Federation of German Industries - 11053 Berlin, Germany

Taxation and Fiscal Policy

Dr. Gabriele Rautenstrauch
Via Email

Date
6 June 2008

Dear Ms. Rautenstrauch,

We would like to thank the European Commission for giving us the opportunity to comment on the working document regarding the possible integration of anti-abuse rules into the framework of a Common Consolidated Corporate Tax Base (CCCTB/WP065). Please find our comments as well as our answers to the questions in the aforementioned working paper below.

General remarks

Regarding the introduction of anti-abuse measures into the CCCTB-framework, we would like to point out that it is essential for any measure to be compatible with the EU-Treaty, in particular considering the jurisdiction of the European Court of Justice (ECJ). Any anti-abuse rule must become applicable only in case of wholly artificial arrangements. Beyond that it has to be ensured that businesses are not punished for taking advantage of the fiscally best construction as long as the business is actually established in another Member State (MS) and also carries out a genuine economic activity in that MS. In particular, the ECJ has established that the following points do not constitute justifications for the infringement of the right to establishment in another MS:

- it must be accepted that there is competition between the tax regimes of the various Member States[1],
- the MS of establishment is a low tax country[2],
- the intention of doing business in the other MS is (also) due to a possible reduction in taxation[3].

Thus, we would like to urge the European Commission to not randomly integrate certain national measures into the CCCTB-framework without prior

[1] Opinion Cadbury Schweppes, C-196/04, text nr. 55-60
[2] Opinion Thin Cap, C-524/04, text nr. 63
[3] Decision Cadbury Schweppes, C-196/04, text nr. 55; Decision Thin Cap, C-524/04, text nr. 74

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thorough examination of whether the given measure is compatible with the EU-Treaty.

A) Do experts think that a general anti-abuse rule should be established?

A general anti-abuse rule is not considered necessary, especially in case specific anti-abuse rules are put in place. Legal certainty can hardly be assured in practice regarding general anti-abuse rules. In addition, the fiscal authorities are oftentimes hesitant to provide up-front binding information regarding a given structure based on general anti-abuse rules, thus exacerbating legal uncertainty.

In case a general anti-abuse rule is indeed introduced, however, the European Commission should stress the fact that abusive constructions can only exist between related parties. In Germany, the general anti-abuse regulation of § 42 AO ("Abgabenordnung", German General Tax Code) also captures constructions where independent third parties happen to gain an advantage from a given construction.

B) How should a general anti-abuse clause relate to a specific anti-abuse provision? I. e. if a transaction is tested against a specific anti-abuse rule and found not to be abusive, can the same transaction be tested against the general anti-abuse rule?

Provided that a general anti-abuse rule is being introduced into the CCCTB-framework, any specific anti-abuse regulations must be "lex specialis" with regards to the general regulation. For the sake of proportionality and legal certainty, the European Commission must furthermore ensure that general anti-abuse measures are not applicable in case specific anti-abuse legislation exists and is generally applicable to a certain situation. Tax law must provide certainty in advance regarding the question of whether a certain construction will be subject to taxes or not.

C) Do experts agree on the introduction of a rule limiting the deductibility on interest to a certain threshold of EBIT or EBITDA as foreseen in paragraphs 15 to 17?

The introduction of a so called "limitation of interest deduction" regulation does not find support by the BDI, especially if the regulation is targeted to any kind of interest expense without differentiation between third party and related party debt. Such a regulation violates the principle of net taxation, especially if such a regulation was also applicable to interest payments to third parties. This is the case both for traditional thin capitalization rules as well as for limitation of interest deduction regulations based on a certain threshold of EBIT or EBITDA.

In addition, even if the regulation was only applied to related party debt, it should be applicable to purely artificial arrangements exclusively. The introduction of a safe haven can be supported for the sake of simplicity and legal certainty. However, the taxable person should always be granted the possibility of proofing the economically genuine content of a given construct. Otherwise, the regulation would not be proportionate. Therefore, a practical, unbureaucratic equity-related escape clause would be an absolute prerequisite. Otherwise, the regulation would result in a clear violation of the net principle without any justification. The regulation would be discriminating against both capital-intensive industries and corporate groups short of equity as a result of difficult years in the past, for example. Furthermore, an EBIT/EBITDA test without an escape-clause would constitute a major setback to multinational corporate groups domiciled in the CCCTB-area who are planning to expand abroad. The financing costs of expansion for which there is no alternative in a competitive business environment for purposes of maintaining and enhancing the well-being of both the European economy and its multinational corporate groups would in principle no longer be tax-deductible.

