RIPE NCC Tax Position

for 1998 and Beyond

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Document: ripe-165
See also: ripe-161

Scope

At the RIPE NCC contributors meeting in September 1996 the NCC were asked to seek ways in which to minimise the paying of company tax. This document, ripe-165, answers that request within the framework of the proposed new RIPE NCC organisation (hereafter referred to as RNA). This document is a companion document of ripe-161 (The de-facto organisational rules of the RIPE NCC-new organisation). The aim of this document is to detail the tax position of the RNA during its set up phase and during its general operations. The intended audience of this document is the RIPE NCC contributors, the TERENA General Assembly, and any interested parties. Comments to the authors are welcome.

Status

This document is still in draft form. A definite version of this document can only be given once the Dutch Tax Authorities (Belastingdienst) have made a written statement as to their position on the taxes of the RNA. At present they have verbally agreed to all aspects, and have given written agreement to all set up phase issues.

Introduction

There are two separate tax issues regarding the RNA; firstly the tax implications of the set up of the RNA and the transfer of funds from TERENA; and secondly tax agreements regarding general operations following the set up phase. Each of these issues will be detailed in turn. When explaining each point it will be stated as to the present level of commitment by the Dutch Tax Authorities, and where applicable the expected decision by them.

RNA Set Up Phase

During the set up phase of the RNA i.e. the period up to 1 January 1998, funds will have to be transferred from TERENA to the RNA. These funds take the form of:

- fixed assets: computers, furniture, and building infrastructure
- current assets: cash, debtors
- goodwill
- pre-payments / accrued income

These funds can be liable to two various forms of tax: company tax, and succession tax. Company tax is levied at 35% and succession tax is levied up to a maximum rate of 65%.

The Dutch tax authorities have agreed that the value of the funds to be transferred will be that stated in the "RIPE NCC project" balance sheet, which is part of the audited TERENA annual accounts, as at 31 December 1997. With regard to the goodwill asset, the tax authorities have agreed that this will have nil value. They have also agreed that the transfer of funds will not be liable to any company tax or succession tax. Therefore the initial transfer of funds will be free of any form of tax. All these agreements with the tax authorities are formal written statements.

Personnel Fund

It is proposed that in addition to the RNA another organisation is started. This organisation would be a foundation called the 'RNA Personnel Fund'. A personnel fund is of benefit to the RNA since it gives the employees a sense of security should the RNA run into difficult times. This security will make it more likely that employees will stay on working in the difficult times instead of immediately leaving and finding alternative employment. If a mass exodus of employees would occur during difficult times then the RNA would not be able to function, thus endangering the stability of the European Internet. Therefore it is felt that this fund gives the RNA far more stability and thus gives all contributors a more guaranteed level of service. It is proposed to start this foundation whilst future RNA employees are still employed by TERENA.

This fund would build up reserves with the aim of being able to give RNA employees some compensation should the RNA cease operations for whatever reason. The reason to put this fund in a separate foundation is so that in the event of bankruptcy the staff would still receive this benefit since it is not an asset of the RNA.

The RNA would administer the foundation but the funds in it could only be used for the designated purpose of paying to staff should RNA operations cease. Any RNA employee who leaves the organisation in the normal course of their career has no right to any funds in the 'RNA Personnel Fund'.

The tax authorities have given written approval that any transfer of funds TERENA may do to the 'RNA Personnel Fund' would be free both company and succession tax.

General Operations

During operations of RNA, the objective is to minimise company tax payments by avoiding any surplus which is liable for company tax. Another essential objective is for the RNA to ensure that at all times a prudent amount of working capital is available.

The RNA aims to be a not for profit organisation and therefore does not aim to build up surpluses or be liable for company tax. However in order to be financially prudent the RNA should, when budgeting, not over-estimate income or under-estimate costs. This prudent financial management coupled with the need to keep working capital and personnel fund reserves at desired levels will normally lead to an excess of income over expenditure at the year end. This surplus will be used for the purposes of building up the personnel fund reserves (detailed later) and keeping working capital at desired levels.

Clearinghouse

To avoid having to pay company tax on any surplus destined for working capital, the RNA will operate a clearinghouse system. The clearinghouse system works by setting up current accounts for every RNA contributor and reducing any profit or loss to nil by means of either crediting or debiting these accounts,

The RNA itself administers these current accounts. This system has been verbally agreed to by the tax authorities but as yet no written confirmation of that agreement has been received.

Clearinghouse Example

The system is best illustrated by an example. In this example there are initially 10 contributors, 5 "A" contributors who pay ECU 10,000 per year, and 5 "B" contributors who pay ECU 5,000 per year. It is assumed that contributions for years 1, 2 and 3 stay fixed at these rates. It will also be assumed that any surplus referred to in the example will be surplus left after any funds have been transferred to the personnel fund.

Year 1

The total income for the year 1 is ECU 75,000. Assume the expenditure for the same year is ECU 60,000, giving a surplus of ECU 15,000. In order to bring the surplus level to nil the ECU 15,000 surplus is distributed to the contributor current accounts. The distribution is based on the individual amount of contribution paid. At the end of year 1 "A" contributors have been credited ECU 2,000 each and "B" contributors ECU 1,000 each. Therefore the current accounts have the following balances:

"Year 1 'A' contributors"	ECU 2,000
"Year 1 'B' contributors"	ECU 1,000
Cumulative total of current account balances	ECU 15,000

Year 2

In year 2 the contributions stay fixed but Year 1 contributors get a refund on their contribution. The level of the refund given is determined by the amount of working capital needed. Suppose the working capital, i.e. the cumulative total of current account balances needed at the end of Year 1 is ECU 7,500, thus a total refund of ECU 7,500 could be given. This refund difference is made up from money in the current accounts. "Year 1 'A' contributors get a refund of ECU 1,000 and "Year 2 'A' contributors" get a refund of ECU 500. This results in the following current account balances.

