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Staff working paper

The internal market: factual examples of double non-taxation cases

Consultation document

Important notice: this document is a staff working paper of D.G. Taxation and Customs for discussion and consultation purposes. It does not purport to represent or pre-judge any formal proposal of the Commission.

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PUBLIC CONSULTATION PAPER

The Internal Market:
Request for contributions on factual examples and possible ways to tackle double non-taxation cases

Note:

This document is being circulated for consultation to all interested parties. The sole purpose of this consultation is to contribute to the debate, to collect relevant information and to help the Commission develop its thinking in this area.

This document does not necessarily reflect the views of the European Commission and should not be interpreted as a commitment by the Commission to any official initiative in this area.

Each contribution received will be acknowledged.

All contributions received, including anonymous ones, will be taken into account. Your identity (personal data) and the content of your contribution will only be published on the Internet if you give your specific consent to this by indicating "Yes" in the relevant boxes in the questionnaire. For more detailed information on how your personal data and contribution will be treated, we recommend that you read the specific privacy statement on the consultation website[1].

In the interests of transparency, organisations responding to this consultation are invited to provide the public with relevant information about themselves by registering in the Interest Representative Register and by subscribing to its Code of Conduct

(see https://webgate.ec.europa.eu/transparency/regrin/welcome.do?locale=en).

If the organisation is not registered, its submission will be published separately from those of registered organisations.

[1] [link to the website for this specific consultation]

[2] For the purposes of identification, please check whether your company is a medium, small or microenterprise, according to the Commission Recommendation (2003) 361 of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises; in its annex, Title I, Article 2, SMEs are defined as

1. IDENTIFICATION OF THE STAKEHOLDER

The Commission services would be interested in receiving contributions from all interested parties on the issues described below. In order to analyse the responses, it will be useful to group the answers by type of responder.

Question -You could be included in one of the following groups[2]:

☐ ~~Multinational enterprise~~ ☐ ~~Large company~~

☐ ~~Medium small micro sized enterprise (SMEs)~~ ☐ ~~Academic~~

☐ Non-Governmental organisation (NGO) ☐ ~~Tax advisor or tax practitioner~~

☐ Others. Please specify _____

Name/denomination of your organization/entity/company: Tax Justice Netherlands on behalf of Tax Justice Network Europe

Country of domicile__Netherlands_____

Contact details, including e-mail address ___info@taxjustice.nl_____

Brief description of your activity or your sector _TJN is an independent organisation dedicated to high-level research, analysis and advocacy in the field of tax and regulation. TJN works to map, analyse and explain the role of taxation and the harmful impacts of tax evasion, tax avoidance, tax competition and tax havens. Our objective is to encourage reform at the global and national levels. Tax Justice Network Europe brings together the European members of TJN. _____

Do you agree to publication of your personal data?

Yes ☐ ~~No~~ ☐

Do you agree to have your response to the consultation published along with other responses?

Yes ☐ ~~No~~ ☐

2. Introduction

The Commission is launching this fact-finding public consultation in order to establish evidence concerning double non-taxation within the EU and in relation with Third Countries. Members of the public are encouraged to provide factual examples of cases of double non-taxation on cross-border activities that they have encountered or have knowledge of. Double

[2] For the purposes of identification, please check whether your company is a medium, small or microenterprise, according to the Commission Recommendation (2003) 361 of 6 May 2003 concerning the definition of micro, small and medium-sized enterprises; in its annex, Title I, Article 2, SMEs are defined as enterprises which employ fewer than 250 persons and which have an annual turnover not exceeding EUR 50 million, and/or an annual balance sheet total not exceeding EUR 43 million.

non-taxation cases encompass cases where there is no taxation of the activities as well as cases where the taxation is extremely low. Double non-taxation cases do not encompass cases where a company is not taxed because the activity is effectively taxed elsewhere, e.g. the exemption of dividends paid to parent companies where there is taxation of the activities in the subsidiary, or where a company is not taxed in a profitable year because of losses carried forward form previous years.

The scope of this consultation only includes cases of double non-taxation, i.e. cases where the tax rules of two countries combined lead to non-taxation. The decisions in single member states on how to tax certain types of income received by resident and/or non resident are therefore outside the scope of this consultation as direct taxation generally falls within the competence of the member states although legal measures of approximation is issued for the establishment and functioning of the internal market.

The consultation concerns taxes which companies or other entities pay directly to tax authorities (i.e. "direct taxes") such as corporate income taxes, non-resident income taxes, capital gains taxes, withholding taxes, inheritance taxes and gift taxes.

It is undesirable that in the EU Internal Market a taxpayer is subject to double non-taxation on his/her cross-border activity as this gives the taxpayer a competitive advantage compared to other taxpayers who are subject to ordinary taxation. Our aim is to obtain a better picture of the real problem and, if possible, of its financial impact. You are also invited to provide any suggestions you might have for ways in which the different cases of double non-taxation could be tackled, for instance by legislative approaches, increased information measures or good governance rules.

Legislative approaches (i.e. closing loopholes and stopping mismatches) could be done at different levels. The different levels would be unilateral legislation in the individual Member States, bilaterally between the Member States or on EU level through directives.

Increased information measures could include rules on disclosure to the tax authorities (e.g. early mandatory disclosure of certain tax planning schemes).

Good governance rules could be e.g. soft law agreements between Member States or exchange of good practices.

