and significant errors to such an extent as to be considered as not reliable, the tax authorities issue an assessment based on an estimate according to their best knowledge⁷². Even in case of unreliability of the consolidated tax returns – where, in the author’s view, it would be sufficient that one of the tax authorities concerned considers the returns to be unreliable and, if different from the principal tax authority, informs this latter accordingly – the principal tax authority could thus issue an amendment based on an estimate, the principal taxpayer could appeal against the estimate and the substantive audit could be decided again by the administrative body. This case could thus create a second exception to the general role of the principal tax authority in taking the substantive tax audits initiative. The reason would be – just like case 3) – to guarantee that, pending the proceeding, the audit decision rests on a body which has not been involved in the original decision (the issue of the estimate by the principal tax authority) against which the taxpayer has appealed.

The circumstance that, in the event of failure to file the tax returns (first situation in case 3), the formal verification phase would lack, suggests to distinguish this hypothesis from the remaining ones in which both phases would be possible, and to propose the procedural rules for these other cases.

⁷¹ Which appears to reflect the current orientations which emerged at the Conference: retro, par. II.

⁷² As recalled in European Commission, 19 May 2006, CCCTB\WP\036\doc\en, Points for discussion on ‘Administrative and Legal Framework’, 19 May 2006, p. 7.

5.3. Hypothesis for procedural rules concerning the “formal verification” and the remaining cases for “substantive tax audits” suggested for inclusion in the CCCTB legislation.

Although the latest working document⁷³ does not express an opinion on whether Directive 77/799/EC is the right legal tool for the necessary communication between the principal tax authority and other tax authorities concerned, two observations could be formulated. First, the exchange of information provisions contained in DTCs between Member States could no longer be relevant for companies opting for the CCCTB if the recent suggestion⁷⁴ of “freezing” these DTCs for such companies was accepted. In turn, this suggestion appears to be certainly reasonable, in light of the need for effective communication between the tax administrations involved in administering not their own internal tax base regimes, but an EC law tax base which was not even considered at the time of negotiations of the (exchange of information provisions of) DTCs. In other words, the administration of a new EC law tax base should rely on uniform EC law provisions concerning the necessary communication between the principal tax authority and other tax authorities for this purpose. Second, and as a result, this communication *could fall within the categories of exchange of information on request, of automatic exchange and of spontaneous exchange* which are already indicated by Directive 77/799/EEC (concerning mutual assistance by the competent authorities of the Member State in the field of direct taxation), irrespective of whether the new provisions will amend Directive 77/799/EEC in this respect, to include reference to the CCCTB, or whether they will be designed to be self-sufficient and included exclusively in the CCCTB Directive. This latter may be indeed the most appropriate option, as tools such as the central data base and the initial notice to opt for the new regime, which are complementary to the communication that will be necessary throughout the audit procedure, go much beyond what was contemplated at the time of introduction of Directive 77/799/EEC.

However, in the author’s view the key choices to be made for devising an *efficient working of the audit procedure* would be *which information should fall within each of the three cases of exchange on request, of automatic and of spontaneous exchange*.

Because the consolidated tax returns and supporting documents filed to the principal tax authority – which supporting documents, by assumption, would consist of the balance sheets, profits and loss accounts and accompanying reports by directors and auditors – would be stored on the central database to which all other tax authorities would have access, neither these consolidated returns nor the supporting documents would need to fall within the transmission of information. After the receipt of the consolidated tax return and their supporting documents (to be submitted by the principal taxpayer within 9 months of the end of the tax year)⁷⁵, the principal tax authority could have the responsibility for filing them into the central database, and for informing each year the other tax authorities of the submission and of the availability of the documentation in the central database. This information⁷⁶ would, in other words, fall within the category of “automatic” (regular) exchanges. The CCCTB

⁷³ European Commission, 13 November 2007, CCCTB/WP061\doc\en, CCCTB: possible elements of the administrative framework, p. 10.

⁷⁴ Formulated by Prof. Pasquale Pistone during the Conference.

⁷⁵ European Commission, 13 November 2007, CCCTB/WP061\doc\en, CCCTB: possible elements of the administrative framework, p. 8

⁷⁶ Which could include a reference number to identify the group and be followed by an acknowledgment of receipt by the receiving tax authority.

Directive could either impose directly an obligation to this effect, or amend Art. 3 of Directive 77/799 to include specifically the exchange of information concerning the notice of submission of consolidated tax returns with supporting documents by the principal tax authority (and of the acknowledgment of receipt by the other competent tax authorities) in the case of groups opting for the CCCTB within the cases of automatic exchange of information.

