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# THE EU ANTI-TAX-AVOIDANCE DIRECTIVE



# 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
  - Switch-over clause
  - Generally applicable anti avoidance rule (GAAR)
  - Controlled foreign corporations (CFC)
  - Hybrid mismatch arrangements and linking rules
  - Transfer pricing
  - Political scope, what to be expected in 2016?
  
- Reflections upon:
  - The possible effects on domestic law of EU member states
  - MNE's tax strategy



# Background and introduction

- The international tax policy environment
  - Emphasizes the tendency to increased alignment in international corporate tax law
- 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
  - 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



# Background and introduction

- Political process and timeframe:
  - Unanimity - TEUF 115
    - Competence? (Professor Haslehner)
    - European Parliament want to be able to use TFEU art. 116
  - Enhanced cooperation procedure (minimum 9 states)
  - Time frame – Aim on agreeing on 26 May 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.	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
  - MS are obliged to ensure at least the level of protection as described in the directive
  - However, MS cannot offer less restrictive rules
  - Consequently, MS are allowed to apply more restrictive rules (Article 3)
  - European business associations prefers a de maximis directive to ensure certainty and clarity
- 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 *"prescribes 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 country entities
  - Variation between MS
  - E.g. entities in principle subject to tax, although objectively exempt from corporate income tax
- Preferably an annex should be produced to the directive

# 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*
  - Interpretation á contrario regarding tax exempt income?
- The rule caps deduction at 30% of EBITDA, however, minimum 1 million EURO (3 mill. has been proposed by CFE)
  - Constitutional issues?
    - German Zinsschranke as applied in domestic situations found to violate the net principle as grounded in the German constitution (Bundesfinanzhof 10 February 2016).
    - Comparable discussions in Canada and the US will influence OECD's success
- EBITDA
  - Add back to taxable income of 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.
  - EBIT regimes are computed on the basis of a lower amount but maybe on the basis of a higher percentage (e.g. 80%).
  - Comparison depends on concrete circumstances.

## 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



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# 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
  - Following BEPS recommendations – but has left out certain business friendly recommendations
  - Domestic provisions not fully parallel should be carefully assessed



# Exit Taxation (Article 5)

- 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
- Assets?
  - Not defined



## Exit Taxation (Article 5)

- Deferral: Annual installment 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 state (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 with respect to EU MS – only possible regarding third countries.
- 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:**
  - 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)
    - Including capital gains?
  
- **Low taxation requirement:**
  - Statutory corporate tax rate lower than 40% of the statutory tax rate in the MS of the taxpayer
    - No abuse threshold
  - Legal consequence: Taxpayer shall be subject to tax on the foreign income
  - Credit-relief for tax paid in third country (ordinary credit)
    - No tax credit carry forward
  
- **Not applicable to:**
  - PE losses
  - Losses from the disposal of shares

# Switch-over Clause (Article 6)

## - 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)
- Impact?
  - Tax incentives on rate (but not on tax base)
  - E.g. permanent establishment in Dubai
  - Potential double taxation: low tax sub owns high tax lower tier sub
- In fact retrospective effect without grandfathering
  - Accumulated earnings and value increases from the original time of investment
  - Review group structures and joint ventures (different treatment among partners)
  - Constant monitoring of tax regimes
  - Exit strategies
- Not part of the BEPS project – rooted in CCCTB discussions
- Harsh criticism (further than BEPS)
- 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"*
- Tax authorities should carry the burden of proof

# 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 interpretational information in the BEPS report
- Applicable domestically as well as cross-border
- Difference implementation is a risk
  - Up to 28 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

# CFC-Legislation (Article 8)

- Legal effect
  - Parent company shall include the non-distributed income
  - Inclusion, in accordance with the parent's entitlement to profit
    - Difference compared to full inclusion
  
- 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
    - What is effective corporate tax rate?
  - (3) 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 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 (not defined)
  - The income requirement only applies if > 50% of the subsidiary's CFC-income originates from intra-group transactions
  - 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
- 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
    - Seemingly not coordinated with the GAAR in article 7
    - 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 shall be carried forward
- Deduction of previously CFC-taxed income from the amount of tax due on distributed profit and capital gains
- Credit relief *not* explicitly mentioned



## CFC-Legislation (Article 9)

### – Comment:

- Significant impact: 14 EU MS do not have CFC rules
- Carefully designed to meet the ECJ standard regarding the abuse doctrine (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)
  - Double tax relief not mentioned
  - Possible multiple application in multiple MS?
  - New forms for tax planning – routing investments through MS with lower tax rates?





# 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 does 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 – ATA directive goes further – complete mutual recognition of entity/instrument
- 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 and does not apply to lower or higher tier mismatches through intermediate companies.



# Final Remarks

- Does the draft ATA-Directive fit its policy objective?
  - “Over BEPS-ification”?
  - More than Aggressive Tax Planning is being targeted
  - Grandfathering clause or transitional period needed for existing structures which cannot be considered abusive
- 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
- Political expectations
  - Dutch Presidency is pushing the agenda
  - Possible at all or with significant amendments?



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