Briefing

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European Parliament

Anti-tax-avoidance directive

SUMMARY

The proposal for a directive on 'Rules against tax avoidance practices that directly affect the functioning of the internal market' is one of two legislative proposals of the 28 January 2016 European Commission 'anti-tax-avoidance package'.

Linked with the OECD/G20 Base erosion and profit shifting action plan (BEPS), it targets schemes where corporate taxpayers operating businesses in several countries take advantage of disparities and loopholes to reduce their tax bills. The objective is to realign corporate taxation with the relevant business substance (income) of the corporate taxpayer, fighting against aggressive corporate tax avoidance.

The proposed directive sets legally binding minimum standards for six practices. Three of these are included in the BEPS action plan (interest limitation rules, controlled foreign company rules, and rules on hybrid mismatches). The other three (a general anti-abuse rule, exit taxation rules and a switch-over clause came out of discussions on the common consolidated corporate tax base (CCCTB) proposal. As a tax measure, Parliament is only consulted, with the proposal to be adopted by the Council.

Proposal for a Council Directive laying down rules against tax avoidance practices that directly affect the functioning of the internal market

Committee responsible:	Economic and Monetary Affairs (ECON)	COM(2016) 0026 *of* 28.01.2016
Rapporteur:	Hugues Bayet (S&D, Belgium)	*procedure ref.*: 2016/0011(CNS)
Next steps expected:	Debate and vote: June I plenary	Consultation

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In this briefing:

Introduction

The proposal for a directive on 'Rules against tax-avoidance practices that directly affect the functioning of the internal market' (referred to the as anti-tax-avoidance directive, or ATA directive) is one of the two legislative proposals of the 'anti-tax-avoidance package' presented by the European Commission on 28 January 2016.[1] It targets schemes involving situations whereby corporate taxpayers operating businesses in several countries take advantage of disparities and loopholes to reduce their tax bill.[2] It is linked with the OECD/G20 BEPS (Base erosion and profit shifting) action plan.

Context

Taxing multinational enterprises (MNE) in a global market raises the challenge of taking into account economic reality in delineating the tax base.

MNEs' tax base

Corporate tax systems were designed for the economic realities of the 1920s when business was grounded in physical or legal presence in local markets, whereas this is often not the case today.[3] The principle that companies should pay taxes in the country where profits are generated is not straightforward to apply when activities are cross-border and flows of money move easily.

The term 'multinational' refers to an economic entity spanning different countries and legal systems where different legal entities (subsidiaries, branches, etc.), connected to the multinational corporation, operate.[4] Yet, it is not a legal concept and on the basis of tax rules a MNE is not considered as a single firm; its various affiliates are instead considered as if they were independent entities ('separate entity' approach). For tax law, legal entities are taxed in different countries, based on their status and tax residence. This means that the income of the various affiliates is considered separately in several tax bases (treated by several tax jurisdictions) and not considered in its entirety (though the business may be run as a whole). In short, a corporate tax system taking into account physical or legal presence does not catch the actual economic link (substance requirement[5]). Both are not necessarily congruent and can create a mismatch between economic reality (unitary business) and tax rules, resulting in several tax bases, application of which may provide varying global results.

There are several ways of tackling the issue, including:

- The 'unitary business approach' which means taxing MNEs according to the real economic substance of where they actually do business.[6]
- The 'allocation of profits between jurisdictions' approach.[7] The CCCTB (common consolidated corporate tax base) belongs to this approach, and a re-launch of the Commission's 2011 proposal is expected to be put forward in 2016 (as the anti-tax-avoidance package reiterated).

- An approach consisting of specific actions to address the shortcomings of current tax rules. This relates to the base erosion and profit shifting phenomenon, the fight against which was the object of the OECD/G20 BEPS project (2013-2015) as well as actions undertaken at EU level.[8]

OECD/G20 BEPS

The 15 BEPS final reports were finalised in autumn 2015 and endorsed by G20 leaders at their summit in Antalya, Turkey, in November 2015. They cover common forms of BEPS practices following MNEs' corporate tax avoidance practices, the use of which can result in aggressive tax planning,[9] which flourishes as a result of harmful tax competition between tax jurisdictions.

The actions were designed to be implemented in domestic law and practice, as well as through changes in the provisions of relevant treaties. BEPS has three main pillars: creating more consistency in national tax rules that affect cross-border activities; strengthening substance requirements in existing international standards; and improving certainty and transparency. Implementation is under way, and the follow-up and future of work to tackle BEPS is organised so as to provide a more inclusive framework which is able to involve more countries.

