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No agreement yet on EU draft Anti-Tax Avoidance Directive

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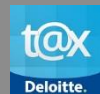

Global tax app

Anti-Tax Avoidance Package ('ATAP')

On 28 January 2016, the European Commission released an Anti-Tax Avoidance Package ('ATAP') that, amongst others, included a draft anti-tax avoidance directive ('ATAD') (see this previous Deloitte alert).

On 25 May 2016, the Ecofin Council convened to discuss and agree on a compromise text of the draft ATAD, prepared by the Dutch Presidency. However, it was not (yet) able to reach a political agreement on the draft ATAD.

Draft Anti-Tax Avoidance Directive ('ATAD')

As a result of multiple rounds of negotiations, the provisions in the compromise text of the draft ATAD discussed by the Ecofin Council substantially deviate from the text of the original proposal. Below, the focus will be on the provisions of the compromise text regarding interest deductions, switch-over clause and CFC rules (the exit tax, hybrid mismatch rules and general anti-avoidance rule are still part of the draft ATAD but are not discussed in this text).

Interest limitation rule

The original interest limitation rule was significantly modified, in view of ensuring an improved reflection of the OECD BEPS Action 4 recommendations and to accommodate concerns raised by the member states.

The compromise text, as a general rule, limits the deduction of 'exceeding borrowing costs' (i.e. the excess of deductible borrowing costs over taxable interest or equivalent income) to 30% of taxable earnings before interest, taxes, depreciation and amortisation (EBITDA).

Compared to the original proposal, member states are given additional flexibility to modify the scope of the above general rule. In particular, member states are given options which, among others, include the following:

- Allow all taxpayers to deduct 'exceeding borrowing costs' up to EUR 3M (which shall be considered for the entire group);
- Exclude 'financial undertakings' from the scope of the general rule;
- Exclude 'exceeding borrowing costs' arising from loans that have been concluded before 22 May 2016 (this 'grandfathering clause' however does not apply to subsequent modifications);
- Allow, under certain conditions, taxpayers that are part of a consolidated group to either (i) fully deduct 'exceeding borrowing costs' or (ii) deduct 'exceeding borrowing costs' in excess of 30% of taxable EBITDA. This is in line with the OECD's BEPS Action 4 recommendations.

Finally, according to the compromise text, member states may enact rules allowing the carry forward and carry back of unused exceeding borrowing costs or interest capacity (which may in some cases be subject to temporal restrictions).

Switch-over clause

The compromise text contains a 'switch-over clause', albeit in brackets, meaning that it is unsure whether the clause will make it into the final ATAD. According to the switch-over clause, profit distributions received from and proceeds from the disposal of shares of non-EU resident companies must be taxed (with an ordinary credit for underlying tax), in the member state where the parent company is located, if the non-EU resident company is subject to tax at a nominal corporate tax rate that is lower than 40% of the statutory tax rate that would have been charged under the corporate tax system in the parent's member state.

An important change in comparison to the original proposal is that the above rule does not apply where a tax treaty is in place between the non-EU state and the member state of the parent company.

Controlled foreign company ('CFC') rule

The CFC rule included in the compromise text requires member states to tax the undistributed profits of 'controlled entities' and (tax-exempt or non-taxable) permanent establishments ('PEs') only if the profits thereof have been taxed at an effective rate lower than 50% of the effective rate that would have been charged in the member state of the controlling entity or head office.

As currently drafted, the CFC income that must be included in the taxable base of the controlling entity or head office comprises:

- Non-distributed income falling within the following categories: financial income (e.g. interest), income from intellectual property (e.g. royalties), dividends and capital gains on shares, income from financial leasing, income from insurance, banking and other financial activities, and certain intra-group service income. Such items of income may however not be treated as CFC income if the CFC has been set up for valid commercial reasons and carries on an economic activity (having sufficient 'substance') that justifies the income attributed to it. Member states may however choose not to apply this exception for CFC's located in non-EU/EEA member states.

or

- Non-distributed income arising from non-genuine arrangements put in place for the essential purpose of obtaining a tax advantage. An arrangement (or a series thereof) would be regarded as non-genuine where income has been artificially diverted to the controlled entity or PE. Member states have the option to exclude (smaller) entities or PEs from this test when certain thresholds are not exceeded.

The CFC rule of the compromise text provides for some other exceptions, as well as rules for calculating and allocating the CFC income, and to avoid double taxation.

Entry into force

The Dutch Presidency's compromise text requires that member states implement the directive's provisions by 31 December 2018 at the latest and apply those provisions from 1 January 2019.

By way of derogation, member states are only obliged to implement the exit tax provision in national law by 31 December 2019 at the latest, and apply that provision from 1 January 2020.

Next steps

As indicated, the Ecofin Council was not able to reach a political agreement on the Dutch Presidency's compromise text. The Finance Ministers however were able to agree on a proposal for a general approach on the ATAD.

Next to (i) some general political reservations of various member states and (ii) concerns related to the introduction of rules that require significant changes to the national tax system, the most important disagreements related to the following issues:

- The switch-over clause, particularly whether it should be excluded or remain part of the ATAD; and
- The CFC rule, particularly (i) whether it should apply to both non-EU/EEA situations and intra-EU/EEA situations, (ii) the definition of the 'substance' requirement, and (iii) whether the taxpayer or tax authorities should carry the burden of proving the presence of 'substance'.

In light of the above, the member states agreed to continue to work on the draft proposal in the coming weeks, with the aim of reaching a final agreement on the ATAD at the next Ecofin Council meeting of 17 June 2016.

Contacts

If you have any questions concerning the items in this alert, please contact your usual tax consultant at our Deloitte office in Belgium

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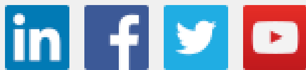

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