European Business Initiative on Taxation: Enabling Business Innovation

The European Business Initiative on Taxation (EBIT) was created by a group of leading European-based businesses to respond effectively to the challenge of modernising direct tax policy in Europe.

EBIT is convinced that the modernisation of tax policy will help to create an environment in which businesses can comply more easily with tax regulations and enable them to concentrate on sustainable growth, investing in people and innovation.

EBIT objectives include entering into a constructive dialogue with European policymakers and Member States tax authorities to achieve practical progress and improve the tax framework in which business operates in the European Union. In particular, EBIT believes that its dialogue-based approach can help to improve the competitiveness of European business and will bring benefits both to governments and businesses, large as well as smaller ones.

The European Business Initiative on Taxation currently includes Buhrmann, Cisco Systems, Deutsche Post, Ford, General Electric, Hewlett-Packard, IBM, Microsoft, Nutreco and Rockwell Automation.

EBIT asked PricewaterhouseCoopers to facilitate and project manage its activities, providing advice on taxation, European policy and strategic communication. PricewaterhouseCoopers is not a member of EBIT, but acts as a consultant and spokesperson for the group. The paper below contains the collective views of EBIT. Nothing in this document can be construed as an opinion or point of view of any individual member of EBIT or of PricewaterhouseCoopers.

EBIT's Tax Analysis below presents the main issues with regard to direct taxation, their context, the practical business concerns and recommendations. The paper further elaborates on EBIT's main recommendations for urgent action:

- The scope of the Merger and Parent-Subsidiary Directives needs to be extended. The Directives need to be implemented and interpreted consistently across the European Union and both Member States and the European Commission must act in accordance with their commitment to the Single Market.
- A Single Market needs a consistent approach to Transfer Pricing.
- Administrative rules and practices must recognise the increasing move away from nationally organised businesses and the impact of new technology on business processes.

EBIT believes that there is an urgent need for the European Commission, and for the E.U. Member States, to act now. Real and immediate benefits will only be achieved by a targeted approach that is focused on practicalities and specific measures.

This paper has been produced by the members of EBIT with the support of a team of experts from PricewaterhouseCoopers.[1] It contains the collective views of EBIT. Nothing in this document can be construed as an opinion or point of view of any individual member of EBIT or of PricewaterhouseCoopers.

1 More information on EBIT and on membership can be obtained from EBIT's Secretariat, PricewaterhouseCoopers: **Ine Lejeune**, Partner Leader for e-business Tax & Legal Services EMEA (E-mail: ine.lejeune@be.pwcglobal.com); **Paul M. de Haan**, Partner Tax & Legal Services (E-mail: paul.de.haan@nl.pwcglobal.com); **Olivier Boutellis**, Director Policy Advisory Services (E-mail: olivier.j.boutellis@be.pwcglobal.com). The Secretariat has drawn on the expertise of the leading experts of the EMEA network of PricewaterhouseCoopers.

European Business Initiative on Taxation Analysis

Introduction

(1) This paper sets out the key priorities of the European Business Initiative on Taxation (EBIT)[1] with regard to direct taxation in Europe, and details a series of practical targeted measures that could be taken by policymakers to improve the fiscal environment for businesses in Europe.

(2) EBIT welcomes the initiatives aimed at creating consistency in corporate taxation in the Single Market. These are essential if the European Union is to have a fiscal environment with the necessary flexibility to support modern business practices and structures. In an increasingly global economy, European businesses need at the very least to be able to operate and be managed efficiently and effectively on a Europe-wide basis, without tax rules and costs acting as a barrier. Like the European Commission in its recent study,[2] EBIT is of the opinion that there are in the European Union still a large number of tax obstacles to cross-border economic activity and the effective operation of the Single Market.

(3) Differences in direct tax rules and practices between the 15 E.U. Member States result in substantial compliance costs and in double taxation, even where there are E.U. measures already in place which are designed to avoid these problems.

Businesses need to be able to comply with their tax obligations in a way which does not involve a disproportionate use of time and resources.

