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THE EU ANTI-TAX-AVOIDANCE DIRECTIVE

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Agenda

- The seminar will cover the following topics:
  - Background and introduction
  - Overarching principles: Minimum directive
  - Subjective and geographical scope of the Directive
  - Deductibility of interest
  - Exit taxation
  - Generally applicable anti avoidance rule (GAAR)
  - Controlled foreign corporations (CFC)
  - Hybrid mismatch arrangements and linking rules
  - Other initiatives

- Reflections upon:
  - The possible effects on domestic law of EU member states
  - MNE’s tax strategy

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Background and introduction

- The international tax policy environment - alignment

- EU Anti-Tax-Avoidance-Package presented the 28. January 2016:
  - Package:
    - Recommendation on Tax Treaties
    - Amended Directive on mandatory exchange of information (CbC)
    - External Strategy for Effective Taxation
    - Anti-Tax-Avoidance Directive (ATA-Directive)
  - Policy objective:
    - Effective taxation: Ensuring tax is paid where the value is created
    - Transparency: Ensuring effective access to tax information
    - Addressing the risk of double taxation
- Relation to OECD Base Erosion and Profit Shifting project (BEPS)
  - ATA-Package is the joint European Union’s coordinated answer to BEPS:
    - Ensuring EU-law conformity of ATA-rules
    - Creation of a better/fairer business environment?

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Background and introduction

- Final adoption by the Council on 12 July 2016
- Contains significant changes compared to the draft version
  - Implementation no later than 1. January 2019
    - Exit rules by 1. January 2020
    - Existing interest limitation rules may be applied until the OECD agrees on a minimum standard no later than 1. January 2024.
  - Review 4 years after entry into force
  - "*Study on Structures of Aggressive Tax Planning and Indicators*". Working paper N. 61 2015 (Ramboll Management Consulting and CORIT advisory)
  - ATA-Directive is partially a carve out of the anti-tax-avoidance rules of the CCCTB
- Impact in Denmark and in other EU MSs?

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Minimum Directive

- The ATA-directive is a minimum directive – de minimis approach
  - Multiple options
  - MS are obliged to ensure at least the level of protection as described in the directive
  - However, MSs cannot offer less restrictive rules
  - Consequently, MSs are allowed to apply more restrictive rules (Article 3)
    - *"This Directive shall not preclude the application of domestic or agreement-based provisions aimed at safeguarding level of protection for domestic corporate tax bases"*.

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Subjective and Geographical Scope of the Directive (Article 1)

- Applicable to all taxpayers subject to corporate tax (entities and PEs)
  - Includes more taxable entities than the current EU company tax directives, including PEs of third county entities
  - Variations between MSs
  - E.g. entities in principle subject to tax, although objectively exempt from corporate income tax

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Interest Limitation Rule (Article 4)

- International trend towards EBITDA-based rules
- 30% of EBITDA (tax)
  - Option to apply an EBIT-test in an equivalent way (undefined)
- Net borrowing costs
  - Broadly defined
- The taxpayer may be given the right
  - To deduct exceeding borrowing costs up to a minimum of 3 million EUR
  - To fully deduct exceeding borrowings costs for a stand alone entity
- Optional application at group level if entity member of group which may opt for tax consolidation
  - Consolidated computation of exceeding borrowing costs and EBITDA
  - 3 mill EUR for the entire group

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Interest Limitation Rule (Article 4)

- Escape clause options if taxpayer is member of consolidation group for accounting purposes (IFRS or Local GAAP definition)
  - Option (a): Fully deduct exceeding borrowing costs
    - Demonstrate that the ratio of equity over total assets equals or exceeds group-ratio
      - Two percentage point deviation is accepted
      - Valuation determined by accounting method
  - Option (b): Deduct some exceeding borrowing costs
    - Excess net borrowing cost (group vs. third party over EBITDA)
- Options for carry forward/back
  1. Infinite carry forward of restricted borrowing costs
  2. Infinite carry forward of restricted borrowing costs AND carry back up to 3 years
  3. Infinite carry forward of restricted borrowing costs AND carry forward of surplus EBITDA (interest capacity) for up to 5 years
- Financial undertakings are exempt
- Exempt loans
  - Concluded before 17 June 2016 (and remain unchanged)
  - Long term public infrastructure projects within the EU

