Chartered Institute of Taxation

Excellence in Taxation

European Commission consultation document - The internal market: factual examples of double non-taxation cases
Response by the Chartered Institute of Taxation

1 Introduction

1.1 On 29 February 2012 the European Commission published a consultation document on 'The internal market: factual examples of double non-taxation cases'.

1.2 Although the document says that the purpose of the consultation is to contribute to the debate, as well as to collect relevant information, the consultation document is presented as a questionnaire which seeks information in respect of situations where it is perceived that double non-taxation could occur. It is based on a view of double non-taxation planning in the broadest sense, and appears to be predisposed to the conclusion that all such planning is 'harmful practice'. It offers no possibility of considering any alternative views or arguments as to why double non-taxation may be a good thing or why a general rule against double non-taxation would not be helpful. For example, the consultation does not consider or invite comments on the alternative view that tax competition between Member States is beneficial.

1.3 Another significant omission from the consultation is any consideration of the impact that the proposals would have on EU headquartered multi-national companies. If all of the situations addressed in the consultation were prohibited, this would result in an increase in the tax base of all EU Member States, which would significantly impact the ability of multi-national companies headquartered in the EU to remain globally competitive unless statutory headline tax rates were lowered. It would also hinder legitimate business restructuring and constrain normal commercial transactions both within and outside the EU.

1.4 As a result of these concerns about the structure and bias of the questionnaire, we consider that it would not be helpful to simply answer the questions posed. Instead we take this opportunity to comment on the issues raised and set out some arguments against the proposals for what appear to amount to a general prohibition of double non-taxation.

2 Scope of the consultation and the meaning of double non-taxation

2.1 Although the consultation only covers direct taxes, the paper defines double non-

ARTILLERY HOUSE
11-19 ARTILLERY ROW
LONDON SW1P 1RT

REGISTERED AS A CHARITY NO 1037771

Tel: +44 (0)844 251 0830
Fax: +44 (0)844 579 6701
E-mail: technical@tax.org.uk
Web: www.tax.org.uk

UK REPRESENTATIVE BODY ON THE CONFEDERATION FISCALE EUROPEENNE

taxation much more broadly than simply the use of hybrid instruments and entities, and seeks to include examples of territorial non-taxation (or relatively low taxation) of specific activities compared to other member states. This definition is far too broad.

2.2 Although we disagree with the basic premise of the consultation, that any action at an EU level is required, it would have been helpful if, before this consultation was undertaken, more consideration had been given to the precise meaning of double non-taxation. A limited definition of double non-taxation in an effort to narrow the scope so that only the most egregious schemes with artificiality were targeted would have been preferable. Currently the extremely broad definition of double non-taxation in the consultation document seems to be targeting both such 'schemes' and genuine tax planning by EU multi-national companies in member states who choose to structure their EU operations efficiently to remain competitive.

2.3 The participation exemption for holding companies across most EU member states seems to be under attack in the consultation. This is surprising as the participation exemption is a cornerstone of most EU member states' tax systems. If groups cannot borrow in a tax efficient manner to fund an acquisition of exempt participations, then they would have to look at alternative ways to structure transactions; for example asset purchases or, at worst, relocate to non-EU jurisdictions.

2.4 Even though the scenarios discussed in the consultation may arise because of asymmetry in tax treatment, consideration must be given to wider issues than just tax before concluding on the impact of targeting double non-taxation. It is important to also understand the associated legal and accounting analysis. Tax cannot be considered in isolation without understanding the interaction with other legislative systems.

2.5 Further afield, the consultation suggests extraterritoriality in places, referring to third countries, which clearly extends the legislation beyond the EU.

3 Subsidiarity

3.1 The consultation seems to ignore the fundamental principle that there is no common tax system within the EU.

3.2 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, as well as significant compliance costs.

3.3 Further 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. This does not make the so-called tax competition inherently 'unfair' as the consultation seeks to characterise it. Rather it is an essential economic fact of life for most member states. 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 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.

