AMCHAM EU
AMERICAN CHAMBER OF COMMERCE TO THE EUROPEAN UNION
SPEAKING FOR AMERICAN BUSINESS IN EUROPE

CONSULTATION RESPONSE

AmCham EU's response to the European Commission Consultation on the Internal Market: Factual Examples of Double Non-Taxation Cases

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Background and Analysis

AmCham EU welcomes the opportunity to comment on the European Commission's public 'fact-finding' consultation on the 'The internal market: factual example of double non-taxation cases', which seeks to collect 'evidence concerning double non-taxation within the EU and in relation with third countries'.

The consultation identifies a number of issues where different cases of double non-taxation could occur based on various sources including international tax literature, articles and lectures and presents a 'non-exhaustive' list of examples in a questionnaire format. However, this structure does not allow for comments on whether the examples listed present a problem or not, which makes it very difficult to respond in a meaningful way. Therefore, rather than answering the questions within the consultation document, this position paper provides broader comments on the arguments against a general prohibition of double non-taxation.

EU Member States retain extensive competences in direct tax matters and can determine the scope of their tax jurisdiction, either unilaterally or bilaterally. This allows Member States to introduce domestic rules on anti-avoidance, which we believe remains the better approach to address double non-taxation rather than a new EU-wide regime. If EU-wide restrictions were to go ahead, they would constrain normal commercial transactions and also reduce the attractiveness of Europe as a place to invest.

Existing provisions

As it currently stands, Member States can make decisions about their own tax policy and introduce provisions around non-double taxation. This allows Member States to decide whether or not – and for a variety of policy reasons – to prevent double non-taxation. The anti-arbitrage rules found in the UK are an example of how this works effectively when a Member State decides to prevent double non-taxation. The UK anti-arbitrage rules, introduced in 2005, apply to both deductions of interest and receipts, and are designed to counter artificial arrangements avoiding UK tax. The deduction rules apply to companies within the charge to corporation tax, which includes UK resident companies and the UK permanent establishments of overseas companies. Likewise, many other EU jurisdictions already have a limitation on exempt dividends derived from passive income along with limitations on deductible interest on acquisition of subsidiaries which generate tax exempt dividends. These are all relevant examples of how things can and do work at individual Member State level.

Other countries have also taken action against double non-taxation, however the consultation takes no account of this, potentially resulting in double taxation. Of particular interest to AmCham EU members is the American example; in the US, any opportunities for exploiting the differential treatment of hybrid entities or instruments have been addressed by unilateral legislation. The US Dual Consolidated Loss Rule restricts double deduction of net operating losses resulting from differences between US and foreign definition of 'corporate residence'.

Alongside domestic legislation, some Member States have double tax treaties that also address double non-taxation. This is true for example of the UK-US Double Taxation Convention (which entered into force on 31 March 2003). Article 23 is designed to counter abusive arrangements intended to enable persons who would not otherwise be entitled to the benefits of the Convention to obtain such benefits. To claim treaty benefits, a resident of a contracting state must be a 'qualified person', meaning an individual, a government-owned entity, a local pension or employee benefits fund, or a local charity. Corporations will qualify only if they satisfy one of several alternative tests, including a public trading test, an ownership-plus-base-erosion test or an active business test. This is backed up by an 'anti-hybrid' rule, which denies treaty benefits for income derived through an entity that one state treats as transparent but the other does not. Article 1 (8) states, 'An item of income, profit or gain derived through a person that is fiscally transparent under the laws of either Contracting State shall be considered to be derived by a resident of a Contracting State to the extent that the item is treated for the purposes of the taxation law of such Contracting State as the income, profit or gain of a resident'. Again we believe this is best handled at the Member State level in bilateral conventions reflecting Member States tax policy priorities.

The fact that EU Member States have adhered to their national direct tax sovereignty, makes a well-designed system of information exchange and tax collection between the Member States possible. In February 2011, the ECOFIN Council formally adopted a new Council Directive 2011/16/EU on administrative cooperation in the field of taxation and repealing Directive 77/799/EEC. Article 9 states that 'the competent authorities of each Member State may communicate, by spontaneous exchange, to the competent authorities of the other Member States any information of which they are aware and which may be useful to the competent authorities of the other Member States'.

Also at an EU level, there is anti-avoidance protection in the EU Interest & Royalty Directive and Double Tax Conventions and furthermore, the Joint International Tax Shelter Information Centre (JITSIC) offers sufficient opportunities for territories to be transparent with one another.

