EXIT TAXES: SERIOUS OBSTACLES FOR INTERNATIONAL BUSINESS RESTRUCTURINGS AND MOVEMENTS OF CAPITAL

POLICY STATEMENT

Prepared by the ICC Commission on Taxation

Summary and highlights

Exit taxes generally seek to tax unrealized gains the moment a company's seat or assets leave the country. ICC recommends that states should not enact exit taxes of general application. If states, nonetheless, apply exit taxes, ICC makes recommendations for minimum standards in the design and application of such measures that would take into account the arm's length principle and avoidance of double taxation. Furthermore, where the levy of exit taxes is appropriate a taxpayer should have the possibility to provide adequate guarantees to cover the future tax claim.

ICC INTERNATIONAL CHAMBER OF COMMERCE
The world business organization

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Introduction

Increasingly, states are complementing their existing tax regimes by implementing so-called exit taxes or business restructuring tax regimes to protect their taxation rights when companies transfer their seat, functions and risks or assets to another country. The discussion on Base Erosion and Profit Shifting (BEPS), recently facilitated by the Organisation for Economic Cooperation and Development (OECD) and initiated by the G20, and the decrease of tax revenue will lead to an increased sensitivity on this topic among governments. These exit taxes or business restructuring tax regimes may entail significant double taxation, acceleration of tax claims and considerable compliance burdens for multinational enterprises. The international transfer of corporate seats, functions, risks or assets have become progressively more common given the international mobility of capital and the tendency of global business models to evolve in the face of competitive pressures.

Exit taxes generally seek, in some manner, to tax unrealized gains the moment the company seat, functions, risks or assets leave the country. However, the fact that the former state has already taxed part of the gain does not automatically mean that the new state in which a later realization actually takes place, will take account of such taxes by limiting its taxation right to the value accrued in its country or by granting a tax credit for the taxes paid in the former state. Tax treaties do not generally afford sufficient protection because they lack precise rules to deal with such situations.

States should find means to protect their tax bases using the existing and the generally accepted tax rules to tax the recapture of previously tax deductible amortization or depreciation without resorting to additional exit taxes.

If such regimes are nevertheless enacted, ICC strongly believes that, in the interest of avoiding excessive or double taxation, at a minimum certain safeguards should be included to protect the free movement of capital and the efficient functioning of enterprises.

Different kinds of exit taxes (static / dynamic exit taxes i.e. Germany)

The domestic law of most states includes provisions in order to tax unrealized gains when the seat of a company, its functions and risks are transferred abroad. Technically, these regimes generally measure the amount of such unrealized gains by determining the amount which would have been realized had the assets been sold in the market. In effect, the enterprise realizes “phantom” income as if it had sold its inventory, fixed assets and possibly intangible property at market value.

The scope of such exit taxes varies among states. In addition to the taxation of unrealized gains, states may also provide in their domestic law for the recapture of previously enjoyed deductions or deferrals, such as depreciation or reserves. Some states also impose a tax in lieu of the levy of dividend withholding taxes.

Finally, businesses have encountered situations where tax administrations determine the amount of exit tax by computing the net present value calculation based on:

- The actual earnings relating to the function/activity in question; or
- Possible future earnings under the arm’s length principle.

Harmful effects for the business community

Exit taxes have a number of adverse effects on international business:

- They make it more difficult for companies to restructure and adapt to changing economic conditions in a globalized world. The taxation of phantom income may pose a considerable obstacle to commercial re-organizations that would otherwise occur.
- They withdraw liquidity and net equity by taxation of unrealized gains or by an obligation to provide adequate security for such deemed gains.

- They create new complexity and increased burdens of compliance and administration for both companies and tax authorities. A substantial difficulty is to determine the market value of transferred assets.

Furthermore, such taxes may lead to double taxation of the same gains. In many cases, the second state simply taxes the full gain on realization with no recognition of the exit taxation previously applied in the other state. Even if the second state does provide some form of recognition, excessive taxation may remain if the states do not apply the same valuation. The taxation rights need to be synchronised; otherwise the burden remains at the level of the multinational enterprises.

ICC recommendations

ICC recommends that states should not enact exit taxes of general application. This position is consistent with certain supranational rules such as the European Union law providing for non-discrimination and free movement of capital. Exit taxes should rather be reserved for exceptional circumstances, such as in cases of tax evasion or where a coordination of taxation between the two states is rendered difficult by the absence of a bilateral tax treaty.

If states believe that they must protect their tax bases by retaining the right to tax unrealised gains in respect of international business restructurings, then they should rely on cooperation with other jurisdictions and bilateral tax treaties to preserve their right to tax only upon the actual alienation of property in such a manner as to avoid all double taxation. Such substantive measures of coordination may be coupled with appropriate exchange of information and assistance in collection provisions in the tax treaties.