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Interest Limitation Rule (Article 4)

- Comment:
  - EBIT(DA) rules are part of a new tendency in interest limitation rules
  - Largely following the BEPS recommendations
  - Simple model to "connect" taxable income to deductible financing costs
  - Choice of escape clause will determine whether to focus on all interest or only intra group interest
  - Groups should pay attention to group ratio (balance)

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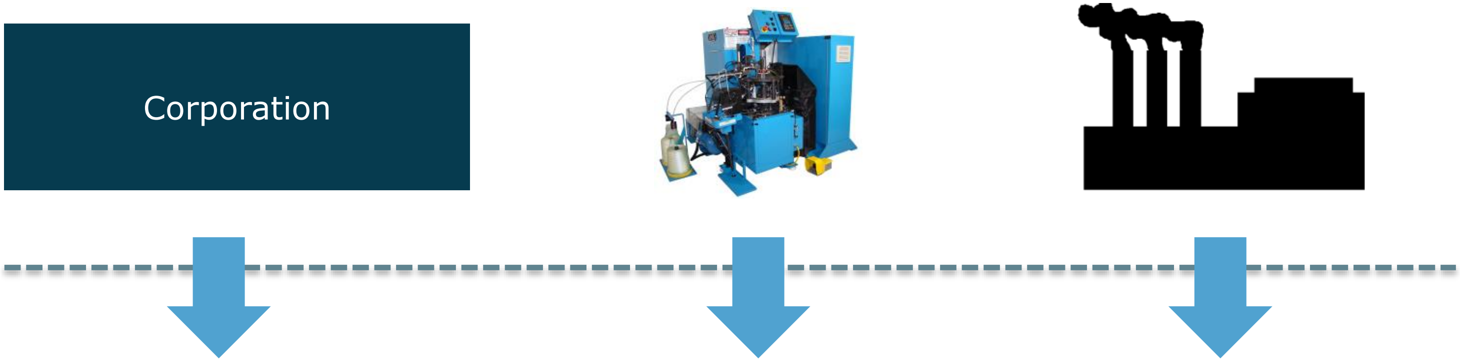
Exit Taxation (Article 5)

- Exit tax on an amount equal to the market value of the transferred assets less their value for tax purposes
  - At the time of exit



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Exit Taxation (Article 5)

- Deferral: Annual installments over 5 years if exit to EU/EEA or:
  - The transferred assets are disposed of;
  - The transferred assets are subsequently transferred to a third country;
  - The taxpayer's tax residence or its PE is subsequently transferred to a third country;
  - The taxpayer goes bankrupt or is wound up.
  - The taxpayer fails to honor installments over a reasonable period of time
- Interest may be charged in accordance with the legislation in the MSs
- Guarantee: If demonstrable and actual risk of non-recovery
  - Not applicable if possibility of recovery through another taxpayer, which is member of the same group and is resident for tax purposes in that MS.
- Entry value equals market value in the recipient state (step-up)
  - Unless this does not reflect the market value
- Certain exemptions for *temporary* assets

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Exit Taxation (Article 5)

- Comment:
  - Not part of BEPS (instead derived from CCCTB)
  - Exit taxation is very common within the EU
  - Market value vs. ALP?
  - No room for stricter domestic legislation within the EU (ECJ case law)
    - Installments
    - Interest

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GAAR (Article 6)

