The Strategy of Shifting-To-Losses: The Case of Common Consolidated Corporate Tax Base (CCCTB) in the European Union*

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Abstract: *It has been long assumed that multinational taxpayers tend to shift profits to relatively low tax rate jurisdictions, for the purpose of reducing their global overall tax burden. Recently, research additionally shows the opposite: multinational taxpayers may shift profits to relatively high tax rate jurisdictions where there are loss-making affiliates. The proposed Common Consolidated Corporate Tax Base (CCCTB) system in the EU also provides the same opportunity of such »Shifting-To-Losses«strategy. This paper explains how the same scenarios can take place under the proposed CCCTB and suggests a practical solution: to adopt an annual quantitative restriction to the losses that could be offset every tax year.*

Keywords: Common Consolidated Corporate Tax Base (CCCTB), losses, Base Erosion and Profit Shifting (BEPS), un-harmonized tax rate, European Union, tax planning

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1. Introduction

Multinationals have the capacity, and the long-term practice, to make use of disparities of national tax laws, in order to minimize their overall tax burden. Strategically making use of losses as a type of aggressive tax planning scenario is one of the most intriguing problems. OECD has recognized Base Erosion and Profit Shifting (BEPS) in 2013 as an aggressive tax-planning phenomenon and launched action plans to combat typical BEPS scenarios and propose solutions. Being influenced by the BEPS campaign, the European Union also takes anti-BEPS/anti-tax avoidance as one policy goal of its ambitious project: Common Consolidated Corporate Tax Base Directive Proposal (hereafter CCCTB Directive Proposal).[1]

Being initiated since the early 2000's, the proposed CCCTB system originally aims to provide a harmonized corporate tax base on a group basis in order to reduce high compliance costs for multinational taxpayers within the EU. The CCCTB Directive Proposal is part of the EU internal market development, aiming to create a more business friendly environment, attract more economic activities and stimulate free movement within the European Union consequently. Moreover, the CCCTB Directive Proposal would replace the current bilateral treaties between the EU Member States and adopt a harmonized formula to share the taxing powers between Member States. The CCCTB Directive Proposal also provides a cross-border loss-offsetting mechanism: qualified group members throughout the EU can offset their profits and losses with each other. Adopting CCCTB is expected to encourage more active cross-border activities, because companies will no longer need to worry that their foreign losses cannot be fully offset. In short, CCCTB was originally designed to provide convenience and benefits for multinational taxpayers.

The BEPS discussions have added new aspects to the CCCTB development and led to a paradigm shift. EU legislators are more aware of multinationals' aggressive tax planning behaviors, so now they also expect that the CCCTB can play a role in combating tax avoidance.[2] Ideally speaking, the CCCTB Directive Proposal, once adopted, should be able to mitigate BEPS problems as well. When CCCTB harmonizes EU Member States' corporate tax base, disparities due to different national tax laws would be largely reduced. Moreover, since CCCTB is a

1. The European Commission at their official has published the development and legislative record of the CCCTB and CCTB see European Commission, »Common Consolidated Corporate Tax Base (CCCTB)« <https://ec.europa.eu/taxation_customs/business/company-tax/common-consolidated-corporate-tax-base-ccctb_en> accessed 25 June 2018.
2. The paradigm shift of CCCTB, see Shafi U. Khan Niazi, »Re-Launch of the proposal for a Common Consolidated Corporate Tax Base (CCCTB) in the EU: A Shift in Paradigm« (2017) 44 Legal Issues of Economic Integration 293-314.

group consolidation taxation system and transections within a group are recorded and filed altogether, mismatches would also be eliminated.

However, the ideal does not always match the reality. Even in a harmonized supranational tax system such as CCCTB, there are still manipulation possibilities. The loss-offsetting rule of the CCCTB Directive Proposal would be an example of such a possibility. This might sound pessimistic, but it is undeniable that after the proposed reform under the CCCTB, the opportunity of manipulating losses could still exist and take place in a different form.

In this paper, the research focuses on the loss treatments under the CCCTB Directive Proposal and newly emerging problems. This paper analyzes the less-intuitive scenario of Lisa De Simone, Kenneth J. Klassen, and Jeri K. Seidman's research, »Unprofitable Affiliates and Income Shifting Behavior«,[3] on shifting profits to loss-making subsidiaries in a high tax rate jurisdiction, in order to offset the losses in that jurisdiction. De Simone et al. argue that losses at a high tax rate jurisdiction can effectively offset more profits than the losses at a low tax rate jurisdiction. This is the so-called Shifting-To-Losses scenario. This scenario is far less discussed than the following well-recognized two scenarios: (1) shifting profits to the low tax rate jurisdiction to reduce the overall tax burden[4] and (2) purchasing loss-making entities and making use of the seller's pre-existing losses in order reduce the buyer's overall tax burden.[5] So far De Simone et al. have made impressive progress regarding manipulation of losses, and other scholars have tested their claim by different set of data. It would be meaningful to test and to apply their theory and argument to a specific legal instrument, such as CCCTB. The aim of this paper is a dialogue and an echo to the work from De Simone et al.: their research concludes that the less-intuitive scenario of profits shifting to a high tax rate jurisdiction for the purpose does exist; and the research of this paper shows that the findings of De Simone et al. are consistent with the operation of loss-offsetting rules of the CCCTB Proposal. Since we both have the consensus on the existence of such a problem, we will need to think of a feasible solution as the next step.

The research questions of this paper are: how the losses off-setting rules under the CCCTB Directive Proposal can be used to conduct the scenario of Shifting-To-Losses and what the feasible solutions should be. The research method is, first to analyze the specific loss-offsetting rules in the current CCCTB proposal, explore the opportunities to shift the losses in the formulary apportionment system, and, second, to check if the theory of De Simone et al is also consistent with these opportunities derived from the CCCTB. This paper revisits the research findings

3. Lisa De Simone, Kenneth J. Klassen and Jeri K. Seidman, »Unprofitable Affiliates and Income Shifting Behavior« (2017) 92 The Accounting Review 113-36.
4. ibid.
5. See Section 3.5 of this paper.

that multinationals shift their profits and activities to relative high tax rate jurisdictions when there are utilized losses in these jurisdictions. This empirical data is collected and analyzed by accounting and economic scholars. Then, this paper, from the normative view of the legal discipline, analyzes the current CCCTB Directive Proposal and discusses how the current CCCTB Directive Proposal could be used to conduct the »shift-to-losses strategy« and how it should be improved. In other words, such a research method includes an interdisciplinary element: making use of the findings from accounting and economics scholars, to find out possible unexpected weakness of a tax law reform project, such as CCCTB. It is a risky attempt, but it would be meaningful to start such academic dialogue: to »reform« a tax reform proposal.

The structure of the paper is designed as follows: Section 2 introduces the theory and empirical data regarding the Shifting-To-Losses scenario conducted by multinational corporate groups. I will briefly summarize the main findings of De Simone et al. as well as an earlier research paper published by the OECD regarding aggressive tax planning via manipulating losses. Section 3 introduces the main relevant features of the CCCTB Directive Proposal, specifically the losses-offsetting rule for group termination and business reorganization and how these rules can be used to conduct the Shifting-To-Losses scenario. I will also explain how the CCCTB Directive Proposal fails to combat such a scenario and what solutions the current CCCTB Proposal has tried to adopt. In Section 4, after confirming the existing possibility of a Shifting-To-Losses scenario under CCCTB, I suggest a feasible solution, partially inspired by the Council's discussions on the CCCTB Directive Proposal previously. Section 5 concludes.

2. The Theory And Empirical Evidence of a »Shifting-To-Losses« Scenario

When it comes to »profit-shifting« in the context of international taxation, it is quite intuitive to think of shifting profits or income from a high tax rate jurisdiction to a low tax rate jurisdiction. However, more and more studies indicate that, losses can play a role in the tax planning scenarios, but such scenarios are less explored. The OECD has published a research paper in 2011,[6] describing the one of the various schemes: »shifting profits to a loss-making party«.