The 'anti-tax-avoidance package'

The 'anti-tax-avoidance package' presented by the European Commission on 28 January 2016 reflects the 2015 adoption of the base erosion and profit shifting (BEPS) final reports. It includes three pillars which are:

- Ensuring effective taxation in the EU: the anti-tax-avoidance directive and tax treaty recommendation;
- Increasing tax transparency: revising the directive for automatic exchange of information, so as to introduce in the EU Country-by-country reporting for multinational enterprise groups (implementing BEPS action 13); and
- Securing a level playing field: communication on an external strategy for effective taxation and a tax haven blacklist.[10]

As regards BEPS actions, the package assesses the measures implied by those actions and how they could be implemented in the EU, drawing a connection between the BEPS actions and existing or proposed EU actions, which is summarised in the staff working document, annex A.5.

As indicated in the 'Chapeau Communication', 'Next steps towards delivering effective taxation and greater tax transparency in the EU', the objective is to 'develop a common standard' going further than the implementation of the BEPS recommendations.

Existing situation

A large number of EU Member States have committed to implement the BEPS actions since they all participate in some of the international fora and instruments relevant to BEPS actions (though they are not all members of the OECD itself). In the EU there is consequently a need to avoid varying interpretations of the OECD/G20 BEPS measures, taking into account the Single Market which involves existing initiatives to enhance the effectiveness of taxation and transparency. The EU implementation of the BEPS actions is based on the need for a coordinated approach to avoid inconsistencies that could create uncertainty and administrative burdens, as well as to prevent divergence generating new mismatches in the single market.

The proposal covers elements that have previously been discussed. Member States have extensively discussed anti-avoidance rules in the context of the CCCTB proposal presented by the Commission in 2011. The following rules were discussed in that context: interest limitations, exit taxation, switch-over rules, general anti-abuse rule (GAAR), controlled foreign companies (CFC) rules, hybrid mismatches and definition of permanent establishment.

The EU provisions on taxation already include elements that address some profit-shifting situations, for example, the 2015 amendment of the 'Parent-Subsidiary Directive' (2011/96/EU, or PSD) covering dividend payments between EU subsidiaries and EU parent companies, and the work of the Platform for Tax Good Governance. The 2015 amendment of the PSD allowed Member States the use of unilateral measures against profit-participating loans (a general anti-abuse provision – sometimes referred as PSD GAAR – to counter abusive practices), introducing a 'common minimum anti-abuse rule' for situations that fall under the Parent-Subsidiary Directive. The EU has also developed and recently strengthened transparency provisions relevant to the fight against profit-shifting through the recent amendment of Council Directive 2011/16/EU concerning administrative cooperation in the field of taxation.

The changes the proposal would bring

The proposal for an anti-tax-avoidance directive targets schemes involving situations whereby corporate taxpayers operating businesses in several countries (MNEs) take advantage of disparities and loopholes to reduce their tax bill. The draft directive sets legally binding minimum standards for six practices: Three of them are included as such in the BEPS action plan and relate to the following BEPS actions:

- Action 2 (Neutralise the effects of hybrid mismatch arrangements);
- Action 3 (Designing Effective Controlled Foreign Companies (CFC) rules); and
- Action 4 (Limit base erosion via interest deductions and other financial payments).

The other three were discussed as international anti-BEPS measures in the context of the discussions on the CCCTB proposal (a general anti-abuse rule – GAAR, exit taxation rules and a switch-over clause).[11]

The proposal for an anti-tax-avoidance directive would apply to all taxpayers who are subject to corporate tax in an EU Member State, including corporate taxpayers with a permanent establishment in the EU (article 1).

The six measures are:

- A **general interest limitation rule** (article 4). The deductibility rate would be set at the top end of the scale of 10-30% recommended by the OECD. Member States are allowed to implement stricter rules. It applies equally regardless of the origin of the debt (i.e. intra-group, third party, EU or third country);

- A provision on **exit taxation** (article 5) which obliges Member States to apply an exit tax when a taxpayer transfers assets or its tax residence out of the tax jurisdiction of a Member State, other than for temporary transfers. The exit tax can be paid either immediately or paid in instalments over at least five year (where the Member State may charge appropriate interest;

