POSITION PAPER

BUSINESSEUROPE

7/3/2016

Anti-Tax Avoidance Package

KEY MESSAGES

1 BUSINESSEUROPE fully supports fair tax competition and the objective to fight fraud and evasion as it creates strong competitive distortions at the expense of the vast majority of businesses who pay their taxes in full.

2 However, we are concerned that this proposal goes beyond the OECD agreement and by raising effective corporate tax rates and deviating from international agreements will put the EU at a competitive disadvantage in attracting global investment. We are particularly concerned the Commission has not produced an impact assessment for this proposal.

3 A statement at the ECOFIN council that all Member States will revise their national tax systems to be consistent with the OECD's standards would be preferable and sufficient at this stage. The Commission could be given a role to review whether appropriate changes have been made in line with such a commitment.

WHAT DOES BUSINESSEUROPE AIM FOR?

- *On January 28, 2016 the EU-Commission presented a proposal for a Directive containing measures to prevent tax avoidance and to improve the functioning of the internal market. The Commission states that the Directive is meant to ensure that Member States transpose the OECD BEPS recommendations into their national tax systems in a coherent and coordinated fashion.*
- *However, we believe that by going beyond the OECD agreement the proposal will undermine EU competitiveness, particularly by deviating from international agreements.*
- *The Commission should withdraw its proposals, with Member States agreeing only to implement the BEPS agreement.*

KEY FACTS AND FIGURES

The OECD calculates that only around 5% of corporate tax revenues are currently misallocated between countries. This compares with a gap in VAT revenue for example of over 15% across the EU.
In 2012 businesses paid nearly € 2 trillion of taxes in the EU.

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BUSINESSEUROPE position on the European Commission´s Anti-Tax Avoidance Package

BUSINESSEUROPE fully supports fair tax competition and the objective to fight fraud and evasion as it creates strong competitive distortions at the expense of the vast majority of businesses who pay their taxes in full. We recognise the need to ensure that the international corporate tax system remains fit for purpose in light of challenges from increasing globalisation and particularly increasing digitalisation. For this reason, many BUSINESSEUROPE members have actively contributed to discussion at the OECD on the Base Erosion and Profit Sharing (BEPS) project through the BIAC.

The EU must not put investment and competitiveness at risk

However the Commission's proposal covers a broad range of detailed national tax matters which go beyond the OECD recommendations. Our principal concern is that by acting as lone front-runner in implementing a directive that goes way beyond the OECD BEPS agreement we will undermine the competitiveness of EU industry or damage the EU's attractiveness as an investment location.

For example, the BEPS measures are aimed at ensuring that tax is levied in the country where the value and profit is created. This is hardly the case with e.g., the switch-over clause which results in taxation at the shareholder level and has nothing to do with base erosion within the internal market. Furthermore, the provisions extracted from the CCCTB proposal (the deductibility of interest, the switch-over clause, the general anti-abuse rule and the CFC rules) were part of a broader, consolidated regime across countries with clear ambitions to enhance growth, employment and investment in the EU. The measures now proposed by the Commission will be directed against other Member States as well as third countries. The aim is not to promote a single uniform market but to create tax barriers in certain circumstances. This will have a negative impact on trade and growth.

The proposal also covers a number of areas in which the OECD has recommended best practices or has made no recommendation at all. Introducing these provisions as minimum standards in contrast to OECD-BEPS recommendations could also put European companies in a competitive disadvantage with the rest of the world with the risk of driving key entrepreneurial and management functions out of the EU. The US Congress has repeatedly expressed that it would only accept OECD-BEPS changes supportive of US businesses and the US economy. This view has been endorsed by the US government.

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Moreover, in order to avoid fragmentation due to unilateral uncoordinated action by Member States, the Commission argues that EU action in implementing the OECD-BEPS recommendations is necessary. However, by giving Member States the possibility to implement stricter rules, going beyond what is proposed by the OECD, the risk of fragmentation remains unconstrained.

There is a further risk to EU competitiveness relating to the possibility that other major economic regions will not fully implement the BEPS agreement. The Commission's proposal states that "the EU should encourage its international partners to also adopt these higher standards". However, the Directive would be in place irrespective of actions taken by other countries. The US in particular has expressed considerable reluctance to implement several of the action points in the OECD-BEPS proposal[1].

The Commission must follow its own rules and issue a full impact assessment

In light of the clear danger to competitiveness, we find it unacceptable that the Commission has not followed its own rules in issuing an impact assessment for what is clearly a significant proposal.

We do not agree with the Commission's argument that given the strong links to the OECD project, evidence supplied in the Staff Working Document and stakeholders' input at a previous stage, an impact assessment is not necessary.

