European Business Initiative on Taxation (EBIT)

Additional written contribution by EBIT on anti-abuse with regard to the Stakeholder Meeting "Addressing Double Taxation and Action Plan Initiatives on Parent Subsidiary Directive", 12 April 2013

EBIT is composed of VPs of Tax and European Tax Directors of AIRBUS, BP, CATERPILLAR, EADS, DEUTSCHE LUFTHANSA, INFORMA, MTU, NUTRECO, REED ELSEVIER, ROLLS-ROYCE, SAMSUNG ELECTRONICS, SCHRODERS and TUPPERWARE

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Dear Tom,

EBIT welcomes the opportunity given by you to participating groups in the Stakeholder Meeting: "Addressing Double Taxation and Action Plan Initiatives on Parent Subsidiary Directive" of 12 April 2013 in Brussels, to provide additional written input by 10 May 2013 to the Commission.

This letter adds to the comments already made by EBIT during the Stakeholder Meeting and provides in particular EBIT's views on the two Commission working papers on: "A review of anti-abuse provision in EU legislation" and on: "Double Taxation in the Single Market", which were prepared for this meeting.

Since its establishment in 2001, EBIT's aim has been to help eliminate remaining tax barriers in Europe and encourage the implementation of business-friendly solutions. EBIT considers this to be a very important topic for the business community. EBIT's input to tax policy-makers is always rooted in the day-to-day practice and experience of EBIT's member companies.

General comment regarding the EC's working papers: "A review of anti-abuse provision in EU legislation" and "Double Taxation in the Single Market":

<u>Proliferation of anti-abuse measures in the EU is undesirable, need to ensure legal certainty for taxpayers</u>

On a general note, EBIT is concerned about the recent proliferation of anti-abuse measures and proposals in the European Union at unilateral and also at multilateral level. EBIT believes that what businesses in Europe need most of all is legal certainty and that such proliferation of anti-abuse measures leads to the opposite effect and is not helpful. We note that the EU law requirement for legal certainty in this respect was confirmed in the *SIAT* case.[1]

[1] 5 July 2012 Case C-318/10 *Société d'investissement pour l'agriculture tropicale SA (SIAT) v Belgian State.*

If, notwithstanding these concerns, further anti-abuse measures are considered necessary, we would welcome some kind of anti-abuse ruling process or mechanism that ensures legal certainty for businesses for the longer term so that Europe can stay an attractive place for doing business in the future. The importance of providing some mechanism to counteract the increased uncertainty inherent in anti-abuse rules may be seen from the fact that most of the EU jurisdictions which already have a general anti-avoidance rule (GAAR) on their statute-books do have a system which enables taxpayers to obtain advance rulings on whether the GAAR will apply. Thus Belgium, France, Germany, Italy, the Netherlands, Sweden, and Poland all have rulings systems to support their GAAR arrangements.

Specific comments regarding the EC's working papers: "A review of anti-abuse provision in EU legislation" and "Double Taxation in the Single Market"

1. <u>Taxpayers remain free to choose the fiscally most attractive route</u>

As a starting point, EBIT would like to reiterate that out of the various alternatives open to enable a legitimate objective to be achieved, a taxpayer is in principle free to choose the fiscally most attractive alternative. Illustrative is the quote below from Advocate-General Kokott in her Opinion in the *Zwijnenburg* case, in which she argued that choosing out of the options available, the most favourable option for tax purposes is no ground for application of the anti-abuse provision in the Merger Directive:[2]

> "[i]t seems to me that drawing (…) a distinction between aim and method excessively restricts economic freedom. A whole number of legally permissible set-ups might often be available to enable a legitimate economic proposal to be achieved, some of which might prove to have a more favourable tax regime than others. The fact that the parties ultimately choose the option that is most favourable for tax purposes cannot by itself be sufficient grounds on which to base charges of tax avoidance under Article 11(1)(a) of Directive 90/434."

Whilst sensible and responsible tax planning should be protected, taxpayers should not be permitted, however, to benefit from contrived and artificial schemes.

2. <u>Double non-taxation is not automatically abuse</u>

The European Commission working papers refer very generally to the abuse that should be prevented and these papers link double non-taxation to abuse. In our view, the double non-taxation that arises as a result of hybrid financial instruments cannot necessarily and automatically be equated with abuse, since the double non-taxation may be the outcome of a deliberate policy decision taken by a particular jurisdiction e.g. the Belgian NID regime. As the Commission proposes, if such double non-taxation should be prevented, there is a specific and suitable solution available: the Member State of the parent company follows the classification of the financial instrument by the Member State of the subsidiary. This is not a matter of preventing abuse, but a matter of preventing double non-taxation.

