Comments on document CCCTB\WP\065
Common Consolidated Corporate Tax Base Working Group
– Anti-abuse rules –

Introduction

On 26 March 2008, the Commission issued a Working Paper elaborating on possible anti-abuse rules for the CCCTB. The BUSINESSEUROPE Task Force on CCCTB is grateful to have the opportunity to give some remarks on this important issue. The Task Force would like to underline that the development of any anti-abuse measures, whether aimed at intra-CCCTB transactions or transactions *vis a vis* third countries, must strictly adhere to the concept of wholly artificial arrangements and in no way conflict with *bona fide* business activities. This will be crucial for businesses' interest in opting for the CCCTB. Also, the obligations assumed in Double Tax Treaties must be respected (including the introduction of any switch-over mechanism as elaborated on below).

Given the fact that many of the final details of the CCCTB are yet to be decided on, it is only possible to provide some general remarks at this stage. The Task Force is however, happy to provide additional input once a more detailed proposal is presented. As usual, the positions taken by the Task Force may be subject to revision as other areas of the CCCTB are explored.

General remarks

One of the main objectives of allowing companies to opt for the CCCTB is to enhance the competitiveness of Europe, to promote growth and to create the possibilities for more jobs in Europe. For that purpose, the CCCTB must be a competitive regime, allowing businesses and the society at large to reap considerable benefits from simplification and reduced compliance costs.

Indeed, clearly abusive behaviours need to be addressed as they are harmful not only to the collection of tax revenue, but also as they create an unfair advantage relative to the vast majority of taxpayers that acts to comply with current tax rules. In the present working document, however, the Commission elaborates on a series of very complex rules which we fear would obstruct the carrying on of genuine business activities. Indeed, the working paper merely constitutes a summary of all plausible measures available. If some of these rules were indeed introduced in the CCCTB regime, however, they would hinder companies from carrying on sound business activities in the most efficient way to the detriment of economic efficiency at large. As a result, the costs for businesses would increase significantly, which could result in a sharp reduction of the number of businesses opting for the new tax base. This would obviously be detrimental for the establishment of a competitive CCCTB.

In terms of anti-abuse rules, we would like to underline the significance of the Communication from the European Commission on "The application of anti-abuse measures in the area of direct taxation – within the EU and in relation to third countries,[1] which was issued on December 10, 2007. The Task Force believes that any anti-abuse rules in the CCCTB must follow the principles established therein. Most notably, they must be limited to wholly artificial arrangement with a view to escaping the tax normally due. Given the approach taken in the Working Paper, however, we fear that these principles might not be fully adhered to.

[1] COM (2007) 785.