3. Background

International double taxation is usually defined as the imposition of comparable taxes in two or more States on the same taxpayer in respect of the same subject matter and for identical periods. Its harmful effects have been widely recognized and in particular are mentioned in the first paragraph of the OECD Model Tax Convention.

But also the opposite situation, double non-taxation, has potential harmful effects in terms of fairness of the tax systems and potential distortion of the Internal Market.

In the Annex IV to the Annual Growth Survey 2012, the Commission acknowledged that Member States have to consider revenue-raising measures. Better tax coordination at the EU-level has a role to play in this context.

Therefore, the avoidance of double non-taxation has an enhanced importance in the present Economic Crisis context.

The European Council conclusions of 24 June 2011[3] asked the Commission to ensure the avoidance of harmful practices and proposals to fight tax fraud and tax evasion.

The Commission, in the Communication on Double Taxation in the Single Market[4] stated that in a period when MS are looking for secure and additional tax revenues, it is important for their credibility towards their taxpayers that they take the necessary measures to remove double taxation and double non-taxation.

Moreover, in the Communication, the Commission announced that as regards double non-taxation, it would launch a fact-finding consultation procedure.

The Commission is presenting this consultation to the public in order to gather evidence of double non-taxation within the EU and in relation with Third Countries and of its potential impact on the Internal Market in order to identify and develop the appropriate policy response to double non-taxation.

4. Questions submitted to the public and to interested parties

We have, based on various sources including international tax literature, articles and lectures, identified a number of issues where double non-taxation could occur. These issues are briefly presented below in order to facilitate the consultation. It should however be stressed that we also invite you to describe any other double non-taxation issues (see issue 10 – Other issues?). The list of issues shall not be seen as exhaustive.

Issue 1 – Mismatches of entities

Mismatches of entities occur when entities ('hybrid entities') are treated differently for tax purposes in two jurisdictions (i.e. transparent entity in one jurisdiction and non-transparent in the other).

Assume an enterprise with a parent company in country A and a subsidiary in country B intends to finance an investment by the subsidiary in e.g. machinery or the market introduction of a product. The parent does not have sufficient funds itself so that third-party debt will be used to finance the operation. This debt financing would usually lead to one net financing cost in either country A or country B.

Use of an inserted entity that is treated as transparent in Country A, but is treated as a company in Country B (assuming such an entity can be arranged) could lead to double deduction. If the inserted entity takes up the third-party loan; Country A would give deduction against the parent company' income if Country A applies word-wide income taxation, and Country B would give deduction against the income of the subsidiary if it has some form of consolidation or group loss offset possible.

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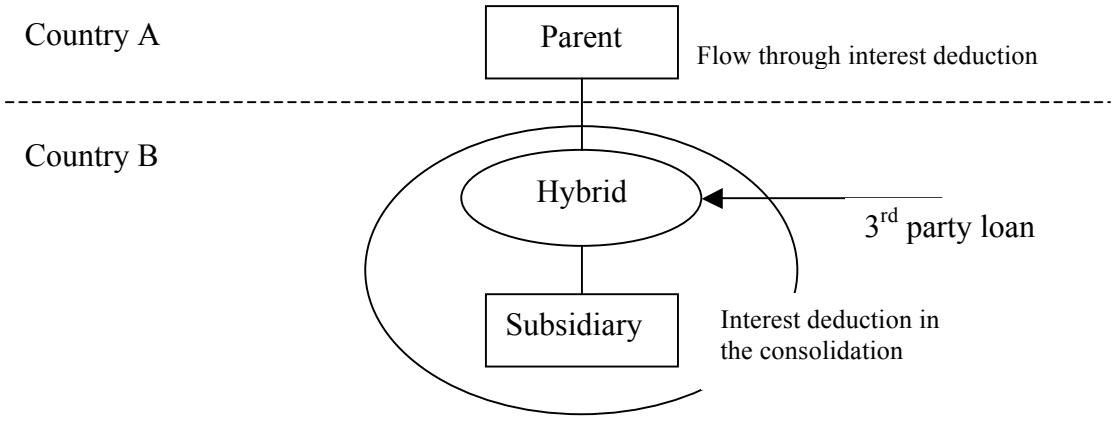
[3] http://register.consilium.europa.eu/pdf/en/11/st00/st00023.en11.pdf

[4] COM(2011)712 final



The outcome of this mismatch in entity qualification is that tax deductible expenses (in this example interest expense) can be deducted in both countries when the 'real' expense is only incurred once.

Double non-taxation can also occur if the mismatch of the hybrid entity is the reverse (i.e. the hybrid entity is seen as an entity in the country of the owners (country A), but seen as transparent by the country where the hybrid entity is located (country B)). In these cases income of the hybrid entity can be excluded from taxation in both countries. If Country A exempt income like dividends and capital gains from shares; it will not tax the income as the income is seen as income of an entity resident in country B. Country B will not tax either unless the activities in the country B qualify as a permanent establishment for the owners in country B.

Question A – Do you find such mismatches of entities relevant in the future discussions on double non-taxation?

Yes ☐ ~~No~~ ☐ ~~Do not know~~ ☐

Questions B – Are you aware of mismatches of entities between member states or towards third countries?