The fact that some, but not all, of the provisions have been extracted from the original proposal for a Common Consolidated Corporate Tax Base (CCCTB) does not alter the fact that this proposal for a Directive constitutes a **new** legislative proposal and should be dealt with accordingly. In addition, the links to the OECD are not consistent in the draft Directive.

In contrast to domestic legislation, when in place, a Directive is extremely difficult to change. It is essential that there is a proper analysis regarding the effect on economic growth, employment or the impact on the EU's investment environment relative to the rest of the world, in the context of both global BEPS implementation and part implementation.

[1] See e.g. letters from US Congress to the Treasury Department on June 9 and August 27, 2015 as well as testimony of Robert Stack to Senate Finance Committee on December 1, 2015.

EU corporate tax rules must be consistent with global agreements

The key to the BEPS project´s success is consistent application. A majority of the EU Member States are members of the OECD. By deviating from the international agreements made at the OECD level, the EU will introduce double or multiple standards undermining the consistency of the international tax system. Measures like the switch-over clause will also require renegotiation of a large number of tax treaties as well as amendments of rules on participation exemption.

BUSINESSEUROPE does not believe that the draft Directive will ensure an appropriate and consistent implementation of the OECD's recommendations within the EU. As stated above, the proposed minimum standard is not likely to solve the problem of fragmentation. An agreed statement at an ECOFIN meeting confirming that all Member States will revise their national tax systems to be consistent with the OECD's recommendations would be more appropriate at this stage. If desired by Member States, the Commission could be given a role to review whether appropriate changes have been made in line with such a commitment.

The proposal risks infringing on Member States' competency on tax as well as introducing further extra-territorial taxes

BUSINESSEUROPE is concerned that the draft Directive reduces the flexibility for Member States to adjust their national tax systems. National governments should be allowed to legislate in an open and transparent manner without running the risk that the right to tax an economic transaction is transferred to another Member State. The explicit or implicit elements of extra-territorial taxation are not conducive to either economic efficiency or to national tax sovereignty. Several proposals from the Commission have lately included such features (the FTT for instance). To continue on such a path is very worrisome, in particular for smaller Member States.

We are also concerned that "the Commission will [therefore] work to include state aid provisions in negotiating proposals for trade and association agreements with third countries, with a view to ensuring fair tax competition with its international partners". An increase of non-tariff barriers must be resisted.

Comments on specific proposals

a) *Interest deductibility*

From a principle point of view BUSINESSEUROPE favours interest limitation rules based on objective criteria, with the predictability and legal certainty that follows with such rules.

However, by setting a cap of 30 percent of EBITDA, with the possibility for Member States to introduce stricter rules, the interest limitation rule in the draft Directive goes beyond the 10-30 percent of EBITDA corridor recommended by the OECD. It also goes beyond the BEPS proposal in applying interest limitations to intra-country interest payments and not just cross-border payments.

BUSINESSEUROPE is of the view that neither the OECD nor the EU-Commission has taken into consideration the various conditions prevailing in different countries.

Within a multinational enterprise (MNE) the borrowing for the entire group is often made through the parent company (HQ), with the benefits that follow such an arrangement. If the HQ is located in a large country with a big home market, the EBITDA of the HQ will most likely be higher than if the HQ is located in a country with a small home market. Hence, bigger countries have a distinct advantage over smaller countries in attracting HQs if both countries apply the same EBITDA-ratio. The advantage for MNEs with HQs in large countries could be decisive, for example in a situation where two MNEs are competing over the acquisition of a company and both MNEs need to finance the acquisition with debt. In such a situation, the MNE with its HQ located in a big home market will, to a greater extent, be able to deduct the interest costs. In this context, it needs to be recognized that it is often not possible to allocate interest costs from the HQ to its subsidiaries.

The small country disadvantage is not mitigated by the group ratio clause in paragraph 3 in the draft Directive. MNEs from large economies generally have a higher indebtedness. The group ratio rule will therefore be more favourable for MNEs based in large countries.

Smaller economies have no way of addressing the above-mentioned distortions. The fact that these issues were not analysed by the OECD is perhaps not surprising, considering that the BEPS project was orchestrated by G20, being the 19 biggest countries in the world. However, considering the fact that many EU Member States have small home markets, it is more surprising that the EU has not elaborated on these differences.

An EU cap of 30 percent EBITDA in a Directive will seriously limit the possibility for future upward adjustments, with a negative impact on the investment, economic growth and competitiveness in the European Union.