With regard to the on-going discussion on BEPS facilitated by the OECD and mandated by the G20, ICC believes that attention should be given on the appropriate steps to address the interests of both, the business community and governments.

If states do, nonetheless, continue to apply exit taxes, ICC makes the following recommendations as minimum standards in the design and application of such measures:

1. Avoidance of double taxation
Exit taxes lead to double taxation if neither the domestic laws of the states involved nor a tax treaty provides a mechanism for its avoidance. Furthermore, even if such mechanisms exist, they may be insufficient to fully avoid double taxation.

The avoidance of double taxation must be addressed and resolved if countries wish to impose exit taxes. Exit taxes should not be applied if the new state does not provide proper recognition for the gain already taxed by the former state.

In case of triggering an exit taxation in Country A (based on a local exit tax regime) a corresponding deduction or depreciation mechanism in Country B needs to be in place.

The OECD Model Income Tax Treaty should be modified to clarify that exit taxes are eligible for Mutual Agreement Procedure (MAP) relief.

2. Valuation to follow the arm's length principle
Where exit taxes are computed on the fair value of assets at the time the seat, functions, risks or assets of the company are transferred abroad, the determination of value should be based on the application of the arm's length principle, following the OECD guidelines. The new state of residence should adopt the same principle in measuring the gain to be taxed on ultimate disposition. Disputes should be resolved by the means provided for, in the applicable tax treaty. Such basic principles for determining the respective value are crucial to reduce both the risk of double taxation and the complexity of compliance.

It is noted that the problem of exit taxes is exacerbated by importation of financial valuation models into the OECD Transfer Pricing Guidelines, as reflected in the 2013 proposed Intangibles Guidelines as well as the 2010 Business Restructuring Guidelines. Such expansion of potentially applicable principles poses an increased risk of potential double taxation.

3. Further recommendations on dealing with exit taxes

Where the levy of exit taxes is appropriate, as the result of treaty negotiation between the respective countries, a taxpayer should always have the possibility to provide adequate guarantees to cover the future tax claim, rather than having to pay the tax immediately.

When the exchange of information and assistance in the collection of taxes due are agreed among the respective countries, a guarantee should not be required. In this case, the principle of non-discrimination should bar the country of origin from imposing extra-costs on the restructuring. The taxpayer should only be required to make a yearly report on the assets that were transferred.

Compliance burdens connected with exit taxes must be minimized. There should be no obligation for the taxpayer to register in both the former and the new state; nor should third parties be obliged to report when a sale of assets takes place or to collect a withholding tax.

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INTERNATIONAL CHAMBER OF COMMERCE

The world business organization

The International Chamber of Commerce (ICC)

ICC is the world business organization, a representative body that speaks with authority on behalf of enterprises from all sectors in every part of the world.

The fundamental mission of ICC is to promote open international trade and investment and help business meet the challenges and opportunities of globalization. Its conviction that trade is a powerful force for peace and prosperity dates from the organization's origins early in the 20th century. The small group of far-sighted business leaders who founded ICC called themselves "the merchants of peace".

ICC has three main activities: rule setting, dispute resolution, and policy advocacy. Because its member companies and associations are themselves engaged in international business, ICC has unrivalled authority in making rules that govern the conduct of business across borders. Although these rules are voluntary, they are observed in countless thousands of transactions every day and have become part of the fabric of international trade.

ICC also provides essential services, foremost among them the ICC International Court of Arbitration, the world's leading arbitral institution. Another service is the World Chambers Federation, ICC's worldwide network of chambers of commerce, fostering interaction and exchange of chamber best practice. ICC also offers specialized training and seminars and is an industry-leading publisher of practical and educational reference tools for international business, banking and arbitration.

Business leaders and experts drawn from the ICC membership establish the business stance on broad issues of trade and investment policy as well as on relevant technical subjects. These include anti-corruption, banking, the digital economy, marketing ethics, environment and energy, competition policy and intellectual property, among others.

ICC works closely with the United Nations, the World Trade Organization and intergovernmental forums including the G20.

ICC was founded in 1919. Today its global network comprises over 6 million companies, chambers of commerce and business associations in more than 130 countries. National committees work with ICC members in their countries to address their concerns and convey to their governments the business views formulated by ICC.

INTERNATIONAL CHAMBER OF COMMERCE
33-43 avenue du Président Wilson, 75116 Paris, France
T +33 (0)1 49 53 28 28 **F** +33 (0)1 49 53 28 59
E icc@iccwbo.org www.iccwbo.org