The findings of De Simone et al. have gone a step further. They first explore the pre-existing literature[7] on tax-motivated income shifting behaviors. They find out that the previous research has discussed the scenario of shifting profits to a

6. OECD, *Corporate Loss Utilisation through Aggressive Tax Planning* (OECD Publishing 2011) <http://dx.doi.org/10.1787/9789264119222-en> accessed 10 December 2018, 52.
7. De Simone, Klassen and Seidman (n 3).

low tax rate jurisdiction and provided ample empirical evidence, such as work from Hines and Rice, as well as Dharmapala. Hines and Rice[8] developed a model of using tax havens where tax rates are low or nil, to shift income. Dharmapala has used Hines and Rice's model as a general setting of multinational income shifting.[9]

However, the previous research does not touch much upon the responses of multinationals to the losses which might trigger the scenario of shifting profits to high tax rate jurisdictions to make use of the losses there. It was not completely clear how the losses will play a role in multinationals' tax planning behaviors, though there are some works[10] affirming that losses do influence multinationals' behaviors. This is where the research of De Simone et al. has proceeded. De Simone et al. follow the Cobb-Douglas' profit prediction model and take more than 50,000 European affiliate's data to observe these affiliates' reported profits. Their hypotheses are: multinationals will have a strategy to shift profits from profitable affiliates (in relatively low tax rate jurisdictions) to loss-making affiliates (in relatively high tax rate jurisdictions) in order to reduce their global overall tax burden, even though conducting such strategy also involve costs. They test such hypothesis and consider the costs from conducting such a strategy. Their results are consistent with their hypotheses. That is to say, their results suggest that the scenario of Shifting-To-Losses scenario does exist.[11]

The data of De Simone et al. show that in practice, in addition to shifting profits to low-tax rate jurisdictions, multinational groups also shift profits from profitable affiliates to unprofitable affiliates in order to make use of losses in the high tax jurisdiction, despite the costs of conducting such a scenario. Their findings also provide evidence that, even if the loss-making situation of an affiliate might be temporary, multinationals still have the incentive to conduct such a »shift to loss« strategy. As Lisa De Simone indicated in an interview herself: so far, the knowledge regarding losses manipulation is still quite limited, and thus the real

8. James R. Hines Jr. and Eric M. Rice, »Fiscal Paradise: Foreign Tax Havens and American Business« (1994) 109 Quarterly Journal of Economics 149-82.
9. Dhammika Dharmapala, »What Do We Know about Base Erosion and Profit Shifting? A Review of the Empirical Literature« (2014) 35 Fiscal Studies: The Journal of Applied Public Economics 421-48.
10. As De Simone et al. reviewed, such research work regarding losses and multinationals' behavior, includes the relation between carry-forward losses and debt issuing behavior, see Jeffrey K. MacKie-Mason, »Do Taxes Affect Corporate Financing Decisions?« (1990) 45 Journal of Finance 1471-93; the relation between loss-carry forward and the bonus depreciation election behavior, see Jesse Edgerton, »Investment incentives and corporate tax asymmetries« (2010) 94 Journal of Public Economics 936-52.
11. De Simone, Klassen and Seidman (n 3) 130.

effect of BEPS is underestimated and that »corporate tax avoidance is bigger than you think«.[12]

Corporate losses can be manipulated in various ways as the OECD research paper already described in 2011. The findings of De Simone et al. in 2016, have confirmed the existence of the less intuitive scenario Shifting-To-Losses based on their empirical evidence. This scenario is actually logical. The loss offsetting process can be seen as making some part of income subject to the zero-tax rate. It is a strong incentive. Shifting profits to offset the losses incurred in a relatively high tax rate jurisdiction will have more benefits because the offsetting losses of a high tax rate jurisdiction compensate more than offsetting losses in a relatively low tax rate jurisdiction.

In addition to the findings from De Simone et al., Hopland et al., test the same claim of Shifting-To-Losses by using a different set of data, involving 300 Norwegian companies from 1998 to 2005.[13] Hopland et al. affirm that the Shifting-To-Losses strategy of increasing the economic activities/the tax base in a high tax rate jurisdiction in order to utilize the losses incurred by affiliates in that jurisdiction. More specifically, Hopland et al. have found that companies make use of transfer pricing practices to achieve the Shifting-To-Losses strategy, not by creating the internal debts. In this regard, the Shifting-To-Losses strategy is a long-standing scenario, and it is inter-related with transfer pricing practices.

The implications from the work of De Simone et al. and Hopland et al. for EU policy makers and legislators are clear: where the scenario of shifting profits to low-tax rate jurisdictions are concerned, we need to be aware of the scenario of shifting profits to high-tax rate jurisdictions. Section 3 of this paper will further indicate how the current CCCTB Directive Proposal, is consistent with the research findings of De Simone et al. The CCCTB Directive Proposal does provide an opportunity to conduct Shifting-to-Losses, but EU legislators have not been aware of this opportunity.

12. See the blog post of Stanford Graduate School of Business, Lee Simmons, »Why Corporate Tax Avoidance Is Bigger Than You Think: An accounting expert examines the impact of new rules on income shifting« *Stanford Business* (Stanford 24 May 2016) <www.gsb.stanford.edu/insights/why-corporate-tax-shifting-bigger-you-think> accessed 24 June 2018.
13. Arnt O. Hopland and others, »Flexibility in Income Shifting under Losses« (2018) 93 The Accounting Review 163-83.

3. The Shifting-To-Losses Opportunity Under The CCCTB

3.1. The Overview Of The CCCTB System: A Three-Factor Formulary Apportionment

The Common Consolidated Corporate Tax Base (CCCTB) is an ambitious project initiated by European Commission.[14] After many working group meetings, in 2011, the CCCTB Directive Proposal was released for the first time. The three main features of the CCCTB are: Common (a harmonized corporate tax base at the EU level); Consolidated (a group taxation which consolidates all qualifying group members) and Formulary Apportionment (a pre-decided formula dividing the common consolidated tax base). By the metaphor of »a pie and a knife«, a multinational group active in different EU Member States can file their harmonized consolidated tax base from all qualifying group members from different EU Member States, and such consolidated tax base is like a big pie, jointly contributed by all group members. The formula is like a knife to decide the share/a piece of the pie which is apportioned to each group member.[15]

Due to the consolidation, losses and profits from all group members will automatically be offset with each other. Therefore, adopting the consolidated tax base has the embedded benefit of cross-border loss offsetting. With the same metaphor of the whole consolidated pie and the knife, the process of loss offsetting is to make the consolidated pie smaller or to make the apportioned piece smaller.

The »knife«, the CCCTB sharing formula, consists of three equally weighted factors: the sales factor, the asset factor and the labour factor.[16] Each factor is a ratio, and the denominator is the whole group's factor items, and the numerator is the factor items, which can be attributed to the group member.

Therefore, each group member's apportioned share[17] of the pie would be:

14. The legislation record of the development of CCCTB is published at the European Commission's website (n 1).
15. The comprehensive introduction of CCCTB, see Christoph Spengel and York Zöllkau (eds), *Common Corporate Tax Base (CC(C)TB) and Determination of Taxable Income: An International Comparison* (Springer 2012) discussions on losses at C.4; Christiana HJI Panayi, »The Common Consolidated Corporate Tax Base and the UK Tax System« (2011) The Institute For Fiscal Studies TLRC Discussion Paper No. 9, <https://ssrn.com/abstract=1809568> accessed 9 December 2019; discussions prior to 2011 CCCTB Directive Proposal on losses, see Saturnina Moreno González and José Alberto Sanz Diaz-Palacios, »The Common Consolidated Corporate Tax Base: Treatment of Losses« in Michael Lang and others (eds) *Common Consolidated Corporate Tax Base* (Linde Verlag 2008).
16. The labour factor consists of two sub-factors: the head counts of employees and the amount of payroll. Both factors are equally weighted as 50% in the labour factor.
17. Article 28 of 2016 CCCTB Directive Proposal.

the consolidated tax base

$$\times \left(\frac{1}{3} \times \frac{the\ member's sales}{group\ sales} + \frac{1}{3} \times \frac{the\ member's\ assets}{group\ assets} + \frac{1}{3} \times \frac{the\ member's\ labour}{group\ labour}\right)$$

Each group member's actual amount of tax due is the apportioned share multiplied by the national corporate tax rate applicable to that group member.[18]