In article 2 paragraph 1 there is a definition of 'borrowing costs'. BUSINESSEUROPE finds this definition far too vague and difficult to interpret. This level of uncertainty regarding interpretation is not acceptable in a Directive. In OECD's BEPS action point 4, it is expressed that certain foreign exchange losses on borrowings and instruments could be included in the definition of interest. The OECD does however not offer any guidance on how to apply this in practice. As far as BUSINESSEUROPE is aware, no country has successfully included foreign exchange losses in their interest limitation rules in a way that makes it simple and predictable for the taxpayer. It is unclear whether or not foreign exchange losses are covered by the definition in the draft Directive. For the reasons just described, BUSINESSEUROPE is of the opinion that such losses should be excluded. It can also be questioned whether an inclusion of foreign exchange losses is compatible with EU law.[2] A clear definition of borrowing costs is crucial in order to have interest limitation rules that are predictable and easy to apply. There is also an imbalance in the formula for calculating the net interest income/cost. The income to be included is much narrower compared to the costs being included. The determination of what to include in income and costs should be more uniform.

The proposal in the draft Directive makes it possible to carry forward borrowing costs that have not been deducted, as well as unused EBITDA capacity. BUSINESSEUROPE strongly supports this, since it will make it possible for companies with fluctuating earnings to reduce the negative impact that the interest limitation rules would otherwise have.

The interest limitation appears to discriminate against countries without a consolidated tax return. If the notions of 'EBITDA' and 'exceeding borrowing costs' were able to be assessed on a consolidated basis within a country, this would have a more limited impact as positive EBITDA excesses of one member in the Group could be offset to reduce the limitations of another company in the Group. The Commission fails to address how a system without consolidation can function in conjunction with the proposed interest limitation rules.

It is notable that the OECD recommended a Group ratio rule based on the net interest to EBITDA ratio, whereas the EU draft Directive proposes such a rule based on the debt to equity ratio in each company compared to the same ratio in the whole group. The fact that the Commission's proposal deviates from the OECD recommendation is clearly not consistent with the proposed goal of a uniform implementation.

[2] C-293/06 - Deutsche Shell.

Introducing minimum standards in a Directive that limits the possibility for future adjustments is, to say the least, highly questionable. As an example, IASB has developed new accounting standards for leasing that will come into effect in 2019. The new standards will have an impact on a Group ratio rule.

There should also be a possibility to demonstrate that the interest expense has been incurred for a valid business reason, even when exceeding the fixed ratio threshold. This would also make the rules more compatible with EU law[3].

BUSINESSEUROPE shares the view that the interest limitation rule shall not be applied to financial undertakings. However the exemption of financial undertakings raises several questions. Captive insurance and reinsurance companies need to be properly considered. There is no guidance how to apply the Group ratio rule for a Group that has both entities that are subject to the interest limitation rules as well as entities that are exempt. In such a situation, shall the Group ratio be based on the entire Group or should financial undertakings not be considered when calculating the Group ratio? This is just one example of the many difficulties the exemption will give rise to. BUSINESSEUROPE calls for much more guidance and clarity in this regard.

b) Exit tax

A proposal for exit taxation is not included in the BEPS recommendations, nor does it belong in the Internal Market. It is also questionable whether the proposal is consistent with the jurisprudence of the European Court of Justice (ECJ) as it is likely to result in an unjustified restriction on the fundamental freedoms, such as the freedom of establishment and the freedom of movement of capital. With this in mind, it is difficult to view the proposal as a minimum standard since a stricter legislation likely would be a breach of EU law.

Many countries have some form of exit tax and need to respect the limitations set forth in ECJ case law. If other countries wanted to adopt such a provision, but for various national policy reasons have chosen not to do so, the national tax sovereignty of the Member States should be respected.

Furthermore, the proposed exit tax clause also seems to go beyond what is necessary to combat tax avoidance as the proposal covers situations where the Member State continues to have tax jurisdiction over the assets that are transferred, such as in the case of transfers of assets from a head office to a permanent establishment in another Member State.

[3] C-524/04 – Thin Cap.

c) *Switch-over clause*

A switch-over clause is not included in the OECD-BEPS recommendations. This is not surprising since such a measure clearly diverts from the principle of taxing profits where the economic activities take place and the value is created. In fact, this is the provision in the draft Directive that strays furthest from merely tackling base erosion and profit shifting and has the greatest likelihood of impeding national tax sovereignty. It forces Member States to abandon the long-established principle of capital import neutrality by effectively turning a Member State's exemption system into a credit system, without regard to whether there is substance or an appropriate level of activity in the subsidiary. The principle of capital import neutrality has traditionally been used by smaller Member States such as e.g., Sweden. However, in recent years it has also been adopted by countries such as Germany and the UK, and it has been proposed in the US as an essential feature of a much-needed reformed tax system. Capital import neutrality is also an important principle in order to foster efficiency and growth in an economic union.

This proposed clause will also impact legitimate business structures where the country of investment may have determined, for legitimate national policy reasons, to apply a low corporate income tax rate in order to encourage investment and attract business operations. Investments in genuine economic activities should not be considered tax avoidance simply because they are located in low tax jurisdictions. Furthermore, it is also likely that the proposed switch-over clause will disproportionately affect investment in developing countries, which often use competitive corporate tax rates or tax-reducing incentives to attract foreign investment.

