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# EU Initiatives Regarding Aggressive Tax Planning Danmarks Skatteadvokater 26. May 2016

# Background and introduction

- The international tax policy environment
  - Emphasizes the tendency to increased alignment in international corporate tax law
  - Increasing tax disputes (legal boundaries and business models are being challenged).
  - Strengthened legislation in terms of transparency and sanctions.
  - Denmark follows OECD and EU recommendations.
- EU Anti-Tax-Avoidance-Package(ATA-package) presented the 28/1 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

# Background and introduction

- The ATA-package is partly based on the research carried out in “*Study on Structures of Aggressive Tax Planning and Indicators*”. Working paper N. 61 2015 (Ramboll Management Consulting and CORIT advisory)
  - The ATA-Directive is essentially a carve out of the anti-tax-avoidance rules of the CCCTB
- **Political process and timeframe:**
    - Unanimity - TEUF 115
    - Enhanced cooperation procedure (minimum 9 states)
    - Time frame?
  - **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

- **Administrative Cooperation in the field of taxation**
  - Effective from 1 January 2017: Exchange of information regarding cross-border tax rulings and advance pricing arrangements.
  - 2016: Country-by-Country reporting – Political agreement already made.
    - **Mandatory automatic exchange of information**
      - Applicable to any MNE with a total turnover of more than EUR 750 mill.
      - Also applicable to third country MNEs with EU subsidiaries or branches
      - Requirement for parent company to submit CbCR to tax authorities
    - **Public disclosure of information regarding taxes paid country-by-country.**



# 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.	ATA Directive includes a provision to address hybrid mismatches.
Action 3: Controlled Foreign Companies (CFCs)	Best practice recommendations for implementing CFC rules.	ATA Directive 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	ATA Directive includes provisions to limit interest deductions, for situations within the EU and externally



# 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>ATA Recommendation 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>ATA Recommendation encourages MSs to use the amended OECD approach.</p>



# 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.

# 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>ATA Package 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>ATA Recommendation 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>



# Minimum Directive

- The proposal is intended as a minimum directive
  - MSs 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)
  
- Based on the principle of subsidiarity and proportionality
  - A non-coordinated solution would *“in fact only replicate and possibly worsen the existing fragmentation in the internal market and perpetuate the present inefficiencies and distortions in the interaction of a patchwork of distinct measures.”*
  - The Directive *“prescribe full harmonisation but only a minimum protection for Member States’ corporate tax systems. Thus, the Directive ensures the essential degree of coordination within the Union for the purpose of materialising its aims.”*

# Subjective and Geographical Scope of the Directive (Article 2)

- Applicable to all taxpayers subject to corporate tax
  - Likely to include more taxable entities than the current EU company directives, including PE of third county entities
  - Variation between MSs
  - E.g. entities in principle subject to tax, although objectively exempt from corporate income tax
- Preferable an annex should be produced to the directive

# Interest Limitation Rule (Article 4)

- Introduction of an interest limitation rule based on net borrowing costs
- The rule caps deduction at 30% of EBITDA, however, minimum 1 million EURO
- Escape clause:
  - Demonstrate that the ratio of equity over total assets equals or exceeds group-ratio.
- Infinite carry-forward of surplus EBITDA and capped borrowing costs (Max 30% EBITDA)
- Financial undertakings are exempt (further analysis)
- Comment:
  - EBITDA rules are widely used as part of global tendency
  - Following BEPS recommendations
  - Domestic provisions not fully parallel should be carefully assessed
  - No corresponding reduction of the creditor
  - One common system with different levels (10-30%) or Ms free to have parallel systems?

# Exit Taxation (Article 5)

- 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
    - Exit tax upon subsequent transfer to third country from MS PE
  - PE out of a MS
- Deferral: Annual installment over (at least) five years
- Interest and guarantee
- Entry value equals market value in the recipient state (step-up)
- Comment:
  - Exit tax is not a BEPS action point – rooted in CCCTB discussions
  - No room for stricter domestic legislation with respect to EU MSs – only possible regarding third countries
  - ATA draft seems in conformity with the TFEU and corresponds to the existing domestic practices in some MSs
  - Risk of double taxation?

# Switch-over Clause (Article 6)

- **Switch over from exemption-relief to credit-relief:**
  - Participation exemption of distribution from third country entities
  - Participation exemption 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)
- **Comment:**
  - Aiming at too generously applied tax-exemption regimes
  - Not part of the BEPS project – rooted in CCCTB discussions
  - Harsh criticism (further than BEPS)
    - Proposal: Not applicable if active business, if tax treaty in place. PE to be taken out.
  - Amendments required in a number of MSs

## GAAR (Article 7)

- Resembles the PSD GAAR – designed to reflect the artificiality tests of the ECJ
- 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
  - *"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"*
- Comment:
  - Largely similar to BEPS action 6 (Principle Purpose Test)
  - Proposal: align with PSD wording

# CFC-Legislation (Article 8)

- **Legal effect:**
  - Parent company shall include the non-distributed income
  - Inclusion, in accordance with the parent's entitlement to profit
- **Requirements:**
  1. Wide control test: > 50% of voting right, capital or profits
  2. Low tax requirement: Subsidiary's effective corporate tax rate < 40% of the effective tax rate in the state of the parent company
  3. Wide income requirement: > 50% is CFC income
- **EU/EEA exemption – Not wholly artificial**
- **Comment:**
  - Significant impact: 14 EU MSs do not have CFC rules
  - 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)
    - Double tax relief not mentioned
  - Proposal: adjustments re. types of income, lowering of CFC-threshold or limit CFC to non-genuine arrangements.

# 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
- **Comment:**
  - Different rule under BEPS – Payer denied deduction
  - If two states view itself as source state?
  - Risk of double taxation
  - Proposal: BEPS alignment (e.g. no deduction if no inclusion), limited to associated companies.



# Final Remarks

- Dispute resolution mechanism?
- Avoidance of double taxation?
- Amendments needed broadly across MSs
- Relationship to Tax Treaties:
  - Issues concerning tax treaties have not been included in the directive
  - However, directive would require changes to Tax Treaties
    - Superiority of EU-law
- Does the draft ATA-Directive fit its policy objective?
- Political expectations:
  - Possible at all or with significant amendments?
- Pushing (C)CCTB?



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