As to the selection of weighting factors under the CCCTB, there have been some debates, whether the CCCTB should follow the trend of the USA to adopt the single sales factor.[19] Weiner[20] endorses a three-factor formula, and the European Commission is of a similar opinion. There are also other supportive views on a three-factor formula. For example, Mayer[21] argues that, based on the benefit principle, the sales factor represents the customers' market side, whilst the asset factor and the labour factor represent the production side. Furthermore, the European Commission also argues that a three-actor formula would be less vulnerable to abuse because it is too difficult to abuse every factor at the same time.[22] In any case, even though the European Commission has tried to prevent possible abusive scenarios such as those that have already taken place in the States. The current CCCTB Directive Proposal is not perfect. In fact, even in the sales factor, which is arguably harder to manipulate,[23] there are still possibilities to inflate the ratio if the sales factor is not properly designed.[24] From formulary apportionment

18. Article 45 of 2016 CCCTB Directive Proposal: »The tax liability of each group member shall be the outcome of the application of the national tax rate to the apportioned share, adjusted in accordance with Article 44, and further reduced with the deductions provided for in Article 25«.
19. For example, Llopis argues that the CCCB should be a single sales factor formula. See Estefanía López Llopis, »Formulary Apportionment in the European Union« (2017) 45 Intertax 631–41.
20. Joann Martens Weiner, »CCCTB and Formulary Apportionment: The European Commission Finds the Right Formula« in Dennis Weber (ed), *CCCTB Selected Issues* (Kluwer Law International 2012).
21. Stefan Mayer, *Formulary Apportionment for the Internal Market* (IBFD 2009) 206. Mayer endorses a three-factor formula of payroll, gross receipts and tangible property based on the benefit principle. He is skeptical with the amount of employees as a weighting factor.
22. See the CCCTB working document European Commission, »Common Consolidated Corporate Tax Base Working Group« <https://ec.europa.eu/taxation_customs/sites/taxation/files/docs/body/ccctbwp060_en.pdf> accessed 10 December 2018, No.60, paragraph 63.
23. See Maarten de Wilde, »Tax Competition within the European Union – Is the CCCTB Directive a Solution?« (2014) 7 Erasmus Law Review 24-38.
24. For example, Shu-Chien Chen, »Tax Avoidance in the Sales Factor: Comparison between the CCCTB and USA's Formulary Apportionment Taxation« (2017) 3 Indian Journal of Tax Law 1-27.

experiences in the USA, there are still quite a few possibilities to manipulate the sharing formula.[25]

According to the EU law legislative procedure requirement, the CCCTB Directive Proposal must be approved by the Council of the European Union, unanimously.[26] Such unanimity has not been achieved until now (2018), due to political sensitivity. In different Council presidencies from 2011 to 2015, there had been different compromise proposals being produced, but none of them were approved. Despite the rocky process, the Council still affirms the necessity of adopting the CCCTB, especially as a response to the BEPS campaign. In 2016, the European Commission withdrew the 2011 CCCTB Directive Proposal and re-proposed two separate Directive Proposals. The first one is the 2016 Common Corporate Tax Base (CCTB) Directive Proposal and the second one is the 2016 CCCTB Directive.[27] Once being accepted, the 2016 CCTB Directive will be implemented first to achieve a harmonized corporate tax base. The 2016 CCCTB Directive will be implemented consequently to achieve a consolidated corporate tax base with the formulary apportionment mechanism, which will replace the current bilateral tax treaties between EU Member States regarding corporate tax. The 2016 CCCTB Directive, in fact, copies the 2011 CCCTB Directive mostly, regarding consolidation and formulary apportionment, without major modifications.

Since it requires unanimity in the Council to adopt the CCCTB Directive according to the TFEU, it is not easy to achieve such political consensus. After issuing the CCTB and CCCTB Directives, some national parliaments of EU Member States' reactions are also negative so they issue reasoned opinions, trying to invoke »the yellow card procedure« to challenge the legitimacy of the CCTB and

25. Hellerstein analyzes the tax planning scenarios on the weighing factors from American experiences, see Walter Hellerstein, »Tax Planning under the CCCTB's Formulary Apportionment Provisions: The Good, the Bad and the Ugly« in Dennis Weber (ed), *CCCTB Selected Issues* (Kluwer Law International 2012); Walter Hellerstein, »Formulary Apportionment in the EU and the US: A Comparative Perspective on the Sharing Mechanism of the Proposed Common Consolidated Corporate Tax Base« in Ana Paula Dourado (ed), *Movement of Persons and Tax Mobility in the EU: Changing Winds* (IBFD 2014). Not only the sales factor, but also the asset factor and the labour factor can be manipulated. Examples based on the 2011 CCCTB Directive Proposal, see de Wilde, »Tax Competetition within the European Union – Is the CCTB Directive a Solution?« (n 23). These manipulation opportunities still exist under the 2016 CCCTB Directive Proposal, see Maarten de Wilde, »Tax Competition Within the European Union Revisited: Is the Relaunched CCCTB a Solution?« in Dennis Weber and Jan van de Streek (eds), *The EU Common Consolidated Corporate Tax Base: Critical Analysis* (Wolters Kluwer 2017).
26. Article 115 of Treaty on the Functioning of the European Union, the full text is available at <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex:12012E/TXT> accessed 9 December 2018.
27. The overview of the latest of CCTB and CCCTB, see Daniel Gutmann and Emmanuel Raingeard de la Blge tit i re, »CC(C)TB and International Taxation« (2017) 26 EC Tax Review 233-45.

the CCCTB Directive Proposal.[28] National parliaments from small Member States, such as the Netherlands and Ireland, are still skeptical.[29] Nonetheless, when we read into these reasoned opinions, we still see conditional support of CCCTB/CCTB, even in a negative reasoned opinion. For example, the Dutch lower parliament's opinion simply collects all different opinions and aspects from different parties, and thus, in such a piece of opinion, we can also see the positive support from several Dutch parties.[30] Moreover, other national parliaments submit their positive opinion on the CCCTB, such as Austria,[31] so it would not be completely impossible to adopt the CCTB/CCCTB for EU Member States, because CC(C)TB could be useful to contribute to combat BEPS and tax avoidance problems.

Briefly speaking, CCCTB has the ambition to reduce compliance costs and provide a cross-border loss offsetting mechanism. Ideally, implementing CCCTB will make the corporate tax system in the EU more neutral to multinational tax-

28. The yellow card procedure is provided in TFEU Article 5 (3) in combination with Protocol no.2. Specific conditions see Rita Szudoczky, »Is the CCCTB Proposal in line with the Principle of Subsidiarity?« in Dennis Weber (ed), *CCCTB Selected Issues* (Kluwer Law International 2012).
29. As to the parliaments of EU Member States' reaction to 2016 CCCTB Directive, see Jan van de Streek, »Some Introductory Remarks on the Relaunched CCTB/CCCTB Proposals from a Policy Perspective« in Dennis Weber and Jan van de Streek (eds), *The EU Common Consolidated Corporate Tax Base: Critical Analysis* (Wolters Kluwer 2017). As to the parliaments of EU Member States' reaction to 2011 CCCTB Directive, see Szudoczky (n 28) 125. As Szudoczky analyzes, the 13 negative reasoned opinions submitted by parliaments of the Member States, have the common pattern: these reasoned opinions are formulated as being more similar to discuss the proportionality of the element of consolidation of CCCTB Directive Proposal, instead of arguing the two tests indicated in the impact assessment. Member States are arguing the same objectives, including eliminating compliance costs from national tax law disparities and lowering high transfer-pricing costs, should be achieved in a less intrusive way for Member States.
30. All the reasoned opinion written in English submitted by national parliaments are archived at European Parliament's official legislative observatory website, under the procedure file number 2016/0336(CNS), search from <http://www.europarl.europa.eu/oeil/home/home.do> accessed 13 September 2018. <http://www.europarl.europa.eu/oeil/popups/ficheprocedure.do?lang=en&reference=2016/0336(SLP)#tab-0> accessed 9 December 2018. The Dutch parliament's reasoned opinion has included some positive thoughts, from the party PvDA, on the CCCTB.
31. It is worth noticing that, while several national parliaments submit reasoned opinion expressing their concerns about CCTB/CCCTB, there are other Member States submitting positive opinion contributions, including Austria, House of Commons in UK, etc. More specifically, the opinion from Austria parliament is archived at <http://www.europarl.europa.eu/RegData/docs_autres_institutions/parlements_nationaux/com/2016/0683/AT_BUNDESRAT_CONT1-COM(2016)0683_EN.pdf> and the opinion from House of Commons in UK is archived at <http://www.europarl.europa.eu/RegData/docs_autres_institutions/parlements_nationaux/com/2016/0683/UK_HOUSE-OF-COMMONS_CONT1-COM(2016)0683_EN.pdf> accessed 9 December 2018.

payers' economic activities. Multinationals will not need to deal with great disparities of Member States' tax laws, so they will not be deterred from conducting cross-border activities; their profits and losses can also be offset effectively even when they are incurred in different EU Member States. Therefore, the loss offsetting of CCCTB will make the tax law more consistent with taxpayers' economic reality.