Whereas the formal verification of the consolidated tax return by the principal tax authority would be a necessary phase, and in this sense could be intended as a “primary” responsibility of this tax authority, whether or not the other competent tax authorities could play a role during this verification could depend again on the scope of the CCCTB Directive and on the contents of the consolidated tax return that these other tax authorities would be able to access in the database. In this regard, it must be recalled that the CCCTB Directive would define the tax base itself but not the methodology for adjusting the individual company’s accounts to arrive at the tax base⁷⁷, while at the same time the consolidated tax returns would show the “details of the calculation of the consolidated tax base of the company or group”. If accepting that, in showing the “details” of this calculation, the consolidated tax return would show the adjustments made to individual company accounts to arrive at the tax base (which would mean to show the calculation made to arrive at the tax profit or tax loss before the consolidation and then to arrive at the consolidated tax base), and if these adjustments would remain outside the scope of the Directive and regulated by national laws, the other competent tax authorities, by accessing the consolidated tax returns and the supporting documentation, would be able to check whether the methodology for adjusting the accounts of companies located in their own jurisdictions has been correctly applied. Should they find that this is not the case, these tax authorities would be in a position to inform the principal tax authority of any mistake made in the adjustments as well as of any implication in terms of under-calculation of the individual tax base of the company concerned, and thus of the consolidated tax base of the group and of the share of each consolidated entity in each State. Accordingly, it would appear logical to require, at this stage, a “spontaneous exchange of information” within the meaning intended by Art. 4 of Directive 77/799, i.e. to require the tax authority concerned (who realises that the methodology for adjusting the individual accounts of a consolidated company resident in its jurisdictions has not been properly applied, resulting eventually in an under-calculation of the consolidated tax base and of the share of each State) to forward the information at issue, without prior request, to the principal tax authority and to all other concerned tax authorities. This is because, in the case under consideration, the tax authority concerned would have “grounds for supposing that there may be a loss of tax in the other Member State”⁷⁸ (more precisely, in all other Member States where the group operates). For the smooth functioning of the system, it could be appropriate to set a deadline by which this tax authority should spontaneously send the information to the principal tax authority and to all other competent tax authorities. The principal tax authority, after receiving the information (and acknowledging receipt to the authority sending it), should use it in issuing an amended assessment to the principal taxpayer, as a conclusive result of the phase of formal verification of the consolidated tax returns.

⁷⁷ European Commission, 26 July 2007, CCCTB/WP057\doc\en, CCCTB: possible elements of a technical outline, p. 5

⁷⁸ Art. 4 (1)(a) of Directive 77/799/EEC.

Again, after issuing this amended assessment and filing it with the central database, the principal tax authority should inform the other competent tax authorities.

Even outside the case considered, i.e. without the notice of errors in the adjustment of an individual company accounts given by the tax authority of the Member State of location of the company, the principal tax authority should notify the principal taxpayer, as well as the other competent tax authorities, that this first phase of the tax audits has been carried out, and let them know the outcome (no amended assessment on the consolidated tax return), within a specific deadline.

Shortly, it is submitted that, during the first (necessary) phase of tax audits - which would consist of the formal verification of the consolidated tax returns with the necessary involvement of the principal tax authority and the possible involvement of other competent tax authorities – there would always need to be an automatic exchange of information at the initiative of the principal tax authority, and there may be a spontaneous exchange of information at the initiative of other competent tax authorities. An observation can be formulated: as regards case 4) above indicated, i.e. the case of multiple and significant errors and inconsistencies that make the tax returns unreliable, this would inevitably emerge during the formal verification phase, when any tax authority should be allowed to notify the others that it considers the tax returns unreliable. From that time, the case would however, with the issue of the amended assessment based on an estimate, follow its own route (i.e. possible appeal, possible substantive audit at the decision of the administrative body), so that an overall procedure will be proposed below with regard to the remaining cases that, by assumption, would be set out by the CCCTB Directive. The cases indicated in 5.2. – i.e., the case of multiple and significant errors (Case 4) and of failure to file the consolidated tax returns (Case 3) – could reasonably be assumed to be bound to represent in the reality a minority of cases, to the extent that CCCTB taxpayers can be expected to entrust their professional tax advisors to carry out all fulfilments on their behalf. Accordingly, the exceptions to a general rule of leaving the principal tax authority the input for the tax audits initiative introduced by these cases could be supposed not to create significant departures from such a general rule, because the majority of situations triggering the substantive tax audits according to the criteria set by the Directive could be expected to fall within the remaining cases. These remaining cases corresponding to the criteria set by this Directive would be, as indicated in 5.2., those of continuous losses or continuously decreasing profits declared by a company included in the consolidation if accompanied by inflows of financial resources, and of continuous errors in the calculation of the share of a tax base.

The rules concerning the second (possible) phase of tax audits (“substantive tax audits”) should take into consideration both these cases for substantive tax audits and the already existing national practices.