4 'Good' double non-taxation

4.1 There are circumstances where double non-taxation is not necessarily bad from a policy perspective.

4.2 Specifically, participation exempt receipt of dividends from a low (or no) tax country is the normal system for relief of double taxation within the EU/OECD; the US being one of the very few remaining OECD countries to retain the credit system for relief of double taxation. To categorise this at all as double non-taxation is technically highly questionable and in any event, we strongly disagree with any suggestion that such arrangements should be countered.

4.3 Further, consider the example of a leveraged holding company acquiring a target, and the acquisition debt interest being offset against the profits of the target via tax consolidation/tax grouping. This is a function of the availability of tax consolidation/tax grouping, and, if this is abused, it should be addressed via domestic thin capitalisation/debt cap/anti-earnings stripping rules, rather than being uniformly categorised as double non-taxation.

5 Is a general EU double non-taxation anti avoidance regime required?

5.1 Although there are scenarios where effective double non-taxation arises from a difference in treatment of the same item in different countries (eg hybrids) counteracting this should be left to national fiscal authorities. An example of a member state doing that are the anti-avoidance arbitrage rules in the UK. Similarly, many 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 work and do work at individual member state levels.

5.2 Opportunities for exploiting the differential tax treatment of hybrid entities or instruments have already been much reduced by anti-avoidance legislation in individual member states. There are clear models for other states to adopt if they wished to do so. We suggest that it may be legitimate to infer that if jurisdictions have not adopted anti-hybrid, anti-CFC etc. rules, it is because those jurisdictions have, for their own reasons, chosen not to do so.

5.3 Furthermore, there is already existing EU anti-avoidance protection in the EU Interest & Royalty Directive and Double Tax Conventions, and JITSIC offers sufficient opportunities for territories to be transparent with one another. Finally, 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.

5.4 Cross-territory anti-avoidance is simply not needed alongside the plethora of existing national legislation and the well-established OECD Guidelines that are understood by both Governments and business as to how to operate across member states.

6 Alternative approaches

6.1 We draw your attention to the OECD document on Hybrid Mismatch Arrangements published very shortly after this consultation (March 2012). It advocates a different approach to countering these situations. We agree with the OECD that the better way to address these issues 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.

6.2 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 will equate to tax harmonisation.

6.3 We would also mention that the Code of Conduct Group has also recently considered hybrid instruments (PPLs). We are surprised, therefore, to see this parallel initiative from the Commission without reference to the Code of Conduct Group's prior and ongoing work in this area.

7 Tax competition within the EU

7.1 The consultation also seems to be at odds with what has been acknowledged in the *Cadbury Schweppes*, *FII GLO* and the *Thin Cap GLO* cases: 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.

7.2 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?

8 Conclusion

8.1 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. Any discussion of double non-taxation needs to be narrower and much more specifically targeted. There are circumstances where double non-taxation is not necessarily bad from a policy perspective.

8.2 Proper consideration must be given to the impact of any proposals on EU headquartered multi-national companies. If all of the situations addressed in consultation were prohibited, it would hinder legitimate business restructuring and constrain normal commercial transactions both within and outside the EU.

8.3 There is no need for cross-territory anti-avoidance rules targeting double non-taxation as there are already adequate protections at national and international levels.

9 The Chartered Institute of Taxation

9.1 The Chartered Institute of Taxation (CIOT) is a charity and the leading professional body in the United Kingdom concerned solely with taxation. The CIOT's primary purpose is to promote education and study of the administration and practice of taxation. One of the key aims is to achieve a better, more efficient, tax system for all affected by it – taxpayers, advisers and the authorities.

The CIOT's comments and recommendations on tax issues are made solely in order to achieve its primary purpose: it is politically neutral in its work. The CIOT will seek to draw on its members' experience in private practice, Government, commerce and industry and academia to argue and explain how public policy objectives (to the extent that these are clearly stated or can be discerned) can most effectively be achieved.

The CIOT's 16,000 members have the practising title of 'Chartered Tax Adviser' and the designatory letters 'CTA'.