Many Member States have tax treaties with exemption provisions. Without a safe-harbor clause, a measure like the switch-over would clearly require renegotiation of a large number of bilateral tax treaties.

A switch-over clause is sometimes used by countries as an alternative to CFC rules. In the draft Directive, however, it is proposed to be applied in conjunction with CFC rules, with the risk of multiple taxation and interaction with participation exemption rules as a result. At the outset of the CCCTB, the switch-over clause was seen as THE anti-abuse measure, applied uniformly. The present proposal is anything but the original proposal under CCCTB. In addition, the proposed switch-over clause looks at national statutory rates. Since it is the statutory rate in the Member State receiving the income that will be decisive for the application of the measure, it will be enacted differently within the EU causing a distorted and fragmented, as opposed to uniform, tax environment. Such a scenario does not facilitate a level playing field and may very well be in violation of EU law.

d) General anti-abuse rule

A general anti-abuse rule (GAAR) is not included in the OECD-BEPS recommendation.

BUSINESSEUROPE believes that the proposed GAAR may be in conflict with national GAARs and developed case-law. It may also be in conflict with other EU GAARs such as the one contained in the Parent-Subsidiary Directive ("main purpose or one of its main purposes" instead of "essential purpose") or the one contained in the Recommendation on the tax treaties ("unless it is established that it reflects a genuine economic activity"). Irrespective of whether the test relies on the main purpose or one of the main purposes or the essential or principal purpose (as stated in relation to the principal purpose test in BEPS Action 6), the focus of any EU proposed GAAR must be on the artificiality of the arrangement as such and not only on the purposes or intentions when entering into the arrangement.

For an EU GAAR to work effectively, it must be consistently interpreted and applied by the different Member States. However, it should be noted that it is very difficult to draft a wording that is appropriate in each territory given different systems and varying needs in different Member States. For example, the ATAP refers to the 'object or purpose' of the applicable tax provisions, but such terminology is frequently not clear and is often subject to debate and misinterpretations.

The fact that some countries, e.g. the UK, spent years crafting their GAAR reflects the complexity and the time frame that can be required to get it right. Rushing through some quickly put together wording that is intended to apply in all Member States despite their different legislative positions and case law is not appropriate.

Without sufficient clarity, the GAAR will have a negative impact on business investment between EU Member States and inbound investments from third countries into the EU.

e) CFC legislation

The OECD concluded that CFC rules should be addressed at a national level, recognizing that countries will want to implement the most appropriate regime to complement their wider corporate tax strategy. The draft Directive, on the other hand, proposes a much more rigid "one size fits all" framework, with little room for adjustment at the national level.

Shareholdings in establishments of other EU Member States are excluded. However, where investments outside of the EU are made through a chain of entities in multiple Member States, it appears that each Member State could seek to tax the income simultaneously. There is no mechanism in the draft Directive indicating that such taxes would be creditable against another tax. It is also not clear which Member State (if any) would have predominant taxing rights. Ultimately this could lead to many layers of taxation on the same income, without ever receiving a credit. Additionally, different tax rates and holding percentages in different Member States will mean that the rules will apply in different EU holding companies at different times, making the rules incredibly complicated to apply in practice.

In addition, using effective rates of taxation instead of blacklisted countries or statutory rates of taxation will increase the administrative burden since it will require repetitive analysis to be completed each year. Furthermore, the measure gives different results for different Member States. The rationale behind this is unclear and the provision may potentially be in breach of EU law.

The fact that the draft Directive discriminates against genuine economic activity in non-Member States is also questionable since it may have a negative effect on the economic interests and attractiveness of countries that introduce CFC rules in this form.

f) Hybrid mismatches

The proposal on hybrid mismatches is not consistent with the OECD recommendations. Whereas the latter only apply to group hybrids and tax structured arrangements, the rule in the draft Directive does not seem to be limited in this way. As a result, this could result in a number of uncertainties, including the following:

Will an issuer of public instruments need to be able to demonstrate the taxation of its holders in order to show that the hybrid rules do not apply (and is this possible)?

The OECD had considered applying the hybrid rule more generally, but concluded that a targeted approach was appropriate. It is not clear as to what the position of the draft Directive is in this regard.

The draft Directive also takes a different approach to determining whether there is a hybrid financial instrument, looking only at legal characterization and a different approach to the counteraction, by requiring that the income be taxed in the country receiving the payment – rather than denying the tax deduction in the country where the payment has its source. If Member States are to implement the proposed rules for hybrid instruments with counterparties within the EU while adopting the OECD recommended rules for third country counterparty instruments, this will lead to different sets of rules, depending on where the counterparty is located. This inconsistency and double standard would increase the risk of mismatches as well as the administrative burden for companies.