



Double Taxation Cases Outside the Transfer Pricing Area

December 2013

FOREWORD

At the meeting of the Platform for Tax Good Governance that took place on October 16, 2013, a discussion was held on remaining cases of double taxation in the Single Market.

In order to collect data illustrating the problem, DG TAXUD conducted a public consultation in 2010, 'Double taxation conventions and the internal market: factual cases of double taxation'. In 2011 the Commission adopted a Communication, "Double Taxation in the Single Market" COM (2011) 712 where it concluded the need to take actions against international double taxation.

At the Platform for Tax Good Governance meeting, several Member States claimed that double taxation was no longer a problem within the EU. This was challenged by business representatives.

BUSINESSEUROPE promised to conduct a small survey illustrating some of the double taxation cases that exist outside the Transfer Pricing area. In our Tax Policy Group we often hear companies complain about cases of double taxation.

The tax policy group, led by its chair Krister Andersson, has approached some of Europe's largest Multinational Enterprises (MNE's) to answer a questionnaire on double taxation outside the Transfer Pricing area for the period 2008-2012. The survey was sent to Siemens, GE, Unilever, Shell, AB Volvo, Yves Rocher, Volkswagen, Microsoft, ABB, Novartis, Caterpillar, AstraZeneca and BP. One other very large company sent in a reply without being asked to do so. In total we received 10 responses. This report provides an overview of these responses.

I am very grateful to Krister and colleagues at the Confederation of Swedish Enterprise for carrying out this survey on behalf of BUSINESSEUROPE. I hope the report can help properly inform policy discussion in this important area. If you have detailed comments on the report, Krister can be contacted directly at the following email address kriste.andersson@swedishenterprise.se



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EXECUTIVE SUMMARY

This study confirms that double taxation outside the Transfer Pricing area remains a problem and an obstacle for cross border trade and investments. In respect of **allocation of group common cost**, the responding MNE's in this limited study have encountered double taxation in as much as *seven* Member States. **Limitation in interest deductibility** has resulted in double taxation in *ten* Member States. Furthermore, MNE's have encountered double taxation as a result of **foreign tax credits** in *five* Member States and in respect of Permanent Establishment (PE) issues, in *six* Member States. **Diverging qualifications or interpretations** have caused double taxation in *seven* Member States. Germany and Italy have been identified as the Member States in which most double taxation cases have occurred.

In addition to the actual cases where double taxation have occurred, MNE's express concern that double taxation is likely to increase due to a number of new tax proposals in some Member States. Such proposals have been presented in France and Belgium in respect of limitations in interest deductibility and in Germany, France, Spain and Portugal in respect of loss utilization. Furthermore, MNE's complain that, where double taxation has been avoided, the issue has been very resource intensive and has required restructurings with significant increase in administrative costs. Several MNE's also bring up that they expect that the Base Erosion and Profit Shifting (BEPS) project will result in many more cases of international double taxation. It is therefore crucial that much work is undertaken regarding Dispute Resolution Mechanism and Arbitration (BEPS action point 14 in particular). If governments were to act unilaterally, the situation would be even more serious.

The responses from ten large MNE's are certainly not representative for illustrating the occurrence of international double taxation in Europe outside the Transfer Pricing area. The MNE's included all have large tax departments and spend considerable resources ensuring compliance with laws and regulations in the countries where they operate. Their knowledge of tax laws is probably in general higher than for Small and Medium Sized businesses (SME's) in Europe. One might expect that SME's find the cost of ensuring compliance to be so large that they may refrain from making use of the full potential of the Single Market. If very large MNE's encounter the number of international double taxation cases indicated in this very brief survey, SME's can be expected to encounter even more cases, in particular regarding tax credits and withholding taxes. The cost of "getting it right" is in many cases out of proportion to the disputed amount in each transaction. The net outcome may therefore be abstention from cross-border activities as the tax systems act as a deterrent to investment and cross-border activities.

The BEPS project is an opportunity to review which tax regimes are acceptable for countries to use and to ensure taxpayer compliance with EU law compliant national laws and regulations. During a transitional period, as tax laws are changed, the risk for conflicting national tax laws and diverse implementations will increase. It is therefore very important to ensure a proper framework for resolving tax disputes between Member States with timely corresponding adjustments. Unfortunately, the starting position is not ideal. It merely underlines the need for actions by Member States.