In the situations falling within these remaining cases set out by the CCCTB Directive, the initiative could be taken by the principal tax authority, who should also interact with the principal taxpayer, and the decision whether to actually carry out the enquiries and inspections of the company’s books, administrative documents and premises could be jointly taken. This in order to reconcile the adoption, to the maximum possible extent, of the “one stop shop” approach (which is important for the efficient functioning of the system in allowing taxpayers to interact with one tax authority only) with the participation by all concerned tax authorities. On the other hand, as it was previously argued, one of the reasons for indicating in the Directive the criteria for selecting taxpayers for substantive tax audits consists of creating

common rules for tax authorities which have to adopt a “team working” approach⁷⁹: should therefore the principal tax authority, in a situation that may trigger substantive tax audits under the Directive, omit to take the initiative, the other competent tax authorities would have grounds for requiring it to do so, which would apply towards companies located in any of the jurisdictions concerned (i.e., both to the principal taxpayers and to any other consolidated company).

As regards the initiative and the various steps, a typical procedure through which the principal tax authority takes the initiative regarding consolidated companies resident in other jurisdictions may be as follows.

The principal tax authority – after noting, thanks to the information contained in the consolidated tax returns and in the accompanying documents, that one (or both) of the two anomalous cases (corresponding to the criteria set by the Directive) occurs – could ask the tax authority of the jurisdiction of location of the company concerned to forward any information and related documentation which cannot be found in the documents accompanying the tax returns and *which may explain the situation*.

Again, as it was noted above, in 5., the information that the requested tax authority could forward would not include commercial, business, industrial or professional secrets properly understood, but would be limited to those details concerning transactions entered into by the company or in any case illustrating the company’s trends in the market, i.e. to those details from which the actual economic and financial situation as *relevant for tax purposes* can be inferred.

The tax authority receiving the request may have the information due to its previous contacts with the company (i.e., due to its contacts with the company before the option for the CCCTB regime and the inclusion in the consolidated group) or may be in a position to easily get the information and the related documents under national laws (e.g., the financial situation as indicated by bank accounts; the number of employees in the payroll as registered with social security institutions etc.). In other words, a preliminary stage of substantive tax audits could start with an “exchange on request” , where, however, the authority of the requested State, unlike the case indicated by the second indent of Art. 2(1) of Directive 77/799/EEC, would always need to comply with the request, because the principal tax authority would have, by definition, exhausted its own usual source of information (the consolidated tax returns and the accompanying documents transmitted by the principal taxpayer). The tax authority of the requested State could comply with the request *either* by forwarding the information and related documents if required *or* by responding that it does not have proper information which may explain the situation. In order for the principal taxpayer to be kept updated with the tax audit initiatives concerning the consolidated group on the whole and to interact with the principal tax authority since the preliminary stage, the principal tax authority should inform the principal taxpayer about the request made to the competent tax authority and about the response, and expressly give the principal taxpayer the possibility to forward whatever information it considers to be useful for the purpose within a deadline. The principal taxpayer could in this way obtain from the consolidated company at issue, and forward to the principal tax authority, even any information that the competent tax authority may not possess and it considers to be useful for explaining the situation. Whether the information provided by the principal taxpayer ought to be considered as satisfactory should be a matter for joint decision by the two tax authorities, who may thus decide by common agreement not to go on with further enquiries, investigations and inspections of the company’s premises and documents.

⁷⁹ Retro, 5.1.

In the case that either the information forwarded by the competent tax authority does not justify the situation at stake or this tax administration does not have any useful information and the principal taxpayer does not forward any (useful) detail or has not forwarded, in the opinion of either of the tax authorities concerned, any satisfactory detail, the principal tax authority, together with the competent tax authority, would decide the substantive tax audits and establish, together with this latter authority, *which* enquires, inspections and investigations would be necessary. The audit would be carried out by the local tax authority, which would proceed to the inspection of the company's books, documents, premises etc...according to the procedural requirements of national law⁸⁰. The decision to carry out the inspections and investigations, as well as the target of inspections and investigations, could thus be a decision jointly taken by the principal tax authority and the local tax authority, on the proposal of either the former or the latter (and, in any case, after the first input – i.e., the request for information – by the principal tax authority).

It was suggested in a working document that there should be agreement on some elements of the audit procedure, e.g. “a common maximum length of the audit or common statute of limitation”⁸¹ which would decrease the scope of tax planning aimed at choosing the administration with the most generous procedural rules, and that a common statute of limitation “is particularly important for tax administrations in order to avoid being blocked by too generous legislation”⁸² in one participating jurisdiction (where the author would intend “common statute of limitation”, in this context, as meaning “common statute of limitation” to the powers of inspectors)⁸³. Undoubtedly, a provision of the Directive establishing a common maximum duration of the substantive audit, i.e. how long inspections on company's books and premises could last, and some common obligations to be complied with by inspectors in carrying out the audit – such as, e.g., an obligation to minimise any disruption to the activity carried out in the company's offices and premises – would go in the direction indicated in the working documents. However, two observations can be made. First, just like the limitations in terms of tax years covered by the audit⁸⁴, a common maximum duration of a substantive audit or common obligations on inspectors would need to cover the inspections intended to verify both the compliance with the Directive provisions and the compliance with national provisions which are deemed to be essential in arriving at the correct determination of the tax base as identified by the Directive. Second, other features of the inspections, such as which documents can be examined and/or in which order, would inevitably need to remain governed by national laws, unless and until a complete harmonisation (not only of accounting principles but also) of all kinds of administrative documentation, such as the main books, the auxiliary books and the individual supporting documents, took place.