Yes ☐ ~~No~~ ☐ ~~Do not know~~ ☐

Question C - Please give relevant details about these mismatches of entities *(max 500 words)?*

The World Commerce Review is carrying a series of articles that look in detail at Dutch hybrid structures. In three articles (of a serie of 5) of Jos Peters (a senior Tax Partner with a Tax Solutions Group, a group of former BIG 4 accountants) outlines how hybrid entities work in the Dutch context.

One article looks at Dutch LLPs (Limited Liability Partnerships) and explains how "LLP's, both Dutch and foreign, may give rise to double non-taxation, or to "double dipping" -- or to the tax deductibility of expenses in one country without income pick-up elsewhere in the group in another country.
The article can be read through: http://www.worldcommercereview.com/publications/article_pdf/273

The other articles can be found on http://taxjustice.blogspot.com/2011/05/some-details-on-five-trillion-euros-in.html

Question D – Please provide any suggestions you might have for ways in which these mismatches of entities could be tackled *(max 500 words)*.

The underlying problem is that companies can exploit differences in the definition of the tax base, and that tax treaties are an inadequate way of dealing with this problem. According to TJN this proves the necessity of a Common Consolidated Corporate Tax Base, and to make it compulsory not voluntary, to address mismatches within the EU. The CCCTB would also need to be comprehensive in its coverage of hybrid entities.

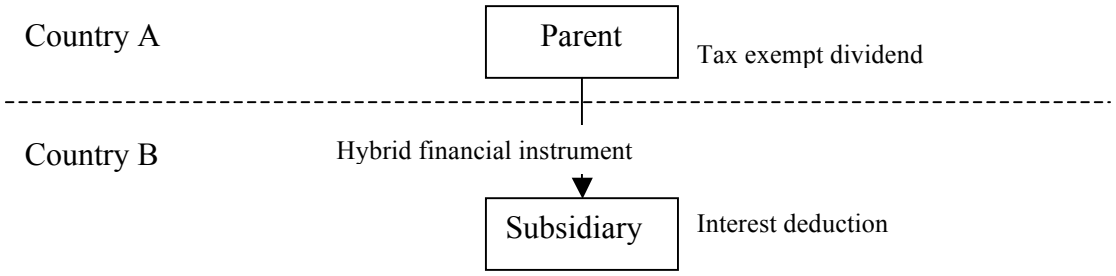
Issue 2 - Mismatches of financial instruments

There are financial instruments that include characteristics of both debt and equity (or seen from the creditor/shareholder: loan and shares). These financial instruments are usually known as hybrid financial instruments and include instruments such as preferred shares and profit participating loans.

Member states will not necessarily qualify these hybrid instruments in the same way. If there is a mismatch in the qualifications of such financial instruments between member states (i.e. as debt in one jurisdiction and as equity in the other), double non-taxation might occur.

Assume an enterprise with a parent company in country A and a subsidiary in country B intends to finance an investment of the subsidiary in e.g. machinery or the market introduction of a product (i.e. the same factual situation as under issue 1) but this time, the parent does have sufficient funds itself and intends to use them for the investment.

The parent company may choose to use of a hybrid financial instrument that is treated as equity in country A, but as debt in country B. When the subsidiary is funded with such an instrument, the subsidiary will have interest deductions in country B while the corresponding income for the parent company in country A will be dividends which in many member states are tax exempt income for parent companies.



The outcome of this mismatch of financial instrument qualification is an interest deduction in one member state without taxation of the corresponding income in another member state.

Question A – Do you find such mismatches of financial instruments relevant in the future discussions on double non-taxation?

Yes ☐ ~~No~~ ☐ ~~Do not know~~ ☐

Questions B – Are you aware of mismatches of financial instruments between member states or towards third countries?

Yes ☐ ~~No~~ ☐ ~~Do not know~~ ☐

Question C - Please give relevant details about these mismatches of financial instruments *(max 500 words)?*
See the examples provided under Example 1, Question C

The World Commerce Review is carrying a series of articles that look in detail at Dutch hybrid structures. In one article (of a serie of 5) of Jos Peters (a senior Tax Partner with a Tax Solutions Group, a group of former BIG 4 accountants) outlines how hybrid instruments work in the Dutch context: for example, reducing their tax bills by using artificial intra-company lending constructs: so-called "Profit participating loans."
The article can be read through: http://www.worldcommercereview.com/publications/article_pdf/328

The other articles can be found on http://taxjustice.blogspot.com/2011/05/some-details-on-five-trillion-euros-in.html

Question D – Please provide any suggestions you might have for ways in which these mismatches of financial instruments could be tackled *(max 500 words)*.

The underlying problem is that companies can exploit differences in the definition of the tax base, and that tax treaties are an inadequate way of dealing with this problem. According to TJN this proves the necessity of a Common Consolidated Corporate Tax Base, and to make it compulsory not voluntary, to address mismatches within the EU.

Issue 3 – Application of Double Tax Conventions leading to double non-taxation

Member States have over the years concluded bilateral or multilateral double tax conventions (DTCs) with each other that help to allocate taxing rights between the signatory states and provide relief if double taxation arises.

The application of DTCs (in connection with national legislation in the signatory states) could in some cases lead to double non-taxation.

The commentary to Article 23A of the OECD Model Tax Convention already tackles with one situation of double non-taxation that would arise from a conflict of qualifications of income. In such cases the state of residence is according to the OECD commentary not required to exempt the income when the source state based on its domestic law considers that the provisions of the treaty precludes it from taxing.