ALLOCATION OF GROUP COMMON COSTS

The first question in the questionnaire addresses the allocation of group common costs. As businesses are operating more globally, group common functions (such as HQ-costs etc.) need to be distributed throughout the various legal entities of the group. In many countries, deductibility is not allowed unless it is possible to show with specificity that a service has been provided which is for the benefit of the particular legal entity.

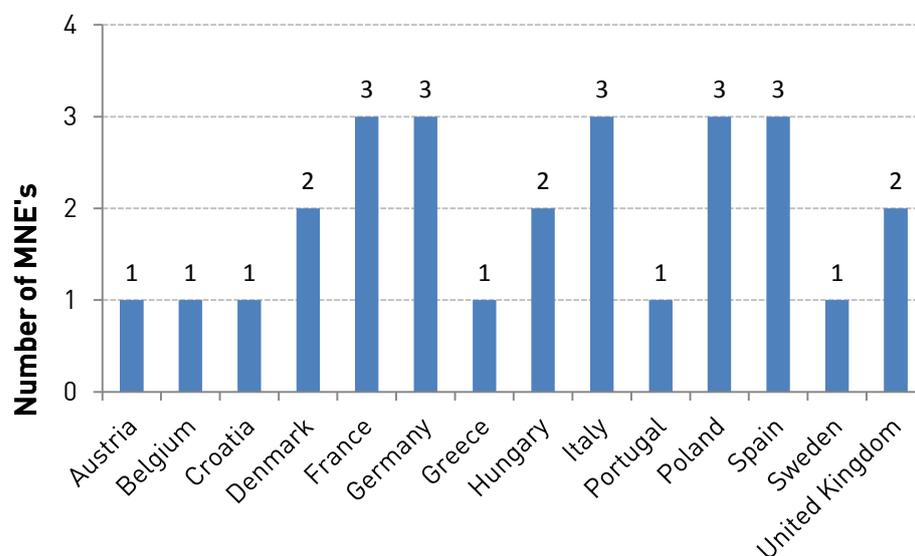
Q1.a

In which MS of the EU have your cost allocation been challenged by tax authorities during the income years 2008 to 2012?

Six MNE's have answered that their cost allocation for group common cost has been challenged by tax authorities during the income years 2008 to 2012. *Chart 1* below indicates the number of MNE's that have had their group common cost allocation challenged in each respective Member State.

Chart 1

In which MS have your group common cost allocation been challenged by tax authorities (income years 2008 to 2012)?



As indicated in *chart 1*, *three* MNE's have experienced this problem in each of France, Germany, Italy, Poland and Spain, *two* MNE's in each of Denmark, Hungary and the UK and *one* MNE in each of Austria, Belgium, Croatia, Greece, Portugal and Sweden.

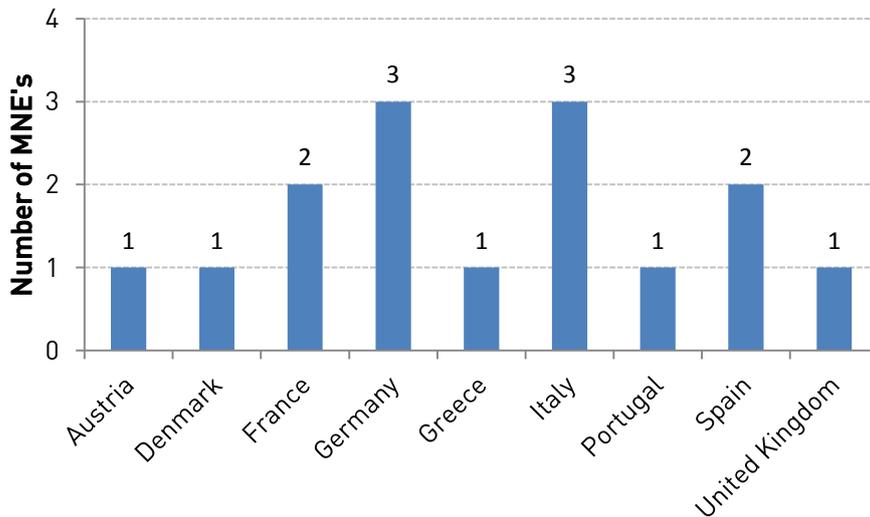
Q1.b

For which EU countries has it resulted in an uncertain tax position in your accounts?

