Corporate Taxes and EU Law
Some recent developments

Thessaloniki Judicial Training on EU Direct Taxation
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Prof. Gerard Meusselen
How it all began ....

• Starbucks
• Amazon
• Google
• Bahamas IP companies
• Double Irish Dutch sandwich
• Luxembourg leaks
• Panama Papers
BEPS – BASE EROSION & PROFIT SHIFTING

- **Challenges of the Digital Economy**
- **Neutralise Effects of Hybrid Mismatch Arrangements**
- **Strengthen CFC Rules**
- **Limit Base Erosion by Interest Deductions**
- **Counter Harmful Tax Practices**

- **Prevent Treaty Abuse**
- **Prevent Artificial Avoidance of PE Status**
- **Assure Transfer Pricing Outcomes are in line with value creation**

- **Collect & Analyse Data on BEPS**
- **Disclose Aggressive Tax Planning Arrangements**
- **Re-examine Transfer Pricing Documentation**
- **Improve Dispute Resolution Mechanisms**

- **Develop a Multilateral Instrument to Implement BEPS**
Topics covered

• New anti-abuse provisions in the P/S-Directive
• Obligatory exchange of tax rulings
• Draft BEPS-Directive and other proposed EU-measures
• Outlook on the near future
Abuse of tax law, different levels

- Domestic: GAAR (Par. 42 AO) or unwritten concept of abuse of law (Netherlands, fraus legis)
- Domestic: specific anti-abuse provisions
- EU-level, new provision to combat hybrid loans in the Parent/Subsidiary Directive
- EU level, new GAAR-provision in the Parent/Subsidiary Directive
- BEPS Initiative, Action 6: Preventing of the Granting of Treaty Benefits in Inappropriate Circumstances: general GAAR and specific LOB
Anti-abuse provisions

• Members States often apply a written or unwritten GAAR as well as specific anti-abuse provisions.
• One may wonder what the relation between those two is.
• May a GAAR not be applied if there is a specific anti-abuse provision applicable?
• Dutch Supreme Court: Even if the Dutch legislator has drafted specific anti-abuse provisions, the GAAR principle (fraus legis) still applies.
Fraus legis the Netherlands

• Three requirements:
  • The taxpayer obtains a tax benefit as a result of one or more transactions;
  • Tax avoidance is the *decisive* reason for the choice of the transaction(s);
  • The purpose and intent of a particular tax law provision would be frustrated if the non-taxable situation was not re-characterized as a taxable situation.
• If abuse of law is applied, the actual facts of the transaction are reclassified or substituted to reflect its true substance
GAAR-provision in P/S-Directive

• In Article 1, paragraph 2 is replaced by the following paragraphs:

• “2. Member States shall not grant the benefits of this Directive to an arrangement or a series of arrangements that, having been put into place for the main purpose or one of the main purposes of obtaining a tax advantage which defeats the object or purpose of this Directive, are not genuine having regard to all relevant facts and circumstances.

• An arrangement may comprise more than one step or part.
GAAR-provision in P/S-Directive

• For the purposes of paragraph 2, an arrangement or a series of arrangements shall be regarded as not genuine to the extent that they are not put into place for valid commercial reasons which reflect economic reality.

• 4. This Directive shall not preclude the application of domestic or agreement-based provisions required for the prevention of tax evasion, tax fraud or abuse.”

• Article 2

• 1. Member States shall bring into force the laws, regulations and administrative provisions necessary to comply with this Directive by [31 December 2015] at the latest. They shall forthwith communicate to the Commission the text of those provisions.
Article 80 draft CCCTB-Directive

• Artificial transactions carried out for the sole purpose of avoiding taxation shall be ignored for the purpose of calculating the tax base.