Nonetheless, the target of inspections and investigations could be jointly decided in the sense that the aspect(s) of relevance in the concrete case should be agreed by the principal tax authority and the local tax authority. E.g., in case of a would-seem under-declaration of the share of a company in a Member State for more than one year on the base of data provided in the consolidated tax returns and in supporting documents, the aspect of relevance would lie in the correct application of the sharing

⁸⁰ European Commission, 19 May 2006, CCCTB\WP\036\doc\en, Points for discussion on ‘Administrative and Legal Framework’, 19 May 2006, p. 7.

⁸¹ Ibid.

⁸² Ibid.

⁸³ About a common time limitation, retro, par. IV.

⁸⁴ Retro, par. III and par. IV, 4. and 4.1.

mechanism, and this target could be proposed by either the principal tax authority or the local tax authority concerned (even if one of the two administrations considered the information provided by the principal taxpayer to be acceptable, this tax authority would have no interest in opposing a proposal of the other tax authority to carry out the inspections; the two authorities could, in this case, decide to limit the audit to certain investigations). The audit would then be carried out by the local tax authority, who should inform, without prior request, the principal tax authority and the competent tax authorities in the other countries where the group has consolidated subsidiaries of the outcome of the audit.

This would be, again, a “spontaneous” exchange of information falling within the category of Art. 4(1)(e) of Directive 77/799: the information could in fact indicate, as a conclusive finding of the audit, that either the contribution of the consolidated company at stake to the group’s taxable base was correctly determined in the consolidated tax return or that a re-assessment needs to be made. In both cases, there would be an effect on the amount of the consolidated tax base, which may be increased as a result of the re-assessment, and thus on the amount of the share of each other involved State too.

5.4. Hypothesis for procedural rules concerning the event of “substantive tax audits” carried out in accordance with national practices.

The tax authority of a Member State of location of a consolidated company may have – in accordance with its national legislation, guidelines or practices - reasons for carrying out a substantive tax audit of this company, which would not be carried out if this company were located in the jurisdiction of the principal tax authority. E.g., as it was recalled, some Member States have calculated a minimum income for certain categories of individual and corporate taxpayers, based on average income of business operating in a specific economic sector or other statistical tools, and expect taxpayers to submit a tax return indicating at least such a minimum taxable income⁸⁵: a situation may thus occur where the Member State of the principal tax authority does not expect its resident corporate taxpayers to indicate a minimum taxable income, but the Member State of residence of one of the consolidated companies does so, and where the tax authority of the latter Member State, by accessing the consolidated tax returns in the database, realises that the consolidated company resident in its jurisdiction has not indicated such minimum income in determining its taxable profit before consolidation. In such a situation, this latter tax authority could be required or allowed by its national laws to proceed to enquiries and further inspections and investigations of the company’s books, premises, documents etc...aimed at ascertaining whether the lower income indicated by the company concerned corresponds to the income actually derived: it appears logical to leave the substantive tax audits initiatives directly to the tax authority concerned, which would introduce a further exception to the general choice of leaving the substantive tax audits initiative to the principal tax authority. The exception would be motivated, in the case here considered, by reasons of efficient time management, as the alternative would seem to be an initiative taken by the principal tax authority but on a proposal from the tax authority concerned (which would thus, in any case, offer the first input).

If these situations were covered by a “principle of mutual recognition”, each Member State where the group has consolidated companies would accept that the

⁸⁵ European Commission, 19 May 2006, CCCTB\WP\036\doc\en, Points for discussion on ‘Administrative and Legal Framework’, 19 May 2006, p. 7; also retro, 5.1.

consolidated tax base, and consequently its own share in this tax base, could ultimately depend on an audits initiative of tax authorities of another Member State justified by reasons indicated by the legislation of this latter State and which may have no equivalent in its national laws. The local tax authority carrying out the audit should again, without request, inform the principal tax authority of the audit initiative and of its final outcome. Moreover, the rationale for substantive tax audits already envisaged by national laws, by giving the national tax inspectors the occasion to enter the company's premises, checking the individual documents and verifying the physical assets used by the company, would give the possibility to audit the proper application of the sharing mechanism too, even where the case of under-calculation of the tax base share for more than one year does not occur. This possibility appears to be important, because in a situation in which the calculation of the share of a company in a Member State shown in the consolidated tax return is consistent with the data provided in the accompanying documents, a potentially wrong application of the sharing mechanism would not emerge from the formal verification by the principal tax authority located in another Member State. Accordingly, any tax authority who, at the occasion of an audit carried out on a consolidated company on grounds prescribed by national law or in any case in accordance with its national practice, checks the elements of the sharing mechanisms and discovers a wrong application which could not have been suspected on the sole basis of the formal verification of the consolidated tax returns and supporting documents, should without request inform all other tax authorities.