Cost allocation challenged by tax administration has resulted in uncertain tax position for five MNE's. *Chart 2* below indicates the number of MNE's that have experienced uncertain tax position as a result of assessments by tax authorities in respect of group common costs in each respective Member State.

Chart 2

For which EU countries has it resulted in an uncertain tax position in your accounts?



As indicated in *chart 2*, *three* MNE's have experienced problem in each of Germany and Italy, *two* MNE's in each of France and Spain and *one* MNE in each of Austria, Denmark, Greece, Portugal and the UK.

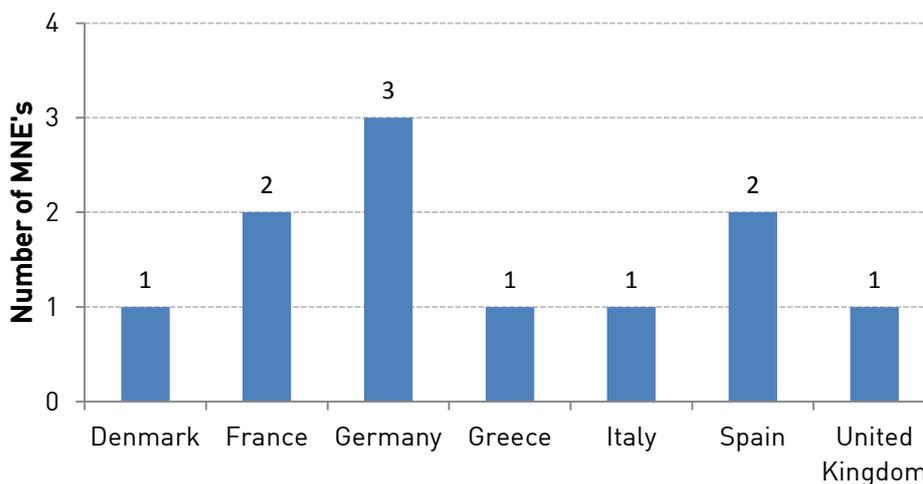
Q1.c

In which EU countries has it resulted in double taxation?

Five of the six MNE's that have had their allocation of group common cost challenged by tax administrations have experienced double taxation within the EU in respect of group common cost. *Chart 3* below indicates the number of MNE's that have experienced double taxation in this regard in each respective Member State.

Chart 3

In which EU countries has it resulted in double taxation?



As indicated in *chart 3*, *three* MNE's have experienced double taxation in Germany, *two* in each of France and Spain and *one* in each of Denmark, Greece, Italy and the UK. Companies have complained that Poland's documentation requirements for deducting some group common cost are too onerous and that some cost are not deducted for that reason.

Q1.d

Did the assessing officer alter the assessment when the question of Mutual Agreement Procedure (MAP)/arbitration was brought up? (Increased risk of future audits, higher assessments etc.)

Among the comments received on this question were the following;

- In some countries, like Germany, the assessing officer even increased the position in order to have a "better negotiation level".
- Yes. Denmark proposed an assessment conditioned on taxpayer rejection of MAP rights.

LIMITATION OF INTEREST DEDUCTIBILITY

The trend towards more stringent rules for interest deductibility (thin cap, earning stripping rules etc.) tends to give rise to difficulties for groups with high overall level of debt financing. The second question of the survey refers to double taxation as a result of limitation of interest deductibility.

