

EU Proposal to Revive the CCCTB: Areas of Concern

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Does the EU's new CCTB require significant development in the accounting that underpins taxation? This article considers the issues.

The leak of the European Union's ("EU") proposal for the revival of the Common Consolidated Corporate Tax Base ("CCCTB") has attracted much attention, not least because it embraces the idea of an interim step towards the ultimate, consolidated goal, of creating a Common Corporate Tax Base ("CCTB") in which the consolidation process does not take place.

The CCCTB has always been a proposal for a unitary taxation base to cover all the Member States of the EU in which (broadly speaking) a multinational corporation ("MNC") trading in more than one Member State with turnover of more than 750 million euros per annum would be required to submit a single tax return to just one country. That tax return would adjust the European profits as declared by the MNC for accounting purposes in accordance with a commonly agreed series of non-taxable revenues and disallowable expenses (the job of the CCTB being to define just what these adjustments might be). Then, when the CCCTB is introduced the resulting CCTB calculated figure will be subject to an apportionment between Members States based on where the sales, employees and capital base of the MNC are located.

Candidly, much of what is being introduced looks like the last CCCTB iteration from 2011. Much will be made of the addition of an R&D super deduction to replace patent box arrangements as well as allowances on equity to compensate for current biases towards debt within the corporation tax system and the building in of interest rate caps and other Anti-Tax Avoidance Directive proposals into the CCCTB (including the revival of switch over rules), but for those casting a critical eye over the proposal none of these issues are where the real interest lies.

Areas of Concern

There are, in fact, several areas of much bigger real concern about the CCCTB, some of which were addressed by Prem Sikka and me in a 2015 research paper, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2633997. *These are all, I suggest, of greater significance.*

First, it has to be remembered that the CCCTB does not solve the problems of transfer mispricing: it simply seeks to address it within the EU. There remains a water's edge problem as a result where all the illogicalities and inconsistencies inherent in the OECD model of international taxation remain. This is an EU solution as a result, but no more.

Second, this is a perverse EU solution, especially as it includes the word "consolidated" in its title since it is not based on consolidated accounts. This is because the CCCTB tax base is not based upon tax adjustment of the consolidated financial statements of an MNC to which the tax rules will apply and from which non-EU transactions will be eliminated. It will instead require that the accounts of each of the separate entities that make up the group which are themselves either resident in or have permanent establishments in the EU be adjusted in accordance with the rules laid down in the new CCTB and then have their results aggregated to create a CCCTB tax base. This, it must be stressed, is not a consolidation process in an accounting sense, but something quite different.

Third, this creates a serious problem for the CCCTB. For the tax base on which it is to be prepared to be meaningful there must be a consistent accounting base in use within the group in question. This assumption is critical if equality of treatment in taxation is to be ensured and tax arbitrage is not to be replaced with accounting arbitrage. Unfortunately, the EU does not have that consistent accounting base. At the highest level, International Financial Reporting Standards ("IFRS") do not mandate a capital maintenance concept to be used by companies in the estimation of their profits, and so can produce widely differing results when applied in different ways, whilst there is no requirement that a group use IFRS in all subsidiaries, and many do not. The alternative generally accepted accounting principles ("GAAP") available in the EU offer substantial differences in the recognition and valuation of critical revenues and expenses, e.g., in long-term contracting and transactions requiring mark to market approximations. The consequence is that there may be double or non-taxation of some transactions depending on the various GAAPs a group may use in the calculation of its CCCTB tax base even if it applies the CCTB consistently, and this has to be unacceptable in any new tax system for the abuse it may permit.

Fourth, whilst the CCCTB formula suggested may well be appropriate for

many uses it is not a panacea. Labor is, admittedly, appropriately weighted by both headcount and cost, but sales are by destination only (which is open to as much potential abuse as a source only model would be, suggesting a split is required in this area), and whilst the asset base makes sense in some sectors the failure to take into consideration the formula requirements of the extractive industries (where a weighting for degradation of natural resources is required for the state where it occurs) and for financial services (where a labor-only base may be the only possible answer) is surprising.

In addition, and fifth, the CCCTB is ambiguous on whether turnover is to be that recorded for accounting or a broader definition (as might be appropriate in some sectors) that would include financial revenues and trading gains that might be important in some cases. This is to be settled by whether the latter arise in the normal course of business, which is far too ambiguous a definition to be useful, especially as this may vary from company to company within a CCCTB group.

Sixth, the destination basis for sales seems to give no clue as to how exports are to be treated. It does not say that the part of turnover attributable to them is to be ignored, but nor does it explicitly say to where they are to be allocated for apportionment within the EU. Are they really covered by their last known location within the EU provision (which might be a port, in transit)? If not, what treatment is proposed?

Uncertainty Within the Proposals

All of these issues (and more) leave open serious uncertainty within these proposals. Some of these simply require enhanced definitions, but many are related to accounting. If differing GAAPs allowing differing accounting treatments exist in the EU it has to be asked whether or not a viable CCCTB can really be created even if a CCTB is possible. And if IFRS allows different capital maintenance concepts and so varying income recognition bases then its relevance for taxation has also to be questioned.

In addition, the obvious need for country-specific data to which the CCCTB gives rise raises questions on the adequacy of the OECD based country-by-country reporting template. This does not, for example, provide the labor or fixed asset details that the CCCTB requires, and it would seem necessary that considerable extra information on non-sales turnover will, as a minimum, be necessary on a country basis in future. How a measure for resource depletion can be added for the extractive industries needs also to be resolved in accounting terms.

What this suggests is that whilst there are accounting aspects of the CCCTB that make a lot of sense, including its suggestion that it is not a tax on profit but is instead a charge on a specific transaction subset of all those items included in accounts, there is still a lot of accounting development required before a CCTB or CCCTB can work.

This, though, is in itself a worrying suggestion. The International Financial Reporting Standards Foundation has been adamant in its stance that its accounts are not a suitable basis for taxation (and given that no-one has yet worked out the taxation implications of the consolidation journals required for their preparation they well be right) but in that case who is going to ensure that relevant, reliable, consistent and comparable accounting data suitable as a basis for taxation is available?

I have argued for some time that there is a need for tax reporting standards that might address the creation of such data for both tax authority and public consumption. I think the European Commission needs to take this issue on as a matter of priority now if it is to really achieve its taxation goals. If it does not then all we face is a shift in the location of tax arbitrage into the accounting arena, and that is something no one but the accountancy profession needs.