(4) As a first step towards modernising and streamlining business taxation within the Single Market, EBIT has identified a number of key changes that would substantially ease the impact of tax on cross-border economic activity in the European Union and enable businesses to operate on a genuinely European basis.

(5) Indeed, as previously indicated by the Union of Industrial and Employers' Confederations of Europe (UNICE); " … it is a foregone conclusion that, as long as tax systems continue to place artificial and unnecessary restrictions on the behaviour of companies in pursuit of pan-European business objectives, European business and industry will not be able to generate all the savings and other economic benefits available from utilisation of the full potential of the Internal Market".[3] EBIT would like such restrictions reduced or even removed.

(6) EBIT intends to use the real-life experience of its members to guide changes that will not only ease day-to-day tax burdens within the European Union but also contribute to the competitiveness of European businesses on the global stage.

(7) The issues identified by the group are arranged in three sections – E.U. Directives, Transfer Pricing and Tax Administration. Each section contains an explanation of the issues, practical examples of situations in which they occur and recommendations as to how they can be resolved.

(8) These are by no means the only issues that concern the group but are those that it feels are either more pressing or easier to resolve. The group will eventually make recommendations in other areas such as cross-border utilisation of losses, tax treaties and other measures that may be in conflict with the principles laid down in the EC Treaty.

EBIT's Main Recommendations

- The scope of the Merger and Parent-Subsidiary Directives needs to be extended. The Directives need to be implemented and interpreted consistently across the European Union and both Member States and the European Commission must act in accordance with their commitment to the Single Market.
- A Single Market needs a consistent approach to Transfer Pricing.
- Administrative rules and practices must recognise the increasing move away from nationally organised businesses and the impact of new technology on business processes.

Extended Scope of and Common Interpretation of the Merger and Parent-Subsidiary Directives

The Merger Directive

Context

(9) On July 23, 1990, the European Council approved the Directive on the common system of taxation applicable to mergers, divisions, transfers of assets and exchange of shares concerning companies of different Member States (hereinafter referred to as the "Merger Directive").

(10) The purpose of the Merger Directive is to prevent tax obstacles to cross-border transactions such as mergers, divisions, transfers of assets and exchange of shares in which companies from two or more Member States are involved.

Business issues

The full operation of the Directive is prevented by continuing delays to required company law changes

(11) The proposed 10th Directive (Cross-border Merger Directive) on the company law aspects of cross-border transactions is still pending, with the result that the Merger Directive is not being fully applied as envisaged in many Member States.

> Example: At present, the enabling company law for certain cross-border transactions covered by the Merger Directive only exists in Denmark, Germany, Spain and Portugal.

The need for a continuing local presence

(12) In order to benefit from the relief granted by the Directive a company is often required to maintain a local presence after the restructuring (*e.g.*, a local branch after a contribution of a branch of activities to a non-resident company). It does not, therefore, allow existing multinational groups to move to operating from a single European location (*e.g.*, centralising warehousing or customer relationship functions) without potentially facing substantial tax charges.

Required shareholding retention periods

(13) Groups are often left with a complex multiple shareholding structure for sometimes between three and seven years because of the different retention requirements in Member States in order to enjoy exemption from capital gains on shares obtained during/at the time of the restructuring.

Inconsistent anti-abuse measures across the European Union

(14) The implementation of the Directive into the tax laws of the Member States has resulted in different conditions being applied to the operation of the Directive. This is especially true in relation to the anti-abuse measures provided for in Article 11 of the Directive. Member States apply local anti-abuse measures that sometimes include conditions not laid down in the Directive itself. This results in cases where companies are either not able to undertake cross-border reorganisations because of the potential tax cost or do so but not on what should have been a tax-neutral basis.

Certain transfer and other taxes are not covered by the Directive

(15) The Directive of July 17, 1969 concerning indirect taxes on the raising of capital does not allow capital duty to be levied in the case of mergers. The Merger Directive does not, however, prevent Member States from levying various transfer taxes, real estate transfer taxes, capital gains taxes and stamp duties.