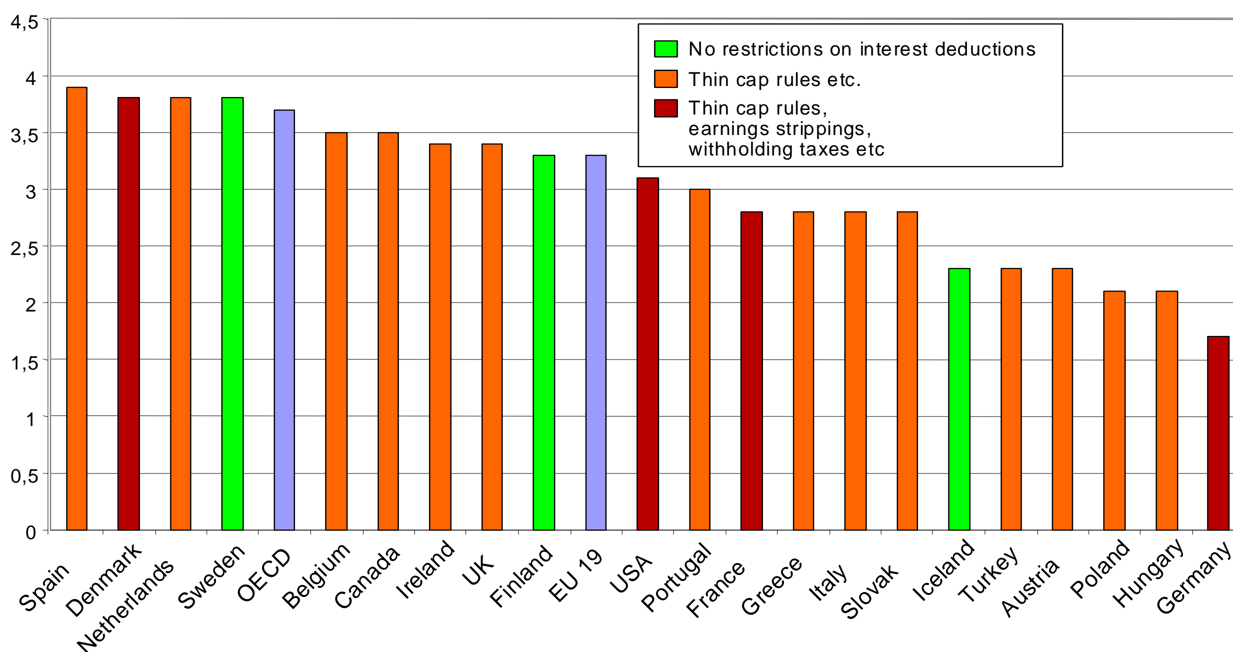
In the Communication, it is established that ”*the objective of minimising one's tax burden is in itself a valid commercial consideration as long as the arrangements entered into with a view to achieving it do not amount to artificial transfers of profits. In so far as taxpayers have not entered into abusive practices, Member States cannot hinder the exercise of the rights of freedom of movement simply because of lower levels of taxation in other MSs. This is the case even in respect of special favourable regimes in the other MSs tax systems*” [COM(2007) 785, p. 3].

The Communication further states that:

”*Short of abolishing CFC rules altogether or refraining from applying them within the EU/EEA, it is therefore necessary to ensure that the CFC rules are targeted at wholly artificial arrangements only.*” [COM(2007) 785, p. 7], and

”*In Thin Cap the ECJ acknowledged that measures to prevent thin capitalisation are not per se impermissible. Their application must however be confined to purely artificial arrangements.*” [COM(2007) 785, p. 7].

These fundamental conclusions are recognised in the introductory parts of working document WP065. However, in later sections of the paper, proper adherence to these principles seems to be considerably less emphasized and complex rules are discussed and suggested. The Task force finds that most regrettable and we would like to point out that the best way to limit the need for anti-abuse rules is to have an attractive and competitive tax system. Looking at corporate tax revenue as a percentage of GDP, it turns out that those countries having the most restrictive anti-abuse rules generally collect less in corporate tax revenues compared to other countries (see chart below).[2] This conclusion should obviously be borne closely in mind when considering the level and type of anti-abuse measures needed for CCCTB-purposes.



Sources: IBFD och OECD Revenue Statistics 1965-2006 .

[2] According to the chart, Denmark collects a sizeable amount in corporate taxes. However, the chart depicts the situation in 2005 and at that time Denmark did not impose as restrictive rules as in 2008.

Specific remarks

Before turning to some possible approaches which we believe deserves further analysis and consideration, the Task force would like to raise the following specific points.

Paragraphs 8-9. As indicated by the Commission, general anti-abuse rule are vague by nature and therefore introduces much uncertainty. This uncertainty will act to reduce investments and thus decrease the competitiveness of a CCCTB. In addition, general anti-avoidance rules face constitutional limitations and obstacles in many Member States as they essentially act to delegate taxing power to the judicial system (typically to the Administrative Courts). Given these facts, it is hard to foresee any such rule which is specific enough not to create undue uncertainty and at the same time ensure a coherent interpretation and application in the various Member States.

On this basis, we do not find it advisable to introduce such rules. The CCCTB must be based on solid and sound tax principles, which are comprehensive and exclusive thereby giving investors confidence in their investment decision as far as taxation goes.

Paragraphs 12-14. We do not see a Thin Capitalization regime as an appropriate anti-abuse measure for limiting interest deductions for CCCTB-purposes. We share the view that the justification for such rules is not found in tax principles. As will be dealt with further below, we believe that a switch-over mechanism could be considered also with respect to interest and that such an approach need to be further analysed. In this respect it should be underlined that any restriction on the deductibility of interest on loans is an infringement on the principle of net taxation.

