European Commission Publishes Anti Tax Avoidance Package

D&I Alert

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» Tax & Structuring

EUROPEAN COMMISSION PUBLISHES ANTI TAX AVOIDANCE PACKAGE

On 28 January 2016, the European Commission ("EC") published an Anti Tax Avoidance Package containing proposals for concrete measures to prevent aggressive tax planning, boost tax transparency and create a level playing field for all businesses in the EU.

The European Commission fears fragmentation of the internal market: Unilateral action by Member States would not adequately tackle Aggressive Tax Planning

With the Anti Tax Avoidance Package the European Commission intends to help Member States take strong and coordinated action against tax avoidance and ensure that companies pay tax wherever they make their profits in the EU.

The Anti Tax Avoidance Package includes:

i. A proposal for an Anti Tax Avoidance Directive

ii. A recommendation on Tax Treaty Issues

iii. A proposal for a Directive implementing the OECD Country by Country Reporting rules

iv. General policy Communications on (a) the rationale behind the Anti Tax Avoidance Directive and (b) an EU External Strategy for effective taxation

v. A study on Aggressive Tax Planning and a Staff Working Document

The Anti Avoidance Directive could come into effect already on 1 January 2017

The proposed Anti Tax Avoidance Directive is tabled for approval by the European Council already on 25 May 2016. If adopted, the Member States will be required to implement the provisions of the Directive in domestic laws. The proposal does not contain the implementation date.

The source documents can be found (here). The fundamental elements of the proposed Anti Tax Avoidance Package are summarized below.

PROPOSAL FOR AN ANTI TAX AVOIDANCE DIRECTIVE

Material changes to Finnish tax rules are expected

The proposed Anti Tax Avoidance Directive includes the following key elements. It is intended that the Directive will function as a "de minimis rule" and the Member States may adopt more stringent provisions. Although Finland already has implemented domestic rules including certain elements of the Anti Tax Avoidance Directive, it seems obvious that material changes to Finnish domestic tax rules will be required.

i. **Deductibility of interest** would be limited to the higher of 30% of EBITDA or EUR 1 million, including group interest as well as third party interest expenses. The suggested wording includes an equity ratio based carve out. Both excess EBITDA and excess interest expense could be carried forward. A temporary exemption for financial institutions would exist.

ii. **Exit taxation** would apply on transfers between Member States or a third country of (a) tax residence, (b) assets from a head office to a permanent establishment, or vice versa, or between permanent establishments, or (c) a permanent establishment.

iii. **Switch over clause** substitutes the participation exemption for low taxed income with an ordinary credit. The switch over clause would apply for dividends and capital gains, as well as profits of a permanent establishment, in respect of low tax jurisdictions. The test for "low tax" has been set to 40% of the statutory tax rate of the tax payer.

iv. **GAAR** is similar to the 2015 amendment to the Parent Subsidiary Directive. Non-genuine arrangements undertaken for an essential purpose of obtaining a tax advantage that defeats the object or purpose of the applicable law would be ignored. Arrangements would be regarded as non-genuine to the extent that they are not put into place for valid commercial reasons which reflect economic reality. The application of the GAAR should be limited to wholly artificial arrangements in order to ensure that it is in line with the EU fundamental freedoms.

v. **CFC legislation** that applies where:

(a) the taxpayer by itself, or together with its associated enterprises, holds directly or indirectly more than 50 percent of the capital, voting rights, or is entitled to receive more than 50 percent of the profits of an entity;

(b) profits are subject to an effective corporate tax rate lower than 40% of the effective tax rate that would have been applied in the Member State of the taxpayer; and

(c) more than 50% of the income accruing to the entity falls within any of the categories listed in the Anti Tax Avoidance Directive (e.g. interest, dividends, royalties, income from banking and insurance activities and income from related party services).

The CFC legislation would not apply within the EU unless the establishment of the entity is considered as "wholly artificial" (non-genuine).

vi. **Hybrid mismatch rule** providing that the legal characterization by a Member State of a hybrid entity or a hybrid instrument must follow that of the Member State of source. The hybrid mismatch rule would only apply to hybrid mismatches between Member States.

> RECOMMENDATION ON TAX TREATY ISSUES

Modification to OECD template to comply with EU law

The recommendation addresses the implementation by the Member States of measures against tax treaty abuse taking into account the final recommendations of the OECD BEPS project on Action 6 (Preventing the granting of treaty benefits in inappropriate circumstances) and Action 7 (Preventing the artificial avoidance of permanent establishments).

It is notable that, in order to be EU law compliant, the European Commission suggests that Member States adopt a modified principal purpose test based anti-avoidance rule such that genuine economic activity is not affected.

> PROPOSAL FOR A DIRECTIVE IMPLEMENTING THE COUNTRY BY COUNTRY REPORTING RULES

The proposal is aimed at the implementation of the Country by Country Reporting obligation as developed by OECD in BEPS Action 13. The proposal extends the automatic exchange of information between the Member States to include the information on the Country by Country Reports.

For more information and guidance, please contact the head of our Tax & Structuring practice group, Kai Holkeri.

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