Shortly, the audit of the correct application of the sharing mechanism would be carried out, in the proposed approach, *either* as a result of a possible criteria for substantive audit emerging from the formal verification of consolidated tax returns and set out by the new Directive, *or* as a result of other reasons triggering substantive audit established by national laws and/or administrative guidelines and mutually recognised by Member States. Member States should be required, in this connection, to regularly inform each others about the changes in their provisions and/or administrative guidelines which establish the strategies and methods for substantive audits and which can be used to identify (due to the mutual recognition) the CCCTB taxpayers for substantive audits purposes. With a view to maintaining the attractiveness, in any aspect, of the CCCTB regime for taxpayers' viewpoint, this solution would seem preferable to the an alternative which would consist of a choice of making the audit of the sharing mechanism through access to company's premises and inspections possible at any time.

Although a principle of mutual recognition of the methods for substantive tax audits already set out by national legislations would appear workable from the viewpoint of national administrations, as none of them could be expected to have an interest to oppose an initiative by another tax administration which may result in an increase in its own tax revenues, the following question could be raised: given that the tax audit initiative by one national authority could affect, even if based on grounds for substantive tax audits established by the specific national legislation at issue, the share of the overall consolidated tax base and thus that of other Member States too, would there be the case of a *mutual recognition* as amongst the tax authorities *of the circumstances which*, in a situation where substantive tax audits (thus, involving access to the company's premises, inspections of books etc..) could be carried out under a specific national legislation, *have induced the national tax authority concerned to conduct or not to conduct the audit?* Assume that one of the national legislations concerned provides that substantive tax audits may be carried out if the

income declared by a company is inferior to a minimum which is regarded as normal in the economic sector concerned⁸⁶, but the national tax authority concerned decides not to carry out the audit in the specific case. These situations inevitably reflect the different degree of greater or lower trust and cooperation that, in the different Member States, exists as between tax administrations and taxpayers, as well as the specific relationships between the tax authority and different taxpayers within a single Member State (e.g., a taxpayer who has, in past years, always regularly honoured tax declarations and payments obligations might be less subject to substantive audits, by the national tax administration, than a taxpayer who has breached these obligations and incurred penalties, even if for the same tax year substantive tax audits could be in principle carried out, according to national legislations, guidelines or practices, towards both taxpayers).

In this author's view, to foster mutual transparency between all tax authorities concerned, each tax authority should not only be made fully aware of all cases when, under the national laws of another Member State, substantive tax audits could be carried out, but should also know whether or not the substantive tax audit has been or will be actually carried out by the tax authority concerned. For this purpose, it appears reasonable to suggest that the central database should store not only the consolidated tax returns and the consolidated and annual accounts, but also all data concerning consolidated companies which serve to show any situations where, under the national tax law and practice of any Member State, there would be reasons for conducting substantive tax audits. Because the tax records concerning all consolidated companies, including those concerning the audits and their outcomes, would be stored in the central database, each national tax authority of a jurisdiction where one of the companies included in the consolidation is located, and who realises that the tax authority of another Member State where another company included in the same consolidated group is located has not carried out or does not conduct a substantive audit in a situation where it could have done or do so under the national provisions of this second Member State, could require the latter tax authority an explanation of the reasons why the audit has not or is not being carried out. The Directive should provide for an obligation, upon the tax authority who receives the request, to explain these reasons, and, in the absence of a detailed explanation, should entitle the requesting authority to obtain, from the other authority, that the substantive tax audits be carried out. This solution would appear to be able to strike a balance between on the one hand the maintaining of the discretion for any national tax authority to decide whether to conduct a substantive tax audit whenever *under its national provisions* may be allowed to do so, and, on the other hand, the need for transparency as amongst national tax authorities, because the decision whether to carry out an audit taken by any tax authority could have effects for all Member States in which the consolidated groups operates.

Conclusively, it could thus be suggested that a mutual recognition of the national regimes governing substantive tax audits and, in this regard, the related obligation on Member States to keep each other informed about the changes in their provisions, should be accompanied by a "mutual recognition" of the circumstances which have induced any tax administration to carry out or not to carry out the tax audit when allowed (but not mandatorily required) to do so by its national legislation, provided there be an detailed explanation of the underlying choice.

⁸⁶ Such is the case, e.g., in Italy, according to the "sector studies" methodology - mentioned retro, 5.1. - where the relevant provisions empower, but not oblige, the tax authority to conduct the substantive tax audit.

