



## Position Paper

Ref. BUSINESSEUROPE FISCAL AFFAIRS GROUP  
Contact : Mr. Krister Andersson, chairman

18 February 2009

To : Mr. Jeffrey Owens  
Director  
OECD Centre on Tax Policy and Administration

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SUBJECT : BUSINESSEUROPE Fiscal Affairs Group – comments on the OECD Discussion Draft entitled “Transfer Pricing Aspects of Business Restructurings: Discussion Draft for Public Comment 19 September 2008 to 19 February 2009”

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Dear Jeffrey,

BUSINESSEUROPE is pleased to provide the following comments on the OECD Discussion Draft entitled “Transfer Pricing Aspects of Business Restructurings: Discussion Draft for Public Comment 19 September 2008 to 19 February 2009”.

Business restructuring is an important topic that raises difficult tax issues from a transfer pricing aspect. BUSINESSEUROPE recognises and compliments the OECD for its efforts to reach a common understanding on how business restructurings should be treated for transfer pricing purposes.

BUSINESSEUROPE is, however, concerned about the impact the proposed guidelines could have on European companies’ ability to restructure. To achieve a well functioning market within the EU it is essential that rules and guidelines for companies are designed to that end. Considering the fact that many OECD countries also are members of the EU, OECD guidelines must be in line with EC law. Unfortunately, as discussed below, there are aspects of the Discussion Draft that raise questions in this regard.

### General comments

Business operations take place in an ever changing environment and the need for companies to adapt quickly is essential. The current financial crisis shows what extreme challenges businesses have to confront. Business restructurings constitute a natural part of the endeavour of a business to remain efficient and to stay competitive.

The overwhelming majority of business restructurings are conducted out of sound commercial reasons. BUSINESSEUROPE would, however, like to stress that the fact that a restructuring has led to a tax saving is legitimate and should not in itself give rise to a tax dispute between governments. As long as functions, assets, and risks are transferred on an arm’s length basis, a tax saving resulting from a restructuring is a valid commercial consideration.

Companies need predictability and clear guidance on how to structure and apply transfer pricing rules to a business restructuring. Consequently, the need for



consensus and equal application of transfer pricing rules in the Member States and beyond is of utmost importance. Unfortunately, there are ambiguities and widely divergent views expressed in the Discussion Draft. This increases the risk of unresolved double taxation in connection with business restructurings. BUSINESSEUROPE finds that unacceptable.

### **Documentation requirements**

BUSINESSEUROPE is concerned that the Discussion Draft places too much emphasis on the existence of written contracts.

BUSINESSEUROPE agrees that the contractual terms between parties constitute a natural starting point for an arm's length analysis. However, in business dealings between dependent parties, written contracts may not always be as frequent or comprehensive as is the case between independent parties. Although there may be different reasons for this, it essentially stems from the fact that an intra-group transaction does not imply the same commercial risk as a transaction with an independent party. In the latter case, the written agreement is the sole instrument to stipulate the contractual terms between the parties. Within a group (especially between wholly owned entities), there are many other control functions ensuring that the parties adhere to the intended transactions and business objectives.

Consequently, the mere fact that not all terms of a transaction have been formalized in writing or otherwise have been fully documented should not as such be taken as an indication that there is a deviation from the arm's length principle. In this case as well, it is the actual transactions taking place that should be evaluated.

BUSINESSEUROPE is concerned that the increased demand for documentation will prove excessively burdensome to businesses and may hamper their ability to restructure. Taxpayers may have to prove to the tax authorities not only that the restructuring makes commercial sense to the group as a whole, but also that the transactions are at arm's length at the level of each company concerned in the transaction, taken into account its rights (and other assets), its expected benefits from the restructuring as well as the realistically available options etc. BUSINESSEUROPE fears that this ultimately will lead to an increasing number of disputes ending in international double taxation.

### **EU - Exit taxation**

As cross-border investments intensify, tax systems need to be clear and predictable. Multinationals should be able to conduct their day-to-day business without having to pay the price of unresolved tax disputes between governments. Exit taxation is a tax obstacle and accordingly not conducive to competitiveness and economic growth.

BUSINESSEUROPE would have liked to see the issue of exit taxation addressed in the Discussion Draft. Unfortunately, the Draft lacks a thorough analysis of this topic. This is a concern since many of the OECD members also are members of the EU.



From the ECJ cases *de Lasteyrie* (C-9/02) and *N* (C-470/04) it is clear that immediate taxation of unrealized capital gains on assets transferred to another Member State is contrary to the freedom of establishment. Furthermore, a Member State cannot levy a disproportionate burden on a taxpayer as a condition for a tax deferral. Any means to preserve the tax claims must be strictly proportional and not entail disproportionate costs for the taxpayer.

As confirmed in the *N* case, a Member State is not prevented from assessing the amount of income on which it wishes to preserve its tax jurisdiction, provided this does not give rise to an immediate tax charge and that there are no further conditions attached to the deferral. Such a practice is in line with the principle of fiscal territoriality. However, due account has to be taken of any reduction in the value of the assets incurred after the transfer. As a consequence, Member States should provide for an unconditional deferral of tax until the moment of actual realisation.

In its Communication, COM (2006) 825, the European Commission concluded that although the two ECJ cases mentioned above refer to exit taxes on individuals, their outcomes have direct implications for exit taxes on companies levied by Member States.

The Commission concluded that although an unconditional deferral may resolve the immediate difference in tax treatment, double taxation or unintended taxation may still arise due to mismatches between different national rules. This can be the case e.g. where Member States apply different methods in the valuation of assets.