"Year 1 'A' contributors"	ECU 1,000
"Year 1 'B' contributors"	ECU 500
Cumulative total of current account balances	ECU 7,500

At the beginning of year 2, 1 new "A" contributor and 1 new "B" contributor join. All "A" contributors pay contributions of ECU 10,000 and "B" contributors ECU 5,000. Therefore the total income for year 2 is thus ECU 90,000. (Note: In practice any refund given will be deducted from the contribution bill paid) Assume that expenditure for the same year is ECU 72,500, giving a surplus of ECU 18,000. In order to bring the surplus level to nil the ECU 18,000 surplus is distributed to the contributor current accounts. The distribution is based on the individual amount of contribution levied in year 2. At the end of year 2 "A" contributors have been credited ECU 2,000 each and "B" contributors ECU 1,000 each. Taking in account the balances at the begining of year 2, the current accounts have the following balances at the end of year 2:

"Year 1 'A' contributors"	ECU 3,000
"Year 1 'B' contributors"	ECU 1,500
"Year 2 'A' contributors"	ECU 2,000
"Year 2 'B' contributors"	ECU 1,000
Cumulative current account total	ECU 25,500

Year 3

In year 3 the contributions stay fixed, but Year 1 and 2 contributors get a refund on their contribution. Suppose the level of working capital needed at the end of Year 2 is set at ECU 16,500, thus a total refund of ECU 9,000 can be given. The level of working capital needed is higher than the year before since Year 3 looks as though it might be an unstable year. This refund difference is made up from money in the current accounts. "Year 1 and 2 "A" contributors" get a refund of ECU 1,000 and "Year 1 and 2 "B" contributors" get a refund of ECU 500. This results in the following current account balances:

"Year 1 'A' contributors"	ECU 2,000
"Year 1 'B' contributors"	ECU 1,000
"Year 2 'A' contributors"	ECU 1,000
"Year 2 'B' contributors"	ECU 500
Cumulative current account total	ECU 16,500

At the beginning of year 3, 2 new "A" contributors and 2 new "B" contributors join. All "A" contributors pay contributions of ECU 10,000 and "B" contributors ECU 5,000. Therefore the total income for the year 2 is ECU 120,000. Assume the expenditure for the same year is ECU 132,000, resulting in a loss of ECU 12,500. In order to bring the loss level to nil the ECU 12,500 loss is recovered from the contributor current accounts. The recovery is based on the individual amount of contribution paid in year 3. At the end of year 3 "A" contributors have been debited ECU 1,000 each and "B" contributors ECU 500 each. Taking in account the balances at the begining of year 3, the current accounts have the following balances at the end of year 3:

"Year 1 'A' contributors"	ECU 1,000
"Year 1 'B' contributors"	ECU 500
"Year 2 'A' contributors"	ECU 0
"Year 2 'B' contributors"	ECU 0
"Year 3 'A' contributors"	ECU -1,000
"Year 3 'B' contributors"	ECU -500
Cumulative current account total	ECU 4,500

It is stressed that this is only an example and that giving a refund to present contributors is dependent upon the level of current account balances at that time and the wished for level of working capital. The obvious aim to keep the current account balances and thus working capital in a healthy positive state so as to maximise stability.

The clearing house system allows the RNA to make use of the current account reserves by being able to make a loss if needs be. This has the large advantage that no company tax has to be paid. If a contributor leaves the RNA then they are entitled, at that time, to payment of their current account balance at the end of the current financial year. If at any time the RNA would cease to carry out its activities then contributors would be entitled to receive payment of their current account balance. The tax authorities have stated that the maximum limit the current account is allowed to reach is three times the yearly contribution, after which any surplus is to be directly distributed back to the contributor. The RNA will aim to keep the current account balance far below this set limit.

Personnel Fund

The level of reserves in the personnel fund should increase as the number of employees increases and thus the RNA wants to be able to transfer a portion of the surplus made to the 'RNA Personnel Fund' foundation at each year end. This transfer should be not liable to company tax since it is destined for a defined liability, and will not directly benefit either the RNA or the contributors. Therefore the tax authorities have been asked to agree to a tax free transfer of funds to the "RNA Personnel Fund" from RNA once a year, providing the previously stated reserves limit is not exceeded. The tax authority has verbally agreed to this proposal.

Summary

As previously stated the tax authority have verbally agreed in principle to all of the proposed RNA tax structures, and have given written confirmation on all but a few minor points. The aim of the proposed tax structures of the RNA is to conform to organisational principles of ripe-161 (the de-facto organisational rules of the RIPE NCC-new), to minimise the tax paid, and to maintain a healthy level of working capital and personnel fund reserves. The paying of minimal tax is a condition laid down by the RIPE NCC contributors at the 1996 general meeting (see ripe-145 'minutes of 1996 contributors meeting'). The tax structure as presented in this document fulfills all of these wishes and is in our opinion the best possible solution achievable.