- For the first time a real GAAR has been introduced aiming at all non-genuine arrangements ***domestically and in cross border situations:***
  - Resembles the PSD GAAR – designed to reflect the artificiality tests of the ECJ
  - However, with a much broader scope
- Legal effect:
  - Arrangements etc. shall be ignored for the purposes of calculating the corporate tax
    - Calculated by reference to substance in accordance with national law
- Requirements:
  - *"Arrangement or series thereof"*
    - An arrangement may comprise more than one step or part
  - *Having been put in place for the main purpose or one of the main purposes of obtaining a tax advantage*
  - *That defeats the purpose or object of the otherwise applicable tax provision*
  - *"Non-genuine"*
    - Not put into place for valid commercial reasons, which reflect economic reality
- Tax authorities should carry the burden of proof

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GAAR (Article 6)

- Comment:
  - Largely similar to BEPS action 6 (Principle Purpose Test)
    - Relevant interpretational information in the BEPS report
  - Unbelievable how little attention the GAAR has received.
  - Consequences
    - Uncertainty in general as well as with respect to SAARs
    - Different implementation is a risk
      - MSs must introduce a GAAR
      - Up to 28(27) different GAARs
      - Minimum harmonization may lead to great legal uncertainty and possible double-taxation
      - Need for a corresponding adjustment or more effective dispute resolution mechanisms
      - EU Arbitration Convention currently not applicable
    - Many transactions must also be reviewed in light of the GAAR
      - How difficult will it be to pass the artificiality test?
      - Reliance on "non-genuine" requirement?

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GAAR (Article 6)

- No general examples available – only examples from the PSD and tax treaties
- Practical scenarios:
  - Classic conduit/flow through structure – Are holding companies genuine? (Case C-6/16 Holcim)
  - Determining the location of production facilities?
  - Determining the location of Joint venture entities?
  - Application of beneficial provisions through increase of ownership/shares. E.g. increase from 9% to 10% or from 24% to 25%, new share classes etc.
  - Mismatches not covered by other SAARs? (e.g. tax credit, timing mismatches etc.)

CFC-Legislation (Article 7)

- Several changes compared to draft and additional complexity

- Legal effect:
  - Parent company shall include the specifically mentioned non-distributed income OR income arising from non-genuine arrangements……
  - Inclusion, in accordance with the parent's entitlement to profit
  - Applicable to subsidiaries and PEs

- Common Requirements:
  - (1) Wide control test: > 50% of voting right, capital or profits
  - (2) Low tax requirement: Actual corporate tax paid is lower than the difference that would have been charged under the applicable corporate tax system of the taxpayer and the actual corporate tax paid
    - In effect a 50% low tax threshold
    - PE's of CFC not included if principle of territoriality applies

CFC-Legislation (Article 7)

- Included CFC income:
  - Option (a):
    - Interest or any other income generated by financial assets
    - Royalties + any other income from IP
    - Dividend income and income from disposal of shares
    - Income from financial leasing
    - Income from insurance, banking and other financial activities
    - Income from invoicing companies that earn sales and services income from goods and services purchased from and sold to associated enterprises, and add no or little value
  - MS option to exempt if 1/3 or less of the income falls within the above categories
  - MS option to exempt financial undertakings if less than 1/3 of CFC income is group related
  - EU/EEA exemption:
    - Option (a) not applicable within EU/EEA where the CFC carries out substantive economic activity supported by staff, equipment, assets and premises, as evidenced by relevant facts and circumstances

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CFC-Legislation (Article 7)

- Included CFC income:
  - Option (b):
    - The non-distributed income of the entity or PE arising from non-genuine arrangements which have been put in place for the essential purpose of obtaining a tax advantage
    - Non genuine:
      - Would not own the assets or would not have undertaken the risks
      - which generate all, or part of, its income
      - if it were not controlled by a company
      - where the significant people functions, which are relevant to those assets and risks, are carried out and are instrumental in generating the controlled company's income
  - De minimis exemptions regarding option (b):
    - Accounting profits below EUR 750,000, and non-trading of no more than EUR 75,000, or
    - Accounting profits amount to no more than 10% of its operating costs

