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# The EU's Common Framework for Implementing the OECD/G20's BEPS Recommendations

Guest Lecture at New York University, School of Law, The International Tax Program

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# Agenda

- EU tax law in a nutshell
- Background and introduction to the European Commission's Anti-Tax Avoidance Package (ATA-Package)
- Overall comparison of EU initiatives and BEPS
- The proposal for an Anti-Tax Avoidance Directive (ATA-Directive)
- Effects on domestic law of EU member states
- Political scope – what to be expected in 2016?

# EU Tax Law in a Nutshell

- Lack of Union competence in direct tax matters
  - MS have retained their competence
  - Substantial differences among the corporate tax regimes
- Instead directives have been issued
  - Based (primarily) on art. 115 TFEU
  - Requires unanimity → “Fiscal veto”
- As a result only a few (material) directives on direct tax matters have been adopted
  - Lack of positive integration
- However: Fundamental freedoms must be respected
  - As a main rule a national tax provision must not discriminate or constitute a restriction (an obstacle to the free movement)
  - Many judgements from the ECJ on direct tax matters
  - Has led to negative integration (harmonization through the back door)

# Background and Introduction

- The international tax policy environment
- ATA-package of 28 January 2016:
  - Package:
    - Anti-Tax-Avoidance Directive (ATA-Directive)
    - Recommendation on Tax Treaties
    - Amended Directive on mandatory exchange of information
    - External Strategy for Effective Taxation
  - 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
- The ATA-Directive is to some extent a carve out of the anti-tax-avoidance rules of the CCCTB

# Background and Introduction

- Political process and timeframe (legislative proposals):
  - Unanimity - TEUF 115
  - Time frame – before summer 2016?
- 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?

# Background and Introduction

	OECD BEPS	EU ACTION
Action 1: Digital Economy	The digital economy is the whole economy, so ring fenced solutions are not appropriate. OECD BEPS actions in general should address risks posed by digital economy.	EU agrees with OECD assessment that no special action needed. Situation will be monitored to see if general anti-avoidance measures are sufficient to address digital risks
Action 2: Hybrid Mismatch Arrangements	Specific recommendations to link the tax treatment of an instrument or entity in one country with the tax treatment in another, to prevent mismatches.	<b>ATA Directive</b> includes a provision to address hybrid mismatches.
Action 3: Controlled Foreign Companies (CFCs)	Best practice recommendations for implementing CFC rules.	<b>ATA Directive</b> includes provisions on CFC rules, for within the EU and externally.
Action 4: Interest Limitation	Best practice recommendations on limiting a company's or group's net interest deductions	<b>ATA Directive</b> includes provisions to limit interest deductions, for situations within the EU and externally

Source: Commission Staff Working Document, SWD(2016) 6/2

# Background and Introduction

	OECD BEPS	EU ACTION
Action 5: Harmful Tax Practices	<p>Tax rulings: Mandatory spontaneous exchange of relevant information.</p> <p>Patent Boxes: Agreement on "Nexus Approach" to link tax benefits from preferential regimes for IP to the underlying economic activity.</p>	<p>Tax rulings: Mandatory automatic exchange of information on all cross-border rulings and APAs from 2017.</p> <p>Patent Boxes: Member States agreed to ensure that their Patent Boxes are in line with the nexus approach (Code of Conduct Group, 2014).</p>
Action 6: Treaty Abuse	<p>Anti-abuse provisions, including a minimum standard against treaty shopping, to be included in tax treaties.</p> <p>Choice of either Limitation of Benefits (LOB) or Principle Purpose Test (PPT) or a combination of both.</p>	<p><b><u>ATA Recommendation</u></b> on Tax Treaties encourages Member States to use an EU-compatible PPT approach.</p> <p>LOB clauses are less easily adapted to the needs of the Single Market.</p>
Action 7: Permanent Establishment	<p>Definition of Permanent Establishment (PE) is adapted in Model Tax Convention, to prevent companies from artificially avoiding having a taxable presence.</p>	<p><b><u>ATA Recommendation</u></b> encourages MSs to use the amended OECD approach.</p>

Source: Commission Staff Working Document, SWD(2016) 6/2

# Background and Introduction

	OECD BEPS	EU ACTION
Actions 8 -10: Transfer Pricing Intangibles Risk and Capital High Risk Transaction	Arm's Length Principle and Comparability Analysis confirmed as pillars of Transfer Pricing. More robust framework for implementing this standard.	Joint Transfer Pricing Forum (JTPF) working on EU approach to implementing BEPS conclusions. Work includes looking at more economic analysis in TP, better use of companies' internal systems, and improving TP administration.
Action 11: Measuring and monitoring BEPS	The OECD aims to publish new statistics on corporate taxation and the scope and revenue impact of BEPS.	EU study underway on the impact of some types of aggressive tax planning on Member States' effective tax rates. The tax rates are based on a representative firm and calculated by using a neoclassical investment model.
Action 12: Disclosure of Aggressive Tax Planning	Recommendation to introduce rules requiring mandatory disclosure of aggressive or abusive transactions, structures or arrangements	To be discussed in the Code of Conduct. The Commission will keep the issue under review, as part of its tax transparency agenda.