• The first paragraph shall not apply to genuine commercial activities where the taxpayer is able to choose between two or more possible transactions which have the same commercial result but which produce different taxable amounts.
Position the Netherlands

• Netherlands State Secretary of Finance Wiebes resisted the amendment very much, as did the Netherlands business community
• In the end the State Secretary gave in to the pressure of other Member States
• What is the effect of this provision for the Netherlands holding regime and the Netherlands tax climate?
• Problem may not so much be the Netherlands, but the dividend distributing Member States
Example

• Russian grandparent, Dutch parent and Spanish daughter company
• Spain may argue that the Dutch parent company is only interposed for tax purposes
• This means that Spain may refuse the benefits of the P/S Directives. On distributed dividends, Spanish withholding tax is due
• In the Netherlands the participation exemption applies. So the Spanish withholding tax cannot be credited against Dutch corporate income tax
Dutch implementation

• No specific GAAR-provision in the Dutch participation exemption and participation credit regime
• Only technical amendments:
  • FSS-regime
  • Coops within the Dividend Withholding Tax Act
• These amendments do not seem to result in major changes in Dutch tax practice
Amendment concerning hybrid loans

• Under the amended Directive Article 4.1 (a), the Member State of the parent company (or its permanent establishment) receiving the distribution will be required to "refrain from taxing such profits to the extent that such profits are not deductible by the subsidiary, and tax such profits to the extent that such profits are deductible by the subsidiary...." This amendment is based on a November 2013 European Commission (Commission) proposal.
Dutch implementation of hybrid loans rule

• Article 13, Paragraph 17 Dutch CITA (as of 1 January 2016)
• The proposed Dutch rule will disallow the application of the participation exemption for payments received that are tax deductible at the level of a group company.
• With reference to the OECD BEPS project and the global scope of the participation exemption, the Dutch government did not intend to limit the scope of the anti-hybrid rule to EU situations, so the rule also would apply to non-EU participations.
• In essence, the rule would aim to catch income received under hybrid financing arrangements, such as certain types of profit-participating loans and preferred share arrangements.
• However, capital gains and foreign exchange results in relation to these instruments would continue to be exempt under the participation exemption, since these items generally will not lead to a deduction.
• Specific rules will apply where a hybrid instrument is acquired with existing accrued dividends: such dividends, when paid out, would not be credited against the value of the investment (which generally is not a taxable event), but instead will be treated as taxable income.
Some thoughts

• Looking at the specific tax position of the Netherlands: one can imagine that flow through entities (intermediate holding companies) will gradually fade away from the Dutch tax jurisdiction, as a result of mounting pressure of politicians and the society, as well as severe anti-abuse provisions in the PSD and bilateral tax treaties.

• Gradually the global tax world is becoming more ‘civilized’. Aggressive tax planning structures are on the retreat.

• This is the result not only of an increased interest of states to fight abuse of tax law, but also because multinational companies are more and more aware of the possible negative consequences of a publicly disclosed tax planning structure.
Some thoughts

• The new GAAR-rules in the PSD and the possible introduction of a GAAR in the OECD Model Tax Convention create a lot of uncertainty.

• In the end, every GAAR, being it a domestic GAAR, the GAAR in the PSD or the possible new GAAR provision in a future bilateral tax treaty, is applied by national tax courts in a domestic tax disputes.

• The application of a GAAR literally takes place on a case-by-case basis, depending on the specific facts and circumstances of the litigated case in question.

• National supreme tax courts and the ECJ may provide general guidelines, but in the end every case stands on its own.
Some thoughts

• A genuine fear in the present BEPS euphoria may be that Member States and OECD Members too eagerly apply the abuse of tax doctrine.
• And this will have a serious negative effect on the European internal market.
• The tension between legitimate tax planning and abuse of tax law is eminent.
• Hopefully tax administrations will make a prudent use of the instruments regarding the combat of abuse of tax law. A tax inspector should be lenient where possible, but determined and stern in cases of tax fraud and tax avoidance.
Cross-border tax rulings: transparency rules

• On 8 December 2015, the Council adopted a directive aimed at improving transparency on tax rulings given by member states to companies in specific cases about how taxation will be dealt with.

• The directive is one of a number of initiatives aimed at preventing corporate tax avoidance.

• It will require member states to exchange information automatically on advance cross-border tax rulings, as well as advance pricing arrangements. Member states receiving the information will be able to request further information where appropriate.