3.2. The Source of The Problem: The Un-Harmonized Corporate Tax Rate

Despite of all the efforts to combat tax avoidance by harmonizing EU Member States corporate tax base, the embedded incentive under the CCCTB Directive Proposal to shift profits is due to un-harmonized corporate tax rates.[32] Therefore, as long as national tax rates are still different, multinationals still have the incentive to conduct tax planning to make use of the disparity in order to minimize their tax burden legally.

Adopting a consolidation system combined with the formulary apportionment, like CCCTB, is not the panacea to aggressive planning. CCCTB still faces the aggressive planning in the new form of shifting weighting factors of the formula, in order to strategically plan the apportioned share.[33] In other words, it is still possible for multinationals to shift their asset or labour factor, to change the result of applying the sharing formula, as discussed in Section 3.1 above.

Practically speaking, it is impossible to expect a harmonized or uniform tax rate at the EU level. Therefore, we need to live with such inherent and imperfect features of the system and think of feasible solutions. In Section 3.3 I will demonstrate that the CCCTB can also give rise to the Shifting-To-Losses scenario, in Section 3.4 I will further discuss the scenario of strategically apportioning the losses, also possibly to a high tax rate jurisdiction. I identify the scenario of apportioning losses under the CCCTB system as »Shifting-To-Losses 2.0«, and it can be regarded as a variation from the scenario of Shifting-To-Losses. In Section 3.5, there are explanations why Shifting-To-Losses scenarios cannot be easily solved by the general anti-avoidance rule as such.

3.3. The Losses-Offsetting Rules Under The CCCTB Provide Shifting to Pre-Entry Losses Opportunities

The rationale of loss offsetting rules under the CCCTB is actually quite simple and following a group taxation rationale. Losses and profits of all qualifying group members[34] are consolidated with each other and offset automatically.[35]

32. Preamble of 2016 CCTB and 2016 CCCTB Directive Proposal.
33. Antony Ting, »Multilateral Formulary Apportionment Model – A Reality Check« (2010) 25 Australian Tax Forum 95-136.
34. Only qualifying subsidiaries can be in the group. The requirements of the qualification of a group member are provided in Article 5 of 2016 CCTB Directive Proposal: »1. A qualifying

CCCTB does not have the retrospective effect, and therefore the pre-entry losses that are incurred before the CCCTB enters into force will still be subject to national rules or the 2016 CCTB Directive Proposal.[36] Pre-entry losses that are incurred by a company before the company joins the CCCTB group, may not be consolidated with the profits of other group members either. This is the so-called »ring-fencing effect«.[37] These two types of pre-entry losses can only be offset against its group members' apportioned share of the consolidated tax base. In other words, the CCCTB's cross-border group loss-offsetting benefit is not applicable to these pre-entry losses.

Although the pre-entry losses are ring-fenced, i.e. they cannot be offset directly against the consolidated tax base of the whole group, the ring-fencing mechanism does not eliminate tax-planning opportunities. Although not offset against consolidated tax base, the pre-entry losses can offset the apportioned share of the group member. Multinational group taxpayers can shift their weighting factors to adjust their sharing formula after they join the CCCTB group for the purpose of optimally setting off their pre-entry losses. When pre-entry losses are incurred in a relatively high tax rate jurisdiction, offsetting these losses represents reducing more tax burden.[38] There is still an incentive to shift factors to these jurisdictions

subsidiary means every immediate and lower-tier subsidiary in which the parent company holds the following rights: (a) it has a right to exercise more than 50 % of the voting rights; and (b) it has an ownership right amounting to more than 75 % of the subsidiary's capital or it owns more than 75 % of the rights giving entitlement to profit. 2. For the purpose of calculating the thresholds referred to in paragraph 1 in relation to lower-tier subsidiaries, the following rules shall be applied: (a) once the voting-right threshold is reached in respect of a subsidiary, the parent company shall be considered to hold 100 % of such rights; (b) entitlement to profit and ownership of capital shall be calculated by multiplying the interests held, directly and indirectly, in subsidiaries at each tier. Ownership rights amounting to 75 % or less held directly or indirectly by the parent company, including rights in companies resident in a third country, shall also be taken into account in the calculation«.

35. Article 7 of 2016 CCCTB Directive Proposal: »Effect of consolidation. 1. The tax bases of all members of a group shall be added together into a consolidated tax base. 2. Where the consolidated tax base is negative, the loss shall be carried forward and be set off against the next positive consolidated tax base. Where the consolidated tax base is positive, it shall be apportioned in accordance with Chapter VIII«.
36. Article 15 of 2016 CCCTB Directive Proposal: »Pre-entry losses. Unrelieved losses that have been incurred by a group member in accordance with national corporate tax law or Directive 2016/xx/EU (ie the CCTB Directive once adopted) before the rules of this Directive became applicable to that group member may be set off against the apportioned share of that group member if and to the extent that this is provided for under the national corporate tax law or Directive 2016/xx/EU«.
37. The brief introduction of the ring-fence mechanism, see Jan van de Streek, »The CCCTB Concept of Consolidation and the Rules on Entering a Group« (2012) 40 Intertax 24–32.
38. Borg also observes this: »If Member States B & C for example have higher tax rates, the losses would be more beneficial for the group if utilized in those Member States against future

to effectively utilize these pre-entry losses subject to a high tax rate. The taxpayers can even reduce their tax burden more than the scenario of shifting factors/profits to offset losses incurred in a relatively low tax rate jurisdiction. This scenario is exactly what De Simone et al. already observed in their empirical research, summarized in Section 2 above. In other words, even under the current CCCTB proposal, the Shifting-To-Losses scenario can also exist.

The ring-fencing mechanism cannot prevent the Shifting-To-Losses scenario. It is because the scenario of shifting weighting factors from its appearance just looks like the normal operation of formulary apportionment. The ring-fence mechanism will not influence this result. Unless there are further indications of abuse of law or shifting factors mainly for the purpose of avoiding tax, such a scenario is presumed to be legitimate. The ring-fencing mechanism is actually toothless to combat a Shifting-To-Losses scenario.

3.4. Shifting-To-Losses 2.0: Apportioning The Consolidated Losses Strategically

It is not only the pre-entry losses that can be offset strategically, but also the consolidated losses. Such »Shifting-To-Losses 2.0« can take place under the CCCTB in two circumstances: upon group termination and upon business reorganization, when the consolidation losses can be apportioned.

3.4.1. Apportionment of Consolidated Losses upon Group Termination

According to Article 16[39] of the 2016 CCCTB Directive Proposal, when a group terminates, the losses incurred by the consolidated group, will be apportioned according to the single final year of the sharing formula of the group. Therefore, multinationals can use this strategy to shift their weighting factors, to design a preferable formula for apportioning their consolidated losses.

As to group termination, Article 18 provides the rules for these apportioned losses.[40] Upon group termination, there might be three types of situations that need addressing:

taxable profits there«. See Jeanette Calleja Borg, »The Tax Treatment of Losses under the Proposed Common Consolidated Corporate Tax Base Directive« (2013) 41 Intertax 581–87.

39. Article 16 of 2016 CCCTB Directive Proposal: »Termination of a group. The tax year of a group shall end when the group is dissolved. The consolidated tax base and any unrelieved losses of the group shall be allocated to each group member in accordance with Chapter VIII, on the basis of the values of the apportionment factors in the tax year of termination«.
40. Article 18 of 2016 CCCTB Directive Proposal: »Losses after the group terminates. Following termination of a group, losses of that group shall be treated as follows: (a) the losses of a taxpayer who opts for applying the rules of Directive 2016/xx/EU shall be carried forward and be set off in accordance with Article 41 of that Directive; (b) the losses of a taxpayer joining another group shall be carried forward and be set off against the relevant group member's

(1) When the group member still opts into the CCTB system, then the relevant quantitative restrictions of CCTB will apply.[41]
(2) When the group member joins another group, the apportioned losses will be carried forward but also ring-fenced as the pre-entry losses in the new group. All restrictions under the CCCTB will also apply.
(3) When the group member returns to the national tax law regime, these apportioned losses will be subject to the national tax law, as if these losses had incurred under that national tax law.