In the ECOFIN Council of 2 December 2008, Member States agreed on a non-binding resolution on coordinating exit taxes. There is political agreement on two of the three main features in relation to exit taxation; valuation, and dispute settlement. Deferral, being the third aspect, has to be coordinated with those Member States that actually levy exit taxes.

BUSINESSEUROPE agrees with the Commission that divergent views and mismatches in valuation of assets ultimately will lead to double taxation. In BUSINESSEUROPE's opinion, exit tax regimes should therefore be replaced with systems that ensure a net taxation of company profits linked to the respective transaction at the moment of realisation. In that context, caution is needed when calculating the arm's length pricing with regard to the location savings.

The Discussion Draft reports several instances where the countries express deviating views on how to levy tax in the event of a restructuring. Noticing the reasoning in the Discussion Draft and the divergent views expressed therein, BUSINESSEUROPE is concerned that this might result in cases of exit taxation not only where the reorganization involves the reallocation of assets, but also where it merely involves the reallocation of functions and risks. Companies should have a right to decide how to allocate risk and functions within the group, without being challenged from a tax perspective, as long as the conditions between the parties are at arm's length.



Taxation of forgone profits is likely to be asymmetric and to violate the principle of net taxation, especially if such profits include estimates on location savings. Therefore, this avenue should not be explored. Instead, emphasis should be placed on recognising the occurrence of actual profits or losses. While the Discussion Draft mainly refers to how to tax profits, it should be recognised that the arm's length principle also entails situations of overall losses. The very recent changes in the economic situation highlight this in an explicit way. It should be noted that pricing in accordance with arm's length principles based on the allocation of risks or functions in a loss situation, may not result in taxation of the net profits of a Group. Consider the case when a subsidiary in country B experiences losses and is closed down due to better business prospects elsewhere. It is unlikely that the full loss will be recognised at the parent level in country A. At best, some of the loss (closing down costs in country B) will be recognised in country A. However, to achieve taxation of the net profit of the Group, full cross-border loss consolidation would be required (a situation that would materialize under a Common Consolidated Corporate Tax Base). The transfer pricing rules used by the Group over a number of years, should, however, be respected by tax authorities also in a loss situation, enabling the Group to consolidate over time.

BUSINESSEUROPE believes that the question of how to deal with closing costs and loss offset in business restructuring situations needs to be addressed explicitly in the Discussion Draft.

It general terms, it would not be acceptable if the implementation of OECD guidelines resulted in exit taxation within the Internal Market. Such an outcome is not desirable even for states outside the EU.

### **Dispute resolution mechanism**

Another area which BUSINESSEUROPE finds not to have been properly addressed in the Discussion Draft is how to solve disputes between tax authorities. Considering the ambiguity and lack of consensus expressed in the Draft, the risk of international double taxation, resulting from disagreement on the application of the provisions or from different valuation concepts, is obvious. Consequently, there is obviously need for dispute settlement procedures.

Although most tax conventions include a provision for corresponding adjustments of profits of the associated enterprise concerned, they do not impose a binding obligation on the contracting state to eliminate the double taxation.

The EU Arbitration Convention, on the other hand, provides for mandatory arbitration in case Member States fail to reach a mutual agreement on the elimination of double taxation. The Arbitration Convention still has many shortcomings, although some of these have been remedied through the work of the Joint Transfer Pricing Forum (JTPF) since the adoption of the Code of Conduct for the effective implementation of the EU Arbitration Convention. Nevertheless, the Arbitration Convention could be a valuable instrument in tackling valuation disputes from restructurings between EU Member States. The need for a Dispute Resolution Mechanism should be explicitly recognised in the OECD Discussion Draft.



## **In conclusion**

BUSINESSEUROPE finds that the Discussion Draft provides a good framework for analyzing the transfer pricing aspects of business restructurings in the context of the transfer pricing guidelines. Considering the complexity of the issue it would, however, have been desirable to find clearer guidance and more consensus in the Draft. In its present version it does not provide enough certainty or predictability for companies on how to apply the transfer pricing rules of a business restructuring.

Furthermore, BUSINESSEUROPE encourages the OECD to properly address the issue of exit taxation in the Discussion Draft. Although, a number of OECD countries are not members of the European Union, the outcome of this work is nonetheless likely to be implemented in many EU member states. Also, the question of how to solve disputes between tax authorities should explicitly be addressed. It must be recognised that transfer pricing disputes are between governments and not between a government and a business entity. Within the EU, only a well functioning internal market is acceptable. It is therefore imperative that governments involved respect and adhere to the decision by another government by making a corresponding adjustment on a timely basis. If not, international double taxation is likely to occur, with negative consequences for economic activities and employment prospects.

The need for predictability and a coordinated approach by the OECD member countries in this area is paramount. BUSINESSEUROPE fears that the divergent views and the ambiguities in the Discussion Draft will have a negative impact on business restructurings. As cross-border investments intensify national tax systems need to be in accordance with international tax obligations and give clear guidance on the tax consequences of a cross border restructuring.

Although recognising the difficulty of this task, BUSINESSEUROPE encourages the OECD to intensify its work in finding consensus in the areas where, currently, widely divergent views are expressed. In the interest of promoting sustainable growth,

BUSINESSEUROPE would naturally be willing to continue a constructive dialogue with the OECD on this topic.

On behalf of the BUSINESSEUROPE Fiscal Affairs Group

18 February, 2009

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