5.5. Available time for the issue of amended assessments and available time for tax audits.

The overall structure of tax audit above considered would need to be consistent with the choice according to which the principal tax authority could issue amended assessments, in any event, no later than 3 years after the final date for filing of the consolidated return⁸⁷. This implies that the “substantive” audit phase, when carried out, must also be concluded within 3 years from that date, and requires that a much shorter deadline, e.g., within one year, be established for the conclusion of the “formal verification”⁸⁸ (the results of which, as above highlighted, could trigger the substantive tax audits), to leave the necessary period during which the carrying out of the substantive tax audit may take place. The fact that “amended assessments could include one or more adjustments to the consolidated tax returns and would normally be issued no more than once every 12 months”⁸⁹ would thus be consistent with a provision requiring the formal verification phase (which may result in an amended assessment) to be concluded, annually, within 12 month of the deadline for filing the tax return.

The time limits for the conclusion of the tax audits and for the issue of amended assessment as a result of these audits would also need to be consistent with the time limitations concerning the tax years which could be subject to audit. Taking into consideration the choice to set a 9 months deadline, after the end of the tax year, for the filing of the consolidated tax return, and to set, as a normal period, 3 years after the final date for filing of the consolidated tax returns for issuing a re-assessment, which could follow from the result of the audit, tax period 1, whose declaration has to be presented within 9 month and thus during tax period 2, could be subject to (substantive) audit until the end of the ninth month during tax year 5 (included). Consequently, it would be coherent to establish, as a common rule concerning which tax years could be audited⁹⁰, that, during any tax year, tax authorities can audit up to the forth previous tax year. A provision to this effect would help the clarity of the legislation and avoid interpretative doubts.

5.6. Extension in time for the issue of amended assessments in exceptional circumstances and substantive tax audits

In the light of this, the choice whereby “.amended assessment could exceptionally be issued after expiry of the 3 year period where a misstatement resulting from a wilful act or gross negligence on the part of the taxpayer is discovered within 6 years of the final date for filing the consolidated return. The 6 year period for discovery of

⁸⁷ Except for particular circumstances: European Commission, 13 November 2007,

CCCTB/WP061\doc\en, CCCTB: possible elements of the administrative framework, p. 9 and 10.

⁸⁸ Which would consist of a verification of the correctness of the calculation made by the principal taxpayer to determine the consolidated tax base shown in the consolidated tax return, and of a cross-checking between the consolidated tax returns and the supporting documentation forwarded by the principal taxpayer.

⁸⁹ European Commission, 13 November 2007, CCCTB/WP061\doc\en, CCCTB: possible elements of the administrative framework, p. 11

⁹⁰ Which rule should cover the audit carried out to verify compliance with the provisions of the Directive as well as compliance with the national provisions concerning the methodology for arriving at the common tax base: retro 2 and 3.

the misstatement would be extended to 12 years where the misstatement is the subject of criminal proceedings”⁹¹ would need to be, according to this author, completed by a provision specifying that the 3rd year of the final date for consolidated return submission could always be considered as the normal, but not as the absolute, time available for substantive audits.

In other words, it appears reasonable to provide that, in exceptional situations justifying a suspect of misstatements due to wilful act or gross negligence - which could be the case where this suspect derives from information known by the tax authority (in addition to the case of criminal proceedings) due to contacts with other sectors of the national administrative system and/or with financial institutions and/or through the media where the information is well documented - the principal tax authority and the other concerned tax authorities could send to the principal taxpayer, who should be required to give notice to all other members of the consolidated group, enquiries asking for information additional to those provided in the consolidated tax returns and in the supporting documents. In this regard, it could be provided that, should the principal taxpayer fail to respond to these enquiries⁹², a substantive tax audit would be simultaneously carried out on all members of the consolidated group, for the purpose of finding out whether there have actually been misstatements resulting from a wilful act or gross negligence on the part of this taxpayer and/or of any consolidated company, and that the time available to carry out the audit would be extended beyond the 3 years. Again, each tax authority would need to be required to inform each others of the start of the audit, of the findings and of the conclusion.

5.7. Errors discovered by the taxpayers and time available for substantive tax audits.

A further issue on which a detailed choice would appear to be necessary is the treatment of principal taxpayers who, after the filing of the consolidated tax returns in due date, realise that the returns contained errors, deriving e.g. from errors in the books, and notify the principal tax authority accordingly. This hypothesis should refer to errors which could not make the consolidated tax returns unreliable on the whole, and which might not be discovered first by the tax authorities, and should thus be distinguished from the case of multiple and significant errors and inconsistencies making the tax returns unreliable that would become immediately evident to the tax authorities and that would fall in case 4) indicated in 5.1. and 5.2. above.