• The Commission will be able to develop a secure central directory, where the information exchanged would be stored. The directory will be accessible to all member states and, to the extent that it is required for monitoring the correct implementation of the directive, to the
Cross-border tax rulings: transparency rules

• The new rules will be applied from 1 January 2017. In the meantime, existing obligations for member states to exchange information will stay in place.
• Concerning rulings issued before 1 January 2017, the following rules will apply:
• If advance cross-border rulings and advance pricing arrangements are issued, amended or renewed between 1 January 2012 and 31 December 2013, such communication shall take place under the condition that they are still valid on 1 January 2014.
• If advance cross-border rulings and advance pricing arrangements are issued, amended or renewed between 1 January 2014 and 31 December 2016, such communication shall take place irrespectively of whether they are still valid or not.
• Member states will have the possibility (not an obligation) to exclude from information exchange advance tax rulings and pricing arrangements issued to companies with an annual net turnover of less than €40 million at a group level, if such advance cross-border rulings and advance pricing arrangements were issued, amended or renewed before 1 April 2016. However, this exemption will not apply to companies conducting mainly financial or investment activities.
EU Anti Tax Avoidance Package

- Anti Tax Avoidance Directive
- Recommendation on Tax Treaties
- Revised Administrative Cooperation Directive
- Communication on External Strategy

Staff Working Document
Study on Aggressive Tax Planning

• The Anti Tax Avoidance Directive proposes six legally-binding anti-abuse measures, which all Member States should apply against common forms of aggressive tax planning.

• It aims to create a minimum level of protection against corporate tax avoidance throughout the EU, while ensuring a fairer and more stable environment for businesses.
ATA-Directive

• It covers six areas:
  1. Interest limitation rule
  2. Exit taxation
  3. Switch over rule
  4. General Anti Abuse Rule (GAAR)
  5. CFC-rules
  6. Hybrid mismatches
Interest limitation rule

• The aim of the ATA Directive is to discourage the intra-group financing structuring, by limiting the amount of interest expenses that the taxpayer is entitled to deduct under domestic tax legislation.

• However, the interest deduction limitation applies to the overall interest costs, irrespective of whether the interest is owed to a group company or a third party.
Interest limitation rule

• Under the proposed interest deduction limitation rules, interest expenses will only be tax-deductible up to a fixed ratio of the taxpayer’s taxable earnings before interest, taxes, depreciation and amortization (‘EBITDA’).

• As a main rule, interest expenses shall be tax deductible to the extent that the taxpayer receives interest income.

• Any exceeding interest expenses shall be deductible up to 30% of the taxpayer’s EBITDA, or up to an amount of EUR 1 million, whichever is higher.
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Interest limitation rule

• The proposal also contains a “group ratio escape”.
• To the extent that a taxpayer can demonstrate that its equity to total assets ratio is no more than 2 percent point lower than the equivalent ratio of the group, Member States may give a taxpayer the right to fully deduct any exceeding interest expenses.
• The group ratio escape is subject to a set of conditions, including that interest payments to associated enterprises may not exceed 10% of the group’s total net interest expense.
• Therefore, the scope of the group ratio escape is likely to be very limited in practice.
Interest limitation rule

• The amount of interest expenses that is non-deductible may be carried forward for future tax years.

• Furthermore, for the time being, financial institutions fall outside the scope of the proposed interest limitation rules.
Exit taxation

• In case of a transfer of residence and certain transfers of assets, an exit taxation is proposed.
• The EU Member State of origin is allowed to levy tax on the difference between the fair market value minus the tax book value and the receiving Member State is required to provide a step-up to the fair market value as established by the Member State of origin.
• For transfers within the EU and EEA the directive provides for an arrangement which allows for the exit tax to be paid in installments over a five year period. However, the debt becomes immediately due for instance in case of a third-party disposal.
Exit taxation

• Transfers under the scope of the proposed exit taxation are the following:
• Transfer of assets from the head office (in a Member State) to its permanent establishment in another Member State or a third country;
• Transfer of assets from its permanent establishment (in a Member State) to its head office or another permanent establishment in another Member State or a third country;
• Transfer of company’s tax residence to another Member State or to a third country (except assets connected with a permanent establishment that remains in the Member State of origin);
• Transfer of its permanent establishment out of a Member State.
Exit taxation

- The proposed exit taxation seems partly in contrast to the case law from the EU Court of Justice (‘ECJ’) which stipulates that Member States may not levy exit taxes until the moment of realization.