This does however not solve all cases of double non-taxation that comes from the application of DTCs. It does for instance not solve cases where the double non-taxation is based on different interpretations of the facts or of the provisions of the treaty. This could for example be cases where the two countries have different interpretations of when electronic commerce will constitute a permanent establishment. This would result in double non-taxation if the state of residence believes there is a permanent establishment (and exempt the income) and the source state believes there isn't a permanent establishment (and therefore does not tax the income).

Question A – Do you find such cases relevant in the future discussions on double non-taxation?

Yes ☐ ~~No~~ ☐ ~~Do not know~~ ☐

Questions B – Are you aware of cases where member states application of double tax conventions lead to double non-taxation?

Yes ☐ ~~No~~ ☐ ~~Do not know~~ ☐

Question C - Please give relevant details about these cases *(max 500 words)?*

One of the problems that TJN has encountered in relation to Double Tax Conventions (DTC)is the tension between source and residence taxation, as a result of which double non-taxation can occur. Broadly speaking there is a difference between countries using the model treaties of the United Nations (source-based, used by a lot of developing countries) and the OECD (residence-based). A TJN briefing paper on source-based and residence-based taxation can be found on http://www.taxjustice.net/cms/upload/pdf/Sourceresidence.pdf

The problem can be clarified in a hypothetical Dutch example. The Netherlands has an extensive network of DTC's in which the Netherlands strives to lower (preferably to 0%) the withholding tax levied by source countries on dividends, royalties and interest. The Netherlands themselves don't levy a withholding tax on most interest payments or on royalties.
When one takes the hypotheses of a DTC between the Netherlands and source-country X with a 0% withholding tax on interest and royalties, and residence-country Y being a country with no corporate income tax this could lead to the following situation: interest and royalties are not being taxed when entering the Netherlands, nor when leaving the Netherlands. In residence-country Y the income is not taxed. So the hypothetical company could end up untaxed on the income it transfers out of country X through interest and royalty payments via the Netherlands to country Y.

Question D – Please provide any suggestions you might have for ways in which this problem could be tackled *(max 500 words)*.

In TJN's view a shift toward a more source-based taxation would be preferred in relation to active corporate income. This way taxes would be levied where real economic activities are located. This is both legally and economically more fairer than a predominantly residence based model, which would nonetheless remain applicable to passive income (personal and corporate). It would also help developing countries to close the existing gap with more developed countries. Double taxation can be prevented by the residence country by granting a credit for taxes on income levied by the source state.

Issue 4 - Transfer pricing and unilateral Advance Pricing Arrangements

An advance pricing arrangement (APA) is an arrangement that determines, in advance of controlled transactions, an appropriate set of criteria for the determination of the transfer pricing for those transactions over a fixed period of time. An APA may be unilateral involving only one tax administration.

In transfer pricing there can be good reasons for issuing unilateral APAs or similar advance agreements concerning transfer pricing although bilateral APAs should be preferred over unilateral APAs. Unilateral arrangements give the taxpayers certainty of the taxation of intra-group transactions in the issuing member state.

APAs may however create double non-taxation. This could e.g. be the case if the member state (Country A) where the associated enterprise is situated is not aware of the APA issued in the other Member State (Country B). If the APA determines that the group may use one transfer pricing method (e.g. the cost plus method) for a controlled transaction, there could be a risk for double non-taxation if Country A believes that the arm's length price should be determined on the basis of another method (e.g. the comparable uncontrolled price method).

The outcome of using different transfer pricing methods could be double non-taxation as well as double taxation. The risk of double taxation can be tackled by using the EU Arbitration Convention[5].

It could be noted that member states with the "Code of Conduct" (Business Taxation) have committed themselves to spontaneously exchange details of concluded unilateral APAs. The Exchange of Information should be made to any other tax administration directly concerned by the unilateral APA and should be done as swiftly as possible after the conclusion of the APA.[6]

Question A – Do you find unilateral advance pricing arrangement relevant in the future discussions on double non-taxation?

Yes ☐ ~~No~~ ☐ ~~Do not know~~ ☐

Questions B – Are you aware of unilateral advance pricing arrangements that could lead to double non-taxation?

Yes ☐ ~~No~~ ☐ ~~Do not know~~ ☐

Question C - Please give relevant details about these unilateral advance pricing arrangements *(max 500 words)?*

Energias de Portugal SA has a subsidiary in the Netherlands (EDP Finance BV) that issues publicly traded bonds and lends the proceeds onwards to related entities abroad. In 2007, the subsidiary obtained an APA that specifies its minimum taxable income as an arms-length return on equity plus a spread of 0.03% on onlent funds, minus operational costs. At the start of 2010, the subsidiary had total equity of EUR 23 million while it had onlent over EUR 10 billion. Due to the tax ruling, the subsidiary's tax charge for 2010 was less than EUR 1 million even though it earned net interest income, after operational costs and expenses, of EUR 63 million. This illustrates that unilateral APAs specifying an alternative tax base may result in almost complete double non-taxation of a intra-group payments, because the payments may de tax deductable in one member state but largely excluded from the tax base in another member state due to such an APA. The annual accounts of EDP can be found on: http://www.edp.pt/en/Investidores/publicacoes/relatorioecontas/Pages/RelatorioeContas.aspx

Question D – Please provide any suggestions you might have for ways to tackle unilateral advance pricing arrangements leading to double non-taxation *(max 500 words)*.