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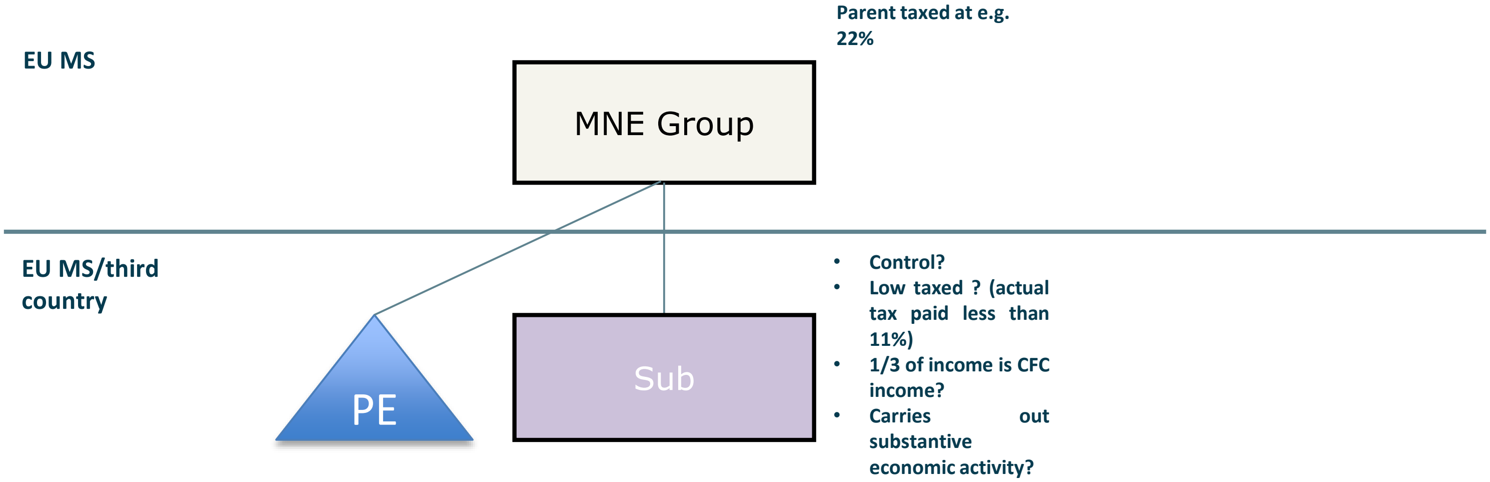
CFC legislation



Parent taxed at e.g. 22%
EU MS
MNE Group
EU MS/third country
PE
Sub

- Control?
- Low taxed ? (actual tax paid less than 11%)
- 1/3 of income is CFC income?
- Carries out substantive economic activity?

CFC-Legislation (Article 8)

- Computation:
    - Re option (a)
        - Income to be calculated in accordance with the corporate tax rules in the domicile state of the parent/head office
        - Losses shall not be included but shall be carried forward
    - Re option (b)
        - Inclusion of amount generated through assets and risks which are linked to significant people functions carried out by the controlling company.
        - Calculated in accordance with the arm's length principle
    - Common features
        - Inclusion to be calculated in proportion to the taxpayer's participation in the entity (as widely defined)
            - Higher or lower control trigger to be included?
        - Income shall be included in the tax period of the parent in which the tax year of the CFC entity ends
    - Deduction of previously CFC-taxed income from the amount of tax due on distributed profit and capital gains in order to ensure avoidance of double taxation
    - Credit relief explicitly mentioned (article 8(7))
        - Parent MS shall allow a deduction of the tax paid by the CFC entity or PE
        - Deduction calculated in accordance with domestic law (e.g. net principle etc.)