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[2] Advocate General Kokott's Opinion of 16 July 2009, C-352/08, *Modehuis A. Zwijnenburg v Staatssecretaris van Financiën* (point 44).

In EBIT's opinion it is key that the term abuse is carefully defined. This may take the form of specifically identified abuses or if appropriate the application of a more general definition, as for example in the draft UK GAAR. We believe that there is also a need for a level playing field and that taxpayers engaging in responsible tax planning should not be disadvantaged at the expense of those that choose to do otherwise.

3. ***Specific*** **anti-abuse rules are preferable to** ***general*** **anti-abuse rules**

The papers display a great degree of enthusiasm about the adoption of general anti-abuse rules. However, with a view to legal certainty, *specific* anti-abuse rules are preferable to *general* anti-abuse rules. In, amongst others, the *Pelati* case, the CJEU confirmed the relevance of the principle of legal certainty in the field of the direct tax directives:[3]

> "[i]t should be recalled that the objectives pursued by Directive 90/434 must be achieved in national law in compliance with the requirements of legal certainty."

In addition, it is a rule of law that *specific* rules in a directive are not only preferable, but also prevail over *general* rules laid down in a directive. The CJEU clearly recognised this in the (first) *Denkavit* case:[4]

> "It is to be noted that Article 1(2) of the Directive is a provision of principle, the content of which is explained in detail in Article 3(2) thereof. Thus, Article 3(2) – and this is not disputed by any of the parties which have submitted observations to the Court – is aimed in particular at counteracting abuse whereby holdings are taken in the capital of companies for the sole purpose of benefiting from the tax advantages available and which are not intended to be lasting. In those circumstances, it is not appropriate to refer to Article 1(2) of the Directive in interpreting Article 3(2)."

In our view, the directives should therefore contain specific anti-abuse rules aimed at specifically identified types of abuse (*e.g.*, the avoidance of dividend stripping, the avoidance of third country nationals setting up EU companies to obtain Parent-Subsidiary Directive benefits, the avoidance of only temporarily set-up structures etc.).

The view that a too general examination of abuse, as opposed to a case-specific approach, should be rejected also emerges from settled case-law of the CJEU:[5]

> "(…) in order to determine whether the planned operation has such an objective, the competent national authorities cannot confine themselves to applying predetermined general criteria but must subject each particular case to a general examination. According to established case-law, such an examination must be open to judicial review (…)"

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[3] 18 October 2012 Case C-603/10 *Pelati d.o.o. v Republika Slovenija*, paragraph 36.
[4] 17 October 1996, *Joined Cases C-283/94, C-291/94 and C-292/94*, *Denkavit*, paragraph 31.
[5] 17 July 1997 Case C-28/95 *Leur-Bloem*, paragraph 41.

Whilst there nevertheless may be circumstances where some form of a more general provision which is not broadly drafted could work, EBIT believes there would be merit in the Commission considering the relative merits of both approaches (specific and general abuse measures) together with an impact analysis of how the introduction of additional layers of anti-abuse rules would interact with various domestic provisions.

4. Anti-abuse elements should not too easily be inserted in general provisions of the directives

The settled case-law of the CJEU on the Merger Directive clearly shows how the CJEU considers both its personal and its material scope as a filter which absorbs qualifying operations, regardless of the reasons for those operations:[6]

> "it is clear (…) from the general scheme of the Directive that the common tax rules which it lays down, which cover different tax advantages, apply without distinction to all mergers, divisions, transfers of assets or exchanges of shares *irrespective of the reasons, whether financial, economic or simply fiscal, for those operations* [emphasis added]."

The CJEU thus takes a very literal approach and it distinguishes what happens factually from the specific reasons underlying a certain operation. This line of reasoning is therefore clear: to assess whether a restructuring operation falls within the scope of the Merger Directive, only the facts matter. Fraudulent intent does not affect the qualification of a restructuring operation as a 'merger' etc. within the meaning of Article 2 of the Merger Directive, but it may justify a refusal of the Merger Directive's benefits pursuant to Article 15 of the Merger Directive. In subsequent cases, such as *Zwijnenburg*[7] and *Foggia*,[8] the CJEU embroidered on the above line of reasoning.

In our view, anti-abuse provisions should therefore not too easily be inserted in general provisions of the directives, but they should be confined to (a few) specifically targeted anti-abuse provisions.