In each situation, there are tax-planning opportunities existing. It can be imagined that, tax payers might tend to apportion losses to group members in the high tax rate jurisdiction or the group members which will still be subject to the CCCTB, since the indefinite carry forward period of the CCCTB is much more favorable than most national tax laws.

3.4.2. Apportionment of Consolidated Losses upon Business Re-organization

In case of business re-organization between two or more groups, the CCCTB Directive Proposal provides special rules for loss offsetting. It is provided in Article 23[42] of 2016 CCCTB Directive Proposal.[43] As the main rule, when there are two or more CCCTB groups merging or conducting share sales or share exchange and

apportioned share, subject to the restrictions of Article 41(3) of Directive 2016/xx/EU; (c) the losses of a taxpayer returning to national corporate tax law shall be carried forward and be set off in accordance with the national corporate tax law becoming applicable, as if those losses had arisen while the taxpayer was subject to that law«.

41. See Section 3.5.1 of this paper.
42. Article 23 of 2016 CCCTB Directive Proposal: »Treatment of losses where a business reorganization takes place between two or more groups. 1. Where, as a result of a business reorganization, one or more groups, or two or more group members, become part of another group, any unrelieved losses of the previously existing group or groups *shall be allocated to each of the group members* in accordance with Chapter VIII and on the basis of the factors as they stand at the end of *the tax year in which the business reorganization takes place*. Unrelieved losses of the previously existing group or groups shall be carried forward for future years. Where two or more group members become part of another group, no unrelieved losses of the first group shall be allocated as referred to in subparagraph 1, provided that the joint value of the asset and labor factors of the departing group members amounts to less than 20 % of the value of these two factors for the entire first group. 2. Where two or more principal taxpayers merge within the meaning of points (i) and (ii) of Article 2(a) of Council Directive 2009/133/EC, any unrelieved losses of a group shall be allocated to its members in accordance with Chapter VIII, on the basis of the factors as they stand at the end of the tax year in which the merger takes place. Unrelieved losses shall be carried forward for future years«. (emphasis added).
43. It should be clarified that in case that business reorganization takes place between group members within a group (which is regulated by Article 22 of 2016 CCCTB Directive), in principle it should not give rise to any profits or losses, and therefore an intra-group business reorganization is regarded as fiscally non-existent, not in the scope of this section.

making one whole group or some group members of one group affiliate to another group, this is a type of business reorganization between groups. In such cases, the unrelieved losses of these groups will be apportioned according to each group's formula of the year of business re-organization. This rule of apportionment also applies to the situation when two or more principal taxpayers merge. From the perspective of the new big group after the merger, these apportioned losses become each group member's pre-consolidated losses.

The second part of Article 23(1) of the 2016 CCCTB provides the exception to the main rule of business reorganization. When there are two or more departing members, the joint value of the asset and labor factors only involve less than 20% of the value of these two factors for their original group, the departing members cannot take away their share of consolidated losses. In other words, when two or more members depart, where the asset and labor factors merely represent less than 20 % of the value of the original group, the legal effect is the same as the leaving rule, i.e. consolidated losses will stay at the original group.

Where two or more group members become part of another group, no unrelieved losses of the first group shall be allocated as referred to in subparagraph 1, provided that the joint value of the asset and labor factors of the departing group members amounts to less than 20% of the value of these two factors for the entire first group.

3.4.3. The Strategy of Combing The Group Member Leaving Rule

As indicated above, loss-offsetting under the CCCTB follows the consolidation method. Losses incurred during the consolidated group period, can be offset against profits from other group members. When one loss-making group member leaves the group, the leaving member may not take its losses incurred in the consolidated group period away at all. Following the same rationale, Article 21 of 2016 CCCTB Directive Proposal clearly provides this: »*No losses shall be attributed to a group member leaving a group*«. Article 21 demonstrates that CCCTB emphasizes group thinking: losses incurred at the group level should »stay« at the group.

When the leaving rule is combined with the business reorganization rule, a manipulation scenario immediately arises: when two CCCTB groups (A and B) aim to conduct transactions to achieve business re-organization. For example Group A purchasing 100% of the shares of three group members (b1, b2, b3) from Group B, they can choose to first let go of one group member (b1) and let all the consolidated losses incurred by this group member, »stay« in the group. Following this, Group B can let go of the other two group members later. The consequence of letting go one group member first is obvious; the consolidated losses will *not* be apportioned to the first leaving member (b1), and will stay at the group and be apportioned to all the remaining members of Group B, based on the formula of the year of letting go the second two group members (b2 and b3).

By combining the leaving rule under the CCCTB Directive Proposal, two groups can achieve the effect of »concentrating losses« to specific jurisdictions while they conduct business re-organization. Taxpayers can concentrate the losses and then apportion their consolidated losses strategically. They may apportion part of the consolidated losses to high tax rate jurisdictions too. EU legislators are not aware of such a planning opportunity.

3.5. What The Current CC(C) TB Directive Proposals Have Combated and Have Not

3.5.1. Article 41 and Article 42 of 2016 CCTB Directive Proposal: The Scenario of Purchasing Loss-Making Companies to Join The Group Is Addressed

It should be clarified that the EU legislators are not completely ignorant with the aggressive tax planning regarding the corporate losses when they were drafting the 2016 CCTB Directive Proposal. Article 42 of the 2016 CCTB Directive Proposal provides a common tax base, and further provides a temporary and cross-border loss-offsetting mechanism with recapture that is applicable between taxpayer companies and their »foreign permanent establishments situated in other EU Member States and qualifying subsidiaries«.[44] The re-capture for loss offsetting means that such a loss-offsetting mechanism is merely temporary, because the amount of deduction will be recaptured, provided that a loss-making subsidiary or permanent establishment (PE) makes no profits after five years since the year of loss offsetting.[45] Although the 2016 CCTB Directive Proposal is not a consolida-

44. Regarding the loss relief of the 2016 CCTB Directive Proposal, see Bruno da Silva, »Cross-Border Loss Relief under the Proposed CCTB Directive« in Dennis Weber and Jan van de Streek (eds), *The EU Common Consolidated Corporate Tax Base: Critical Analysis* (Wolters Kluwer 2017).
45. Article 42 of CCTB Directive Proposal: »Loss relief and recapture. 1. A resident taxpayer that is still profitable after having deducted its own losses pursuant to Article 41 may additionally deduct losses incurred, in the same tax year, by its immediate qualifying subsidiaries, as referred to in Article 3(1), or by permanent establishment(s) situated in other Member States. This loss relief shall be given for a limited period of time in accordance with paragraphs 3 and 4 of this Article. 2. The deduction shall be in proportion to the holding of the resident taxpayer in its qualifying subsidiaries as referred to in Article 3(1) and full for permanent establishments. In no case shall the reduction of the tax base of the resident taxpayer result in a negative amount. 3. The resident taxpayer shall add back to its tax base, up to the amount previously deducted as a loss, any subsequent profits made by its qualifying subsidiaries as referred to in Article 3(1) or by its permanent establishments. 4. Losses deducted pursuant to paragraphs 1 and 2 shall automatically be reincorporated into the tax base of the resident taxpayer in any of the following circumstances: (a) where, at the end of the fifth tax year after the losses became deductible, no profit has been reincorporated or the reincorporated profits do not correspond to the full amount of losses deducted; (b) where the qualifying subsidiary as referred to in Article 3(1) is sold, wound up or transformed into a permanent establishment; (c) where the permanent establishment is sold, wound up or transformed into

tion system, its loss-offsetting mechanism makes it possible to conduct (1) cross-border loss-offsetting between a resident taxpayer and its PE of another EU Member State; (2) loss-offsetting between a resident taxpayer's domestic and EU-based qualifying subsidiaries.[46]

In addition to the recapture mechanism in Article 42, the 2016 CCTB Directive Proposal provides another restriction to loss-offsetting: Article 41 (3). Article 41(3) is designed to combat the specific scenario of »acquiring a continuously loss-making company to become a qualifying subsidiary«[47] in order to reduce the overall tax burden. The acquired loss-making company will discontinue its activities after the acquisition. When a transaction qualifies as this scenario the loss off-setting, under CCTB, will be rejected.