- It is not clear yet from the ECJ decisions whether a fixed five year period for payment in installments would qualify as a realization for all situations.

- This part of the directive may therefore be in violation of the principle freedoms.
Switch-over-rule

• Member States must implement a switchover clause which ensures the taxation of:
  • Dividends received from a low taxed third country; and
  • Capital gains arising from disposal of shares in a low tax third country; and
  • Low taxed PE profits from a third country.
• So no exemption method but the application of the credit method.
Switch-over-rule

• For the purpose of the switch-over clause, foreign income is considered to be low taxed if the foreign income is subject to a statutory corporate income tax rate lower than 40% of the statutory corporate tax rate of the Member State where the recipient is located.

• If the foreign income is considered to be low taxed, this income cannot be tax exempt by the recipient Member State.

• Instead of granting a tax exemption, a deduction of the tax paid in the third country must be granted.

• Please note that the deduction is limited to the amount of tax attributable to the foreign income.

• Furthermore, the switch-over clause is not applicable in case of operating losses or capital losses on the disposal of shares in a participation, to avoid the importation of losses.
General anti-abuse rule (GAAR)

• By introducing a General Anti Abuse rule (GAAR), the European Commission aims to target the gaps in the specific anti-abuse rules of the various countries.
• With a GAAR the tax authorities will be able to combat certain forms of tax avoidances.
• A transaction which is not put into place for valid commercial reasons which does not reflect the economic reality are considered as ‘non-genuine arrangements.’
• Non-genuine transactions or a series of such transactions carried out with the purpose to avoid tax or obtain a tax advantages in counter of the purpose of tax provisions, will be ignored by introducing this GAAR.
Controlled foreign company rules (CFC)

• The Directive proposal provides formandatory CFC rules for all 28 Member States, despite the fact that until now the majority of the Member States opted not to introduce CFC rules.

• In short, the effect of CFC rules is that profits of a CFC are included in the tax base of the parent company.

• A CFC is roughly defined as:
  • a foreign subsidiary in which the parent holds a >50% share; which is established in a low tax jurisdiction, i.e. a jurisdiction with an effective tax rate lower than 40% of the effective tax rate of the parent company’s state of residence;
  • which generally derives passive income, i.e. over 50% of the income consists of income such as dividend, royalty, interest, leasing and banking income.
Controlled foreign company rules (CFC)

• In principle a company resident in the EU/EEA cannot be a CFC unless its establishment in the EU is wholly artificial or if the company engages in non-genuine arrangements mainly set up for tax purposes.
• The proposal stipulates that the tax base is calculated according to the rules of the corporate tax law of the Member State where the (parent) company is resident for tax purposes.
• Generally the entitlement to these profits should be calculated in accordance with the company’s entitlement to the profits of the CFC and in accordance with the arm’s length principle.
• Losses, however, are not included in the tax base but carried forward and compensated with future CFC profits.
Hybrid mismatches

• Hybrid mismatches arise due to disparities in the tax systems of different countries and take the form of hybrid entities and hybrid instruments.

• A hybrid entity is the consequence of two Member States giving a different legal characterization to the same taxpayer (including its permanent establishments) and when this leads to one of the following situations:
  • A deduction of the same payment (including expenses or losses) is taken into account in both the Member State in which the payment has its source as well in another Member State (so-called double dip); or
  • A deduction of a payment in the Member State in which the payment has its source without a corresponding inclusion of the same payment in the other Member State (deduction without inclusion).
Hybrid mismatches

• Under the proposed rules, in any of the above situations, the legal characterization given to the hybrid entity by the Member State in which the payment has its source shall be followed by the other Member State.

• A *hybrid instrument is the consequence* of two Member States giving a different legal characterization to same payment and this leads to a situation where there is a deduction in the Member State in which the payment has its source without a corresponding inclusion of the same payment in the other Member State (deduction without inclusion).
Hybrid mismatches

• It is proposed that in case of a hybrid instrument the legal characterization given to the hybrid instrument by the Member State in which the payment has its source shall be followed by the other Member State.