The idea that “If the principal taxpayer discovers that the consolidated tax return was inaccurate, it would notify the principal tax authority of the error. The principal tax authority would, where appropriate, issue an amended assessment in accordance with the procedure below”⁹³ (which evidently refers to the discovery of errors by the taxpayer before the issue of the amended assessment by the tax authority) leaves open any solution as regards: whether the principal taxpayer who discovers the error would be required to notify the tax authority or whether would be simply permitted to do so as a form of “spontaneous correction” to its own benefit (e.g., for avoiding totally or partly the fines that could be associated with a re-assessment by the tax administration), in which latter case it can be assumed that it would notify the

⁹¹ European Commission, 13 November 2007, CCCTB/WP061\doc\en, CCCTB: possible elements of the administrative framework, p. 10

⁹² Due to either its own negligence or will or to the negligence or will of another member of the consolidated group to which the suspect refers.

⁹³ European Commission, 13 November 2007, CCCTB/WP061\doc\en, CCCTB: possible elements of the administrative framework, p. 10.

principal tax authority; when it would be appropriate for the principal tax authority to issue an amended assessment; if there would be any consequence for the tax audits.

In the working document, the case where the principal tax authority issues an amended assessment as a result of the notification by the principal taxpayer of errors that this latter has discovered is equated with the case where the principal taxpayer has failed to file the consolidated tax return by the due date (“..in accordance with the procedure below”) ⁹⁴, i.e. the amended assessment, issued by an administrative act, would be based on an estimate, taking the available information into account, against which the principal taxpayer could appeal.

In light of the need to make the CCCTB regime (not only attractive for corporate taxpayers but also) as simple as possible to administer, and to encourage a collaborative relationship between taxpayers and tax administrations, it seems to be appropriate to avoid a situation where taxpayers who (in good faith) realise that they have made unintentional errors, and who thus allow the tax authority to become aware of the error, are more likely to be subject to re-assessment than taxpayers who may have willingly tried to escape the regular fulfilment of tax obligations, and who may have tried to do so e.g., by failing to file the return by the due date, by accepting the possibility of estimate by the tax administration and by renouncing the appeal against the assessment based on the estimate in case that this estimate leads to a lower taxable profit than the one actually gained (and that the tax burden deriving from the estimate, together with the cost of any penalty for failure to file the tax return, is lower than the tax burden corresponding to a proper determination of the taxable base). For this reason, the preferable option would seem to be that of giving taxpayers who discover errors the possibility of “spontaneous correction”, and of drawing a distinction according to the consequences of the error discovered by the taxpayer and of the necessary correction: if the error notified by the taxpayer, and the consequent correction made by the taxpayer himself in either the notification or a subsequent tax return intended to rectify the first one, leads to an higher amount of the taxable base, a presumption of good faith on the part of the taxpayer would seem to be well grounded. In such case, it appears reasonable to establish that the tax authority should not issue an amended assessment, whereas the issue of an amended assessment based on an estimate should remain possible in the opposite case, i.e. if the result of the correction of the error led to a lower amount of the taxable base. Moreover, in this latter case, the time limit for audits could start from the notification by the taxpayer or from the issue of the amended assessment, whereas, in the former case (correction to the benefit of tax revenues), it could remain linked to the deadline for the submission of the consolidated tax return (already) filed by the taxpayer. While keeping the auditing powers, this distinction in the time limit⁹⁵ could thus avoid creating disadvantages for taxpayers who signal unintentional errors, in good faith and to the benefit of the tax revenues. In addition, as a measure to encourage this behaviour, the non application of penalties and tax surcharges should be considered.

VI. SUMMARY AND CONCLUSION

In summary, as responses to the questions which were raised for discussion concerning the tax audits, it has been basically argued in this work that:

⁹⁴ Ibid, p. 10.

⁹⁵ Not envisaged by the CCCTBWG.

- a) the common time limitation for tax audits should cover the compliance with all provisions (including the ones left to national laws) concerning the determination of the tax base;
- b) in the relations with third countries, a mutual recognition of the time limits could operate, at least in the short term;
- c) the Directive should specify, with clear and precise provisions, the objective criteria for selecting the CCCTB taxpayers towards whom to carry out “substantive tax audits” (consisting of further enquiries, investigations, inspections of the company’s books, premises), i.e. the grounds for these audits, and not limit itself to provide for a mutual recognition of the national regimes in this respect;
- d) the transmission of information throughout the audit procedure could be based on the categories of automatic, spontaneous and requested exchanges introduced by Directive 77/799/EEC, except that it should not be possible for a national tax authority to refuse to comply with the request of another national tax authority;
- e) the substantive tax audits could receive the “first input” from the principal tax authority in the majority of situations falling under the criteria set by the Directive, with exceptions which may be expected not to occur frequently (i.e. the cases of request from the body handling the appeal against an amended assessment based on an estimate), or, during the initial period of application of the CCCTB, these audits could receive such input from other national tax authorities by virtue of the mutual recognition of existing national practices during such period;
- f) the national tax authorities should keep each others informed about the evolution of national provisions concerning the strategies and methods for substantive tax audits;
- g) the “mutual recognition” should extend to the circumstances which have induced a tax authority to conduct or not to conduct the audit in situations where it would be allowed to do so by its national legislations, if clearly explained to other tax authorities and, without this explanation, the tax authority of another Member State should be entitled to require the audit;
- h) the kind of supporting documents which, together with the consolidated tax returns, should be stored in the central database would have a key importance for the working of the system;
- i) last, the taxpayers who signal unintentional errors that the tax authority may not discover first should receive a better treatment than the taxpayers who do not do so, for audit purposes too.