In addition to these developments in the EU, the Organisation for Economic Cooperation and Development (OECD) has also achieved significant progress in the area of information exchange. The OECD has developed a number of instruments that provide a legal framework for exchange of information which includes Article 26 of the Model Tax Convention, Tax Information Exchange Agreements (TIEA) – developed jointly with a number of non-member

economies – and the Multilateral Convention on Mutual Administrative Assistance in Tax Matters. The Global Forum on Transparency and Exchange of Information for Tax Purposes has been the multilateral framework within which work in the area transparency and exchange of information has been carried out by both OECD and non-OECD economies since 2000. The Global Forum's main achievements have been the development of the standards of transparency and exchange of information through the publication of the Model Agreement on Exchange of Information on Tax Purposes in 2002. In addition, the Global Forum has, since 2006, produced an annual assessment of the legal and administrative framework for transparency and exchange of information in over 80 jurisdictions.

The OECD *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* provide guidance on the application of the 'arm's length principle' for the valuation, for tax purposes, of cross-border transactions between associated enterprises. Any intercompany transactions conducted on a non-arm's length basis are already dealt with by domestic Transfer Pricing regulations which will be in line with these OECD guidelines. The need for cross-territory anti-avoidance is simply not needed alongside existing national legislation and well established OECD Guidelines that are understood by both Governments and Business as to how to operate across Member States.

EU principles of fiscal flexibility and subsidiarity

Member States have recognised their relative economic and geographic differences by reserving the right to provide, within EU anti-state aid rules and after recognising the importance of the fundamental freedoms, more or less attractive tax regimes. Their decisions are taken on the basis of what works best for their jurisdiction within its national boundaries and according to the economic and social challenges it is facing. It is thus neither surprising nor objectionable that such internally focused national tax policies may not always mesh. However, this makes it possible, to some extent, for Member States to engage in a certain degree of tax competition. They can pursue external objectives through tax measures such as the promotion of Research and Development.

So-called tax competition is thus not inherently unfair as the consultation seeks to characterise it, but an essential economic fact of life for most Member States. European Court of Justice cases, such *as Cadbury Schweppes*, *FII GLO* and the *Thin Cap GLO* all acknowledge that tax competition within Europe is an inevitable consequence under the EC treaty of Member States maintaining sovereign control of budgets and taxation policy and the fundamental freedoms. Seeking to level the playing field in some areas but not others will distort this, and potentially create uncertainty or conflict as to whether tax policy in one Member States can or should be counteracted by additional taxation in another Member State. If a Member State objects to giving a deduction for an expense when the corresponding income is not taxed elsewhere, it can address that issue in its own internal policies or rules. There is no reason to have any solution to this perceived problem that is more complicated than that.

Furthermore, the EU's free movement provisions legally support the right of companies to genuinely establish themselves in a lower-tax Member State. We support the ending of aggressive artificial tax schemes. This consultation, however, creates confusion between aggressive schemes, normal tax planning and, legitimate responses to government-enacted incentives.

EU initiatives that are aimed at creating consistency on corporate taxation in the Single Market present a real danger, and the lack of coordination between the EU and non-EU third countries with respect to the current issue may lead to a significant deterioration of European economic competitiveness in the world.

Consultation document and double non-taxation

At present, the consultation gives an extremely broad definition of double non-taxation and in doing so it fails to differentiate between such 'schemes' and legitimate tax planning by EU MNCs in Member States that choose to structure their EU operations efficiently to remain competitive. Therefore, before seeking views on double non-taxation in the form of the questions set out within the consultation, there needs to be clarity on the precise definition of double non-taxation.

As noted above, many countries place restrictions on certain (usually related-party) acquisitions of subsidiary stock, but if groups could not borrow at all in a tax efficient manner to fund an acquisition of exempt participations, then they would have to look at alternatives, e.g. asset purchases or at worst relocate to non-EU jurisdictions.

Even though the scenarios discussed in the consultation may arise because of asymmetry in tax treatment, the consultation needs to look wider than just tax and include an understanding of the associated legal and accounting analysis before concluding on the impact of targeting double non-taxation. The latter cannot be considered in isolation without understanding the interaction with other legislative systems. Further afield, the consultation seems to envisage extraterritorial effects at times, referring as it does to third countries, which would clearly extend the legislation beyond the EU (and potentially clash, as noted above, with the anti-avoidance rules of those third countries).

Conclusion

AmCham EU believes that the scope of double non-taxation in the consultation is too broad in light of the existing provisions outlined in this position paper. As it stands, this would have a significant impact on the EU's principles of fiscal flexibility and subsidiarity, further hindering legitimate business restructuring both within and outside the EU, and therefore reduce the attractiveness of Europe as a place to invest. We believe any measures against double non-taxation should be handled at the Member State level.

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AmCham EU speaks for American companies committed to Europe on trade, investment and competitiveness issues. It aims to ensure a growth-orientated business and investment climate in Europe. AmCham EU facilitates the resolution of transatlantic issues that impact business and plays a role in creating better understanding of EU and US positions on business matters. Aggregate U.S. investment in Europe totaled $2.2 trillion in 2010 and directly supports more than 4.2 million jobs in Europe.

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