Executive summary

On 28 January 2016, the European Commission released an anti-tax avoidance package comprising four separate documents: (i) a proposed European Union (EU) Anti-Tax Avoidance Directive (the ATA Directive); (ii) a proposed Directive implementing the automatic exchange of country-by-country (CbC) reports (CbCR Directive); (iii) a communication proposing a framework for a new EU external strategy for effective taxation (the external strategy communication); and (iv) a recommendation on the implementation of measures against tax treaty abuse.

Pierre Moscovici, Commissioner for Economic and Financial Affairs, Taxation and Customs, said: “Billions of tax euros are lost every year to tax avoidance - money that could be used for public services like schools and hospitals or to boost jobs and growth. Europeans and businesses that play fair end up paying higher taxes as a result. This is unacceptable and we are acting to tackle it. Today we are taking a major step towards creating a level-playing field for all our businesses, for fair and effective taxation for all Europeans.”

Today’s package represents a significant set of developments which, whether adopted in all or part of its current form will have significant impacts on businesses operating in both the European Union and third countries.
Detailed discussion

The explanatory memoranda of all measures describes how Member States have called for an EU-wide approach to address external challenges to their individual tax bases, given the global nature of harmful tax competition and aggressive tax planning. In addition, it also describes how the European Parliament has demanded a unified and coherent EU position on international tax arrangements and a stronger stance against tax havens.

It continues by considering in particular how, currently, effective taxation in relation to third countries is mainly tackled through national anti-avoidance measures, which tend to vary considerably. Accordingly, this divergence between measures allows certain companies to exploit loopholes and mismatches, shifting profits out of the single market, untaxed. Moreover, businesses face legal uncertainty and unnecessary administrative burdens due to the existence of 28 different national policies for assessing and addressing third countries’ tax systems. These factors have prompted the Commission to develop a coordinated EU external strategy, made up of the four components described.

All four measures are designed to create a level playing field of minimum protection for all Member States’ corporate tax systems.

The Anti-Tax Avoidance Directive


In those conclusions, ECOFIN directed the Commission to present a legislative proposal regarding the EU-wide implementation of Organisation for Economic Co-operation and Development (OECD) BEPS Actions 2 (hybrid mismatches), 3 (Controlled Foreign Company (CFC) rules), 4 (interest limitation rules), 6 (general anti-abuse rule, or GAAR) and 7 (permanent establishment (PE) status).

ECOFIN asked that the Commission take into account the consideration already given to those Action items within the Commission's ongoing work, notably with respect to the EU common consolidated corporate tax base (CCCTB) proposal.

Provisions dealing with the artificial avoidance of PE that were contained in the previous ECOFIN working draft of the Directive are now absent from the revised draft but are covered alongside a proposed general anti-avoidance rule based on a principal purpose text in the recommendation on the implementation of measures against tax treaty abuse. The mandate to additionally develop an EU-consistent approach to implement the CbC reporting element of BEPS Action 13 was dealt with by the Commission in a separate Directive proposal, as outlined below.

In the explanatory memorandum to the proposed ATA Directive, the Commission states that the Directive is one of the constituent parts of its anti-tax avoidance package and has been developed in response to the finalization of the G-20/OECD BEPS project, as well as to demands from the European Parliament, several Member States, businesses and civil society, and certain international partners for a stronger and more coherent EU approach against corporate tax abuse.

The Commission notes that the unilateral and divergent implementation of the BEPS recommendations by each Member State could fragment the Single Market by creating national policy misalignments, distortions and tax obstacles for businesses in the EU, and could create new loopholes and mismatches that could be exploited by taxpayers seeking to avoid taxation. The Commission states that, “it is therefore essential for the good functioning of the Single Market that, as a minimum, Member States transpose the ATA measures into their national systems in a coherent and coordinated manner.”

The Commission explains that the proposed Directive aims to achieve a balance between the need for a certain degree of uniformity in implementing the BEPS outputs across the EU, and Member States’ needs to accommodate the special features of their tax systems within the new rules. The text of the proposed Directive therefore sets out principle-based rules and leaves the details of their implementation to the Member States. In that regard, Member States may choose to implement measures that go above and beyond those set out in the Directive; in effect, it represents a set of minimum standards.