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CFC-Legislation (Article 8)

- Comment:
  - Included in BEPS project and CCCTB proposal
  - Significant impact: 14 EU MS do not have CFC rules
  - Difficult to assess the implications due to two different options
  - Conformity with fundamental freedoms
    - "*Substantive economic activity*" and "*non-genuine arrangements which have been put in place for the essential purpose of obtaining a tax advantage*" vs. "*wholly artificial arrangements*" from Cadbury Schweppes as leading case regarding intra EU CFC-taxation?
  - Broad scope:
    - Control (based on profit participation)
    - CFC income (invoicing companies, all IP income)
    - Double tax relief specifically mentioned
    - Possible multiple application in multiple MS?
    - New forms of tax planning – routing investments through MS with lower tax rates fulfilling the substantive economic activity test + the GAAR?

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Hybrid Mismatches (Article 9)

- New approach to combat hybrids compared to proposal
- Definition (article 2(9)
  - A situation between a taxpayer in one MS and an associated enterprise in another MS OR
    - Associated enterprises
      - Hybrid instruments: 25% ownership of capital, voting rights or profit participation (directly or indirectly)
      - Hybrid entities: 50% ownership of capital, voting rights or profit participation (directly or indirectly)
  - A structured arrangement between parties in MS
    - Undefined?
  - Where double deduction or deduction non-inclusion is caused by differences in the legal characterization of a financial instrument or entity.
- Double deductions
  - A deduction of the same payment, expenses or losses occurs in both MS
  - The deduction shall be given only in the MS where such payment has its source, the expenses are incurred or the losses are suffered and in another MS
- Deduction non-inclusion
  - There is a deduction of a payment in the MS in which the payments has its source without a corresponding inclusion for tax purposes of the same payment in the other MS
  - The MS of the payer shall deny the deduction of such payment

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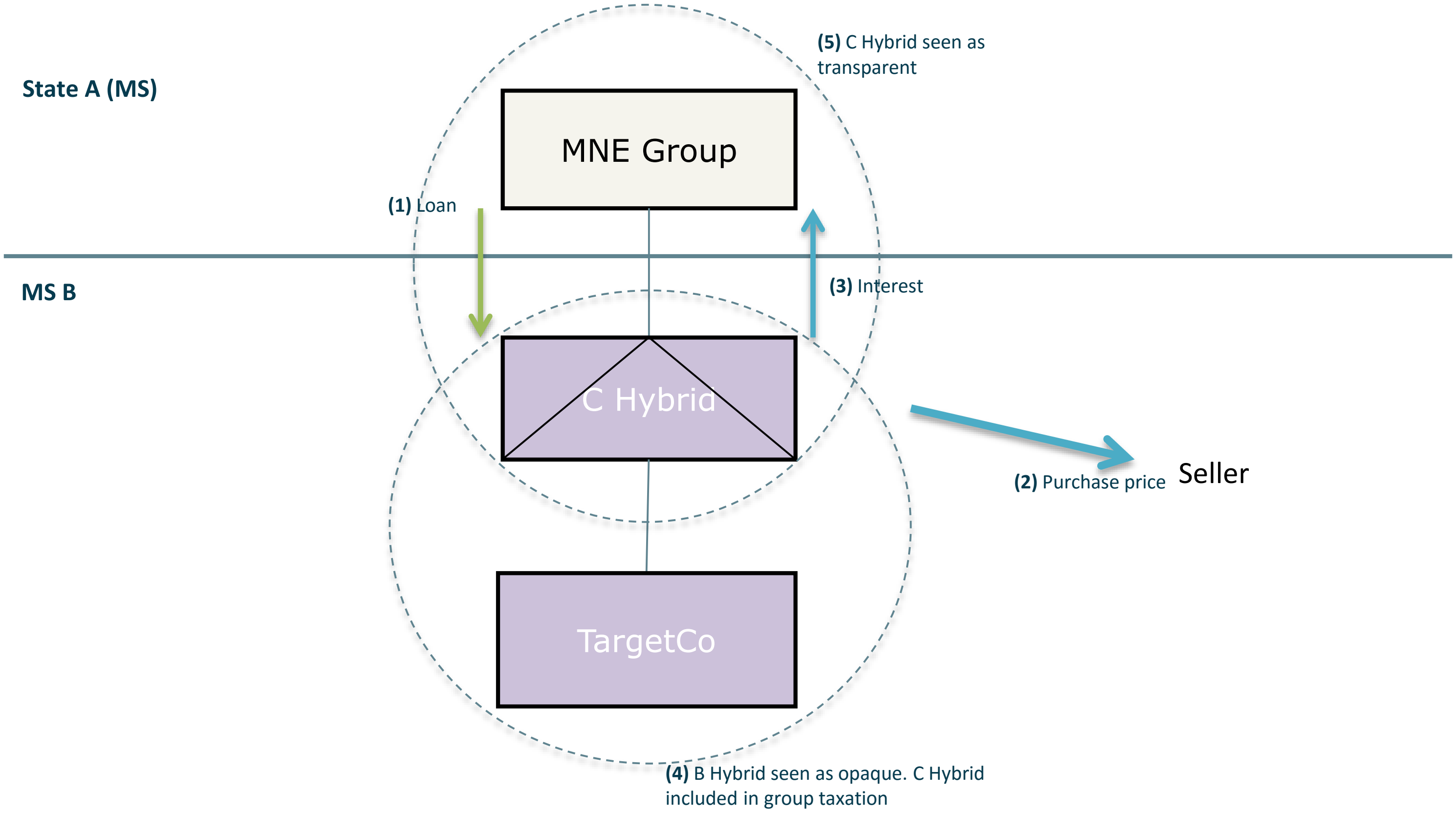
Hybrid Entity