[5] Convention 90/436/EEC on the elimination of double taxation in connection with the adjustment of profits of associated enterprises

[6] Communication 2007/71 on the work of the EU Joint Transfer Pricing Forum in the field of dispute avoidance and resolution procedures and on Guidelines for Advance Pricing Agreements within the EU, paragraph 68.

In the context it is explained that APAs should preferably be bilateral to avoid that they result in unintended double non-taxation in combination with, for example, double tax conventions. In TJN's view more openness at the European level would be desirable. APAs should be made public, so that public scrutiny of the agreement is possible as a safeguard against secret deals that deviate from normal tax rules. If public disclosure is not possible, the minimum that should be aimed at is information exchange between Tax Authorities on APAs being agreed with business. This could be achieved with a European database, that is accessible by all European Tax Authorities and other cooperating tax authorities.

Issue 5 – Transactions with associated enterprises in countries with no or extremely low taxation

There could be a risk of double non-taxation if member states do not have appropriate rules in place to deal with transactions with associated enterprises in countries with no or low taxation.

These appropriate rules would include transfer pricing rules to ensure arms length conditions between the associated enterprises.

There could also be a risk of double non-taxation if dividend exemption applies to untaxed profits. The aim of the profit distribution exemption between groups of companies is to prevent double taxation of parent companies on the profits of their subsidiaries. The exemption should therefore only apply when the profits of the subsidiary has been (effectively) taxed.

Similarly there could be a risk of double non-taxation if interest and royalty payments are exempted from withholding tax in cases where the company which is the beneficial owner is not (effectively) taxed. This would create double non-taxation as the payment will be deductible in the EU member state and not (effectively) taxed in the other country.

Question A – Do you find transactions with associated enterprises in no/low tax countries relevant for the future discussions on double non-taxation?

Yes ☐ ~~No~~ ☐ ~~Do not know~~ ☐

Questions B – Are you aware of transactions with associated enterprises in no/low tax countries that could lead to double non-taxation?

Yes ☐ ~~No~~ ☐ ~~Do not know~~ ☐

Question C - Please give relevant details about these kinds of transactions *(max 500 words)?*

The Netherlands is one of the countries not levying withholding tax on most interest and royalties, while striving for to a low or 0% source taxation in Double Tax Conventions with third countries. See also the explanation under Casus 3, Question 3.

Switzerland is a jurisdiction with low taxes in the heart of the European Union. As KPMG puts it, one of the strategic advantages of Switzerland is its "low taxation with various tax planning possibilities". See for more info (unfortunately without concrete examples):
http://www.kpmg.com/CH/en/Library/Articles-Publications/Documents/Tax/pub-20120425-investment-in-switzerland-en.pdf

Furthermore TJN would like to highlight the public hearing the US Congres Joint Committee on Taxation that took place in 2010 on more or less the similar subject as this consultation. See: https://www.jct.gov/publications.html?func=download&id=3692&chk=3692&no_html=1
This study includes 6 concrete case studies of aggressive tax minimization strategies of companies (company names are anonymized)

Low-tax jurisdictions can be used for diminishing taxation in several ways. For example, shifting corporate income from an EU subsidiary to a Swiss headquarter (or a Swiss subsidiary in charge of "corporate financial services" or a Swiss letterbox) can be achieved not only through "classic" transfer mispricing of traded merchandise, but also through overpriced royalties (for which there is no market-based "arms-length" price) and interest payments (in the case of "thin capitalization" of the foreign subsidiary). Notably, EU member states cannot raise a source tax on these transfer payments, as the bilateral Taxation of Savings Income Agreement between the EU and Switzerland (the bilateral "twin" of the EUSTD) stipulates a zero withholding tax on intra-firm dividends, royalties and interest payments. (In the case of developing countries, withholding taxes on dividends, royalties and interest are likewise often abolished, or at least significantly lowered, by means of bilateral double tax agreements.)

Question D – Please provide any suggestions you might have for ways in which these kinds of double non-taxation could be tackled *(max 500 words)*.

First, as mentioned under Case 3, the European Commission should assure the possibility of source-taxation for active business profits (including withholding tax on interests, dividends and royalties), as opposed the residence model. This would lead to a fairer tax system, since taxes would be taxed where real economic activities are located. The unilateral or treaty-based exemption of withholding taxes on passive income (withholding tax on royalties, dividends and interests) creates strong incentives for profit shifting to non-or low tax jurisdictions and induces tax competition in the rest of the world which backfires on EU competitiveness.
This could be achieved by the implementation of the Common Consolidated Corporate Tax Base, and to make it compulsory not voluntary.

Second, the European Commission could promote or mandate a differentiation in outgoing payments, following the Brazilian example. When the third country, where interest or royalties are going to, is a low- or non-tax jurisdiction a higher withholding tax rate would be applied.
What is needed for this is an independent list of low-tax jurisdictions (Tax Havens), for whom these stricter requirements would apply. Such a list can be issued independently by the European Union.
The report by the PACE of the Council of Europe could serve as a model:
http://assembly.coe.int/ASP/Doc/XrefViewPDF.asp?FileID=18151&Language=EN
A common list for the entire EU, instead of the different lists that are currently used by national tax authorities, would facilitate cross-border business and enhance the functioning of the single market.
More information on the Brazilian example can be found on:
http://www.mondaq.com/article.asp?articleid=88194 and
http://www.questionnaire.legalink.ch/xms/files/Newsletter/August_2010/New_Brazilian_Blacklist.pdf