(16) In the experience of the members of EBIT, these taxes can result in substantial costs on restructuring or on rationalising a group following an acquisition. As a consequence groups often have to consider

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less straightforward ways of achieving structural and operational rationalisation.

Example: In the United Kingdom certain asset transfers are subject to 0.5 percent stamp duty if the registered office of the acquiring company is in the United Kingdom but subject to 4 percent stamp duty if the registered office is in another state.

Example: Multiple real estate transfer tax is possible in Germany on certain reorganisations.

EBIT recommendations

(17) The proposed 10th Directive (Cross-border Merger Directive) on the company law aspects of cross-border transactions should be implemented.

Furthermore, to fully meet its legitimate policy objectives, the scope of this Directive should include non-publicly traded companies.

(18) A local presence should no longer be required. The application of the Merger Directive should be broadened to allow cross-border mergers without the company having to maintain a local presence. This would give companies the flexibility they need to operate cost effectively and adapt to the rapidly changing business environment.

(19) The varying shareholding retention requirements should be brought into line. This would help to simplify existing complex shareholding structures.

(20) Anti-abuse measures should be consistent and also reflect the spirit and objectives of the Directive. The European Commission should notify Member States that local tax measures do not comply with the Directive and, if necessary, invoke infringement proceedings.

(21) The scope of the Directive should be widened to include transfer and other taxes on mergers and reorganisations in the European Union.

(22) The Directive should be extended to cover all company forms that are subject to corporate tax.

(23) The Cross-border Merger Directive on European company law should be adopted. This would allow the Merger Directive to fulfill its original objectives.

The Parent-Subsidiary Directive

Context

(24) The European Council Directive on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States (hereinafter referred to as the "Parent-Subsidiary Directive") was approved on July 23, 1990.

(25) The Parent-Subsidiary Directive applies to distributions of profit between subsidiaries and their parent companies, where these companies are located in different Member States. Its purpose is to eliminate tax obstacles to these income flows within the European Union.

Business issues

25 percent participation requirement

(26) Partnerships and joint ventures with third parties are an increasingly common feature of the business world. However, they often involve equity participations which do not meet the threshold of 25 percent. As a consequence distributions on such shareholdings remain fully exposed to withholding taxes.

(27) Indirect shareholdings of different members of the same multinational group are not taken into account in assessing whether the 25 percent participation EBIT Tax Analysis requirement has been met. This is unnecessarily restrictive and takes no account of the commercial rationale of such an investment or the group's overall economic interest in the entity concerned.

Recurring retention requirements

(28) The Directive does not address the consequences of a group reorganisation on the required retention period to benefit from the withholding tax exemption. In some states the retention period has to be satisfied again.

Example: Belgium: the retention period of one year is triggered again if the shares are transferred from one group company to another.

Example: Netherlands: the retention period starts from scratch on the occasion of an intra-group transfer of a participation in a Dutch company.

Companies covered by the Directive

(29) The Parent-Subsidiary Directive does not apply to all company forms in the different Member States that are subject to corporate tax.

Examples: French SAS and Dutch open CV.

Administrative requirements to prove entitlement

(30) The formalities imposed by the Member States in order to claim the relief provided by the Directive result in substantial work for both the payer and the recipient/beneficial owner of the dividend. This is particularly true with respect to confirmation of the residence and substance of the beneficial owner of the dividend. The requirements also vary from state to state.

Inconsistent anti-abuse measures across the European Union

(31) As with the Merger Directive, different conditions are being applied by Member States to the scope and operation of anti-abuse measures. It is intolerable that there are national anti-abuse measures which frustrate the objective of the Directive.

Example: Spain and Germany require a level of substance in the parent company which is not defined.

EBIT recommendations

(32) A lower participation threshold or "business purpose test" should be introduced. A lower threshold would enable members of joint ventures to invoke the Directive.

(33) Alternatively a "business purpose test" could be introduced whereby all participations below 25 percent, which are entered into for genuine commercial purposes, would qualify.