Source: Commission Staff Working Document, SWD(2016) 6/2



# Background and Introduction

	OECD BEPS	EU ACTION
Action 13: Transfer Pricing documentation and Country-by-Country Reporting	<p>MNEs required to file an annual Country-by-Country report (CbCR) to tax administrations on key financial data, as well as a master file and local file.</p> <p>Information for tax authorities only – not public CbCR</p>	<p><b>ATA Package</b> proposes legally binding requirement for Member States to implement the OECD CbCR provisions. EUTPD, broadly in line with the master file and the local file, but to be reviewed to take into account the conclusions of the BEPS project.</p> <p>Work ongoing on feasibility of public CbCR in the EU.</p>
Action 14: Dispute Resolution	<p>Resolution G20/OECD countries agreed to measures to reduce uncertainty and unintended double taxation for businesses, along with a timely and effective resolution of disputes in this area. A number of countries have committed to a mandatory binding arbitration process.</p>	<p>In 2016, the Commission will propose measures to improve dispute resolution within the EU, as foreseen in the June 2015 Action Plan.</p>
Action 15: Multilateral Instrument to modify tax treaties	<p>Interested countries have agreed to use a multilateral instrument to amend their tax treaties, in order to integrate BEPS related measures where necessary</p>	<p><b>ATA Recommendation</b> sets out the Commission's views on Treaty related issues and their compatibility with EU law, which MSs should consider in their negotiations on the Multilateral Instrument.</p>

Source: Commission Staff Working Document, SWD(2016) 6/2

## Minimum Directive (Article 3)

- Contains 6 measures against tax avoidance
- Applies to all taxpayers subject to corporate tax in one or more MS (+ EU PEs), cf. art. 1
- The proposal is intended as a minimum directive, cf. art. 3
  - MS are obliged to ensure at least the level of protection as described in the directive
    - MS cannot offer less restrictive rules
    - Consequently, MS are allowed to apply more restrictive rules (Article 3)
- Designed to comply with:
  - The principle of subsidiarity
    - The nature of the subject requires a common EU initiative
  - The principle of proportionality
    - The measures do not go beyond the minimum necessary level of protection

## Interest Limitation Rule (Article 4)

- Introduction of an interest limitation rule based on net borrowing costs
  - Article 4 (1)... *Borrowing costs shall always be deductible to the extent that the taxpayer receives interest or other taxable revenues from financial assets*
- The rule caps deduction at 30% of EBITDA, however, minimum 1 million EURO
- EBITDA
  - Adding back to taxable income the tax-adjusted amounts for net interest expense and other costs equivalent to interest as well as the tax-adjusted amounts for depreciation and amortization.

# Interest Limitation Rule (Article 4)

- Escape clause:
  - Demonstrate that the ratio of equity over total assets equals or exceeds group-ratio.
    - Two percentage point deviation is accepted
    - Group equals IFRS or US GAAP definition
    - Accounting valuation
    - Claw-back 6 months post and prior to balance sheet day
    - Escape clause is not applicable if intra-group payments exceed 10 % of group's total net-interest expense
- Infinite carry-forward of surplus EBITDA and capped borrowing costs (Max 30% EBITDA)
- Financial undertakings are exempt
  - Defined broadly in article 2(4)
  - Further analysis to be carried out

# Interest Limitation Rule (Article 4)

- Comment:
  - EBITDA rules are widely used as part of global tendency
  - 4 MS still have no thin cap or other interest limitation legislation in place
  - 24 MS offer general interest deductibility of interest costs without making it conditional on the tax treatment in the hands of the recipients or without imposing the full scale thin cap or other interest-limitation rules, interest withholding tax or a beneficial owner test.
  - Following BEPS recommendations
  - Domestic provisions not fully parallel should be carefully assessed

## Exit Taxation (Article 5)

- Taxation of unrealized gains in certain situations
  - Market value of transferred assets less their value for tax purposes
- Provision designed to be in accordance with the ECJ case law
  - No room for stricter domestic legislation
- Exit tax on transfers of:
  - Assets from head office to PE in another MS or third country
  - Assets from PE to head office or to PE in another MS or third country
  - Tax residence to another MS or a third country
  - PE out of a MS
- The term "assets" are not defined

## Exit Taxation (Article 5)

- Deferral for intra-EU/EEA transfers: Annual installments over at least five years
  - Discontinued:
    - 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.
- Interest may be charged in accordance with the legislation in the MS, to the extent necessary to preserve the value of the assessed tax liability.
- 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 MS (step-up)
- No exit tax on *temporary* assets

# Exit Taxation (Article 5)

## - Comment:

- Exit rules are widely known within the EU and have been tested by the ECJ on several occasions
- Exit tax is not a BEPS action point – rooted in CCCTB discussions
- No room for stricter domestic legislation
- ATA draft seems in conformity with the TFEU and corresponds to the existing domestic practices in some MSs