The Directive is intended to be broadly inclusive by including all taxpayers that are subject to corporate tax in a Member State, which includes PEs situated in the EU, of corporate taxpayers that are not themselves subject to the Directive, albeit financial institutions are exempted from some provisions until further work has been carried out.
Six specific areas covered
The proposed Directive significantly expands the scope of what was envisioned in ECOFIN’s 8 December 2015 conclusions, with provisions addressing the OECD BEPS measures requested by ECOFIN (interest deductibility, a GAAR, CFC rules, and a framework to tackle hybrid mismatches), expanded with provisions on uniform exit taxation and a switch-over clause as regards a minimum effective corporate taxation rate that were earlier considered as part of the CCCTB proposal.

Interest deductibility
The proposed ATA Directive reconfirms that its aim is to provide a fixed level of minimum protection to Member States, and an entity-by-entity limit on borrowing costs of 30% of taxable earnings before interest, taxes, depreciation and amortization (EBITDA), or €1m, if higher, subject to countries being able to introduce an override if a taxpayer can demonstrate that its equity to total assets ratio is no more than two percentage points lower than the equivalent group ratio.

The ATA Directive opts for an equity-based group test rather than a group interest to EBITDA ratio test which is also permitted under the BEPS Action 4 recommendation. Moreover, the OECD recommendation was issued as a “Best Practices” recommendation, meaning that countries would be free to assess and pick from the elements of each BEPS Action that are most suited to their current tax regime and tax competitiveness strategy. In this regard, a uniform application of a set rate (i.e., which Member States must apply, without choice) differs from the OECD recommendation. In addition, the Directive states that Member States may also choose to introduce stricter rules. It should be noted that for the time being these interest limitation rules are temporarily not applicable to financial undertakings.

Exit taxation
The ATA Directive proposes an exit taxation of assets in specific circumstances (including company migration, transfers from a head office to a PE or on a transfer of assets out from a PE) subject to an ability to pay in instalments over at least five years for transfers within the Member States or the EEA. Specifically, a taxpayer shall be subject to tax at an amount equal to the market value of the transferred assets, at the time of exit, less their value for tax purposes in any of the four following circumstances:

- Taxpayer transfers assets from its head office to its PE in another Member State or in a third country
- Taxpayer transfers assets from its PE in a Member State to its head office or another PE in another Member State or in a third country
- Taxpayer transfers its tax residence to another Member State or to a third country, except for those assets which remain effectively connected with a PE in the first Member State
- Taxpayer transfers its PE out of a Member State

The ATA Directive further sets out that a taxpayer may defer the payment of an exit tax by paying it in installments over at least five years if any of the following four conditions are met:

- Taxpayer transfers assets from its PE in a Member State to its head office or another PE in another Member State or a third country that is party to the EEA agreement
- Taxpayer transfers assets from its PE in a Member State to its head office or another PE in another Member State or a third country that is party to the EEA agreement
- Taxpayer transfers its tax residence to another Member State or to a third country that is party to the EEA agreement
- Taxpayer transfers its PE to another Member State or a third country that is party to the EEA agreement

Under any of the four conditions described above, interest may be charged in accordance with the legislation of the Member State of the taxpayer or of the PE. It should also be noted that the five year installments of the tax debt might become immediately recoverable in four specific cases listed in the proposed ATA Directive:

- The transferred assets are disposed of
- The transferred assets are subsequently transferred to a third country
- The taxpayer’s residence or its PE is subsequently transferred to a third country
- The taxpayer goes bankrupt or is wound up

“Switch-over” clause
A switch-over clause in the ATA means that Member States shall not exempt a taxpayer from tax on foreign income which the taxpayer received as a profit distribution from an entity in a third country or as proceeds from the disposal of
shares held in an entity in a third country or as income from a permanent establishment situated in a third country where the entity is subject, in the entity's country of residence or the country in which the permanent establishment is situated, to a tax on profits at a statutory corporate tax rate lower than 40% of the statutory tax rate that would have been charged under the applicable corporate tax system in the Member State of the taxpayer.

In those circumstances, the taxpayer shall be subject to tax on foreign income, with a deduction of the tax paid in the third country from its tax liability in its state of residence for tax purposes. The deduction shall not exceed the amount of tax, as computed before the deduction, which is attributable to the income that may be taxed. The switch-over clause shall not apply to losses incurred by the permanent establishment of a resident taxpayer situated in a third country or to losses from the disposal of shares in an entity which is tax resident in a third country.