Paragraphs 16-20 considers possible ways of violating the principle of net taxation. However, paragraph 20 states that:

"It is the Commission Services view that the preferable option could be the EBIT of EBITDA test (option A) as it is simpler to apply and is in line with the view that the traditional thin capitalization rules have not been sufficient to protect the domestic tax revenues from excessive debt financing considered to be carried out mainly for reasons of tax optimization."

The Task Force do not see the EBIT or EBITDA as an acceptable method to combat or force debt push-down transactions. Wholly artificial situations should be identified on a case by case basis and should not result in all businesses having to make calculations based on arbitrary assumptions on the appropriate level of debt or interest paid. Newly established companies tend to have high levels of debt and mechanic threshold calculations would limit investment and growth in Europe making it even harder to meet the Lisbon objectives. Should the CCCTB include an EBIT or EBITDA test, it would most likely result in a strong opposition from the business community at large to the CCCTB resulting in few companies opting for the regime.

Paragraph 22. We do not agree that the measures listed in this paragraph "*should be defined"*. The paragraph even includes discussions on a world-wide test, which is not acceptable from a business perspective. The tenor of these discussions raises considerable concern about the perceived competitiveness of the forthcoming CCCTB. Such proposed extensive anti-abuse rules, which clearly interferes with *bona fide* business considerations and goes beyond the scope of preventing wholly artificial arrangements, is not acceptable from a business perspective.

Paragraph 23. The paragraph states that in the absence of EBIT or EBITDA rules it "*seems desirable to introduce as a minimum a rule limiting the deductible amount of interest according to a fixed equity to debt ratio*". We strongly oppose to this view as it would effectively act as an infringement on the principle of net taxation in situations that are not considered to be wholly artificial.

Paragraph 28. We do not find it necessary to also introduce CFC rules and under no circumstances within the CCCTB area. Such rules tend to go beyond wholly artificial arrangements and they thereby infringe on the principle of net taxation, making European businesses less competitive in the global arena. The discussions in paragraphs 28-34 clearly demonstrates the complexity of such rules and the uncertainty they would impose.

Paragraphs 35-39. We consider the period of two years as adequate, given the need to have simple rules and to reduce tax uncertainty.

As pointed out in the Anti-Abuse Communication of December 2007, the introduction of any anti-abuse measure need to strike a proper balance between the desire to address clearly abusive behaviours and the fundamental need to avoid introducing disproportionate restrictions on cross-border activities. Given the nature of a pan-European consolidated tax base, a distinction should be made in this respect between measures aiming at intra-CCCTB transactions and measures that focuses on transactions made between a CCCTB-company and a company that operates outside the CCCTB-area.

Anti-abuse measures for intra-CCCTB transactions

Currently anti-avoidance rules are largely designed to curb two occurrences:

1. the shifting of profits (and losses) between high and low taxed jurisdictions, and
2. the use of the occasional mischaracterisation of tax objects and tax subjects occurring due to countries' lack of mutual recognition of each others tax systems (i.e. hybrids)

Many of these anti-abuse rules are not tuned to prevent abusive behaviours only, but often interfere with perfectly sound business activities. Clearly, no such rules should be implemented in the CCCTB. Even more importantly, given the fact that the CCCTB will provide for a common set of tax rules (with common definitions and classification rules) which allow for cross-border consolidation within the CCCTB area, these occurrences should not be relevant for CCCTB-purposes.

