IFA Congress Berlin 2021

Subject 1:
Group approach and separate entity approach in domestic and international tax law

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Nowadays, most businesses are organised as groups of companies. This holds true not only for MNEs, but also for most SMEs. Commercial law reflects this economic reality by requiring companies to prepare consolidated group accounts as well as stand-alone financial statements.

In contrast, the starting point for corporate income taxation is the taxation of each individual corporation (separate entity approach), irrespective of whether it is part of an affiliated group or not. Accordingly, intra-group dealings trigger taxable income, profits and losses of group companies cannot be consolidated and profit transfers to shareholders are taxable, leading to economic double taxation, which may only be mitigated by dividend relief.

Furthermore, entities situated in one territory are outside of the tax jurisdiction of other territories. This allows not only for a deferral of taxation in the parent company's jurisdiction until the repatriation of the subsidiary's profits, but also establishes the separate taxation of entities as one the central principles affecting the allocation of taxing rights. Thus, for over 100 years, separate entity accounting and the arm's length principle have been the corner stone of the international approach to intercompany payments for tax purposes. Transfer pricing rules aim both to establish a tax base similar to the one of a stand-alone taxpayer and to prevent the shifting of profits. Similarly, the rules on the attribution of profits to permanent establishments are directed towards the separate allocation of taxable profits. Under the AOA the permanent establishment is treated as a functionally separate entity, aligning the allocation of profits between the head office and its permanent establishments with the determination of transfer prices between associated entities.

However, the long-standing separate entity approach has become more blurred in recent times. One can observe an increasing number of areas in which tax law provides for special rules that take into account the specific relationship of a company to its subsidiaries, parent company or other group members. Group taxation rules deviate from the fundamental principle of taxing each corporation on a stand-alone basis. Change of control rules do the same.

Furthermore, being a member of a controlled group is often the starting point for the application of special anti-tax avoidance regimes such as thin cap rules. However, intra-group transactions sometimes enjoy tax privileges, beyond specific group taxation regimes, such as the group escape clauses embedded into special anti-avoidance provisions.

The purpose of these regimes and rules is manifold.

- Special rules for groups can reflect the economic reality of a unitary business;
- Group and/or control can lead to tax planning and an absence of opposing interests between independent entities can call for special anti-avoidance control;
- Application of certain rules only to groups can reflect considerations of the feasibility and enforceability of tax rules as information is available only to group members.

Further deviations can be observed when applying the separate entity approach in a cross-border context. Traditionally, CFC-rules are piercing the corporate veil in one way or the other. Normally, they apply only in cases of a controlling or substantial shareholding. In addition, other BEPS measures of the 2015 BEPS package focus on groups and/or contain certain group thresholds. Even though BEPS actions 8-10 on transfer pricing still adhere to the principle of separate entity accounting, the ongoing action 1 debate on the tax challenges arising from the digitalisation of the economy explores new concepts of an allocation of group profits. The 2019 OECD global anti-base erosion (GloBE) proposal goes even further by analysing a general income inclusion rule in the country of residence as well as a tax on base erosion payments in the source country. Both components of this twin-track proposal call into question the separate entity approach.

Not only material tax provisions, but also procedural rules take into account the specific circumstances of groups of companies. Furthermore, the complexity of international SMEs and MNEs, regularly organized as a group of companies, is reflected more and more in specific entity-overarching administrative procedures, such as international joint tax audits and other forms of international co-operation between tax administrations, e.g. CbCR reporting.

Against this background, it can be expected that we are going to see more and more tax rules that deviate from the principle of taxing each corporation on a stand-alone basis. Any tax system should strive for a fair and balanced approach with a mix of (in principle) contradictory rules. It is about time to discuss both the current systems for the taxation of entities and groups of companies and the potential future developments in this area.

Prior IFA work on related topics

Single aspects of the subject have been addressed in prior IFA congresses, especially specific regimes of group taxation (Vienna 2004), and taxation of foreign passive income for groups of companies (Copenhagen 2013). However, particularly with regard to the latter, considerable legislative activity has taken place in recent years, as a result of OECD BEPS action 3 and Art. 7, 8 ATAD. A group approach is also core to the still prevailing OECD action 1 debate on the Tax Challenges Arising from the Digitalisation of the Economy; this is true for the new profit allocation rules as well as for the rules on income inclusion and base erosion payments.

Structure of the Report

The main objective of subject 1/2021 is to gain a systematic understanding of where, for what purpose and with what legal consequences there have been deviations from the separate entity approach.

National reporters are requested to describe in

Part 1 the general structure of their domestic tax system in terms of the separate entity approach vs. the group approach. What defines a separate entity for tax purposes? Are there any overriding principles, which restrict deviations from the general rule of taxing the single entity? Apart from gathering information on special group taxation regimes it should be established which tax systems distinguish between stand-alone corporations and corporations belonging to a group. The questionnaire will not be limited to (corporate) income taxation, but will also cover local and regional business taxes and other taxes such as DPT or national digital service taxes.

Part 2 should address which specific problems arise when applying the separate entity or the group approach in an international context. This includes, firstly, the question to what extent the tax system and the double tax treaty network follow the separate entity approach and whether the international allocation of profits is based, at least partly, on a group or on a (functionally) separate entity approach. Furthermore, limitations, when taxing on a group approach internationally, should be examined. The existence and functioning of CFC regimes, and other elements of formulary apportionment, should be considered as well. Finally, we request information about how other anti-BEPS measures (like anti-hybrids rules, interest/royalty capping rules, conditioned withholding taxes) are applied towards transactions within a group of companies.