Article 41(3) provides: »Losses incurred by a resident taxpayer or by a permanent establishment of a non- resident taxpayer in previous years shall not be deducted where *all of the following conditions* are met:

(a) another company acquires a participation in the taxpayer as a result of which the acquired taxpayer *becomes a qualifying subsidiary* of the acquirer as referred to in Article 3;
(b) there is a major change of activity of the acquired taxpayer, which means that the acquired taxpayer *discontinues a certain activity* which accounted for more than [60 %] of its turnover in the previous tax year or embarks on new activities which amount to more than [60 %] of its turnover in the tax year of their introduction or the following tax year«.

Article 41(3) has a specific target to combat: a taxpayer acquiring a losses-making company, to make use of the acquired losses. This is what the CCCTB Directive Proposal has combated. Since the target is specific, Article 41(3) still cannot combat the above-mentioned scenarios of a Shifting-To-Losses scenario or Shifting-To-Losses 2.0. To combat acquiring embedded losses is the traditional idea of manipulating losses and Shifting-To-Losses 2.0 falls outside of EU legislators' imagination and prediction. Article 41 (3)'s limited scope can only address the traditional loss-offsetting manipulation.

3.5.2. Article 23 of 2016 CCCTB Directive Proposal: The Scenario of Small Scale Business Re-Organization Is Addressed

The current proposed loss-offsetting rules under the CCCTB are much more favorable than national tax laws because the carry-forward period is indefinite.

a subsidiary; (d) where the parent company no longer fulfils the requirements of Article 3(1)«.

46. See Article 42 (3) of CCTB Directive Proposal, ibid.
47. Preamble of 2016 CCTB Directive Proposal, explanation of »Losses«, at p.10; Recital (12).

Although the 2016 CCTB Directive Proposal provides loss-offsetting rejection and recapture measures as discussed in 3.5.1, these rules do not apply in the CCCTB system nor the apportioned losses either.[48] In other words, the CCCTB system will face different types of loss-offsetting planning scenarios.

As indicated above, business reorganization between groups, or business reorganization involving two group members, in principle will trigger apportionment of consolidation losses. However, a single group member leaving its group will not trigger any losses apportionment to the departing member. Then here is the question: if two or more members formally leave the group at the same time, but the involved labour and assets in the original group do not change much, does such a situation also qualify as a business-reorganization and trigger the consequence of apportioning the losses? If the answer is affirmative and such a situation qualifies as a business-reorganization, it seems to be providing an easy opportunity to manipulate and trigger the business-reorganization rule by letting go of two or more group members at the same time while the changes of the group assets and labour remain very trivial.

Therefore, Article 23 of the 2016 CCCTB Directive Proposal provides the exception to the main rule of apportioning the losses. When the business organization involves two or more members leaving, but these members only change less than 20% of the whole group's assets and labour, the losses at the group level will not be apportioned. In other words, such re-organization will be regarded as the same as two or more group members just leaving separately. Therefore, a group cannot just make use of the opportunity of letting go small a percentage of labour and assets to trigger apportionment of losses. This is also what the CCCTB Directive Proposal has already combated.

3.5.3. Loopholes Regarding Apportionment of Consolidated Losses

What the CCCTB and CCTB have combated is the classical scenario of making use of built-in losses by purchasing loss-making companies into the group; therefore, the counter-measure is the re-capture mechanism. It is logical. Despite the fact that the re-capture mechanism is not applicable to the CCCTB Directive, the re-capture mechanism is not useful to combating the problem of apportioning the losses at all.

As to the problems arising from apportioning the losses, only Article 23 of 2016 CCCTB Directive Proposal can prevent triggering the apportionment. However, Article 23 of 2016 CCCTB Directive Proposal is limited only to when less

48. Article 71 of CCCTB Directive Proposal: »Loss relief and recapture. 1. Article 41 of Directive 2016/xx/EU on loss relief and recapture shall automatically *cease to apply* when this Directive comes into force. 2. Transferred losses which have not yet been recaptured when this Directive enters into force shall remain with the taxpayer to which they have been transferred«. (emphasis added).

than 20% of the whole group's assets and labour is changed in the business-reorganization. As to apportioning the losses in a normal business-reorganization or group termination, Article 23 of 2016 CCCTB Directive Proposal is not applicable, so it cannot function as a counter-measure. The losses would be apportioned, according to the formula of the year of business-reorganization. Since taxpayers can expect a business-reorganization, it is also possible to plan the formula of that year in advance.

In the case of a group shifting profits and activities to a specific jurisdiction to change its formula just in order to create a set of losses, we might argue that the general anti-avoidance rule (GAAR) of the CCCTB system might look useful. However, when the scenario is shifting activities or profits to a »high-tax rate« jurisdiction, not a low tax rate jurisdiction, it might not be so easy for tax authorities to detect this scenario, because it is unconventional and even a bit counter-intuitive. Therefore, regarding the loss-offsetting mechanism under the CCCTB Directive Proposal in the case of group termination and business re-organization, there is a loophole so that the Shifting-To-Losses 2.0 problem arises. A tailored solution is then necessary.

3.5.4. *Why the Safeguard Clause and General Anti-Avoidance Rule Cannot Solve The Problem of Shifting-To-Losses Scenarios*

It should be noted that, in the CCTB and CCCTB Directive Proposals, there are two instruments having the function of a general anti-avoidance rule. First of all, the CCTB Directive Proposal has a general anti-avoidance rule in Article 58. Second, the CCCTB Directive Proposal has a »safe-guard clause« in Article 29. Although these two provisions are formulated differently and have different origins,[49] from the perspective of tax authorities, these two articles have two similar functions and can be used for the adjustment of unfair or unreasonable results at the tax base level and the apportionment level.[50] In the 2011 CCCTB Proposal Directive, these two Articles are provided in Article 80[51] and Article 87 respectively.

49 The »safe-guard clause« is based on the formulary apportionment experiences from states in USA. See Hellerstein, Tax Planning under the CCCTB's Formulary Apportionment Provisions: The Good, The bad, and The Ugly (n 25).

50. According to Michael Lang, the GAAR in the 2011 CCCTB Directive Proposal is not used to solve the disputes derived from the formulary apportionment. See Michael Lang, »European Union – The General Anti-Abuse Rule of Article 80 of the Draft Proposal for a Council Directive on a Common Consolidated Corporate Tax Base« (2011) 51 European Taxation 223-28. Harris is very skeptical for the effectiveness of the GAAR of 2011 CCCTB Directive Proposal, see Peter Harris, »The CCCTB GAAR: a toothless tiger or Russian roulette?« in Dennis Weber (ed), *CCCTB Selected Issues* (Kluwer Law International 2012).

51. The Comparison between the GAAR in 2011 CCCTB Directive Proposal and 2016 CCCTB Directive Proposal, see Frans Vanistendael, »Tax Avoidance and the Return of CC(C)TB« in Dennis Weber and Jan van de Streek, *The EU Common Consolidated Corporate Tax Base: Critical Analysis* (Wolters Kluwer 2017).