**GAAR**

The ATA Directive propose a GAAR which would target non-genuine arrangements or a series thereof carried out for the essential purpose of obtaining a tax advantage that defeats the object or purpose of the otherwise applicable tax provisions. This follows the embedding of a GAAR into the Parent-Subsidiary Directive, which Member States were required to have transposed into national legislation by 31 December 2015.

**CFCs**

The CFC provisions contained in the proposed ATA Directive would impose a charge on undistributed profits of controlled non-listed entities that are subject to taxation at an effective rate lower than 40% of the equivalent effective rate in the controlling member state, where the entity principally receives financial income (e.g., interest), royalties, dividends, leasing income, certain real estate income, income from insurance, banking and other financial activities, and intra-group service income.

A charge would not arise within the Member states or the European Economic Area (EEA) unless the establishment of the entity in question was "wholly artificial" or the entity engages in non-genuine arrangements which have been put in place for the essential purpose of obtaining a tax advantage. Arrangements would be regarded as non-genuine to the extent that the entity would not own the assets or would not have undertaken the risks if it were not controlled by a company where the relevant significant people functions are carried out. The described CFC provisions are also not applicable to financial undertakings.

**Hybrid mismatch provisions**

Where to Member states give a different legal characterization to the same taxpayer (hybrid entity), including its permanent establishments in one or more Member State, and this leads to either a situation where a deduction of the same payment, expenses or losses occurs both in the Member State in which the payment has its source, the expenses are incurred or the losses are suffered and in another Member State or a situation where there is 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, the legal characterization given to the hybrid entity by the Member State in which the payment has its source, the expenses are incurred or the losses are suffered shall be followed by the other Member State.

Where two Member States give a different legal characterization to the same payment (hybrid instrument) 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, 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 CbCR Directive**

The EU’s automatic information exchange directive (2011/16/EU) was recently expanded in scope to cover information exchange in relation to advance cross-border tax rulings and advance pricing arrangements. The proposed amendments documented within the CbCR Directive largely implement the OECD’s CbC reporting recommendations within an EU context, and would require Member States to implement the exchange of CbC reporting between competent authorities in relation to multinational enterprises for fiscal years beginning on or after 1 January 2016.

In the explanatory memorandum to the proposed Directive, the Commission notes that most Member States, in their capacity as OECD members, have committed to implementing Action 13, and that the proposed Directive aims to achieve a certain degree of uniformity in implementing CbC reporting across the EU. The proposal has been specifically designed to enable the automatic exchange
of CbC reports to build on the existing rules in Directive 2011/16/EU relating to the practical arrangements for exchanging information, including the use of standard forms.

**CbC report requirements**

The proposed Directive states that each Member State shall take necessary measures to require the ultimate parent entity of an MNE group that is resident for tax purposes in its territory to file a CbC report with respect to its reporting fiscal year within 12 months after the last day of the MNE group’s reporting fiscal year.

The CbC report shall contain the following information regarding an MNE group:

- Aggregate information relating to the amount of revenue, profit (loss) before income tax, income tax paid and accrued, number of employees, stated capital, accumulated earnings and tangible assets other than cash or cash equivalents in each jurisdiction in which the group operates.
- Identification of each constituent entity within the group, including the entity’s jurisdiction of tax residence (and the jurisdiction under which the entity is organized, if different from its jurisdiction of tax residence), and the nature of the entity’s main business activity or activities.

The reporting obligation applies to MNE groups with annual consolidated group revenue equal to or exceeding €750 million. To ensure the proper functioning of the Internal Market and fair competition, the reporting obligations should apply to both EU MNE groups and non-EU MNE groups for which one or several of their entities are located in the EU.

**Exchange and timing**

The proposed CbCR Directive provides that Member States shall exchange the report with any other Member State in which, on the basis of the CbC report, one or more constituent entities of the MNE group are either resident for tax purposes or are subject to tax with respect to business carried out through a PE. 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 CbC reports shall be exchanged for fiscal years commencing on or after 1 January 2016.