• The Member State where the recipient resides is, therefore, obliged to follow the source State’s legal characterization.

• The scope of the proposed rules targeting hybrid mismatches is limited to EU Member States.
Revision of the Administrative Cooperation Directive

• The revised Directive proposes **country-by-country reporting** between Member States' tax authorities on key tax-related information on multinationals operating in the EU.

• These new transparency provisions will allow all Member States the information that they need to detect and prevent tax avoidance schemes.
Revision of the Administrative Cooperation Directive

• Under BEPS Action 13, multinational enterprise (MNE) groups with a consolidated group revenue of € 750 million or more are obliged to file the CbC report.
• The proposals introduce automatic exchange of this information among EU Member States, using the common communication network developed by the European Union.
• This enables exchange of key tax-related information on multinationals operating in the EU between tax administrations.
• It would require EU Member States to introduce the necessary laws, regulations and administrative provisions necessary by 31 December 2016 at the latest in order to comply with this directive.
• Consequently, if adopted those provisions will be applied by Member States as of 1 January 2017.
Country-by-country reporting

- Each Member State shall take the necessary measures to require the **Ultimate Parent Entity** of a MNE Group (tax resident in its territory) or any other **Reporting Entity** in accordance with this directive, to file a **CbC report** within 12 months after the last day of the group’s reporting fiscal year.
- The reporting obligations should apply to both EU and non-EU MNE groups for which at least one of their entities are located in the EU. Ideally, the jurisdiction in which the parent company is based should provide the information to all Member States where the group is present, in line with OECD’s BEPS Action 13.
- If this jurisdiction does not provide the information to the Member States, the European subsidiary will be obliged to provide the CbC report for the group.
- Under the proposed rules the exchange must take place within 15 months after the last day of the MNE group’s fiscal year to which the CbC report relates.
- The first reporting relates to fiscal years beginning on or after 1 January 2016.
- The requirement to share information on CbC reports with other Member States only applies to Member States in which an entity (branch) of the MNE group is resident or liable to tax.
- **The information to be reported must include (amongst others) aggregate information relating to the amount of revenue, profit (loss) before income tax, income tax paid and accrued, stated capital, accumulated earnings, number of employees and certain tangible assets of each group company (other than cash or cash equivalents).**
- This information needs to be provided with regard to each jurisdiction in which the MNE Group operates.
- Member states may introduce their own **penalty regimes in their legislation, which should be effective, proportionate and dissuasive.**
Recommendation on Tax Treaties

• The Recommendation advises Member States how to reinforce their tax treaties against abuse by aggressive tax planners, in an EU-law compliant way.

• It covers the introduction of general anti-abuse rules in tax treaties and the revision of the definition of permanent establishment.
External strategy for effective taxation

• The purpose of this strategy is to present a stronger and more coherent approach to working with third countries on good tax governance.

• The coordinated strategy should make the EU Member States more successful in the fight against tax avoidance.

• The proposal is to achieve this by identifying and maintaining a list of third countries that do not meet the proper standards on for instance exchange of information, harmful tax competition and BEPS standards.
What is the impact for MNE’s?

- An ambitious time table (July 2016) has been set for the agreement of the proposals.
- Currently proposals are still in draft form and can only be implemented after unanimous approval by all Member States.
- The tabling of the proposal for the ATA Directive makes it clear that the EU Commission wants to go further than the BEPS Action Plan recommendations and seems to be influenced by the desire to reach a corporate tax harmonization in the EU.
- This could very well have the consequence that the ATA Directive undergoes (substantial) changes and delays before its implementation.
- Furthermore, the effect of the principle freedoms of the TFEU on this proposal needs to be further analyzed.
- The proposals for CbC reporting seem less controversial.
Outlook

• Under the present Dutch EU presidency, the application of the switch over clause in the draft ATA-Directive is softened
• The loud call for more transparency in tax matters (rulings, tax avoidance structures etc.) will continue
• After the Panama papers there is again an appeal for more tax ethics
• Transparency will mount the pressure on multinational companies to behave