Issue 6 – Debt financing of tax exempt income

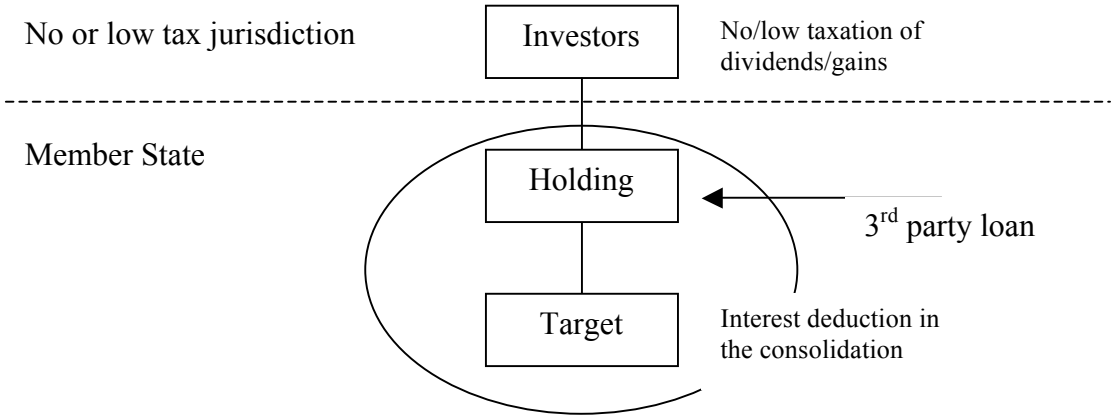
Double non-taxation might occur if interest deductions are allowed on debt that finances income that is not (effectively) taxed in any country.

One example of this could be the financing of foreign subsidiaries or permanent establishments in countries with no or low taxation. Many member states apply the principle

of territoriality for corporate taxation. This means that income not related to activities in the member state is kept outside the tax base. Dividends and capital gains on shares in subsidiaries are tax exempt and income from permanent establishments in other countries is also tax exempt.

Double non-taxation could incur if full interest deductions are allowed for debt financing of activities in foreign subsidiaries and permanent establishments that are not subject to (effective) taxation. The corresponding income from the shares will be tax free and the underlying activities in the subsidiary or the permanent establishment will only be taxable outside the member state, where it's not (effectively) taxed.

Another example could be cases where foreign investors are allowed to allocate their debt financing in relation to acquisition of target companies through consolidation between the acquiring holding company and the target company (see illustration).



Dividends could flow out of the member state without tax. Furthermore gains on the (direct or indirect) sale of shares in the target company will in most cases not be taxable. The outcome will therefore be double non-taxation as there will be interest deductions inside the member state and no taxation of the corresponding income (the dividend or capital gain) outside the member state.

Question A – Do you find these cases relevant for the future discussions on double non-taxation?

Yes ☐ ~~No~~ ☐ ~~Do not know~~ ☐

Questions B – Are you aware of cases where debt financing of tax exempt income is deductible?

~~Yes~~ ☐ ~~No~~ ☐ Do not know ☐

Question C - Please give relevant details about these case(s) *(max 500 words)?*

For TJN and its members it is very difficult to identify the concrete examples the European Commission is looking for, since of their nature it is needed to acces the internal company accounts.

Question D – Please provide any suggestions you might have for ways in which these kinds of double non-taxation could be tackled *(max 500 words)*.

Issue 7 - Different treatment of passive and active income

Some member states apply special tax regimes for passive income such as interests and royalties.

Some of these regimes are justified by technical reasons (i.e. to compensate the inflation depreciation effect) or just by a tax policy choice of a Member State.

Sometimes, however, these regimes may potentially lead to situations of effective double non-taxation.

Double non-taxation might incur in these cases through a combination of the exemption (or extremely low taxation) in the member state with the special regime and the tax rules in another member state. This could for instance be the case if the other member state allow deductions for interest and royalty payments and do not have a withholding tax on the payments. The outcome here would be deductions in one member state and no (effective) taxation in the member state with the special regime.

There could also be a risk of double non-taxation if the other member state apply the principle of territoriality for corporate taxation and therefore exempt income from activities abroad (whether its dividends from subsidiaries, gains on subsidiary shares or income from foreign permanent establishments). The outcome here would (effectively) be a double exemption.

These tax special regimes only apply to passive income and therefore active business activities would be excluded from these double non-taxation schemes.

Question A – Do you find these special regimes relevant for the future discussions on double non-taxation?

Yes ☐ ~~No~~ ☐ ~~Do not know~~ ☐

Questions B – Are you aware of such special regimes leading to double non-taxation?

Yes ☐ ~~No~~ ☐ ~~Do not know~~ ☐

Question C - Please give relevant details about these case(s) *(max 500 words)?*

TJN recognizes the description of issue 7 in the hypothetical Dutch example provided under issue 3. The Netherlands has an extensive network of DTC's in which the Netherlands strive to lowering (preferably to 0%) the withholding tax on dividends, royalties and interest. The Netherlands themselves don't levy a withholding tax on most interest payments or royalties.
When one takes the hypotheses of a DTC between the Netherlands and source-country X with a 0% withholding tax on interest and royalties, and residence-country Y being a country with no corporate income tax this could lead to the following situation: interest and royalties are not being taxed when entering the Netherlands, nor when leaving the Netherlands. In residence-country Y the income is not taxed. So the hypothetical company could end up untaxed on the income it transfers out of country X through interest and royalty payments via the Netherlands to country Y.

