LEWIATAN

Warsaw, 8 March 2016
KL/110/49/PP/2016

Mr.
Konrad Raczkowski
Undersecretary of State
in the Ministry of Finance

Dear Mr. Minister,

In response to the letter ref. no. DD10.RDX/UE1.9005.5.2016 on the consultation of the proposal for a Council Directive laying down rules against tax avoidance practices that directly affect the functioning of the internal market COM(2016)26, I would like to inform you on the position adopted by the Polish Confederation Lewiatan. I would be grateful if you could take our comments and logic into consideration when formulating the position of the Government on the draft of the Directive, or in case such position has already been adopted, to follow it up.

I would also like to draw your attention to the fact that having been given one day to adopt a relevant position, we were unable to analyse the draft properly.

Pursuant to Article 16 of the act on employers organisations in connection with Article 19(2) on the trade unions, employers organoisations shall have 30 days to consult about draft legislation. We find the abovementioned time-limit just right to accurately analyse and consult about draft legislation.

Yours sincerely,

Henryka Bochniarz
the President of the Polish Confederation Lewiatan

Konfederacja Lewiatan
ul. Zbyszka Cybulskiego 3
00-727 Warszawa

tel.(+48) 22 55 99 900
fax (+48) 22 55 99 910
lewiatan@konfederacjalewiatan.pl
www.konfederacjalewiatan.pl

NIP 5262353400
KRS 0000053779
Sąd Rejonowy dla
m.st. Warszawy w Warszawie
XIII Wydział Gospodarczy KRS

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The position on the proposal for Directive of the European Council laying down rules against tax avoidance practices that directly affect the functioning of the internal market

General comments

For quite some time now, the European Council has been stating there is an urgent need to prevent tax avoidance and aggressive tax planning, both at the international and EU level. At the same time, the Council has emphasised that the Organisation for Economic Co-operation and Development (OECD) has completed work on global standards and rules in this regard.

The proposal for Directive of the European Council laying down rules against tax avoidance practices that directly affect the functioning of the internal market COM(2016) 26 (hereinafter the Directive) failed to be accordingly and accurately agreed upon by the representatives of the Member States. Although the Directive is based on OECD reports which include recommendations on preventing practices of tax avoidance and profit shifting ("BEPS"), its provisions go beyond the OECD recommendations.

The European Commission assumes that OECD countries who adopted the abovementioned report shall also adopt the proposal for the Directive without any objections, even though such assumption is ill-formed.

The provisions of the Directive should be discussed in detail by i.a. State Treasury units and Permanent State Representatives, and, as far as possible, by business organisations whose members would be most affected thereby. Failure to hold detailed consultations impedes the proper assessment of the proposed regulation's impact.

Seeking uniform implementation of BEPS solutions throughout the EU shall be deemed eminently reasonable and righteous. Should such provisions be implemented, it will result in reducing administrative burden and decreasing the risk of double taxation. Nevertheless, uniform implementation of BEPS solutions calls for consistent implementation of minimal standards and best practices on preventing the tax avoidance adopted internationally. e.g. standardising Country-by-Contry reporting based on OECD recommendations and introducing Principal Purpose Test or up-to-date definitions of taxable permanent establishment, or renegotiating new agreements on avoiding double taxation.

It needs to be pointed out that the provisions laid down in the proposal for Directive, in its current version, differ from the internationally agreed provisions and go beyond the scope of OECD recommendations. This will result in the provisions of the Directive excluding countries outside European Union. The objective of the Directive will not be fulfilled, unless the wording thereof is compliant with the already agreed-upon OECD documents. Otherwise the Directive will imperil EU business entities.

It is best seen in the proposals for switch-over clause (i.e. application of the credit method instead of the exemption method with progression) or the rules on the taxation of controlled foreign corporations' income which fail to take the actual business activity into consideration. As a result EU member states will be perceived as less attractive by potential investors from outside European Union.

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00-727 Warszawa

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Therefore, according to the Polish Confederation Lewiatan it is necessary for individual member states to assess the impact of the proposed legislation on their respective economies.

For countries outside EU it is unlikely to include best practices recommended by OECD, or for that matter the solutions laid down in the Directive, in their local applicable law. This will put EU entrepreneurs in less favourable position compared to their competitors outside European Union with respect to administrative burden, effective tax rates (other than the independently adopted rates), and will potentially result in multiple taxation. Therefore, implementing the Directive will be disadvantageous for EU entities, investments, jobs and economic growth of European Union. We feel strongly alarmed by the lack of extensive consultation or assessment of the regulation's impact with regard to the solutions proposed by the draft of the Directive – such consultations and analyses need to be carried out by individual EU member states prior to proceeding with the implementation of the Directive as it is currently drafted in order to obtain better understanding of the Directive's impact on national economies.

