European Tax Law

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European Tax Law: Secondary Law – The Anti-Avoidance Directive

“THE ATAD DIRECTIVE” 2016/1164/EU, 12 July 2016

Background

- Fight against tax avoidance and tax evasion (Lux Leaks, Panama Leaks, Swiss Leaks 2014-2016)
- OECD BEPS 2013-2015
- European Commission Resolutions, Communications and Recommendation containing action plans (10 Feb 1975; to 18 March 2015 and 6 Dec 2012) against tax avoidance.
- Directives on exchange of information and advance tax ruling 2014/107/EU, 2011/16/EU, 2105/2376
- Commission Proposal for Anti-Tax Avoidance Package (2016)23 along the BEPS reports, January 2016
- DIRECTIVE ATAD in 6 months, 12 July 2016
- DIRECTIVE ATAD II amending the ATAD with respect to Hybrids mismatches and 3rd Countries 2017/952/EU

“THE ATAD DIRECTIVE”

MAIN AIMS

- Unlike the Directives so far covered ATAD does not provide for beneficial tax treatment of Taxpayers in cross-border operations within the EU.
- Obblige MS to apply stricter rules in certain circumstances
- Effectively Counterng Tax-Avoidance and ensure that income does not remain “untaxed”.
- Ensure a minimum standard and level of protection against aggressive tax planning and in favour of domestic tax bases in the Internal Market

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MAIN ACTIONS

- Interest Limitation Rule (Art. 4)
- Exit Tax Rule (art. 5)
- GAAR (Art. 6)
- CFC Rule (Art. 7 and 8)
- Hybrid Mismatch (Art. 9)

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Interest Limitation Rule

- Interest costs are generally deductible from taxable income
- MNEs take advantage of the high mobility of debt to shift income – in the form of inflated interest payments - towards low-tax jurisdictions
- The group reduces its overall tax burden
- Solution:
  - ➢ interest limitation rule for limiting the deductibility of net interest expenses ('exceeding borrowing costs')
  - ➢ overall interest expense including that paid to third parties
  - ➢ applies across the board, i.e. domestic, intra-EU and towards third countries (no discrimination risks case law on ´fundamental freedoms)
  - ➢ fixed-ratio rule:

    - up to 30% of (tax-adjusted) EBITDA; or

    - up to a safe harbour of EUR 3 million, whichever allows higher deductibility

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Exit Tax

- Purpose: to prevent the risk whereby assets, expected to generate high income, are moved to low-tax jurisdictions to be sold later and realise a high capital gain which will be low-taxed
- Scope: transfers of assets or tax residence out of the tax jurisdiction of a MS, disposals of assets are not included in the scope
- Transactions covered:
  - transfer of assets from head office in the EU to PE in another MS or 3rd country
  - transfers of the whole business of a PE
  - transfer of tax residence to another MS or third country, except if a PE is left behind with assets effectively connected to it

Exit Tax

- **Within the EU/EEA:**
  - **deferral** of the payment of tax in instalments over 5 years

- **Prevention of double taxation**: if the transfer is within the EU, destination MS shall accept the market value determined by MS of the taxpayer as a starting value therein (for tax depreciation purposes)

GAAR

- Purpose: to tackle abuses that have not yet been dealt with through specifically targeted provisions – designed to cover gaps
- Indistinct application domestically and cross-border

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GAAR

- 1. For the purposes of calculating the corporate tax liability, a Member State shall ignore an arrangement or a series of arrangements which, having been put into place **for the main purpose or one of the main purposes of obtaining a tax advantage that defeats the object or purpose of the applicable tax law**, are **not genuine** having regard to all relevant facts and circumstances. An arrangement may comprise more than one step or part.
- 2. For the purposes of paragraph 1, an arrangement or a series thereof shall be regarded as **non-genuine to the extent that they are not put into place for valid commercial reasons which reflect economic reality**.
- 3. Where arrangements or a series thereof are ignored in accordance with paragraph 1, the tax liability shall be calculated in accordance with national law.

CFC (Controlled Foreign Corporations)

- BEPS schemes often involve shifts of mobile passive income (e.g. royalties) within a group, for example, by shifting intangible assets to subsidiaries in low tax jurisdictions (CFCs), as a result
  - overall tax burden of the group is reduced
  - internal market is affected
- CFC rules prevent tax deferral through non-repatriation of income from low-taxed subsidiaries
- Requirements for establishing that a CFC exists:
  - control over the subsidiary:

    ATAD: taxpayer holds (directly or indirectly) more than 50% of voting rights/capital/rights to profits in the CFC (entity or PE)
  - low level of taxation in the third country or Member State where the subsidiary is tax resident:

    ATAD: the actual CIT paid by the CFC is less than half of the CIT which would have been paid in the MSs of the taxpayer

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CFC (Controlled Foreign Corporations)

- To compute CFC income for re-attribution, rules may target:
  (i) the entire revenues of a low-taxed subsidiary
  (ii) specific categories of income (‘tainted’ income)
  (iii) income artificially diverted to the subsidiary
- In ATAD, MS may opt between options (ii) & (iii)
- Under option (ii):
  - ‘tainted income‘ is listed (interest, royalties, dividends, capital gains on shares, etc.)
- Under option (iii):
  - income artificially diverted to the CFC: income arising from non-genuine arrangements which have been put in place for the essential purpose of obtaining a tax advantage
  - what is non-genuine?

    TP approach: who is exercising significant people functions over the assets and risks generating the income?

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Hybrids Mismatch Rules

- Hybrid mismatch: situations arising from the differences in the legal characterization of instruments, payments or entities according to the domestic laws of different states
- Original ATAD hybrid mismatch rules were narrower than BEPS recommendations (BEPS Action 2) and did not apply to third countries ATAD 2
- ATAD and ATAD 2 now cover:
  - deduction/non-inclusion outcomes
  - double deduction outcomes
  - imported mismatches,
  - which are due to a) hybrid instruments, b) hybrid entities, c) hybrid PEs, d) reverse hybrids, e) dual resident entities
- Linking rules: aligning the tax treatment in one state to the tax treatment in the other, for each hybrid mismatch situation a linking rule is provided for

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Comments - Critics

- EU competence to adopt BEPS measures? Subsidiarity?

- Legal basis of Art. 115: facilitating the establishment and functioning of the internal market?

- Minimum harmonization does not serve the purpose of coordination

- Possible conflicts with primary law (fundamental freedoms and their interpretation by the CJEU)