(34) The retention period should not be triggered by transfers to E.U. companies within the same worldwide group.

(35) The Directive should be extended to cover all company forms that are subject to corporate tax.

(36) Administrative requirements to establish relief should be consistent across the European Union and Member States should co-operate to avoid the need to prove entitlement more than once. It should be possible, for instance, for the beneficial owner to prove residence in a Member State just once and for that to be accepted in all other Member States without further formalities.

(37) Anti-abuse measures should be consistent and also reflect the spirit and objectives of the Directive. Any anti-abuse rules need to be clear so that groups have certainty as to their intent and application.

(38) On the issue of substance in the parent, states with anti-abuse rules should consider introducing more specific guidance on the level of substance required to the business purpose for the structure.

A Single Market Needs a Consistent Approach to Transfer Pricing

Context

(39) The Member States adhere, although not always in a consistent manner, to the transfer pricing guidelines set out by the Organisation of Economic Co-operation and Development (OECD).

Business Issues

Uncertainty and inconsistency in transfer pricing approaches across the European Union.

(40) This is a major issue for the members of EBIT which results in exposure to double taxation and involves significant and unnecessary time and costs being incurred. Despite the OECD guidelines, Member States, in practice, take different approaches to the application of these guidelines. Consequently, it is often necessary for multinational groups to apply various transfer pricing methods to similar transactions, use different sets of comparables, compile different sets of transfer pricing documentation, and take into account different safe harbour rules.

Documentation

(41) If a pan-European group adopts a common transfer pricing policy throughout Europe, the various documentation requirements of the Member States force the group to compile different sets of documentation for each country in which it operates. These differences exist both in the statutory approaches taken by Member States and in the day-to-day practice of the tax authorities.

> Example: Stringent documentation rules for cost-sharing agreements in Germany compared to elsewhere.

Methods

(42) The practical experience of the members of EBIT is that in some Member States the use of certain transfer pricing methods endorsed by the OECD is questioned (*e.g.,* profit-based methods such as the TNMM and the profit split methods). Failure to allow OECD prescribed methods increases the risk of double taxation.

Inter-company service charges

(43) Multinational groups often centralise their headquarters or certain intra-group service activities within a single entity in order to deliver, for example, benefits of scale and consistent corporate policies. The arm's length principle requires the provider of the services to receive remuneration that is comparable to the remuneration a third party would obtain for the same services under similar conditions.

(44) However, there are wide variations in practice across the European Union. Some states allow or require mark-ups on group services and some do not. Some insist on a mark-up on charges out of the state but not on charges in.

(45) The level of mark-up required in some states exceed what one would expect to see in an arm's length situation with the result that a portion of the mark-up may be disallowed if the other country finds that the uplift exceeds an arm's length amount.

> Example: For headquarters or centralised services, certain Member States require that a cost-plus method is used with a mark-up of 10 percent. Other Member States require a mark-up of 25 percent for the same type of services.

Exchange of information

(46) Increased scrutiny by tax authorities has also resulted in an increase in the sharing of information between the Member States. However, the fact that information is being shared and the nature of the information shared is often not disclosed to the taxpayer, thus making it difficult for the taxpayer to defend its position properly.

Comparables

(47) Groups are often required to compile different sets of comparables in different states for their transfer pricing policy. This can be because, for example, some countries insist that only local comparable data can be used and not data for similar transactions elsewhere in the European Union, even where no comparable is available locally.

(48) There are occasions when tax authorities use comparables which are not publicly available and which they will not disclose – and which are consequently difficult to refute.

The European Arbitration Convention

(49) The Arbitration Convention gives associated companies the opportunity to obtain relief from juridical and economic double taxation that occurs within the European Union as a result of an upward adjustment to a transfer price in one Member State without a corresponding adjustment in the other Member State.