With respect to the general anti-abuse rule, member states need to be provided the possibility to take into consideration the nature of the existing special clauses or clauses which constitute basis for agreements and CFCs. Multiple overlapping clauses will be disadvantageous for both the tax payers and tax authorities. Should such solutions be implemented, it shall be reasonable to introduce relevant provision, calling for the annulment of the existing clauses or replacing such clauses with a single uniform clause. It is imperative to instruct on eliminating double taxation of associated enterprises resulting from the application of the clauses proposed in the Directive.

The Directive should safeguard the preservation of the acquired rights i.e. it shall not apply to activities or transactions carried out prior to the entry thereof. Currently, the draft fails to provide for such exclusion.

Detailed comments

Article 4 Interest limitation rule

The abovementioned rules were not agreed as minimal standards under OECD. As a consequence, it shall be deemed unsuitable to implement such rules and require European countries to adhere thereto. Restrictions of Article 4(3) will not apply to countries outside European Union. Therefore, EU member states will be limited by such restrictions and incapable of competing with countries excluded therefrom.

The provision should not apply to financial service providers. At the same time, the Directive fails to provide for the means to increase the rate of net interest expenditure by 10% which aims at mitigating double taxation. OECD recommendations in the abovementioned scope shall be taken into consideration.

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Article 5 Taxation of unrealised capital gains in case of transferring assets from tax residence or permanent establishment

All regulations in this regard failed to be agreed as minimal standards under OECD. As a consequence, it shall be deemed unsuitable to implement such regulations and require European countries to adhere thereto. Article 5 shall not apply to EEA countries but rather third countries instead. First, the proposed provisions will complicate the process of computing and establishing tax base in EU member states, and second, it will inhibit the freedom of movement of persons and capital between the member states.

Article 6 Switch-over clause

OECD's stipulations in the abovementioned regard did not provide for the requirement to implement a clause on waiving exemption in aid of credit method. Therefore, the Directive implementing the clause for all EU member states, fails to be compliant with international stipulations.

The switch-over clause which is based on statutory rates and not on the actually conducted business activity or active /passive income, is arbitrary and may result in the member states discriminating some subsidiaries/investments over others. Furthermore, the clause is incompliant with the concept of taxation consistent with value creation/business activity which is the main objective of the Directive and may interfere with the decisions on allocation of capital made by the business entities.

The clause will not apply to third countries which deem it inconsistent with applicable international treaties.

It is worth pointing out that countries which adopted the clause generally use it as an alternative to CFC rules. The Directive advocates for concurrent implementation of both instruments, which increases the risk of double taxation.

Our concerns with regard to clause include, in particular:

- Applying the clause to income from actually conducted business activity (no limitation to justpassive income).
- Uncreditable taxes: there are doubts so as to the type of withholding tax creditable against tax paid at the place of residence, which may cause problems in case of taxes withheld in developing countries.
- Tax incentives for investments: similarly, a question arises of whether low tax rates – which are foundation of the proposed solution – introduced by developing countries as investment incentives should result in the taxation at the level of individual shareholders in connection with applying switch-over clause.

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Article 7 General anti-abuse rule

All regulations in this regard failed to be agreed as minimal standards under OECD. Furthermore, previous experience regarding the implementation of clauses for circumventing the provisions of applicable laws in individual member states, showed there is no uniformity in this regard throughout EU.

Articles 8 and 9 Controlled foreign company legislation/ Computation of controlled foreign company income

The abovementioned rules were not agreed as minimal standards under OECD. As a consequence, it shall be deemed unsuitable to implement such rules and require European countries to adhere thereto.

Similarly to the switch-over clause CFC rules which are based on statutory rates and not on the actually conducted business activity or active /passive income, are arbitrary and may result in the member states treating subsidiaries/investments unequally. Furthermore, the clause is incompliant with the concept of taxation consistent with value creation/business activity which is the main objective of the Directive.

At the same time, we would like to point out all the challenges related to the implementation CFC rules and compliance therewith e.g. multilevel holdings and ambiguous terms such as “non-genuine arrangements” which allow for the occurrence of doubts, unnecessary administrative burden and multiple taxation. Other doubts concern the effective tax rate which may be dictated not by the structure of subsidiary, but the disparities between laws applicable over the jurisdiction of subsidiary and parent undertaking (e.g. disparities in tax loss carry-forward and utilization rules).

Article 10 Hybrid mismatches

All regulations in this regard failed to be agreed as minimal standards under OECD. As a consequence, it shall be deemed unsuitable to implement such regulations and require European countries to adhere thereto. Furthermore, there are doubts so as to whether the regulations comply with European Union law.

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