May 2012

CBI COMMENTS ON EU DOUBLE NON-TAXATION CONSULTATION ON "THE INTERNAL MARKET: FACTUAL EXAMPLES OF DOUBLE NON-TAXATION CASES"

INTRODUCTION

The CBI is the UK's leading business organisation, speaking for some 240,000 businesses that together employ around a third of the private sector workforce. With offices across the UK as well as representation in Brussels, Washington, Beijing and Delhi the CBI communicates the British business voice around the world.

GENERAL COMMENTS

We welcome the opportunity to comment on the European Commission's consultation on *"The internal market: factual examples of double non-taxation cases"*, published on 29 February 2012, to gather evidence of double non-taxation within the EU and with Third Countries with the aim of identifying and developing the appropriate policy response to double non-taxation. We do have significant concerns, however, both on the substance and form of the transaction, and we set these out below.

1 Two Principal Concerns: National Sovereignty And Fiscal Flexibility

In our view the consultation seems to ignore two fundamental EU principles: national sovereignty and fiscal flexibility. There is no common tax system within the EU. Member states have deliberately reserved the right to set their own internal corporate tax policies and rules. How transactions and entities are treated and whether income or gains are taxed or not (or only in a particular way) is therefore an entirely internally focused question, and decisions are then taken solely on the basis of what works best for the jurisdiction concerned 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 (and indeed corporate law regimes) may not mesh with each other. They are not intended to, and any attempt to make them do so will simply result in further anomalies and uncertainty, not to say compliance costs, as well as offending – even putting the question of national sovereignty aside for a moment – against the key EU concept of subsidiarity.

Additionally, 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. Thus, the thrust of this project is not only damaging to the crucial direct tax concept of national sovereignty, but may also overturn a long-decided agreement on the need for fiscal flexibility (that does not contravene the four freedoms or state aid rules). It also ignores ECJ case law such as Cadbury[1], which expressly endorses the right of a company of one Member state to set up a subsidiary in another Member State to access a more favourable tax regime, provided that is a genuine economic establishment. 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 and expressly approved by the ECJ. 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 State can or should be counteracted by additional taxation in

[1] Case C-196/04 Cadbury Schweppes, 12 September 2006

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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. Given the long-agreed importance of fiscal flexibility to Member States, there is no reason to have any solution to this perceived problem that is more complicated than that.

2 Other Broad Concerns

We would mention three further broad concerns which we will address in more detail below:

- If EU-wide restrictions were to go ahead they would constrain normal commercial transactions, including further hindering legitimate business restructuring both within and outside the EU, thereby, inter alia, reducing the attractiveness of Europe as a place to invest.

- Although the consultation only covers direct taxes, the paper defines double non-taxation much more broadly than simply the use of hybrid instruments and entities which comprise true "double non-taxation". In fact the consultation seeks to include examples of territorial non-taxation (or relatively low taxation) of specific activities compared to other Member States.

- The opportunities for exploiting the differential tax treatment of hybrid entities or instruments have already been much reduced by anti-avoidance legislation – most notably in the UK – and, therefore, we believe that the subsidiarity principle has not been taken into account in this consultation.

3 The Unusual Form of the Consultation

We also have significant concerns about the form of the consultation. The questions in the consultation document seem implicitly to assume that there is a problem, and provide space only to comment on how that problem might be addressed. No balance is attempted in the document by asking whether the issue described is or is not a problem. There is no attempt to seek the alternative view as to why tax competition between Member States could be beneficial. The question is not asked as to whether there might be justifications or other mitigating factors at work in any of the various scenarios (for example, government incentives, such as patent box with regard to Issue 7, or simply a lower overall corporation tax rate with regard to Issue 5). Nor does the consultation seek views on the impact of the proposals on EU headquartered MNCs.

We find it somewhat disturbing that normal EC procedures have not been followed, and anonymous submissions have been invited. As a result, there will be no way to check the accuracy of any assertions or allegations made in such anonymous submissions. The CBI has been publicly supportive of ending aggressive, artificial tax schemes. This consultation, however, will damage that process by its confusion – perhaps especially in anonymous replies – between aggressive schemes, normal tax planning and, legitimate responses to government-enacted incentives.

We note that the consultation is a fact finding exercise inviting responses to the questionnaire enclosed with it. As noted above, we consider that the questionnaire steers only one way and also has a focus that goes well beyond what is generally understood as double non-taxation. The way it is structured makes it very difficult for us to respond positively by simply answering the questions posed. We do, however, take very seriously the Commission Services' appeals for business to participate in the consultation. Therefore, rather than responding point-by-point, we are making broader comments to present some of the arguments in favour of some of the structures described in the consultation document.