On this basis, we believe that any measures aimed at curbing abusive behaviours within the CCCTB-area should be strictly limited to prevent wholly artificial behaviours aimed at manipulating the factors of the Formulary Apportionment (FA). It is difficult to elaborate on the need and design of any such a rule until the details of the FA is finally established. As a general observation, however, we strongly believe that behaviours regarded as abusive are best prevented by introducing a solid FA-method based on factors that are difficult to manipulate.[3]

Also, and perhaps even more importantly, it is crucial that the problems currently facing both businesses and tax authorities in the area of Transfer Pricing are not re-introduced in the FA-context. As stated before, this is one of the main objectives of the CCCTB. Commercial agreements and activities, such as reorganizations, must be respected and not disregarded for

[3] For further discussion see the Task Force's Comments on document CCCTB\WP\060, p. 2.

tax purposes. No FA-abuse measure must go beyond the narrow scope of wholly artificial arrangements. Also, no such measure must allow for any kind of unilateral adjustment of the allocation of profits (or losses) according to the FA (e.g. due to the perceived misallocation of profits in a wholly artificial arrangement). Where a wholly artificial arrangement is confirmed, any adjustment must be accompanied with a concurrent counter adjustment.

Anti-abuse measures for transactions out of the CCCTB area

In paragraphs 24-25, the Commission elaborates on a switch-over mechanism as one possible anti-abuse measure.[4] Correctly designed, the Task Force believes that a switch-over rule could be a good way to address the prevailing different levels of taxation in the world without interfering too much with *bona fide* business activities. The Task Force believes that this mechanism could be designed as a sufficient regime with respect to all kinds of transactions and therefore rejects the suggestions made in the paper to introduce other additional measures.

A switch over that provides for a sound and simple threshold level together with an escape clause giving the taxpayer the opportunity to provide evidence of any commercial justification also with respect to transactions falling outside of these thresholds would advocate a reasonable level of predictability and contribute to a CCCTB that is both attractive and competitive.

We agree with the Commission's general approach presented in WP057, meaning that exemption of non-CCCTB income would be granted provided that statutory tax on the profits in the third country exceeds 40 % of the average statutory tax rate applicable in the CCCTB-Member States. Where the tax rate goes below this threshold, the profits will be taxable within the CCCTB-area subject to a credit for the foreign tax unless there is a valid commercial justification for the transaction (i.e. that it does not constitutes a wholly artificial arrangement).

To achieve the objective of preventing undue tax avoidance only, the switch-over should be designed to recognize situations where profits are received or generated in countries which meet the 40 % threshold but where the investment is made through an intermediary situated in a low tax country. Such chain should not be affected by the switch-over provision since the underlying profit exceeds 40% required level.

To provide simplicity, we strongly believe that the general threshold needs to be based on the statutory tax rates. A system based on effective tax rates or a requirement to recalculate the foreign income on the basis of the common tax base would impose an insurmountable compliance burden.

The Commission suggests that an exception should be made with respect to special regimes resulting in substantially lower levels of taxation. To ensure simplicity and predictability, any such regime must apply in exceptional cases only and should be defined using some sort of a "black list". Consideration should also be given to regimes adopted in developing countries aiming at attracting foreign investment.

With respect to the design of the credit mechanism it shall be noted that although the foreign tax generally would fall below the tax level in the country of the recipient (given the 40 % average rate level), there might be cases where the foreign tax paid traditionally would not be fully credited. This could e.g. be the case where the foreign tax, such as a withholding tax on dividends, is constructed not to hit the recipient directly, but is levied on the payor of the

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[4] With further references to CCCTB/WP/057.

distributed income. To resolve this, the switch-over should preferably be designed to allow for a credit in cases where the income indeed is subject to double taxation but where the taxes technically are levied on different group members (i.e. the payor and the payee). This would constitute a competitive feature of the CCCTB relative to many tax systems and treaties of today.

Also, to effectively prevent double taxation on a group basis, the switch-over credit should be based on an overall principle. This would advocate the principle of net taxation and minimize the risk for any outstanding double taxation. For the same reasons, to the extent the switch-over mechanism will be limited to an ordinary credit, any outstanding creditable amount should be subject to an unlimited carry forward.

As pointed out by the Commission a complicating factor is how to allocate the credit in the consolidated tax base. For this reason, and as an additional measure to mitigate any unresolved double taxation, it should always be possible to get a deduction of any outstanding foreign tax.