State A (MS)
MS B
MNE Group
C Hybrid
TargetCo
Seller
(1) Loan
(2) Purchase price
(3) Interest
(4) B Hybrid seen as opaque. C Hybrid included in group taxation
(5) C Hybrid seen as transparent

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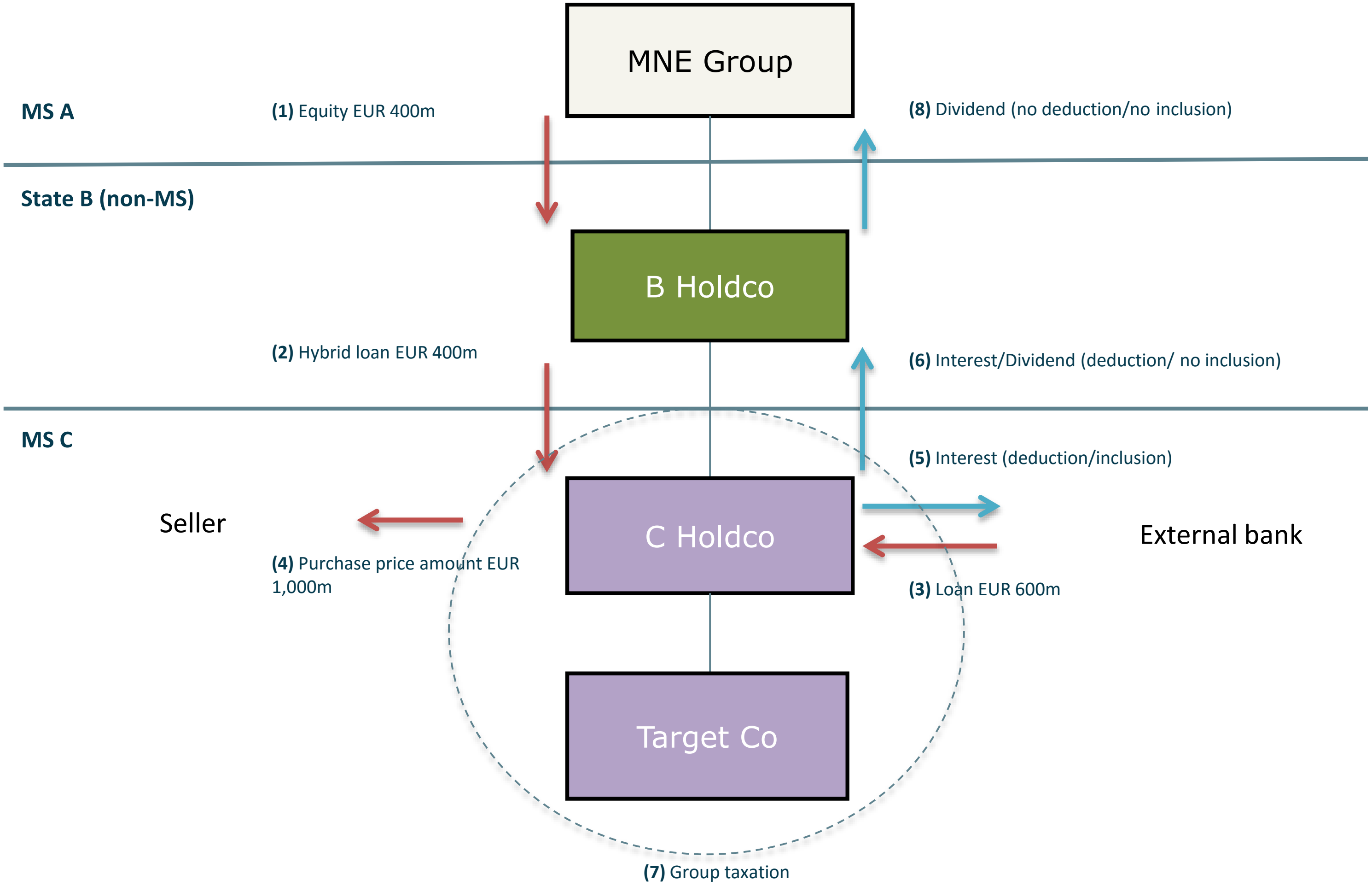
Hybrid Financing



MS A

State B (non-MS)

MS C

MNE Group
B Holdco
C Holdco
Target Co
Seller
External bank
(1) Equity EUR 400m
(2) Hybrid loan EUR 400m
(3) Loan EUR 600m
(4) Purchase price amount EUR 1,000m
(5) Interest (deduction/inclusion)
(6) Interest/Dividend (deduction/ no inclusion)
(7) Group taxation
(8) Dividend (no deduction/no inclusion)

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Hybrid Mismatches (Article 9)

- Comment:
  - Linking rules are increasingly popular - Largely aligned with BEPS action 2
  - Significant impact among EU MS
  - Only applicable to intra-EU mismatches – further work on third country situations to be carried out
  - Scope
    - Should include debt-equity hybrids, REPOs, group contributions, silent partnerships, etc., but not e.g. tax-credit arbitrage.
    - Only applicable with respect to EU MS mismatches
    - Not applicable to lower or higher tier mismatches through intermediate companies
    - Not applicable to ACE (NID) regimes since there is no payment

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Other EU initiatives

- CCTB/CCCTB
- Recommendation on Tax Treaties
- External Strategy for Effective Taxation
- CbC reporting (Public)
- State Aid cases

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Final Remarks

- Does the ATA-Directive fit its policy objective?
  - "Over BEPS-ification"?
  - More than Aggressive Tax Planning is being targeted
  - New disparities?
- Avoidance of double taxation and double non-taxation?
- Amendments needed broadly across MSs
- Relationship to Tax Treaties
- Review of existing structures etc.
  - Only grandfathering clause with respect to debt financing structures according to the EBITDA-rule

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