5. What is exactly the type of abuse that should be prevented under the Merger Directive?

To date, it has never become concrete what types of abuse can actually take place by relying on facilities offered by the Merger Directive and which types of abuse should, therefore, be challenged through the anti-abuse provision in that directive. In our view, the Commission's documents of the last two decades have never been very definite in this regard. With the CJEU's unequivocal judgment in the *Zwijnenburg* case, it is clear that the abuse that may be prevented through Article 15(1) of the Merger Directive is restricted to the evasion or avoidance of the taxes specifically covered by the Merger Directive (*i.e.,* personal and corporate income taxes), excluding therefore, real estate transfer taxes or withholding taxes. Even more specifically, if we apply exactly the same schematic approach as the CJEU in

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[6] 17 July 1997 Case C-28/95 *Leur-Bloem*, paragraph 36.
[7] 20 May 2010 Case C-352/08 *Zwijnenburg,* paragraph 41.
[8] 10 November 2011, Case C-126/10 *Foggia,* paragraph 31.

Zwijnenburg, only those elements of the taxes covered by the Merger Directive for which the Merger Directive contains specific relief (*i.e.*, the capital gains incorporated in (i) the transferred assets/liabilities or (ii) the shares cancelled/exchanged) are protected by the anti-abuse provision. With this in mind, given the specific subrogation requirements already existing in the Merger Directive (*e.g.*, the 'permanent establishment requirement' in Article 4(2)(a) of the Merger Directive or the 'valuation requirement' in Article 8(4)), the only type of abuse we can think of, is the conversion of a taxable gain into an exempt gain. An example would be a transfer of assets which contain hidden reserves to a new company, followed by an immediate sale of the securities received (exempt under participation exemption). This 'dodging of an immediately taxable gain' can be prevented through less restrictive means. One option, in line with an amendment that was proposed by the European Parliament – but that was never adopted – is the insertion of a requirement concerning a minimum period of ownership of the securities received.[9]

6. The Merger Directive does not remove double taxation sufficiently

Although the removal of double taxation is not a specific objective of the Merger Directive, it is clear that the prospect of double taxation may hamper taxpayers from engaging in cross-border restructuring. Two instances of double taxation remain, for which very easy and effective solutions exist.

One instance is with an **exchange of shares**. Article 8(1) in conjunction with Article 8(3) of the Merger Directive prevents the shareholders from attributing to the securities received a value for tax purposes that is higher than the value the securities exchanged had immediately before the exchange of shares. Also with an exchange of shares, therefore, double taxation of effectively the same capital gain may arise if the acquiring company is required to value the securities received at the value that those securities had in the hands of the shareholder. As a remedy, the

[9] The proposed Article 8(11a) read: "[i]n order to avoid possible abuses related to the rapid exchange of shares, Member States shall apply an anti-abuse provision aimed at establishing a minimum holding period of 1 year, with the possibility for each Member State to extend it to 2 years". See European Parliament, 26 February 2004, A5-0121/2004 FINAL, Report on the proposal for a Council directive amending Directive 90/434/EEC of 23 July1990 on the common system of taxation applicable to mergers, divisions, transfers of assets and exchanges of shares concerning companies of different Member States (COM(2003) 613 – C5-0506/2003 – 2003/0239(CNS)), at p. 6. On the other hand, in the Commission Staff Working Paper "Company Taxation in the Internal Market", minimum holding period requirements were regarded as impediments for cross-border economic activity, see Commission of the European Communities, Commission Staff Working Paper "Company Taxation in the Internal Market", COM(2001)582 final, 23 October 2001, at p. 261: "[t]he case most often cited is where a number of Member States require that shares received under a transfer of assets or an exchange of shares be kept for a certain period which varies from three to seven years. The rapid disposal of shares received as a result of a transfer of assets or exchange of shares could be an abuse within the meaning of Article 11 of the Directive. However, in its judgement [sic] in Case C-28/95 *Leur Bloem* (1997), the European Court of Justice ruled that such abuse had to be assessed on a case-by-case basis. A blanket refusal to apply the Directive where shares received are disposed of before a particular deadline without giving taxpayers an opportunity to prove that such disposals are not of an abusive nature is therefore unlikely to be [sic] consistent with the Directive. Moreover, minimum holding periods that are particularly long - up to five or seven years after the initial operation - appear to be difficult to justify on the grounds of preventing abuse.

Commission's 2003 Proposal proposed inserting a new paragraph (10) in Article 8 of the Merger Directive, which read:

> "10. The acquiring company in an exchange of shares shall attribute to the securities received the real value of the securities issued to the shareholders of the acquired company."

This paragraph (10) was never adopted in the Merger Directive. However, to solve the double taxation arising with exchanges of shares, it is recommendable if this paragraph would be inserted.