Member States shall adopt and publish the laws, regulations and administrative provisions necessary to comply with the Directive by 31 December 2016 at the latest, and shall apply those provisions from 1 January 2017. The text of national provisions must be communicated to the Commission.

**External strategy for effective taxation**

The European Commission also published on 28 January a document titled *External strategy for effective taxation*. The external strategy communication summarizes a number of issues around BEPS, the principles underlining the various anti-BEPS measures and the various measures and initiatives being taken within the EU.

The external strategy communication sets out the Commission’s view that a coordinated EU external strategy (i.e., covering third countries and not just EU Member States) is essential to boosting Member States’ collective success in tackling tax avoidance, ensuring effective taxation and creating a clear and stable environment for businesses in the single market.

Alongside mention of the proposed ATA and CbCR Directives, the external strategy communication makes reference to a number of additional measures which the Commission believes could further strengthen the promotion of tax good governance internationally. At the core of these measures lies the creation and maintenance of an EU-wide list of problematic tax jurisdictions.

**Implementation of measures against tax treaty abuse**

Considering OECD BEPS discussions on Action 6 (treaty abuse) and 7 (permanent establishment definition) the European Commission also issued a recommendation to Member States which addresses the implementation of measures against tax treaty abuse in two ways. In the first recommendation as concerns PE definition, the Commission asks the Member States to adhere to the new proposed provisions to Art. 5 of the OECD Model Tax Convention in their upcoming negotiations on tax treaties with other Member States or third countries. The second recommendation takes up the topic of anti-abuse rules and provides for the concrete request to modify a General anti-avoidance rule which is based on a principal purpose test as follows (changes in bold):

“Notwithstanding the other provisions of this Convention, a benefit under this Convention shall not be granted in respect of an item of income or capital if it is reasonable to conclude, having regard to all relevant facts and circumstances, that obtaining that benefit was one of the principal purposes
of any arrangement or transaction that resulted directly or indirectly in that benefit, unless it is established that it reflects a genuine economic activity or that granting that benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions of this Convention."

Implications
It should be noted that, at this stage, the proposed ATA and CbCR directives both remain in draft form, and unanimous agreement of all Member States will be required before they can be implemented. Although there appears to be strong political support for an ATA Directive among Member States, it is possible that the form of the final directive will differ significantly from the current draft and that the timetable set for agreement by July 2016 may not be met. The anti-avoidance directive is much more controversial because it includes elements that are arguably wider than anti-BEPS measures, but in fact represent a compromise between the EU CCCTB proposal and a common EU response to BEPS. As such it goes much further than the OECD BEPS recommendations, including making recommendations which are really not related to BEPS, but are instead related to the desire for increased EU harmonization - such as the switch-over clause, consistent GAARs and consistent exit tax regimes.

While both directives will require unanimous support from all Member States in order to be successful, the majority of debate and discussion will likely focus on the anti-avoidance directive because of its stricter application of the OECD BEPS recommendations and its overt tax harmonization agenda.

It is clear though, that the future implementation of all or parts of either Directive, in either current form or amended, will have a significant impact on the taxation of multinational companies and will trigger an unprecedented change in European taxation.

A broad range of structures involving reverse hybrids, EU holding and financing companies, and branches, among others, may be impacted. MNEs are therefore recommended to not only increase their overall monitoring, assessment and financial modelling of the current proposals, but to engage with local policy-makers to ensure their input is considered as the proposals move forward.

Endnotes
For additional information with respect to this Alert, please contact the following:

**Ernst & Young GmbH Wirtschaftsprüfungsgesellschaft, Munich**
- Dr. Klaus von Brocke  +49 89 14331 12287  klaus.von.brocke@de.ey.com
- Andreas Wohlhöfler  +49 89 14331 11284  andreas.wohlhoefler@de.ey.com

**Ernst & Young LLP, Global Tax Desk Network, New York**
- Gerrit Groen  +1 212 773 8627  gerrit.groen@ey.com
- Dirk-Jan (DJ) Sloof  +1 212 773 1363  dirkjan.sloof@ey.com
- Jurjan Woudakuipers  +1 212 773 6464  jurjan.woudakuipers@ey.com

**Ernst & Young LLP, Washington, DC**
- Rob Thomas  +1 202 327 6053  rob.thomas@ey.com
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