Question D – Please provide any suggestions you might have for ways in which these kinds of double non-taxation could be tackled *(max 500 words)*.

In TJN's view a shift toward a more source-based taxation would be preferred in relation to distributions of active corporate income, and interest/royalty payments. In that way taxes are levied where real economic activities are located. This is both legally and economically more correct than the residence based model, which would still be applicable to passive income (personal and corporate). Besides that it helps developing countries to close the existing gap with more developed countries. Double taxation can be prevented by the residence country by granting a credit for taxes on income levied by the source state.

The problem outlined in this case also proves the necessity of a Common Consolidated Corporate Tax Base, and to make it compulsory not voluntary.

Issue 8 – Double Tax Conventions with third countries

EU businesses operate in a Global Economic Scenario and therefore situations of potential risk of double non-taxations are not limited to the Internal Market. Schemes of double non-taxation frequently imply the use (or abuse) of Double Tax Conventions (DTCs) with Third Countries.

Some DTC between member states and developing countries contain sparing tax clauses[7] and matching tax clauses[8] that intend to promote genuine economic activities in the developing countries. These clauses can however be misused in some circumstances to achieve double non-taxation beyond the initial intentions.

Most member states also have DTCs with countries that (partly or fully) have no or extremely low taxation. These DTCs can also be used to achieve double non-taxation especially if the member state according to the DTC shall apply the exemption method for elimination of double taxation or if the member state according to the DTC cannot apply any (or only low) withholding tax on dividends, interest and/or royalties.

Other schemes include the combination of two DTCs or one DTC combined with EU legislation to achieve double non-taxation.

On 28th April 2009 the Commission issued a Communication on Promoting Good Governance in Tax Matters[9] to present concrete actions that could be taken to better promote the principles of good governance in the tax area (transparency, exchange of information and fair tax competition)

Having full regard to the principle of subsidiarity, the Communication concluded "there is a need to ensure more coherence between Member States individual positions in the international tax arena, and the good governance principles such as in bilateral tax treaties with third countries".

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[7] The State of residence grants a tax credit taking into account the tax that would have been paid at the State of source in absence of a certain tax incentive.

[8] The State of resident grants a notional tax credit, independently of the effective taxation at the State of source.

[9] COM(2009) 201.

Future discussions on double non-taxation could take into account the principles of good governance in the tax area.

Question A – Do you find double tax conventions with third countries to be relevant for the future discussions on double non-taxation?

Yes ☐ ~~No~~ ☐ ~~Do not know ☐~~

Questions B – Are you aware of double tax conventions with third countries that can be used to achieve double non-taxation?

Yes ☐ ~~No~~ ☐ ~~Do not know ☐~~

Question C - Please give relevant details about these double tax conventions with third countries *(max 500 words)?*

As explained before the DTC-networks of some EU-countries could be used for low- or double non-taxation, since withholding tax on royalties and interest are not levied. In addition dividend-conduits are possible. This is when a route A-B-C for dividends is more beneficial than a direct A-C route because of beneficial tax treaties between A and B and between B and C.
Also DTC's may also lead to double non-taxation with respect to capital gains (for example the India-NL and India-Cyprus treaties, which in many cases give exclusive taxing rights to the low-tax regimes on capital gains on the sale of shares in Indian companies).

A couple of clear examples concerning US-corporations (such as Google and Cisco) are provided by Bloomberg. In the outlined structures – leading to a lower overall tax rate – EU-countries like Ireland and the Netherlands play a prominent role. See also: http://topics.bloomberg.com/the-great-corporate-tax-dodge/

Question D – Please provide any suggestions you might have for ways in which these kinds of double non-taxation could be tackled *(max 500 words)*.

The European Commission could promote or mandate a differentiation in outgoing capitalflows, following the Brazilian example. When the third country, where interest or royalties are going to, is a low- or non-tax jurisdiction a higher withholding tax would be applied.
What is needed for this is an independent list of Tax Havens, for whom these stricter requirements would apply. This list can be issued independently by the European Union and the report by the PACE of the Council of Europe could serve as an model:
http://assembly.coe.int/ASP/Doc/XrefViewPDF.asp?FileID=18151&Language=EN
More information on the Brazilian example can be found on:
http://www.mondaq.com/article.asp?articleid=88194 and
http://www.questionnaire.legalink.ch/xms/files/Newsletter/August_2010/New_Brazilian_Blacklist.pdf

Issue 9 –Disclosure

Double non-taxation can be very difficult to detect in an ordinary tax audit. The availability of the relevant information is crucial for detection of double non-taxation and for policy responses to them.

The OECD published in February 2011 a report on disclosure initiatives to tackle aggressive tax planning[10]. In the report it was concluded (in paragraph 29) that:

> "Disclosure initiatives can help fill the gap between the creation/promotion of aggressive tax planning schemes and their identification by the tax authorities. Mandatory early disclosure rules, for example, have proven to be very effective in providing governments with timely, targeted and comprehensive information on aggressive tax planning schemes, thus allowing timely policy and compliance responses."

The mandatory early disclosure rules are rules created by some member states which require certain promoters of tax planning schemes to disclose these schemes to the tax administration. Promoters could be e.g. accountants, solicitors, banks and financial institutions. The rules require the promoters to provide the tax administration with information about schemes falling within certain descriptions. The promoter must explain how the scheme is intended to work and must normally do so before making the scheme available to clients.