(50) Given the lack of a consistent transfer pricing approach by Member States, double taxation may still arise as a result of unilateral upward transfer pricing adjustments. Tax authorities may be reluctant to allow a corresponding downward adjustment because they may view the adjustment made by the other tax authority as inappropriate. When it comes to trying to resolve this situation, they are not obliged by their tax treaties to reach an agreement.

Application of the Arbitration Convention

(51) On May 25,1999, the Member States agreed a provision to extend the application of the Arbitration

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Convention for a period of five years. A Protocol to the European Arbitration Convention was signed to this effect.

(52) Currently, only Denmark, Germany, Luxembourg, the Netherlands, Spain and Finland have ratified this Protocol. Consequently, as from January 1, 2000, the Arbitration Convention can in principle no longer be invoked by taxpayers.

Time limits

(53) There is uncertainty about how to determine the starting point of the three-year period to invoke the mutual agreement procedure. This is especially problematic with some recently renegotiated tax treaties.

> Example: The Treaty signed on July 23, 2001 between the United Kingdom and the United States adopts specific time limits within which a matter must be presented.

Process

(54) Analysis published by the European Commission in late October 2001 shows that about 15 percent of transfer pricing disputes under bilateral tax treaties in the European Union were not satisfactorily resolved. As yet only three have been listed for the Arbitration Convention. So far, no Arbitration Convention process has run to conclusion. Initially, disputes were expected to be resolved within two to three years.

EBIT recommendations

(55) Amongst the Member States double taxation is unacceptable and every effort should be made to speed up the processes to relieve double taxation. In this respect, the Commission's initiative in setting up the Joint Forum on Transfer Pricing is welcomed by EBIT.

(56) The documentation standard should be the documentation required by a prudent manager to support the positions taken. Documentation requirements should be proportionate to the nature and scope of the activity. The requirements should take into account the nature of the activities performed and the risks inherent in the activity.

(57) All Member States should undertake to adopt the OECD guidelines in full (if they have not already) and be prepared to accept all OECD methods, including profit related methods (such as TNMM) and profit split. This approach must be in line with the OECD transfer pricing guidelines to avoid difficulties with non-E.U. Member States.

(58) Member States should adopt a consistent approach to services.

(59) Cost contribution arrangements for the development of intangibles with expected future benefits – these services should be at cost as both parties become owners of any resulting intangibles with the right to exploit these intangibles

(60) Shared services centres – such companies are established for the sole or primary purpose of providing services to group companies. Since the provision of such services is a major activity of the company it should be permitted to charge out the services with an arm's length mark-up. The allocation of service costs to the various group members should be allowed as long as the amount of costs allocated to each entity is done on a reasonable basis. There should be no requirement to specifically allocate direct costs.

(61) Ad hoc services which do not constitute a major activity of the company – where a company undertakes to perform a service on a non-routine basis and the costs related to the service are not significant in relation to the overall cost structure, the company should be permitted to charge out the costs with no mark-up.

(62) Exchanges of information should be disclosed to the taxpayer.

(63) Comparable data from other states should be allowed where such data is the best available information.

(64) Tax authorities should not be allowed to use secret comparables.

(65) Increased availability of advance pricing agreements (unilateral or multilateral) to avoid the risk of double taxation.

(66) Common guidelines should be introduced on the application of the mutual agreement procedure and the Arbitration Convention. In the absence of a consistent approach to transfer pricing, the mutual agreement procedure becomes even more important. The Arbitration Convention should merely be a last resort in resolving disputes. Common guidelines on the interpretation and application of the mutual agreement procedure and the Arbitration Convention need to be worked out to streamline the process and give taxpayers upfront certainty.

(67) Member States must take the necessary action to ratify the Protocol to the Arbitration Convention to avoid further legal uncertainty. In addition, the entrance of Sweden, Finland and Austria to the Arbitration Convention should be ratified by a number of Member States (*e.g.*, France, Greece and Ireland).

Administrative Rules and Procedures

Context

(68) EBIT has identified a number of areas in which there are unnecessary administrative burdens and cost-inefficiencies for European based companies in dealing with their tax affairs. A number of these were not dealt with in the European Commission study but should not be disregarded and require immediate action on an E.U. level.