Another feature mentioned in the working documents, a common length of the audit, would undoubtedly be desirable.

The most controversial aspect amongst the proposed solutions may perhaps be the suggestion that the criteria for selecting CCCTB taxpayers for substantive tax audits purposes should be clearly specified in the Directive, and that these criteria should only lie, at least for the initial period of application of the CCCTB, in those above identified in V, 5.1. and 5.2.. It might perhaps be objected that, since – as the Commission reminded⁹⁶ – the ECJ has stated that direct taxation does not fall as such within the purview of the Community, any provisions empowering tax authorities to carry on substantive tax audits – and the related strategies and methods - should be

⁹⁶ EC Law and Tax Treaties, working document, 9 June 2005 (Ref.: TAXUD E1/FR DOC (05) 2306) for the Workshop of Experts on 5 July 2005, p. 3.

still left to national laws as some of the key provisions concerning direct taxation as such, and that the Directive should limit itself to a mutual recognition. Nonetheless, the response to this objection could be that, unlike the ECJ rulings which - by removing national provisions to the extent that they create tax barriers to the proper functioning of the internal market - generate a “negative” integration, the new Directive needs to provide a system for “positive” integration in which some of the most important tax provisions, such as those setting out the criteria for substantive tax audits, become part of the provisions that need to be introduced (and incorporated in the Directive issued under Art. 94 of the Treaty) for the proper functioning of the internal market. In effect, without these uniform provisions setting out the grounds for substantive tax audit, forum-shopping phenomenon, under the forms of groups unit location decisions, aimed at artificially circumventing those national provisions leaving the widest scope for substantive tax audits, would end up being encouraged (which would increase the risk of distortions). From this viewpoint, it may even be argued that an introduction of uniform criteria for substantive tax audits by a clear provision in the Directive coupled with a mutual recognition of the national criteria, guidelines and practices (which, in this work, has been proposed for the first period of the CCCTB regime), would actually be the “second-best” solution, that may be (politically) acceptable to Member States in the current stage where they still try to safeguard their autonomy in shaping the national tax provisions including those on substantive tax audits. This because the “first-best” solution would be, for all eligible taxpayers opting for the CCCTB as consolidated groups, to be subject to substantive tax audits *only in* accordance with the possible criteria specified by the Directive irrespective of the Member State of residence of the principal taxpayers and of other group’s units. It would seem to the author that this optimal choice - which would obviously enhance the role of the principal tax authority as a “captain” of the “auditing team” - might realistically be proposed only in the medium or longer term, i.e. after the end of the initial period (e.g. 5 years or more) of application of the CCCTB, since, by that time, the experience gained by tax authorities in cooperating with each others may eventually help them to perceive the advantages of common criteria to deal with common concerns. Such a choice could then be implemented by adding in the Directive other criteria for selecting the CCCTB taxpayers for substantive tax audits (such as e.g. the tax compliance - related conduct of these taxpayers during the first years of application of the CCCTB or economic sector related-methodologies), which should replace the national strategies and methods due to the recognition of their ability to achieve the same, ultimate goal of allowing an efficient and effective management of the risks of tax evasion and avoidance.

In addition to enhancing legal certainty for consolidated groups wherever their units are located, and to helping the overall simplicity of the system, this choice, after creating two parallel sets of provisions concerning the grounds for substantive tax audits - the EC provisions applicable only to companies eligible to opt for the CCCTB as consolidated groups, and the national provisions applicable only to companies ineligible to this option - may well generate a market-driven convergence towards the CCCTB provisions if national legislators wish their own systems to be competitive in all more important aspects with the new one. The CCCTB legislation, including its (in the author’s view) most important aspect with regard to the tax audits, would - in producing this effect - become *a true vehicle for “tax integration”* (rather than unintentionally contributing to the risk of “tax disintegration”), consistently with its ultimate purpose.

List of abbreviations

CCCTB: Common Consolidated Corporate Tax Base

CCCTBWG: Common Consolidated Corporate Tax Base Working Group

DTCs: Double Tax Conventions

EC: European Community

ECJ: European Court of Justice

OECD: Organisation for Economic Co-operation and Development

PEs: Permanent Establishments