Aside from the design of the switch-over credit, the question remains to what extent the exemption and the switch over shall apply. In this respect at least four general categories of income need to be considered:

1. PE income (including capital gains)
2. Dividends
3. Undistributed profits generated in foreign subsidiaries (including capital gains)
4. Royalties and interest

As suggested by the Commission, **dividends** and **PE-income** originating from a third country should clearly be exempted for CCCTB purposes. Among other things, this is crucial to uphold the principle of Capital Import Neutrality (CIN). With respect to PE-income, it appears reasonable to consider a switch-over subject to the details outlined above. As for dividends, however, we do not believe that the exemption should be accompanied with such a regime.

It is a fundamental tax principle that business profits shall only be taxed once until they exit the corporate sphere. That is, business profits shall be taxed once upon earnings in the hands of the company generating the profits and then once when the profits are distributed to the ultimate owner (i.e. the individual shareholder). Any intermediary taxation of these profits as they are distributed between group members will lead to an undue double (or triple) taxation. Given this fundamental objective of preventing such double taxation, there seem to be no rationale of denying exemption of dividends to a CCCTB-company due to an underlying low level of corporate tax (or withholding tax). For the same reason we do not believe that minority shareholdings should be treated any differently than majority shareholding in this respect. Under no circumstances should the 10 % requirement (of either capital or voting rights) as established in the parent-subsidiary directive be exceeded.

Indeed, this matter is interlinked with the treatment of **undistributed profits** generated in foreign subsidiaries. The issue has been raised whether there should be any CFC-rules relative to low tax countries outside the CCCTB-area. Such a regime would essentially provide for a switch-over to current taxation of undistributed profits generated in a foreign low taxed subsidiary with a subsequent credit for the corporate tax paid in that state.

Given the merits of CIN, we believe that no CFC-rules should be introduced in the CCCTB. If this cannot be accepted, any such regime should follow the principles of the switch-over

elaborated above. Most notably, even though the tax level of the other state drops below the 40 % threshold, no CFC-taxation should be levied where there is a valid commercial justification for the establishment. In addition, not to interfere with *bona* fide business activities, the rule shall be limited to passive income only and provide for a white list to ensure sufficient predictability. Also, under no circumstances should profits that have been subject to CFC-treatment be subject to additional taxation upon distribution as this would result in an undue double taxation. Any rule that does not comply with these principles is unacceptable as it would clearly go beyond the objective of preventing abusive behaviours.

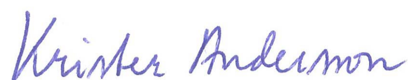
In WP057, the Commission indicates that **interest** and **royalties** paid from a third country to a company within the CCCTB-area should be taxable in the hands of the recipient. The rationale behind this is presumably that such income is considered to have its source within the CCCTB-area. Given the general principles established by the OECD, we see merits with this approach. However, it is very important that any resulting double taxation is effectively resolved. To provide for a symmetrical treatment and provide for an efficient double tax relief, the credit mechanism used in the switch-over (as suggested above) should be used also in this respect.

So far, the switch-over has only been discussed with respect to exempted income. If there are to be any limitations in the deductibility of related-party **interest expenses** we do, believe that this method could be applied also in this respect (subject to some modifications). For such expenses, the switch-over mechanism would essentially allow for full deductions in all cases where the statutory tax rate on interest in the state of the recipient exceeds 40 % of the average statutory tax rate applicable in the EU Member States. Where the tax falls below this safe haven level, the interest would still be deductible provided that the transaction does not constitutes a wholly artificial arrangement. Where this is the case, the interest expense will not be deductible under CCCTB as such. To mitigate any double taxation and promote the principle of net taxation, however, any tax paid on the related-party interest in the third country should be deductible under the CCCTB. In essence, the approach would thus provide for a switch-over from a deduction of the interest expense as such to a deduction of any foreign tax paid on the interest in the third state.

It should be stressed that the safe haven level must be based on the statutory tax rates of the third country. Given the share volume of transactions, a rule that would require the calculation of effective tax rates of each individual credit agreement of an MNE would give rise to an insurmountable compliance burden and simply be impossible to operate in practice. For reasons of simplicity, this should preferably be accompanied with a white list. In cases where the switch-over is triggered, however, the deduction would nevertheless be made on the actual tax paid in the third country.

On behalf of the BusinessEurope Task Force on CCCTB

May 16, 2008



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