Lastly, we would like to emphasize the fact that none of the national “limitation of interest deduction” regulations in Europe thus far has been scrutinized by the ECJ. As we pointed out in our letter to the European Commission dated 11 February 2008 regarding the Communication of the European Commission regarding the application of anti-abuse measures in the area of direct taxation (COM (2007)785), it is possible that regulations such as these are not compatible with the EU-Treaty. For example, the design of the German “Zinsschranke” (§ 8a KStG, German Corporate Income Tax Code) limits the deductibility of interest payments between related parties and thus might be infringing the Interest and Royalty Directive.

Lastly, the legislation also limits the deductibility of interest paid to banks and thus might infringe the freedom of services with regard to banks.

D) Do experts agree with the switch-over rules from exemption to credit, as it is described in CCCTB/WP/057?

Generally, the introduction of a switch-over rule for third country income can be supported by the BDI. However, the design described in text number 182 of working paper CCCTB/WP/057 is too complicated. Rather than basing the test criteria on the suggested 40% of the average statutory corporate tax rate applicable in EU-MS, a fixed tax rate subject to periodic review is simpler to apply and handle. Given the generally low corporate tax rates in the European Union, the relevant tax rate for the application of the switch over rule should be set no higher than 10 %.

Furthermore, the switch over rule should not apply in case a genuine economic activity is carried out in the third country. The switch-over rule should only become applicable in case of wholly artificial arrangements.

E) Do experts agree that CFC-rules should be established for controlled entities located in low tax countries outside the EU? Should the CCCTB rules establish the possibility of applying the CFC rules inside the EU limited to wholly artificial arrangements?

The introduction of CFC rules for entities located outside the EU can be supported, subject to a number of conditions. The critical corporate tax rate for the application of the CFC-rules should not be set higher than 10 %. Also, the relevant catalogue of “tainted” income subject to CFC-regulation must not be too extensive and must furthermore become obsolete in case the income results from a genuine economic activity. As a bottom line, CFC-rules just like the above mentioned switch-over rule must only become applicable in case of wholly artificial arrangements.

Inside the EU, we do not support the introduction of a CFC-regulation into the CCCTB-framework.

F) Do experts agree with the rules to re-characterise the sales of shares as sales of assets to avoid the abuse of the consolidation rules as foreseen in the CCCTB/WP/057?

Given that the transfer of assets between companies of the same CCCTB-group are to be essentially tax exempt, the introduction of a rule to re-characterise the sale of shares as a sale of assets is understandable. In this regard, we consider the two-year period suggested in text number 109 of working paper CCCTB/WP/057 to be appropriate.

However, the re-characterization may only be applied <u>as far as</u> a particular asset has been transferred prior to the sale of shares. The re-characterization may not be applied to the sale in its entirety. In addition, it has to be proven by the tax administrations that a given asset sale taking place prior to a sale of shares has been conducted only with the intention of taking advantage of the participation exemption. If the tax payer can provide genuine economic reasons for the asset transfer, the rule should not be applicable.

The same measure subject to the same above mentioned conditions should be applied in cases where a company leaves the group (or the group terminates), but where no sale of shares takes place.

G) Do experts consider that rules to avoid the possible double deductions in 'sandwich' situations should be introduced?

The fact that these double deductions could arise, is inherent to the system of consolidation. While this admittedly might result in situations where “double dip” situations can be created, it is inappropriate to integrate a general prohibition denying deductions for bad debts with related parties. In fact, inter-company loans do not constitute an abusive structure, especially not when the receiving company is solvent at the time the loan is granted and would easily have received a similar loan by an unrelated third party. A company should not be punished afterwards by not being able to deduct a bad debt expense if the receiving company unforeseeably becomes insolvent at a later stage.

Thus, we believe that generally no abusive structures are given in these situations. No limitation of bad debt deduction should be included in the CCCTB-framework.

H) Do experts consider that there is a need to design rules to avoid the manipulation of the factors in the Formulary Apportionment?

The shift of factors in the Formulary Apportionment generally cannot be abusive in itself. As mentioned above, businesses do not act abusively by taking advantage of the fiscally best construction as long as the shift in assets gives rise to or enforces an already existing genuine economic activity in the destination MS. It is possible that businesses might try to shift activity and thus certain factors contained in the Formulary Apportionment to those EU-MS with low tax rates. This is legitimate, however, as long as the shift in factors does not only occur “on paper”.

This will also strengthen the intention of further harmonization and decrease in European corporate tax rates due to the increased beneficial tax competition between MS.

I) Do experts consider that other specific anti-abuse rules should be established?

No.

We would like to thank you again for providing the opportunity to submit our comments on this topic. Please do not hesitate to contact us in case of questions.

Kind regards

Welling Sotiriu