Other types of disclosure initiatives could be e.g. additional tax reporting obligations, questionnaires, co-operative compliance programmes and rulings.

Question A – Do you agree that targeted disclosure initiatives could be a way to tackle double non-taxation?

Yes ☐ ~~No~~ ☐ ~~Do not know~~ ☐

Question B – Do you have knowledge of the experiences with disclosure rules in member states?

Yes ☐ ~~No~~ ☐ ~~Do not know~~ ☐

Question C – If your answer is yes to A, please specify which disclosure initiatives you believe could be a way to tackle double non-taxation *(max 500 words)*?

TJN is a strong advocate for Automatic Information Exchange between jurisdiction on a multilateral basis. One of the mayor problems with non-automatic information exchange is that information is only exchanged on request. This means one needs to know what one is looking for, before one makes a request for it.

An overview of the pros and cons of bilateral Tax Information Exchange Agreements and Automatic Information Exchange can be found on http://www.taxjustice.net/cms/front_content.php?idcat=140

Double non-taxation through the provision of alternative tax bases in one country might also be avoided by the disclosure of APAs. If public disclosure is not possible, the minimum that should be aimed at is information exchange between Tax Authorities on APAs being agreed with businesses. This could be achieved with a European database accessible by all European tax authorities, and other tax authorities.

Question B - If your answer is yes to B, please specify what the experiences in member states are *(max 500 words)*?

[10] "Tackling aggressive tax planning through improved transparency and disclosure (Report on disclosure initiatives". The report can be found on http://www.oecd.org/dataoecd/13/55/48322860.pdf.

In the Netherlands the Ministry of Finance has reported repeatedly that TIEA's lead to a low amount of information exchange. See for example:
http://www.nisnews.nl/public/271011_1.htm

In general terms, Nobel Laureate Stiglitz (2001), with his research on market failure due to information asymmetries in market exchanges, provided a convincing theoretical framework to understand the role of public disclosure of relevant information.

In its recent report on OECD's Global Forum on Transparency and Exchange of Information for Tax Purposes, TJN provides evidence based on IRS findings about the crucial role of information reporting for tax compliance (page 12 and 13, here:
http://www.taxjustice.net/cms/upload/GlobalForum2012-TJN-Briefing.pdf).

In this framework, country by country reporting is widely believed to create a massive voluntary and anticipatory adjustment in corporate profit shifting because of reputational and audit risks associated with improved taxpayer compliance.
Furthermore, Argentina's tax administration AFIP's recent example of clamping down on massive tax evasion by the world's largest grain exporters (see Guardian here:
http://www.guardian.co.uk/business/2011/jun/01/argentina-accuses-grain-traders-tax-evasion) is an example showing the relevance of intra-firm trading and financial data being included in corporate annual accounts on a country-by-country basis (Argentina's Corporate Law 1950, Article 33).

Issue 10 – Other issues?

As written above the list of issues (issues 1-8) shall not be seen as exhaustive. We would therefore also invite you to describe any other double non-taxation issues that you have encountered or that you are aware of.

We would also be interested in suggestions of increased information measures – not being disclosure (issue 9) - you might have for ways to tackle double non-taxation.

It should be recalled that the consultation only concerns taxes which companies and other entities pay directly to the tax authorities (i.e. "direct corporation taxes"). You should therefore only include double non-taxation issues concerning direct corporation taxes.

It should also be recalled that the cases should be cases with double non-taxation of the activities. This does not include cases where there is low taxation in one tax year because of losses carried forward from previous years nor does it include cases where the "non- taxation" in one jurisdiction is matched by a corresponding (effective) taxation in another jurisdiction. The former is a question on the timing while the later is a question of allocation of taxing right – neither of them is a question of double non-taxation.

Question A– Are you aware of double non-taxation not described above?

~~Yes~~ ☐ ~~No~~ ☐ Do not know ☐

Question B - Please give relevant details about these kinds of double non-taxation case(s) *(max 500 words)?*

Question C – Please provide any suggestions you might have for ways in which these kinds of double non-taxation could be tackled *(max 500 words)*.

Question D - Please provide any other suggestions of increased information measures – not being disclosure - you might have for ways to tackle double non-taxation *(max 500 words)*.

5. Who is consulted?
All interest parties including tax professionals in practice, in business and in academia.

6. How can I contribute?
You are invited to reply to this consultation by completing the questionnaire by sending a response by letter, fax or email within 3 months of the date of publication.

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Fax: +32-2-29 56377

7. What will happen next?
At the end of the consultation process the Commission will publish a report summarising the outcome of the consultation on the website of the Taxation and Customs Directorate General (http://ec.europa.eu/taxation_customs/common/consultations/tax/index_en.htm).

In addition, the Commission will analyse carefully analyse the information provided in order to identify and develop the appropriate policy response. The results will be used as input to the Communication on strengthening good governance in the tax area ("tax havens, uncooperative jurisdictions and aggressive tax planning") planned for the 4th quarter of 2012.

8. Any questions?
Please contact: TAXUD-D1-CONSULTATION-DNT@ec.europa.eu or tel. +32 2 29 64846 or +32 2 29 55136 or fax: +32-2-2956377

We hope you will take this opportunity to contribute your views!