Since 2016, the CCTB and CCCTB Directives are separate, so these two provisions are also separate. Unfortunately, these two provisions are not that useful to the strategy of playing losses. The explanations are elaborated as follows.
Article 58 of the CCTB Directive (the general anti-abuse rule) provides that,

»1. For the purposes of calculating the tax base under the rules of this Directive, a Member State shall disregard an arrangement or a series of arrangements which, having been put in place for the essential purpose of obtaining a tax advantage that defeats the object or purpose of this Directive, are not genuine, having regard to all relevant facts and circumstances. An arrangement may comprise more than one step or part.
2. For the purposes of paragraph 1, an arrangement or a series thereof shall be regarded as non-genuine to the extent that they are not put in place for valid commercial reasons that reflect economic reality.
3. Arrangements or a series thereof that are disregarded in accordance with paragraph 1 shall be treated, for the purpose of calculating the tax base, by reference to their economic substance.«

Article 29 of the CCCTB Directive (i.e. the safeguard clause) provides,

»As an exception to the rule set out in Article 28, if the principal taxpayer or a competent authority considers that the outcome of the apportionment of the consolidated tax base to a group member does not fairly *represent the extent of the business activity* of that group member, the principal taxpayer or competent authority may request the use of an alternative method for calculating the tax share of each group member. An alternative method can be used only if, following consultations among the competent authorities and, where applicable, discussions held in accordance with Articles 77 and 78, all these authorities agree to that alternative method. The Member State of the principal tax authority shall inform the Commission about the alternative method used«. (Emphasized added)

Both provisions (Article 58 of the CCTB Directive Proposal and Article 28 of the CCCTB Directive Proposal) have the similar function of addressing the tax avoidance scenarios. More specifically, Article 28 can be used to adjust the unfair apportionment results that do not fairly represent the extent of the business activity of group members. In other words, when there are »factor-shifting« scenarios, Article 28 can be adopted jointly by Member States involved. However, Article 28 only addresses the situation when the apportionment result does not match the economic activities represented by the three weighting factors. Such unfairness can take place when the scope or definition of the weighting factors are not appropriately regulated. Therefore, it would be difficult to qualify »shifting activities to a high tax rate jurisdiction« in reaction to losses-making realities, as »not fairly representing the extent of the business activity«, because the apportionment result has represented the activities. When a CCCTB taxpayer increases real economic activities in a jurisdiction, the increase of the formulary ratio of that jurisdiction would be justified, and the safe-guard clause in Article 29 of the CCCTB Directive could not be invoked.

As to the GAAR in Article 58 of the CCTB Directive proposal, it is hard to cover the Shifting-To-Losses strategy. First of all, the GAAR concept under the EU law is developed by Directives and jurisprudence of the Court of Justice of European Justice (CJEU)[52] on direct taxation,[53] VAT[54] and customs duties.[55] To invoke a GAAR is in fact quite difficult because there are several tests in a GAAR. There are two tests embedded in a GAAR, the subjective test (i.e. the taxpayer's intention) and the objective test (i.e. the economic reality).[56] The subjective test in different tax law fields is formulated differently by the CJEU.[57] Second, in a EU GAAR as such, the norm test (i.e. the purpose of the law being circumvented and

52. Literature regarding GAAR under the EU tax law is enormous. See foe example, Koen Lenaerts, »The Concept of 'Abuse of Law' in The Case Law of the European Court of Justice on Direct Taxation« (2015) 22 Maastricht Journal of European and Comparative Law 329-51; Judith Freedman, »General Anti-Avoidance Rules (GAARs) – A Key Element of Tax Systems in the Post-BEPS Tax World? The UK GAAR« (2016) WU Institute for Austrian and International Tax Law – Tax Law and Policy Series <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2769554&download=yes> accessed 10 December 2018; Pasquale Pistone, »Abuse of Law in the Context of Indirect Taxation: from (before) Emsland-Stärke to Halifax (and beyond)« in Rita De La Feria and Stefan Vogenauer (eds), *Prohibition of Abuse of Law A New General Principle of EU Law?* (Hart Publishing 2011).
53. Regarding direct taxation, the GAAR discussions arise in two occasions: to examine if a national tax law infringes EU fundamental freedoms or exploring the meaning of the GAAR of a Directive and its national implementation. The most significant case for the first type is C-196/04 *Cadbury Schweppes plc and Cadbury Schweppes Overseas Ltd v Commissioners of Inland Revenue* [2006] ECR I-07995. For an example of the second type, is case C-321/05 *Hans Markus Kofoed v Skatteministeriet* [2007] ECR I-05795 regarding Danish law implementing the Merger Directive. Opinion of Advocate General Kokott, C-115/16 *N Luxembourg 1 v Skatteministeriet* [2018] ECR I-143, discussed the Danish rules implementing the GAAR of the Royalty and Interest Directive, and Advocate General Kokott expressly follows the development in case law including C-196/04 Cadbury Schweppes plc and Cadbury Schweppes Overseas Ltd v Commissioners of Inland Revenue and C-321/05 Hans Markus Kofoed v Skatteministeriet, at AG Kokoot opinion C-115/16 N Luxembourg 1 v Skatteministeriet footnote 17. The implication of C-321/05 Hans Markus Kofoed v Skatteministeriet, see commentary by Dennis Weber, »The New Common Minimum Anti-Abuse Rule in the EU Parent-Subsidiary Directive: Background, Impact, Applicability, Purpose and Effect« (2016) 44 Intertax 98-129.
54. The most significant case C-255/02 Halifax plc, Leeds Permanent Development Services Ltd and County Wide Property Investments Ltd v Commissioners of Customs & Excise [2006] ECR I-01609; Opinion of Advocate General Poiares Maduro in Case 255/02 Halifax plc, Leeds Permanent Development Services Ltd and County Wide Property Investments Ltd v Commissioners of Customs & Excise, paras 70-71.
55. As to discussions on GAAR and customs, see C-116/12 *loannis Christodoulou and Others v Elliniko Dimosio* [2013] ECR I-825. Commentary for this case Krzysztof Lasiński-Sulecki, »Will the Court of Justice apply its anti-abuse doctrine in customs valuation cases?« (2015) 9 World Customs Journal 3-9.
56. Paolo Piantavigna, »Tax Abuse in European Union Law: A Theory« (2011) 20 EC Tax Review 134-47.
57. Rita De La Feria, »Prohibition of abuse of (Community) law: The creation of a new general principle of EC law through tax« (2008) 45 Common Market Law Review 395–441.

abused) also plays a decisive role. A tax avoidance scenario must be conducted to circumvent or qualify the effect of a norm, and thus deviates the original »purpose of the norm«.[58] Therefore, a GAAR under the EU law, would require cumulatively the subjective test, the objective test and the norm test, to negate a claimed tax avoidance. It is especially hard to qualify the norm test in a case of loss offsetting.

The purpose of the loss-offsetting mechanism is to reflect the taxpayer's ability to pay and to allow cross-border loss setting between affiliated group members. This has been seen as a powerful tool to encourage multinational tax payers to accept the CCCTB. Third, from the jurisprudence of the CJEU such as *Marks & Spencer*,[59] the Court is quite concerned that any losses turn to be final losses and are »stranded« in one Member State. Under this context, it would also be difficult to invoke the GAAR in the CCCTB Directive Proposal to restrict cross-border loss offsetting, because cross-border loss offsetting is exactly one of the main purposes pursued and encouraged by the CCCTB. Therefore, to adopt the GAAR to a loss-offsetting scenario would not be easy and would not be a feasible solution.

Furthermore, although establishing a GAAR in the national tax law systems is a well-accepted trend influenced by the BEPS project since 2013,[60] the BEPS project itself does not directly address loss-offsetting issues. As Lüdicke et al. critically indicate,[61] the whole BEPS project does not provide insightful instructions to cross-border losses offsetting issues from the very beginning. The BEPS project as a whole also has a very traditional view of profit shifting, focusing on shifting profits to relative low tax rate jurisdictions.[62] Therefore, a GAAR would not be

58. With the same rationale, Weber analyze the purpose of the norm test under the discussions on there is a »tax advantage«, see Dennis Weber, »Abuse of Law in European Tax Law: An Overview and Some Recent Trends in the Direct and Indirect Tax Case Law of the ECJ« (2013) 53 European Taxation 254.
59. Regarding the final losses argument in the case and development, there are a lot of discussions. See Paul Farmer and Alison Last, »The Marks & Spencer Group Relief Litigation: The No Possibilities Test« in Dennis Weber and Bruno Da Silva (eds), *From Marks & Spencer to X Holding The Future of Cross-Border Group Taxation* (Wolters Kluwer 2011); Michael Lang, »Has the Case Law of the ECJ on Final Losses Reached the End of the Line?« (2014) 54 European Taxation 530-40.
60. Christophe Waerzeggers and Cory Hillier, »Introducing a general anti-avoidance rule (GAAR) – Ensuring that a GAAR achieves its purpose« (2016) Tax Law IMF Technical Note 2016/1, IMF Legal Department <https://www.imf.org/external/pubs/ft/tltn/2016/tltn1601.pdf> accessed 10 December 2018.
61. Jürgen Lüdicke and others, »Cross-Border Loss Utilization« (2014) 68 Bulletin for International Taxation 376-83.
62. The tradition presumption of profit shifting to high tax rate jurisdictions, is precisely reflected by the OECD's vocabulary and definition in the BEPS project, see the brief introduction of BEPS in the official website: »Base erosion and profit shifting (BEPS) refers to tax avoidance strategies that exploit gaps and mismatches in tax rules to artificially shift profits to low or no-tax locations. Under the inclusive framework, over 100 countries and jurisdictions are col-

very useful to address any existing strategy regarding loss offsetting, not to mention the counter-intuitive strategy of Shifting-To-Losses. A GAAR or similar general rules are not as useful as expected.