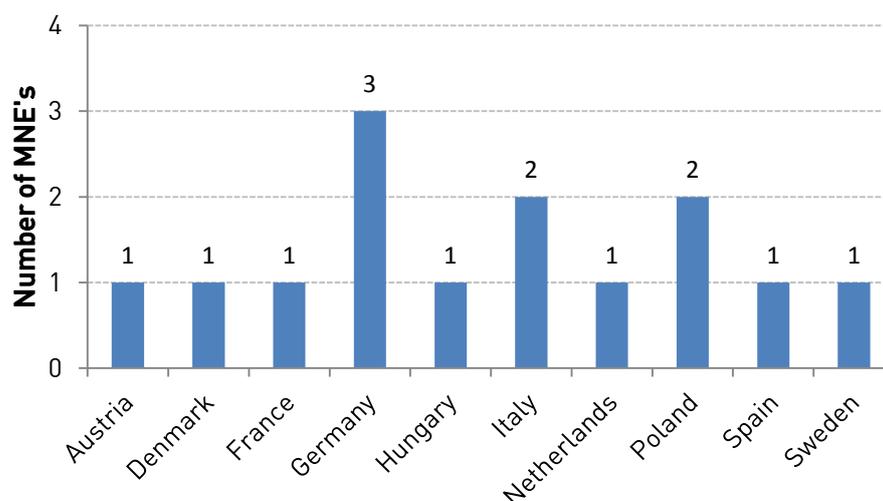
Q2.a

In which countries have disallowance of interest deductions resulted in double taxation?

Five MNE's have experienced double taxation as a result of limitation on interest deductibility. *Chart 4* indicates the number of MNE's that have experienced this problem in each respective Member State.

Chart 4

In which countries have disallowance of interest deductions resulted in double taxation?



As indicated in *chart 4*, *three* MNE's have experienced problem in Germany, *two* in each of Italy and Poland. *One* MNE have experienced problem in each of Austria, Denmark, France, Hungary, Netherlands, Spain and Sweden. In addition to these cases, MNE's are worried that proposed new rules in France and Belgium is likely to cause double taxation in the future.

The fact that withholding taxes and similar taxes are levied on the gross payment in the source state, whereas the foreign tax credit is calculated on the net income in the residence state, often give rise to difficulties in getting full double tax relief. This, in combination with limitations in carry forward rules etc., could lead to double taxation. The third question refers to double taxation connected to foreign tax credits.

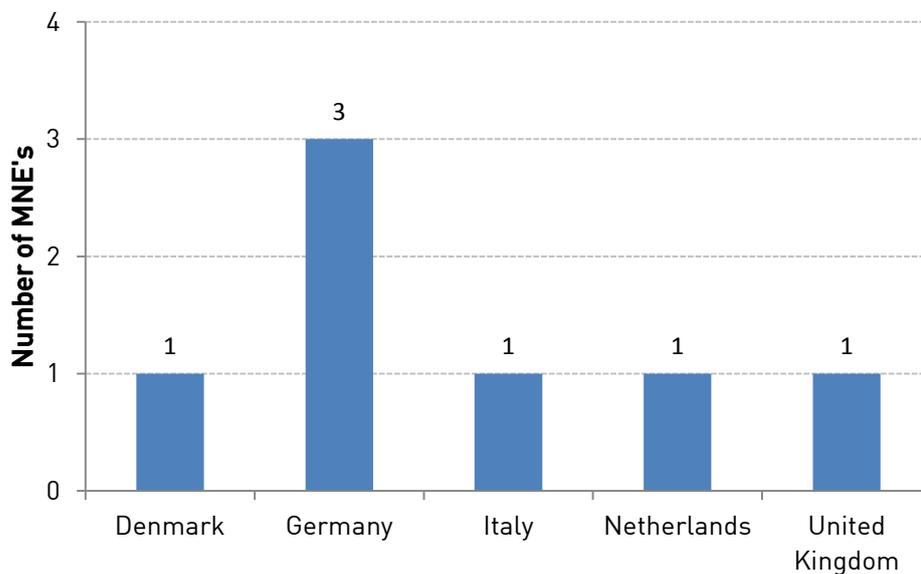
Q3.a

In which countries have you encountered double taxation as a result of tax credits?

Four MNE's have experienced double taxation within the EU in connection with foreign tax credits. *Chart 5* indicates the number of MNE's that have experienced this problem in each respective Member State.

Chart 5

In which countries have you encountered double taxation as a result of tax credits?



As indicated in *chart 5*, *three* MNE's have experienced problem in Germany and *one* in each of Denmark Italy, Netherlands and the UK.

4 PERMANENT ESTABLISHMENT

The PE concept is constantly under review in the OECD model and is creating a lot of interpretation difficulties. Consequently, it is creating a lot of MAP cases. The fourth question of the questionnaire concerns double taxation as a result of issues related to PE.