## Switch-over Clause (Article 6)

- Switch over from exemption-relief to credit-relief:
  - Profit distributions from third country entities
  - Proceeds from disposal of shares in a third country entity
  - Income from a third country PE (principle of territoriality)
- Low taxation requirement:
  - Statutory corporate tax rate lower than 40% of the statutory tax rate in the MS of the taxpayer
- Legal consequence:
  - Taxpayer shall be subject to tax on the foreign income
  - Credit-relief for tax paid in third country (ordinary credit)

# Switch-over Clause (Article 6)

- Not applicable to:
  - PE losses
  - Losses from the disposal of shares
  
- Comment:
  - Aiming at too generously applied tax-exemption regimes
  - Used as an alternative to CFC-legislation in certain countries
    - EU conformity (Case C-298/05 Columbus Container)
  - Not part of the BEPS project – rooted in CCCTB discussions
  - Harsh criticism (goes further than BEPS)
  - Amendments required in a number of MSs

## GAAR (Article 7)

- Arrangements etc. shall be ignored for the purposes of calculating the corporate tax
  - Calculated by reference to substance in accordance with national law
- *"Arrangements or series thereof"*
  - An arrangement may comprise more than one step or part
- *"Non genuine"*
  - Not put into place for valid commercial reasons, which reflect economic reality
- *"That defeat the purpose or object of the otherwise applicable tax provision"*
- *"Carried out for the essential purpose of obtaining a tax advantage"*

## GAAR (Article 7)

### - Comment:

- Uncertainty in general as well as with respect to SAARs
- Significant extension of scope compared to existing EU PSD GAAR
- Largely similar to BEPS action 6 (Principle Purpose Test)
  - Relevant information in the BEPS report
- Applicable domestically as well as cross-border

## CFC Legislation (Article 8)

- Parent company shall include the non-distributed income if:
  - Wide control test: > 50% of voting rights, capital or profits
  - Low tax requirement: Subsidiary's effective corporate tax rate < 40% of the effective tax rate in the state of the parent company
  - Wide income requirement: > 50% of the income is:
    - Interest or any other income generated by financial assets
    - Royalties + any other income from IP
    - Income from tradable permits
    - Dividend income and income from disposal of shares
    - Income from financial leasing
    - Income from immovable properties (unless MS restricted according to a tax treaty)
    - Income from insurance, banking and other financial activities
    - Income from intragroup services
  - The subsidiary is not listed on a stock exchange

# CFC Legislation (Article 8)

- Exception for financial undertakings:
  - CFC-rules not applicable to financial undertakings in EU/EEA
  - The income requirement shall apply to other financial undertakings only if > 50% of the subsidiary's CFC-income originates from intra-group transactions
- EU/EEA exemption:
  - CFC-rules not applicable unless the establishment is wholly artificial or the subsidiary engages in non-genuine arrangements, which have been put in place for the essential purpose of obtaining a tax advantage.
    - Non genuine: Assessment to be based on "significant people functions" (BEPS guidance?)
- Attribution should be in accordance with the arm's length principle

## CFC Legislation (Article 9)

- Income to be calculated in accordance with the corporate tax rules in the domicile state of the parent
- Losses shall not be included but can be carried forward
- Inclusion, in accordance with the parent's entitlement to profit (entity approach)
- Deduction of previously CFC-taxed income from the amount of tax due on distributed profit and capital gains
- Credit relief *not* explicitly mentioned
- Comment:
  - Significant impact: 14 EU MS do not have CFC rules
  - Carefully designed to meet the ECJ standard regarding the abuse doctrine (C-196/04 Cadbury Schweppes)
  - Included in BEPS project and CCCTB proposal
  - Broad scope:
    - Control (based on profit participation)
    - CFC income (real estate, intra group services, including external royalty income based on internal R&D)

# Hybrid Mismatches (Article 10)

- Hybrid entities:
  - Characterization in source state determines classification in home state within the EU
  - Requirement:
    - Different legal characterization of the same taxpayer
    - Leading to double deduction or deduction non-inclusion
  
- Hybrid instruments:
  - Characterization in source state determines classification in home state within the EU
  - Requirement:
    - Different legal characterization of the same payment
    - Leading to deduction non-inclusion



# Hybrid Mismatches (Article 10)

- Comment:
  - Linking rules are increasingly popular
  - Significant impact (25-26 MS do not have linking rules regarding hybrid entities, 20 MS have not linking rules regarding inbound hybrid instruments, while PSD covers outbound hybrid instruments regarding dividends)
  - BEPS action 2

# Final Remarks

- Amendments needed broadly across Member States
  - Also in MS that already have a broad range of anti-avoidance rules
- Does the draft ATA-Directive fit its policy objective?
  - Is it going too far?
- Political expectations
  - Possible at all or with significant amendments?
  - Some criticism at first ECOFIN Meeting