Finally, it should also be noted that the above-mentioned difficulty to apply GAAR to the Shifting-To-Losses strategy does not justify such strategy under the EU law. It is true that, from the EU law perspective, the risk of unutilized losses should not become potential barriers for cross-border investments. It is also true that, increasing investments in a loss-making affiliate can be based on valid commercial reasons, such as taking into account an economic cycle or maintaining the market. Loss-making affiliates can possibly turn to profit making again after receiving intervention and assistance from other affiliates in the same group. Multinational taxpayers are free to legitimately invest for their own benefit. However, the current CCCTB Directive Proposal has already provided opportunities to apportion the losses, and the EU legislators are not aware of such opportunities because they also embrace the traditional view of »shifting profits to low tax rate jurisdictions« like the OECD's BEPS project. From a perspective of reforming EU tax law for establishing a well-functioning internal market, it would also be necessary to take actions in advance and provide appropriate countermeasures to prevent the new CCCTB system from being manipulated.

4. A Feasible Solution: Annual Quantitative Restrictions to Loss-Offsetting

In the previous Section, we have discussed the tax planning opportunities arising from the loss-offsetting rules. To effectively restrict the amount of loss being offset, a quantitative restriction would be practical and easy to administer. Such an approach is actually being discussed in the process of CCCTB development, though it is not adopted in the 2016 CCCTB Directive Proposal.

When the Council discussed the 2011 CCCTB Directive proposal, there were several restrictions suggested. In 2012, the Council presidency produced a compromise Proposal.[63] The 2012 CCCTB Compromise Proposal adopted the quantitative limitation for loss-offsetting: »In a tax year, losses carried forward may be

laborating to implement the BEPS measures and tackle BEPS.« <http://www.oecd.org/ctp/beps/> accessed 10 December 2018.

63. The 2012 compromise Proposal for a Council Directive on a Common Consolidated Corporate Tax Base (CCCTB), 8387/12 FISC 49. The commentary of the 2012 Compromise Proposal, see Jan van de Streek and Martijn Frederik Nouwen, *Comments on The Proposal for a Council Directive on a Common Consolidated Corporate Tax Base of 16 April 2012* (H&I 2012/10.1).

deducted up to a maximum of *EUR 1 million for a single taxpayer* and any exceeding loss can only be deducted up to *60 % of the remaining tax base*«.[64]

The 2012 Compromise Proposal's attempt is quite practical because it addresses the effect directly arising from loss offsetting. The 2012 Compromise Proposal has proposed two indicators in the annual quantitative limitation: the amount of losses that is allowed to be used by a single taxpayer, and the ratio of loss-offsetting from the remaining tax base, including the consolidated tax base as well as the apportioned tax base. In my view, as to the problem of Shifting-To-Losses in a relatively high tax rate, the annual quantitative limitation for loss-offsetting should include a third indicator: *the amount of losses being offset multiplied by the national statutory corporate tax rate of the jurisdiction where the losses are utilized*. This indicator will show the precise amount that a taxpayer»saves« after loss offsetting when the annual quantitative limitation for loss-offsetting includes these three indicators, the annual cap for the losses being offset by one single taxpayer, the cap for the extent of deduction from the remaining tax base, and the cap of the tax burden that is actually being saved (i.e. the taxable income which is offset by the losses, multiplied the statutory tax rate of that Member State). The third indicator can reflect the influence through the different tax rates, and thus represent another aspect different from the amount of losses and the amount of the remaining tax base.

An annual quantitative limitation is desirable, however, such quantitative limitation also requires some flexibility. Since it is a quantitative limitation at the EU law level, the European Commission should play a more active role. Such quantitative limitation for offsetting losses can be published in advance and adjusted annually or every three years by the European Commission. For taxpayers, legal certainty can be achieved because taxpayers can estimate and expect the amount of losses they are entitled to utilize. For Member States, a quantitative limitation is also very straightforward. For the European Commission itself, it can conduct thorough economic research before it publishes the quantitative limitation for losses. Although an annual quantitative limitation is still quite rough, such an annual ratio can be adjusted to fulfill the practical situation every year. A quantitative limitation announced by the European Commission is also easy to administer and apply for tax authorities of EU Member States. Such measure would lead to a win-win situation for all stakeholders: European Union, Member States and taxpayers.

There is indeed a concern for adopting such annual quantitative limitation for offsetting losses under the CCCTB, that such limitation might be contrary to the fundamental »ability to pay principle«, because it directly restricts the amount of loss-offsetting. Such concern might not be convincing. In most national tax sys-

64. ibid, Article 43 (2) of the 2012 CCCTB Compromise Proposal.

tems, loss-offsetting rules are not unlimited. It is quite often to set time limitations for loss offsetting, such as the carry-forward period or carry-back period.[65] The fundamental rationale of allowing loss offsetting in the tax law, is to reflect the real ability to pay and the economic reality of a taxpayer who must file the tax return according to the tax year. Deciding the tax base according to a tax year is an »artificial« division of economic activities, a type of legal fiction, since economic activities are continuous in real life. To set an annual quantitative limitation for offsetting losses under the CCCTB is not to completely abolish the loss-offsetting possibility, but merely mitigate the immediate consequences of strategy of offsetting-to-losses in a relatively high tax rate jurisdiction. As long as the CCCTB still allows a long enough carry-forward period, an annual quantitative limitation would not infringe the ability to pay principle. It is true that, such quantitative limitation would slow down the loss offsetting and thus there is a worry that there will be more unutilized losses for a longer time, and unutilized losses would face the risk of becoming the »final« losses. However, we should bear in mind that, via consolidation or group loss relief mechanisms, the CCTB and CCCTB already provide very favorable loss-offsetting rules. An annual quantitative limitation would be necessary to ensure the apportionment rule not being used to facilitate loss offsetting »too soon« and »too much«.

5. Conclusion

Corporate losses can play a role in multinationals' tax planning scenarios because the process offsetting corporate losses has the same effect of making part of income subject to the zero tax rate. To utilize losses incurred from a relative high tax rate jurisdiction, can *de facto* make more taxable income subject to the zero tax rate because the not-yet-offset taxable income in a relative high tax rate jurisdiction will result in a heavier tax burden than these in a relatively low tax rate jurisdiction. Theoretically speaking, there is an incentive to shift profits to a high tax rate jurisdiction in order to let losses incurred in this relative high tax rate jurisdiction be offset.

Empirical evidence shows that losses incurred in a high tax rate jurisdiction can also be an incentive for multinational taxpayers to shift profits to that jurisdiction. Such scenarios of Shifting-To-Losses can also take place under the proposed CCCTB Directive Proposal under EU law according to its current text and the EU legislators do not seem to be quite aware of this problem. Both pre-entry and consolidated losses can be manipulated under the *Shifting-To-Losses* scenario. The traditional ring-fencing mechanism for pre-entry losses in the consolidation tax

65. See Spengel and York (n 15) 81-84.

system unfortunately does not help to combat such a scenario. Furthermore, the formulary apportionment system under the CCCTB Directive Proposal allows the scenario Shifting-To-Losses 2.0. The Shifting-To-Losses 2.0 scenario makes it possible to shift part of consolidated losses to the jurisdiction other than where they are incurred, including a relatively high tax rate jurisdiction by the CCCTB sharing formula. In a world where tax rates of different jurisdictions will never be harmonized, Shifting-To-Losses scenarios reflect another aspect of the BEPS problem. For implementing the CCCTB Directive in the EU, a feasible and practical solution would be adopting an annual quantitative restriction to loss offsetting, so tax authorities of Member States have to monitor the loss offsetting closely. At the same time, taxpayers also enjoy legal certainty to a greater extent and it could result in a win-win situation while addressing the problem.