SPECIFIC COMMENTS

National Rules already in place mean a General EU Double Non-Taxation Anti-Avoidance Regime is not required

Although there are scenarios where effective double non-taxation can arise from a difference in treatment of the same item in different countries (e.g. hybrids), we believe that this should be left to national fiscal authorities to legislate. A good example of this are the avoidance through arbitrage rules[2] in the UK which require the disclosure of hybrid structures, and provide for a clearance regime. Similarly (as regards Issue 7) many EU jurisdictions already have a limitation or switchover mechanism on exempt dividends derived from passive income, along with limitations on deductible interest on acquisition of subsidiaries which generate tax exempt dividends (Issue 6). These are all relevant examples of how things do work and can work at individual Member State levels.

Furthermore, there is already existing EU anti-avoidance protection in the EU Interest & Royalty Directive and Double Tax Conventions. Additionally, the EU Code of Conduct Group, the new EU Exchange of Information Directive and JITSIC offer sufficient opportunities for territories to be transparent with one another. The new Exchange of Information Directive requires Member States to share information regarding tax rulings including with respect to PEs, and so addresses Issue 3 relating to Double Tax Conventions as highlighted in the consultation document.

Cross-territory anti-avoidance rules are simply not needed alongside the plethora of existing national legislation and well established OECD Guidelines. These rules and guidelines are well-understood by both governments and business as to how they operate across Member States. For example, intercompany transactions conducted on a non-arm's length basis are already adequately dealt with by Transfer Pricing regulations which are in line with the OECD Transfer Pricing Guidelines. We are also concerned that this could be construed as an attack on APAs, which are transparent within the EU, and which provide valuable certainty to both governments and taxpayers. Moreover, our members have hardly ever benefited from double non-taxation because of APAs.

Finally, we also think it important to note the recent ECJ decision in favour of 3M Italia SpA[3] held that there is no EU law obligation for a Member State to have anti-avoidance provisions where there is no abuse of EU law.

The Importance of Member State Freedom to set Tax Policy

The OECD has recently published a document with recommendations as to actions on international tax loopholes. It notes that a better approach to countering these situations is with specific domestic anti avoidance rules and/or rules specifically addressing hybrid mismatch arrangements rather than harmonisation. This is the only way in which problems can be addressed without interfering with the rights of Member States to set their own tax policy. As noted above, the UK already has sufficient anti-abusive measures in place.

Where there are cases of countries applying different policies and tax rates (for example where participation exemption is given to very low or nil taxed dividends), this should be left to each EU Member State to decide how to implement tax policy; to do otherwise would equate to tax harmonisation.

Tax Competition is acceptable within the EU

The consultation seems to be at odds with what has been acknowledged in the Cadbury Schweppes, FII GLO and the Thin Cap GLO[4] cases which concluded 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. If a jurisdiction has economic or geographic attributes which need to be adjusted in global competitive terms by differential tax treatment, then why should some overriding tax principle deny them that opportunity when the ECJ and Member States have decided that tax competition should continue?

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[2] F2A05/S24-31 and F2A05/SCH13

[3] Case C-417/10 3M Italia SpA, 29 March 2012

[4] Case C-446/04 FII GLO, 12 December 2006 and Case C-524/04 Thin Cap GLO, March 2007.

An Attack on the Participation Exemption?
The participation exemption for holding companies across most EU Member States seems to be under attack in the consultation in Issues 5 & 6. This is a cornerstone of the tax systems of most EU Member States so this does seem inappropriate. As noted above, many countries place restrictions on certain (usually related-party) acquisitions of subsidiary shares, 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.

Potentially Erroneous Principles Outlined in the Consultation
Notwithstanding the above view that EU double non-taxation legislation is not required, it is our view that before seeking consultation 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.

We believe the consultation should have initially focussed on engagement with stakeholders from Governments, MNCs and NGOs to agree upon a limited definition of double non-taxation in an effort to narrow the scope so that only truly egregious, artificial schemes are targeted. That is an objective that the CBI would support. However, given the extremely broad definition of double non-taxation that the consultation seems to be targeting, it fails to differentiate between such 'schemes' and genuine tax planning by EU MNCs in Member States who choose to structure their EU operations efficiently to remain competitive.

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.

CONCLUSION

In summary, if many of the situations addressed in the consultation were countered, this would significantly impact the ability of MNCs headquartered in the EU to remain globally competitive. We urge the Commission to refine and narrow the scope of this project in order to avoid damaging both European principles and European business.