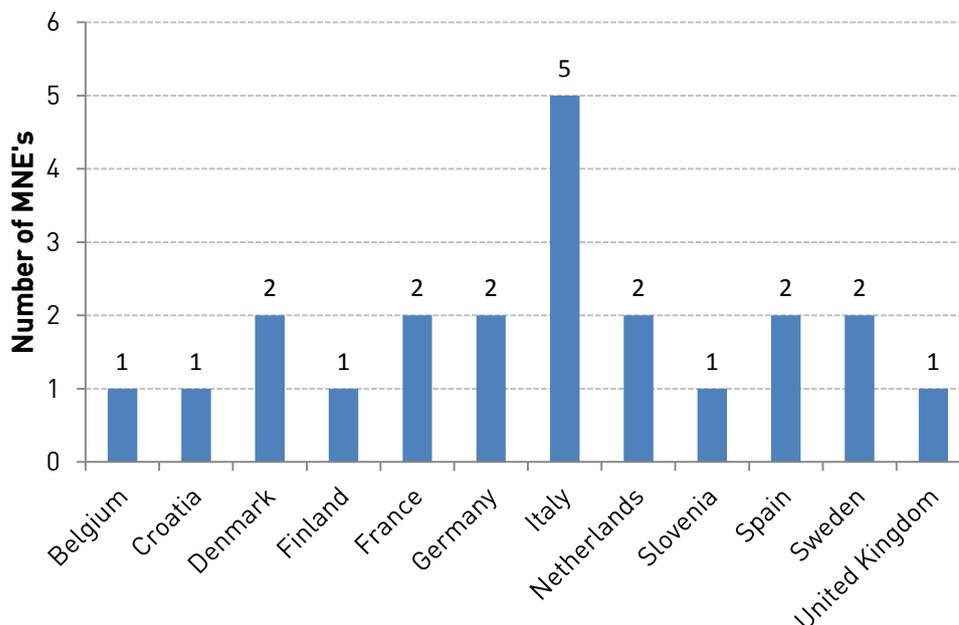
Q4.a

In which countries have you had discussions with tax authorities on PE issues (outside of TP)?

Seven MNE's have had discussions with tax authorities in PE issues outside of the Transfer Pricing area. *Chart 6* indicates the number of MNE's that have had such discussions in each respective Member State.

Chart 6

In which countries have you had discussions with tax authorities on PE issues (outside of transfer pricing)?



As indicated in *chart 6*, *five* MNE's have had such discussions in Italy, *two* MNE's in each of Denmark, France, Germany, Netherlands, Spain and Sweden, and *one* MNE in each of Belgium, Croatia, Finland, Slovenia and the UK.

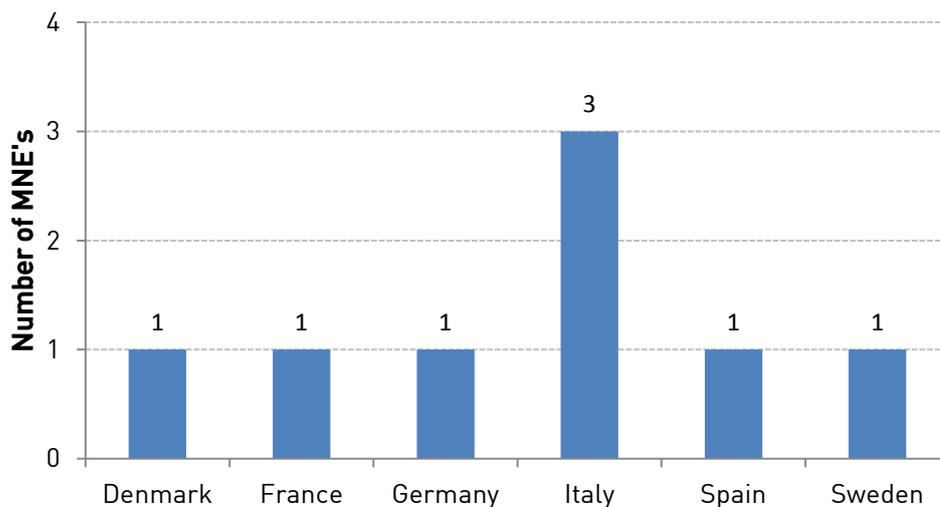
Q4.b

In which countries have you encountered double taxation as a result of unresolved MAP cases concerning the concept of PE?