Business Issues

Statute of limitations

(69) There are wide variations across the European Union in relation to tax statutes of limitation.

> Example: Austria, Finland, Greece and Luxembourg: the statute of limitations for assessment is generally five years following the end of the calendar year in which the tax liability arose (extended to ten years in the case of tax evasion in Austria, Greece and Luxembourg).
>
> Example: Belgium and France: in general three years from the end of the calendar year (extended to five years for tax evasion in Belgium and France).

Example: Germany and Italy: four year period starting at the end of the year in which the tax return for the respective tax year was filed (in Germany extended to five years for negligence and to 10 years for willful tax fraud).

Location requirements for books and records

(70) A number of Member States still require companies to keep their books and records in their territory, for example, Spain and Denmark. The impact of cross-border transactions is not always taken into account in this respect.

(71) Others allow companies to retain their books and records in other countries but only with prior permission of the tax authorities.

Electronic storage of records

(72) Although the majority of the Member States allows companies to keep their books and records in electronic form, a number of Member States still prefer paper based documentation (*e.g.*, Belgium).

(73) Moreover, even if electronic storage is allowed, Member States impose different conditions and require different methods of storage (*e.g.*, microfilms, computer files, CD-WORM).

Consistency with the new VAT Directive on electronic invoicing

(74) The new Invoicing Directive[4] on electronic invoicing allows invoices to be issued and retained in electronic form and stored outside the country, subject to certain conditions. However, in some states similar changes have not been proposed to the corporate tax rules. This may prevent businesses from being able to take full advantage of cost reductions from e-invoicing.

Retention periods for records

(75) The retention periods for financial information for tax purposes are not aligned across the European Union.

Example: The retention period for records is generally six years in Ireland, the United Kingdom, Spain, Greece and Finland and ten years in France, Belgium, and Germany.

Tax treaty claims procedures

(76) In order to claim tax treaty relief, for example, exemption from or reduction of withholding tax, the claimant has to comply with certain formalities (*e.g.*, certificates of residence for claims in respect of dividend distributions, interest and royalty payments). The procedures and time limits for making claims differ from state to state. Some require claims only once, others require claims on an annual basis. Some require the claim to be certified by the claimant's tax authority. These formalities are burdensome, time-consuming and frequently slow.

Example: Certificates of residence are only valid for treaty claims in Spain for one year and have to be renewed on an annual basis.

EBIT Recommendations

(77) Statutes of limitations should be aligned across the European Union.

(78) Companies should be allowed to store books and records outside it's the country. This will help groups to take full advantage of the benefits of shared services.

(79) Companies should be allowed to keep books and records in electronic form. This will bring the corporate tax rules in line with the changes being made from a VAT perspective. It will also recognise the changing business environment and the use of new technology in business processes. Tax authorities should increasingly be looking to test the reliability of systems rather than look for paper copies of documents.

(80) Retention periods for records should be harmonised. This will avoid groups having to take a country-by-country view of the period for which records have to be retained and will again make it easier to set up fully fledged shared services functions.

(81) Tax treaty claims procedures should be the same across the European Union. The procedures need to take account of the different conditions within bilateral treaties for particular relief but this is not a barrier to significant standardisation across the European Union. It should be possible, for instance, to prove residence for treaty purposes just once and for that to be valid for claims in all states.

1 The European Business Initiative on Taxation currently includes Buhrmann, Cisco Systems, Deutsche Post, Ford, General Electric, Hewlett-Packard, IBM, Microsoft, Nutreco and Rockwell Automation.

2 The European Commission study "Company Taxation in the Internal Market", October 23, 2001.

3 UNICE Memorandum on Cross-border Company Taxation Obstacles in the Single Market, April 3, 2000.

4 Council Directive 2001/115/EG of December 20, 2001 amending Directive 77/388/EEC with a view to simplifying, modernising and harmonising the conditions laid down for invoicing in respect of value added tax.

The European Business Initiative on Taxation
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