A second instance is with a **transfer of assets**. The Merger Directive does not contain any rules for the valuation of the securities received by the acquiring company in case of a transfer of assets.[10] Since Article 4(2) of the Merger Directive requires the *receiving* company to continue with value of the assets and liabilities before the transfer, if also the *transferring* company would be obliged to value the securities received at the same value, double taxation may arise. The recent *3D I Srl* case demonstrates that the likelihood of such double taxation is not merely hypothetical.[11] In its 2003 Proposal, the European Commission recognised this problem and it also identified its culprit:[12]

> "(…) the same capital gain from the assets transferred is attributed to two different taxpayers and is taxed twice. The conclusion is that this double taxation problem arises in the Member State of the transferring company. This Member State will tax the income and capital gains derived by the permanent establishment receiving the assets. In addition, it may tax the capital gains derived by the transferring company at the time of a subsequent transfer of the securities received in exchange for the assets transferred. There are no objective reasons that would justify such taxation."

To solve it, the 2003 Proposal suggested inserting the following paragraph (2) in Article 9:[13]

> "2. The securities representing the capital of the receiving company, received in exchange for the transfer of assets by the transferring company,

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[10] See Commission of the European Communities, Commission Staff Working Paper "Company Taxation in the Internal Market", COM(2001)582 final, 23 October 2001, at pp. 238-239.

[11] 19 December 2012, Case C-207/11 *3D I Srl*.

[12] Paragraph 26 of the Introduction of the Proposal for a Council Directive amending Directive 90/434/EEC of 23 July 1990 on the common system of taxation applicable to mergers, divisions, transfers of assets and exchanges of shares concerning companies of different Member States, COM(2003) 613 final – CNS 2003/0239, *Commission of the European Communities*, 17 October 2003, at p. 7.

[13] Proposal for a Council Directive amending Directive 90/434/EEC of 23 July 1990 on the common system of taxation applicable to mergers, divisions, transfers of assets and exchanges of shares concerning companies of different Member States, COM(2003) 613 final – CNS 2003/0239, *Commission of the European Communities*, 17 October 2003, at p. 22. It is noted that the Article 10(3) of the Proposal for a Directive on the common system of taxation applicable to mergers, divisions and contributions of assets occurring between companies of different Member States of 15 January 1969 COM (69) 5 def. contained a similar provision.

> shall have attributed to them the real value that the assets and liabilities transferred had immediately before the transfer of assets."

The preparatory works of the 2005 Merger Directive do not clarify why this paragraph was eventually omitted from that directive. However, to solve the double taxation arising with a transfer of shares, it is recommendable if this paragraph would be inserted.

7. The German anti-directive-shopping rules should not serve as an example for other Member States

The papers refer to the German anti-directive-shopping rules and suggest that other Member States could follow suit by introducing similar rules. Here, we would like to voice a countertone. In our experience, the German rules are very difficult to comply with (even in wholly commercial and legitimate corporate structures), overly complex, and they cause severe administrative nuisance. The rules have clearly made commercially desirable distributions of profit by German subsidiaries much more burdensome.

Firstly, we note that the German rules do not always result in an immediate exemption from withholding tax, but sometimes require a refund thereof. This is at odds with the wording of Article 5 of the Parent-Subsidiary Directive, which requires an immediate exemption.[14]

Secondly, as a deterrent example, we point at Section 50(d)(3) of the *Einkommensteuergesetz* that was amended as of 1 January 2012. The pro-rata test in the provision is so complex; one would almost need to be a Fields medalist to understand it. In essence, if a foreign shareholder earns income on which German withholding tax is imposed the withholding tax will only be reduced – unless individual relief entitlement is applicable – to the extent of the untainted gross receipts in relation to the overall gross receipts. Such pro-rata relief is therefore only granted to the extent there is untainted income. Accordingly, if a foreign company – of which the shareholders themselves would not be entitled to withholding tax relief directly – receives dividends of 1,000 from an actively-managed German subsidiary and the company earns passive income of 100, the German tax administration takes the view that only 91% of the German dividend withholding taxes are to be refunded or a 91% withholding tax exemption should be granted. For the remaining 9%, relief depends on other factual relief entitlement and/or the individual and factual relief entitlement of the shareholders. To understand when gross receipts are considered to be generated by own business activities, one has to rely on wording on a circular that was released on 24 January 2012 ("earnings that are economically functionally linked to own business activities"). All these difficult calculations and ambiguous terms do not make a great example in a field covered by the Parent-Subsidiary Directive, where immediate exemption from juridical and economical double taxation should be the main rule.

EBIT trusts that the above comments are helpful and hopes they will be taken into account in the Commission's policy-making.

[14] See B.J.M. Terra and P.J. Wattel, *European Tax Law*, Kluwer: Deventer 2008, at p. 501.

Yours sincerely,

European Business Initiative on Taxation – May 2013

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