Among the six MNE's that have had discussions with tax authorities on PE issues, four have also experienced double taxation as a result. Furthermore, MNE's complain that, where double taxation has been avoided, the issue has been very resource intensive and required restructurings with significant increase in administrative costs. *Chart 7* indicates the number of MNE's that have experienced double taxation in this area for each Member State respectively.

Chart 7

In which countries have you encountered double taxation as a result of unresolved MAP cases concerning the concept of PE?



As indicated in *chart 7*, *three* MNE's have experienced double taxation in this respect in Italy and *one* MNE in each of Denmark, France, Germany, Spain and Sweden.

DIVERGING QUALIFICATIONS OR INTERPRETATIONS

Diverging qualifications or interpretations might occur when referring to certain types of income (e.g. management fees, technical services, board remuneration, etc.) or for a certain concept (e.g. beneficial ownership for which there is no common definition at the EU level). Question five addresses double taxation as a result of diverging qualifications or interpretations.

Q5.a

In which countries have you encountered double taxation as a result of diverging qualifications or interpretations?

Four MNE's have encountered double taxation as a result of diverging qualifications or interpretations in Belgium, Bulgaria, Germany, Italy, Netherlands, Poland and Romania (one MNE in each country).

The following instances have been brought to our attention by the MNE's.

- “Poland and Bulgaria re-qualify “group common costs” to “non-deductible management fees.”
- “In Poland, a cash-pool leader is not accepted as a beneficial owner, causing withholding tax at full (non-treaty reduced) rate becoming due on payments.”

OTHER AREAS IN WHICH DOUBLE TAXATION OCCUR (OUTSIDE THE TRANSFER PRICING AREA)

In the questionnaire, the MNE's were given the opportunity to elaborate on further areas where double taxation occurs. A number of MNE's have expressed concern that the BEPS project will become a vehicle for international double taxation, and that national legislations derived from the BEPS project may increase the number of double taxation cases. A recent Mexican proposal which de facto declared most of Europe a tax haven is mentioned. In addition, MNE's foresee particular problems in the southern and eastern European countries as well as some major central European states. MNE's have also identified a number of double taxation risks in Norway, which is an EEA country rather than an EU member.

Below are some of the comments which were submitted.

- **Loss utilisation:** "In our case, the most immediate risk for double taxation lies in the increasing limitations in loss utilization that many of the European countries are now introducing. The limitations imposed in e.g. Germany, France, Spain and Portugal constitute a clear risk that we will never be able to utilize our losses with double taxation as a consequence (i.e. the income in state A is taxed whereas the deduction in state B is disallowed). This is to the detriment of companies that already are in a hard financial position. E.g. the Spanish rules where only 25% of the losses are allowed to be used against profits in combination with time limitations are very likely to result in unutilized losses. These kinds of limitations also have a very negative impact on the Group's cash flow."
- **Further on loss utilization in Spain:** "Double taxation arises because of the amendment of the corporate tax law recently enacted in Spain. It results from the limitation of deduction of losses as a consequence of the sale of shares of a non-resident undertaking. The new legislation states that losses arising from the sale of shares of a non-resident undertaking will decrease by the amount of dividends from these shares (dividends obtained since 2009), insofar as the deduction to avoid double taxation can be applied to the dividends. Double taxation arises where the sale of the shares generates a negative income (i.e. losses), the dividends received before the sale (that have been taxed in the other jurisdiction) decrease these losses and, consequently, there is a bigger tax base with the dividends already taxed in the other jurisdiction."
- **Access to the Arbitration Convention:** "Access to the Arbitration Convention is another key issue going forward. Our experience is that countries are very reluctant to allow this and tries to find "loopholes" to avoid access (e.g. serious penalties in "normal" cases, do not adhere to time limits stipulated in the AC etc.). We interpret this as a general unwillingness to resolve double taxation within the EU."
- **Withholding tax in Austria:** "The Austrian tax authorities impose withholding tax on the deemed dividend distribution implied by their re-assessment of Austrian taxable income. This withholding tax can obviously never be collected due to the applicability of the Parent-Subsidiary Directive, which means that its assessment can lead only to extra administrative burden and possible interest effects while the assessment is "in force".