- A **switch-over** clause (article 6) prevents double non-taxation of certain income by precluding Member States from exempting dividends, capital gains, and income from a permanent establishment if the tax rate applied is lower than 40% of the statutory tax rate applicable in the Member State. The Member States must apply a credit system instead of an exemption. It has similar aims to the CFC rules, but is not concluded in the OECD's BEPS plan;

- A **general anti-abuse** rule (article 7). It provides for a mandatory general anti-abuse rule (GAAR) in the tax legislation of the EU Member States to fill gaps that may exist in specific anti-abuse rules. As a result, all Member States will be able to combat abuse under the same conditions, and thus achieve consistency. The scope of the proposed article relates to non-genuine arrangements designed to meet the 'wholly artificial test' set by case-law;[12]
- **Controlled foreign company rules** (articles 8 and 9) enable a jurisdiction to reallocate the income of low-taxed controlled subsidiaries to the parent company. They aim to discourage such income shifting by reattributing the income of a passive, low-taxed controlled foreign subsidiary to its parent company back in the EU. Article 8 defines the conditions to be met and Article 9 delineates the calculation of a CFC's income; and
- A framework against **hybrid mismatches** (article 10) which addresses both hybrid entities and hybrid instruments within the EU. The proposed rules aim at minimising or eliminating mismatches resulting from the fact that EU Member States treat the same income or entities differently for tax purposes. This is to be achieved by following the legal characterisation given in the Member State where a payment originates.

The proposed directive does not preclude provisions that offer a higher level of protection for domestic corporate tax bases (article 3, 'Minimum level of protection'). Member States would have to test their own domestic regimes against these minimum standards. Member States would be required to implement these within three years of its entry into force (article 11) if the proposed directive were implemented.

Preparation of the proposal

EU action against tax avoidance and aggressive tax planning both at global and European Union level has sought to respond to demands made by both the European Parliament and the European Council, following international developments.

As explained in the accompanying documents to the anti-avoidance package, 'the package builds on the outcomes of the OECD/G20 BEPS project as well as on discussions on the international aspects of the CCCTB (including in Council working parties and Council meetings), discussions in the Code of Conduct Group and in the 'Platform for Tax Good Governance on the external agenda'. The work on the BEPS project has involved most Member States in the technical discussions on the actions, which were discussed by Member States in the Council (EU/BEPS roadmap).

Parliament's starting position

The Special Committee on tax rulings (and other measures similar in nature or effect) (TAXE 1), set up on 12 February 2015 in the wake of the Luxleaks revelations, prepared a report adopted in plenary on 25 November 2015. It identified measures needed to address corporate tax-base erosion and revenue losses, both in the EU and in developing countries. The TAXE 2 Committee is working on corporate tax avoidance with a view to presenting a report in July 2016.

The Economic and Monetary Affairs Committee (ECON) prepared a legislative own-initiative report on 'Bringing transparency, coordination and convergence to corporate tax policies in the Union', adopted in plenary on 16 December 2015.

Stakeholders' views

The Commission indicates that consultations have been made over recent years on the topics covered by the proposal. For that reason, no formal consultation was organised.

Yet some have expressed concerns that no specific consultation was undertaken for the anti-tax-avoidance package. This is the case for Business Europe. The association stresses that 'this proposal goes beyond the OECD agreement and by raising effective corporate tax rates and deviating from international agreements will put the EU at a competitive disadvantage in attracting global investment'.

Advisory committees

The European Economic and Social Committee adopted an opinion on the proposal on 28 April 2016.

Council

The proposal for an anti-tax-avoidance directive is being discussed in the Council, with the working party preparing discussions at Council level. The Council adopted conclusions on Base Erosion and Profit Shifting on 8 December 2015

Several elements are reported to be debated, in particular the 'controlled foreign companies' provision and its scope (wholly artificial arrangements)[13] as well as the switchover clause, some Member States are opposed to any provision on CFCs in the directive.[14] The limitation of the tax deduction of loan interest and hybrid mismatches are also still being discussed. While the Presidency had hoped to reach a general approach at the Ecofin Council meeting of 25 May, after lengthy discussions ministers decided to return to the subject at the 17 June meeting.

National parliaments

The deadline for national parliaments to submit comments on the proposal was 30 March 2016. Four chambers had forwarded a position by the deadline. Two of them (the Swedish Parliament and the Maltese House of Representatives) decided to adopt a reasoned opinion.

Parliamentary analysis

Supporting analyses on the different aspects of corporate tax avoidance have been provided on the request of the ECON, TAXE 1 and TAXE 2 committees. In particular, these relate to 'Tax rulings and other measures similar in nature or effect', and 'Spurring transparency, coordination and convergence to corporate tax policies in the EU'. They also include an Assessment of the magnitude of aggressive corporate tax planning as well as an 'Evaluation of the European Added Value of the recommendations in the ECON legislative own-initiative draft report'.

Legislative process

The EP's Committee on Economic and Monetary Affairs (ECON) has discussed a draft report (rapporteur Hugues Bayet, S&D, Belgium) that was adopted by ECON on 24 May 2016. The debate and vote in plenary is due to take place on 8 and 9 June 2016.

The report is more ambitious than the Commission proposal. Regarding deductions for interest payments, for instance, the Commission proposed that companies should not be allowed to deduct more than 30% of their earnings, whereas the ECON report suggests 20% or €2 million within five years (the Commission did not propose a time limit). The report also calls for a stricter switch-over clause. In order to avoid double taxation, foreign income is often exempt from taxation. The Commission proposes that this exemption should be denied if the foreign income was taxed at a rate lower than 40% of the national statutory tax rate. The report favours setting a minimum rate of 15%.

References

Rules against tax avoidance practices that directly affect the functioning of the internal market, European Parliament, Legislative Observatory (OEIL).

Endnotes

[1] The other proposal was for a directive on 'Mandatory automatic exchange of information in the field of taxation', with reference 2016/0010 (CNS), adopted by the Council on 25 May 2016.

[2] Estimates show that countries in the EU lose between €50 and €70 billion every year in tax avoidance by companies, as calculated in the report 'Bringing transparency, coordination and convergence to corporate tax policies in the European Union, I — Assessment of the magnitude of aggressive corporate tax planning', EPRS, PE 558.773, September 2015 (paper by Robert Dover, Benjamin Ferrett, Daniel Gravino, Erik Jones and Silvia Merler.)

[3] For a brief historical summary of international tax and transnational companies see for instance 'Towards unitary taxation of transnational corporations', Sol Picciotto.

[4] See Ronen Palan, 'Second best regulatory solutions to the problem of corporate tax avoidance and evasion', in the compendium The tax policy debate: a matter for society as a whole.

[5] Substance (economic or tax) refers to the actual economic activities of a company, typically assessed through its personnel, its functions and the risks it undertakes, as well as the key assets.

[6] It can be described as follows: 'A fully fledged unitary taxation (UT) system (sometimes referred to as formulary apportionment) would start with the MNE's aggregate worldwide profits (excluding internal transfers), and apportion them by a formula based on factors reflecting its real economic activities in each country (e.g. employees, assets, sales)', as in Unitary Taxation of Transnational Corporations – Summary of findings, ICTD (International Centre for Tax and Development).

[7] It is based on a common set of rules for all participating jurisdictions for calculation of the corporate tax base, on a consolidated basis for all members of the corporate group. There are no longer internal transactions among them to take into account. Then there are criteria for the apportionment of the taxes to be paid between the participating states. See for instance the article 'Towards unitary taxation of transnational corporations', p. 17.

[8] For a presentation of the history and EU steps on the issue of profit shifting, see the Staff Working Document SWD(2016) 6 final, under part '1.3. Scope of the Anti-tax avoidance package', pp. 7-8.

[9] For further elements see also José Manuel Calderón Carrero and Alberto Quintas Seara 'The Concept of 'Aggressive Tax Planning' Launched by the OECD and the EU Commission in the BEPS Era: Redefining the Border between Legitimate and Illegitimate Tax Planning', in *Intertax*, Vol. 44, No 3, 2016.

[10] The Commission subsequently adopted a proposal for public country by country reporting, including a common EU list of tax jurisdictions posing specific tax challenges, following the 'Panama papers' case.

[11] Staff Working Document SWD(2016) 6 final shows OECD BEPS actions and corresponding EU actions in its annex A5., pp. 48-50.

[12] Court of Justice judgment of 12 September 2006, *Cadbury-Schweppes*, case C-196/04.

[13] Covers the distinction drawn between allowing the possibility to apply CFC rules and the actual pursuit of an economic activity, which derives from the existing case-law (*Cadbury-Schweppes* judgement of 2006) and the question whether the BEPS action plan could be a new element to take into account.

[14] Ireland, Slovenia and Estonia; Slovenia's reservations are on the grounds of administrative capacity rather than political reasons.

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