- **Improvements to MAP:** “Generally, we consider that double taxation is usually only suffered where different Member States have unilateral and opposing interpretation of double taxation agreements. The sensitive areas may include HQ charges, permanent establishments (especially, partnerships as PEs for partners; dependent agent PEs or service PEs). In such cases, Mutual Arbitration Procedures should subsequently eliminate the double taxation, but the process is a lengthy one, and there is a feeling that as tax authorities are aware of this fact there is an opportunity for them to seek settlements which result in the acceptance of double taxation by the taxpayer rather than having to go through arbitration. Improvements to the MAP process would help eliminate the risk of this.”
- **Cost allocation in Poland:** “The deductibility of management charges (cost allocations) depends on the evidence that the services were actually provided to the Polish subsidiary and the Polish subsidiary benefited from them. The cost allocation is deemed to be an intangible service provided to the Polish subsidiary by the HQ. Additionally, certain costs (e.g. costs of consolidated financials) are qualified as non-deductible shareholders' costs (stewardship costs) and the definition of such costs may differ from the definition in the shareholders' country of residence.”
- **Carry forward of foreign tax credits in Poland:** “There is no carry forward of foreign tax credits in Poland, which may trigger double taxation, if the foreign-source income is offset with a loss on domestic sources of income. Foreign tax credit can be utilized only if a Polish taxpayer shows a taxable profit in a given tax year.”
- **Withholding tax in Poland:** Poland applies the beneficial owner clause provided in treaties on avoidance of double taxation to look-through the cash pool leader, and claims that the WHT rates applicable to the other participants in the cash pool (who are deemed to lend directly to the Polish cash pool participant) should be used. Application of WHT to leasing fees under the bilateral treaties signed by Poland which qualify the leasing fees as royalties for use of technical equipment. As the treaties refer to gross payments, the Polish tax authorities claim that the tax base for WHT is the leasing fee including VAT. This may lead to double taxation in the other country which sees only the leasing fee net of VAT as the income of the lessor.
- **Legislative proposals in Poland:** “When the new legislative proposals of the Polish Ministry of Finance become a law, sensitive areas could include:

 - Thin capitalization restrictions, through which the non-deductible interest remains interest for international taxation purposes; and
 - The CFC proposals include a rule that CFC rules are applicable to a foreign branch income, even if the tax treaty provides for exemption method for foreign PE income. The tax treaties prevail over the domestic tax rules, but according to the Ministry of Finance it should not be the case with CFC income in the foreign branch.”

- Withholding tax in the Netherlands:** “If a Dutch corporation tax payer (BV1) incurs an expense, that expense is taken into account where its Dutch subsidiary (BV2) claims relief from tax on foreign source income (if BV1 has deducted that expense and it relates to the foreign source income earned by BV2). Thus, if you had BV1 borrowing say EUR 1,000 @ 4.9% and it contributed that amount to BV2 as equity, and had BV2 purchase EUR 1,000 worth of denominated bonds with a coupon of 5% and 15% WHT, then BV2 tax liability is as follows:

Taxable income = 1,000 x 5% = 50

Tax on income = 25% x 50 = 12.5

Foreign tax credit equal to lower of:

(1) 15%WHT x 50 = 7.5

(2) (50 – 49) / 50 x 12.5 = approx. 0

Tax liability is 12.5 with approx. 0 as a foreign tax credit. There’s no relief for double taxation at BV2 level. (For BV1 and BV2, jointly, there’s no double taxation as BV1 can deduct 49 of interest expense, economically offsetting the tax at BV2).”

The responses from ten large MNE's are certainly not representative for illustrating the occurrence of international double taxation in Europe outside the Transfer Pricing area. The MNE's included all have large tax departments and spend considerable resources ensuring compliance with laws and regulations in the countries where they operate. Their knowledge of tax laws is probably in general higher than for Small and Medium Sized businesses (SME's) in Europe. One might expect that SME's find the cost of ensuring compliance to be so large that they may refrain from making use of the full potential of the Single Market. If very large MNE's encounter the number of international double taxation cases indicated in this very brief survey, SME's can be expected to encounter even more cases, in particular regarding tax credits and withholding taxes. The cost of "getting it right" is in many cases out of proportion to the disputed amount in each transaction. The net outcome may therefore be abstention from cross-border activities as the tax systems act as a deterrent to investment and cross-border activities.

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